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Research

The History (and Future) of Recessions

#PositiveImpact

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The word “recession” has been one of the most widely used in markets over the last 12 months. Currently, a big debate among investors is whether there’ll be a hard or soft landing for the US economy. In the meantime, Europe has been flirting on and off with a recession since the war in Ukraine began last year.

Recessions have a variety of causes and come in all sorts of shapes and sizes. Some are fairly common, such as monetary tightening, or the collapse of a speculative bubble. Others are more unique, like a pandemic, or some other natural disaster. Historically, several recessions have also been the result of wars and geopolitical shocks, although the frequency of those has declined over more recent cycles.

In the last 15 years, we’ve been unfortunate to witness the two most severe post-WWII recessions, with both the GFC and the Covid-19 pandemic. But looking further back into history, our current experience of long expansions is historically unusual. For instance, in the century after US business cycle dating begins in 1854, only one economic expansion lasted for more than 5 years.

Several factors lie behind this shift towards longer cycles. In part, it’s because our economies have diversified away from agriculture, so output is far less dependent on the weather and climatic events. Major wars have become far more infrequent, so economies are more likely to avoid catastrophic disruption. Meanwhile, recent decades have seen policymakers launch increasingly aggressive interventions, with the explicit aim of minimising and shortening the recessions that we have experienced.

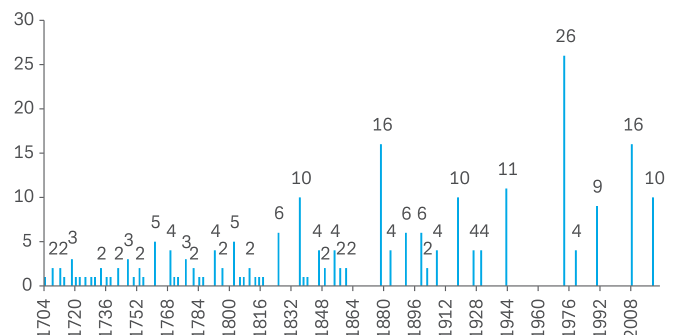
But this approach is running up against increasing limits. In particular, public and private debt burdens have risen to very high levels, which is limiting our room for manoeuvre in the future. Alongside that, real yields have climbed sharply in the last couple of years, so the cost of additional debt is going up. And with several forces continuing to exert upward pressure on inflation, the coming years could well bring more volatile swings in interest rates, and hence more volatile business cycles.

This is likely to impose more constraints on policymakers, hence we think that the recent 40-year period of long cycles and expansions will prove to be the exception and not the norm. Instead, a more regular pattern of boom-bust cycles and more frequent recessions are likely, since policymakers will be up against more constraints when it comes to inflation and debt.

This is where the growth of AI will be very interesting. Technological innovations have helped drive productivity growth through history, but have also caused plenty of intense boom and bust periods. That's the case for the equity market, as bubbles are more likely to form and pop, and for the wider economy as well, since disruption impacts long-standing industries.

Through history, these periods of rapid innovation have often seen more volatility in markets and the economy. The last few decades with low productivity and highly interventionist policy makers has been the antithesis of this with long business cycles and low growth. So thanks to a combination of macro and technological factors, it feels like the business cycle is back.

Length of expansions in the UK - trough to peak in years (as of peak)



Source: ONS, Broadberry et al. (2023), Deutsche Bank.

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