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CAUSES AND IMPACTS OF ECONOMIC RECESSION

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Abstract:

This paper attempts to highlight the causes and impacts of economic recession by critically assessing various definitions put forward by economists. The patterns of consumption and savings behaviour leading up to recessions have been discussed while substantiating with case studies of recession. Drawing from the trends of negative growth of indicators like employment, investment, and corporate profits; different forms of recessions like the V-shaped, U-shaped, L-shaped and W-shaped representations and the predictors of recessions have been discussed. Finally, the fallout of the recession on employment, business, and society and the crisis experienced by the overall nation has been analyzed.

Key words:

Gross Domestic Product, economic recession, politics, social crisis, stock markets.

I NTRODUCTION

In economics, the term economic recession is generally used to describe a situation in which a country's GDP, or gross domestic product, sustains a negative growth factor for at least 2 consecutive quarters. Being that the United States is the leader when it comes to consumption of goods and services; an economic recession here will send shockwaves across the world, creating a global recession. The only way to truly recession proofs your portfolio during a severe global recession is to move your money to cash or US treasury instruments.

Just as there is an agency to define the measure of inflation; the official agency in charge of declaring an economic recession is the National Bureau of Economic Research (NBER). NBER's definition of recession is a bit vaguer than the standard one that was described above; they define recession as a "significant decline in economic activity lasting more than a few months". For this reason, the official designation of recession may not come until after we are in a recession for six months or even longer.

Many professionals and experts around the world believe that a true economic recession can only be confirmed if GDP (Gross Domestic Product) growth is negative for a period of two or more consecutive quarters. The roots of a recession and its true starting point rest in the several quarters of positive but slowing growth before the recession cycle really begins. Often in a mild recession the first quarter of negative growth is followed by slight positive growth, then negative growth returns and the recession trend continues.

While the "two quarter" definition is accepted globally, many economists have trouble supporting it completely as it does not consider other important economic change variables. For

instance, current national unemployment rates or consumer confidence and spending levels are all a part of the economic system and must be taken into account when defining a recession and its attributes. It is more common than you might realize for countries around the world to experience mild economic recessions. Recession (or contraction) is a natural result of the economic cycle and will adjust for changes in consumer spending and consumption or increasing and decreasing prices of goods and labour. Rarely though entirely possible, experiencing a multitude of these negative factors simultaneously can lead to a deep recession or even a long economic depression.

A severe global recession can wipe out a significant portion of your retirement savings account. It is important that when you spot signs of an impending recession that you make moves to preserve your capital. Recession proof stocks may not even do the trick. There is a saying, "throw the baby out with the bathwater". In severe cases, as the one we say in 2007 to 2009, there was no place to hide. Every stock went down, regardless of whether it should have or not. This is typically what happens during a global collapse. In times of heightened crisis, the only haven is cash or US treasury securities. During a mild economic recession, you can focus on being invested in recession proof sectors in the market; such as gold & silver, agriculture, bonds, and consumer staple stocks such as Pepsi and Kellogg.

CAUSES OF ECONOMIC RECESSION

An economic recession is primarily attributed to the actions taken to control the money supply in an economy. The Federal Reserve is the agency responsible for maintaining the delicate balance between money supply, interest rates, and inflation. When this delicate balance is tipped, the economy is forced to correct itself.

The Fed sometimes deals with these situations by dumping huge amounts of money supply into the money market. This helps to keep interest rates low, even as inflation rises. Inflation is the rise in the prices of goods and services over a period. So, if inflation is increasing, it means that goods and services are costing more now than they did before. The higher the level of inflation, the smaller the percentage of goods and services is which can be bought with a certain amount of money. There can be many contributing factors for inflation, which include but are not limited to increased costs of production, higher costs of energy, and/or the national debt.

In an environment where inflation is prevalent, people tend to cut out things. like leisure spending. They also budget more, spend less on things they usually indulge in, and start saving more money than they did. As people and businesses start finding ways to cut costs and derail unneeded expenditures, the GDP begins to decline. Then, unemployment rates will rise because companies start laying off workers to cut more costs, because consumers are not spending like they were. It is these combined factors that manage to drive the economy into a state of recession.

This set of circumstances, coupled with the ability of people to get access to greater amounts of loan money due to extremely lay loan practices, creates a cycle of unsustainable economic activity that will eventually grind an economy to a near halted existence. You could also say that a recession is caused by factors that might stunt the growth that is available from the short-term benefits to an economy that can be brought about by such things as spiking oil prices or even war. And while these are very short term in nature usually, they have been known to correct themselves quicker than the full-blown recessions that have happened in the past.

Generally, an economic recession can be spotted before it happens. There are ways to spot it before it actually hits by observing the changing economic landscapes in quarters that come before the actual onset. You will still see GDP growth, but it will be coupled with signs like high unemployment levels, housing price declines, stock market losses, and the absence of business expansion. When an economy sees more extended periods of economic recession, it goes beyond a recession and is declared that the economy is in a state of depression.

The only real benefit of an economic recession is that it will help to cure inflation. In fact, the delicate balancing act that the Fed struggles to pursue is to slow the growth of the economy enough so that inflation will not occur, but also so that a recession will not be triggered in the process. Now, the Fed performs this balancing act without the help of fiscal policy. Fiscal policy is usually trying to stimulate the economy as much as is possible through such things as lowering taxes, spending on programs, and ignoring account deficits.

HISTORY OF RECESSIONS

Recessions are generally believed to be caused by a drop in spending. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply, increasing government spending and decreasing taxation.

In a; 1975 New York Times articles, economic statistician Julius Shikin suggested several rules of thumb for identifying a recession, one of which was "two down quarters of GDP". In time, the other rules of thumb were forgotten, and a recession is now often defined simply as a period when GDP falls (negative real economic growth) for at least two quarters.

In the United States the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) is generally seen as the authority for dating US recessions. The NBER 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."

Almost universally, academics, economists, policy makers, and business defer to the determination by the NBER for the precise dating of a recession's onset and end.

SHAPES OF RECESSION

A recession has many attributes that can occur simultaneously and includes declines in coincident measures of activity such as; employment, investment, and corporate profits.

A severe (GDP down by 10%) or prolonged (three or four years) recession is referred to as an economic depression, although some argue that their causes and cures can be different. As informal shorthand, economists sometimes refer to different recession shapes, such as V-shaped, U-shaped L-shaped and W-shaped recessions.

In the US, V-shaped, or short-and-sharp contractions followed by rapid and sustained recovery, occurred in 1954 and 1990-91; U-shaped (prolonged slump) in 1974-75, and W-shaped, or double-dip recessions in 1949 and 1980-82. Japan's 1993-94 recession was U-shaped and its 8-out-of-9 quarters of contraction in 1997-99 can be described as L-shaped. Korea, Hong Kong and South-east; Asia experienced U-shaped recessions in 1997-98, although Thailand's eight consecutive quarters of decline should be termed L-shaped.

PREDICTORS OF RECESSION

Although there are no completely reliable predictors, the following areregarded to be possible predictors.

1. In the US a significant stock market drop has often preceded the beginning of a recession. However, about half of the declines of 10% or more since 1946 have not been followed by recessions. In about 50% of the cases a significant stock market decline came only after the recessions had already begun.
2. Inverted yield curve, the model developed by economist Jonathan H. Wright, uses yields on 10-year and three-month Treasury securities as well as the Fed's overnight fund rate. Another model developed by Federal Reserve Bank of New York economists uses only the 10-year/three-month spread. It is, however, not a definite indicator.
3. The three-month change in the unemployment rate and initial jobless claims.
4. Index of Leading Indicators.
5. Lowering of Home Pries. Lowering of home prices or value, too much personal debts.

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GLOBAL RECESSIONS

There is no commonly accepted definition of a global recession, although the IMF regards periods when global growth is less than 3% to be global recessions. The IMF estimates that global recessions seem to occur over a cycle lasting between 8 and 10 years. Economists at the International Monetary Fund (IMF) state; that a global recession would take a slowdown in global growth to three percent or less. By this measure, four periods; since 1985 qualify : 1990-1993,1998, 2001-2002 and 2008-2009.

According to economists, since 1854, the U.S. has encountered 32 cycles of expansions and contractions, with an average of 17 months of contraction and 38 months of expansion. However, since 1980 there have been only eight periods of negative economic growth over one fiscal quarter or more, and four periods considered recessions:

1. July 1981-November 1982: 14 months
2. July 1990-March 1991: 8 months
3. March 2001-November 2001- 8 months
4. December 2007-current: current

For the past three recessions, the NBER decision has approximately conformed with the definition involving two consecutive quarters of decline. While the 2001 recession did not involve two consecutive quarters of decline, it was preceded by two quarters of alternating decline and weak growth.

STRATEGY MOVING AN ECONOMY

Most mainstream economists believe that recessions are caused by inadequate aggregate demand in the economy, and favor the use of expansionary/macroeconomic policy during recessions. Strategies favored for moving an economy out of a recession vary depending on which economic school the policymakers follow. Monetarists would favor the use of expansionary monetary policy, while Keynesian economists may advocate increased government spending to spark economic growth. Supply-side economists may suggest tax cuts; to promote; business capital investment. Laisses-faire minded economists may simply recommend that the government not interfere with natural market forces.

STOCK MARKET AND RECESSIONS

Some recessions have been anticipated by stock market declines. In Stocks for the Long Run, Siegel mentions that since 1948, ten recessions were preceded by a stock market decline, by a lead time of 0 to 13 months (average 5.7 months), while ten stock market declines of greater than 10% in the DJIA were not followed by a recession.

Since the business cycle is very hard to predict, Siegel argues that it is not possible to take advantage of economic cycles for timing investments. Even the National Bureau of Economic Research (NBER) takes a few months to determine if a peak or trough has occurred in the US. During an economic decline, high yield stocks such as fast-moving consumer goods tend to hold up better. However, when the economy starts to recover and the bottom of the market has passed, stocks tend to hold up better. However, when the economy starts to recover and the bottom of the market has passed, growth stocks tend to recover faster.

There is a view termed the halfway rule according to which investors start discounting an economic recovery about halfway through a recession. In the 16 U.S. recessions since 1919, the average length has been 13 months, although the recent recessions have been shorter. Thus, if the 2008 recession followed the average, the downturn in the stock market would have bottomed around November 2008. The actual US stock market bottom of the 2008 recession was in March 2009.

RECESSION AND POLITICS

Generally, an administration gets credit or blame for the state of the economy during its time. This has caused disagreements about when a recession started. In an economic cycle, a downturn can be considered a consequence of an expansion reaching an unsustainable state and is corrected by a brief decline.

The 1981 recession is thought to have been caused by the tight-money policy adopted. Reagan supported that policy. Economists usually teach that to some degree recession is unavoidable, and its causes are not well understood. Consequently, modern government administrations attempt to take steps, also not agreed upon, to soften a recession.

IMPACT OF RECESSIONS

Unemployment

The full impact of a recession on employment may not be felt for several quarters. Research in Britain shows that low-skilled, poorly educated workers and the young are most vulnerable to unemployment in a downturn. After recessions in Britain in the 1980s and 1990s, it took five years for unemployment to fall back to its original levels.

Business

Productivity tends to fall in the early stages of a recession, then rises again as weaker firms close. The variation in profitability between firms rises sharply. Recessions have also provided opportunities for anti-competitive mergers, with a negative impact on the wider economy: the suspension of competition policy in the United States in the 1930s may have extended the Great Depression.

Social effects

The living standards of people dependent on wages and salaries are more affected by recessions than those who rely on fixed incomes or welfare benefits. The loss of a job is known to have a negative impact on the stability of families, and individuals' health and well-being.

Crisis in States

Official economic data shows that a substantial number of nations are in recession as of early 2009. The US entered a recession at the end of 2007, and 2008 saw many other nations follow suit.

The United States housing market correction and subprime mortgage crisis has significantly contributed to a recession.

The 2008/2009 recession is seeing private consumption fall for the first time in nearly 20 years. This indicates the depth and severity of the current recession. Consumers in the U.S. have been hard; hit by the current recession, with the value of their houses dropping and their pension savings decimated on the stock market.

U.S. employers shed 63,000 jobs in February 2008, the most in five years. Former Federal Reserve chairman Alan Greenspan said on April 6, 2008, that "There is more than a 50 percent chance the United States could go into recession." On October 1, the Bureau of Economic Analysis reported that an additional 156,000 jobs had been lost in September. On April 29, 8008, nine US states were declared by Moody's to be in a recession. In November 2008, employers eliminated 533,000 jobs, the largest single month loss in 34 years. For 2008, an estimated 2.6; million U.S. jobs were eliminated.

The unemployment rate of US grew to 8.5 percent in March 2009, and there have been 5.1 million job losses till March 2009 since the recession began in December 2007. That is about five million more people unemployed compared to just a year ago. This has become the largest annual jump in the number of unemployed people since the 1940's.

Although the US Economy grew in the first quarter by 1%, by June 2008 some analysts stated that due to a protracted credit crisis and "rampant inflation in commodities such as oil, food andsteel", the country was nonetheless in a recession. The third quarter of 2008 brought on a GDP retraction of 0.5%, the biggest decline since 2001. A Nov 17, 2008, report from the Federal Reserve Bank of Philadelphia based on the survey of 51 forecasters,suggested that the recession started in April 2008 and will last 14 months. They project real GDP declining at an annual rate of 2.9% in the fourth quarter and 1.1% in the first quarter of 2009.

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These forecasts represent significant downward revisions from the forecasts of three months ago.

December 1, 2008, report from the National Bureau of Economic Research stated that the U.S. has been in a recession since December 2007, based on several measures including job losses, declines in personal income, and declines in real GDP. By July of 2009 a growing number of economists believed that the recession may have ended. The National Bureau of Economic Research will not make this official determination for some time. In the 2001 recession, the recession ended in November 2001, but it was not until July 2003 that the NBER announced its official determination.

A few other countries have seen the rate of growth of GDP decrease, generally attributed to reduced liquidity, sector price inflation in food and energy, and the U.S. slowdown. These include the United Kingdom, Ireland, Canada, Japan, China, India, New Sealand and many countries, within the EEA. India alongwith China is experiencing an economic showdown but not a recession. Also, Africa and South Africa are experiencing economic slowdown and global outbreak. Australia avoided a technical recession in 2009 and had positive growth against the overall global economic downturn.

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