

# Reaction to referee report 1

Thank you for the report and the suggestions, they provide me with excellent advice on how to improve the article.

## *Results are tentative*

I fully agree that the comparison of the two crises is tentative, since the current crisis might not be over. I think I have made this caveat (starting in the second sentence in the abstract), but can strengthen it. But I want to present an argument which lead me to believe, at a somewhat early stage, that the crisis could be over, and why it might be important to take stock now, even if we may see in ten years, that the causes which lead to the crisis have not been solved, and that new problems arose in the aftermath of the crisis and/or from bad exit strategies.

Many economists feared that the Recent Crisis would occur in stages, since this happened in the Great Depression. The Great Depression proved to be so lengthy since problems occurred in sequence (and people in between the stages remained optimistic due to the exuberance of the twenties). This time round all the problems occurred in the first year: the breakdown of stock markets, that of international trade, then bank failures. And many economists very early predicted a long and protracted crisis similar to that in the thirties, and politicians emphasized the dangers of the crisis soon. Many of us were therefore reluctant to accept the green spots to be seen in spring 2009 as signs of recovery.

Now the recovery is rather strong and rather long as compared to any interim recovery in the Great Depression. Some indicators (not all) are on pre crisis level. Specifically the world economy is forecast to grow at 3% to 4% in 2010, which would make up for more than the 1 point GDP loss in 2008/09 (on the world level, not for Europe, by far not for many badly hit countries).

If now a second wave would still come, it would have very different causes as compared to the second and third waves in the thirties. The second and third waves during the Great Depression came from the spreading of the crisis from sector to sector, from country to country, from policies cutting expenditures, raising taxes, protecting your own economy from imports in direct response to the crisis. These first round effects seem definitely over now. A later second wave could very well come from unsolved disequilibria, the non reformed financial sector, from bad or early exit strategies, breakdown of the construction boom in China etc.

## *Descriptive character, maybe more on causes, less redundancies in tables and text*

The paper is descriptive, and this is intentional. Specifically it does not analyze the causes of the crisis. On the one hand I think that several excellent papers exist, and a consensus is coming up that this crisis had three main causes, which all had to come together: macroeconomic imbalances, microeconomic incentives and inadequate regulation. Each of these causes has several sub lines and disagreement comes up as to the weight of the individual components. The position of the author is presented in a paper in Intereconomics, its main findings could be summarized. I would prefer, however, to concentrate on the descriptive evidence. I know of no article in which all the data on activity are summarized

and all the data on policy indicators in a rather comprehensive manner. As the person who collected the data (with a team) I know about many difficulties to make data comparable, I want to present the evidence and make it available to all researchers, independent of their assessment as to the causes of the crisis and the possibility of a second crisis. During my research I met many economists and historians who build their stories on different indicators for different countries, different periodicity, dating the two crises differently, that I decided to present the material carefully, referring to counter evidence or alternative interpretations in references and footnotes as much as possible. For some indicators much better specific data are available but only for one or a few of countries. This sometimes needs double presentations in text and tables. Tables are consistent, the same indicators are used for all countries; the text allows me to present better evidence for one country etc., tables for a multitude of countries. I think it makes sense to construct a data set which fosters some consensus about empirical facts among economists given that economists have different views on the causes of and the prospects of a longer crisis. No such data set comprising both crises has been available in OECD, IMF, and European Commission.

#### *Clarifying specific data and concepts*

Yes, data on M2 and M3 behaved differently, but my attempts to present them in a consistent way for both crises failed. I can add information for specific countries. There is some evidence that money demand fell more according to broader aggregates on money in the Great Depression, and there is ample evidence that monetary policy was expansive this time round according to all definitions.

Core inflation was very low during the Recent Crisis; deflation was confined to very short periods (month) even if measured in core inflation. The only exception of a larger country facing deflation this time is Japan. This is remarkable since 2008 was the year with rather high inflation. Inflation is measured by CPI, this should have been told.

The share of the public sector includes transfer payments.

Thanks for raising these points.

#### *When to take stock, and how long to wait*

It is always difficult to tell, at which time to take stock. If you know everything about the origin, the proliferation, the policy reaction to the crisis and its short and long run effect, it is too late to write an interesting paper. The article was started at a time when many of the best economists claimed that the crisis was or could become as deep as the great Depression (specifically the homepage of Eichengreen, O'Rourke, provided evidence for this claim for about a year; this homepage presented the best quantitative evidence on the evolvement of the crisis, a reference to this homepage was sent to me at least once a week by a friend, suggesting how deep and long the crisis will be). Now we know that the Current Crisis ended much quicker, since recovery started in mid or late 2009. And if policy and institutions work in the exit phase well, a second step of the same crisis will not occur soon. On the other hand problems in the aftermath of the crisis exist and the problems that led to the crisis are not resolved. I think time is good to make an interim assessment. Specifically since economist still do not agree when and why the Great Depression had ended up to now.

Karl Aiginger, April 8 2010