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THE GREAT DEPRESSION

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The current global financial crisis has been dubbed The Great Recession. This is meant to convey that it is the biggest recession the world has seen since The Great Depression of 1929-1933 which was itself the biggest economic downturn of the 20th century.

We actually didn't even have recessions until after The Great Depression – all downturns were depressions culminating in The Great Depression. Depressions were replaced by recessions in the 1940s which may now possibly culminate in the current Great Recession.

What do recession and depression mean?

The definition of recession as two or more consecutive quarters of real negative growth was coined by Julius Shiskin, an economist in the Nixon administration in 1974 but it has no official standing. It doesn't take account of population and productivity for example, which can make a difference – in Australia we expected to receive advice that the second consecutive quarter reading of negative growth happened in the March quarter, but instead, it was positive. So despite Australia having had consecutive quarters of negative per capita real growth, we are not technically in recession. These sort of nuances result in some economists preferring more unambiguous measures such as a rise in unemployment of 1.5% over 12 months.

Generally though, a recession is a slowdown in economic activity in a country over a sustained period of time. The US National Bureau of Economic Research defines an economic recession as: “a significant decline in [the] economic activity spread across the country, lasting more than a few months, normally visible in real GDP growth, real personal income, employment (non-farm payrolls), industrial production, and wholesale-retail sales.”

US	Great Depression	Great Recession
Bank failures	9,096 – 50% of banks (Jan.1930– March 1933)	47 – 0.5% of banks (Dec. 2007– March 2009)
Unemployment rate	25%	8.1%
Economic decline ¹	-26.5% (1929 - 1933)	-1.7% (Second quarter 2008 - fourth quarter 2008)
Biggest decline in Dow Jones industrial average	-89.2% (Sept. 3,1929 - July 8, 1932)	-53.8% (Oct. 9,2007 - March 9, 2009)
Change in prices	-25% (1929 - 1933)	+0.6% (Dec. 2007 - Feb. 2009)
Emergency spending programs	1.5% of GDP for 1 year (increase in 1934 budget deficit)	3% of GDP for 2 years ² (2009 American Reinvestment and Recovery Act)
States' response	Raise taxes, cut spending	Federal stimulus plan gives fiscal relief to states to lessen impact of tax increases
Increase in money supply by Federal Reserve	17% (1933)	140% (September 2008 - March 2009)

Source: CNN FDIC, Federal Reserve, Commerce Department, Dow Jones, Christina Romer, Obama economic adviser.

“Lessons from the Great Depression for Economic Recovery in 2009”

¹Inflation adjusted GDP, peak to trough ²Romer estimate



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How long do they last?

In the last 50 years recessions in the US, UK and Australia have typically lasted between 11-15 months. In the US and the UK the current recession has already well exceeded these average durations with no near term end in sight. In Australia we appear to be lagging the world with the onset of similar conditions by some full 12 months after the northern hemisphere.

By contrast a depression is generally defined as a prolonged recession typically lasting some three to four years and evidenced by severe contractions in growth and employment. For example in The Great Depression in the US, growth fell by some 27% and unemployment rose to 25% of the population.

What causes them?

Economists are generally taught that some degree of recession over an economic or business cycle is inevitable, and part of a natural correction after an extended period of high growth. Having said that, governments and central banks in particular, do have a high degree of influence over economic growth rates and most contemporary governments and central banks take steps to moderate both the highs and lows of the economic cycle. As a result in modern times we accept that recessions are often managed contractions of growth brought on by tight monetary policy (high interest rates).

Depressions by contrast are typically 'unmanaged' and caused by an overload of debt that can no longer be serviced by cash flows and/or supported by asset values. Typically they occur after one or more bubbles burst – such as an asset bubble (housing values fall sharply), stock bubble (stock markets crash) or debt bubble (credit markets no longer function) – and the financial services sector typically takes the brunt of the impact (bank failures). The reason that the 'd' word is being mentioned more frequently in relation to the current financial crisis is that all three of these bubbles seem to have burst simultaneously.

How are they fixed?

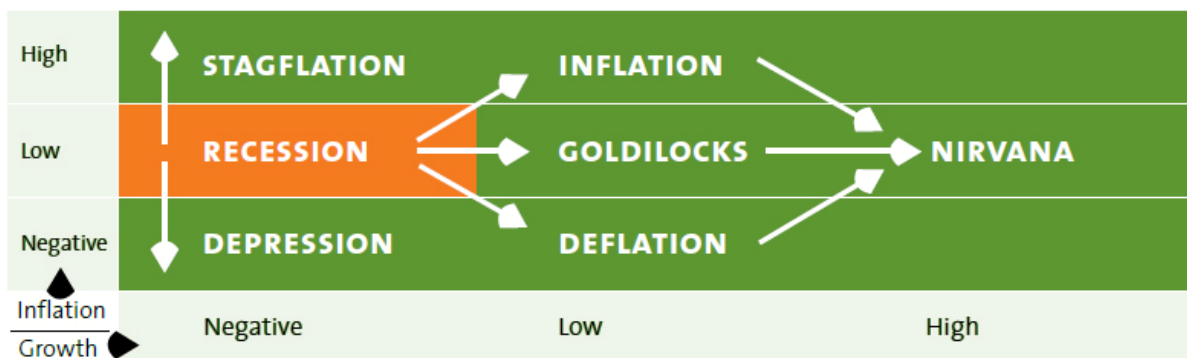
Recessions, given that they are typically a managed phenomenon brought on by tight monetary policy, are also typically fixed by loosening the monetary policy or lowering interest rates. To accelerate economic activity many Governments also add a range of stimulatory taxation and spending measures to the task.

In depressions however, monetary policy being the control of interest rates, is often rendered ineffective as no matter how low official interest rates fall the supply of credit remains severely curtailed. A negative spiral of forced liquidation of assets causes personal and business failures and a self-reinforcing cycle of lower incomes, lower demand, lower economic activity and lower employment. A combination of massive stimulus, restructuring of businesses, increases in the

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money supply, unfettered international trade and crucially the return of confidence or what Keynes called ‘animal spirits’ is required to move back into a period of economic prosperity. A side effect on the way to recovery can be either a period of deflation (falling prices) or inflation (rising prices) or both (in that order) which can have their own destructive effect on asset values and investment portfolios.

In this global financial crisis we have seen an extraordinary global co-ordinated response, designed to address the emergence of the global recessionary and to prevent a re-run of The Great Depression.



What is in store for us this time?

There are at present some very encouraging, early signs of recovery – green shoots. But severe recessions such as this one, particularly the unravelling of a debt burden that has built up over three decades, cannot be expected to be reversed quickly and smoothly. We continue to expect the earliest sustained economic recovery to occur in the 2010/2011 year with a sustained recovery in equity markets anticipating the recovery, to occur in 2009/10.