ECONOMIC RECESSION

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The business cycle is the periodic but irregular up-and-down movement in economic activity measured by fluctuations in gross domestic product (GDP) in real terms and other macroeconomic variables. These cycles happen in a country, a region, a specific industry or even across the globe. A typical business cycle is identified by four phases—**Recession, Recovery, Growth,** and **Decline**—that repeat themselves over time.

So, economic recession is a typical phase of a business showing a general downturn in any economy indicated by a significant decline in activity across various sectors of the economy, lasting longer than a few months. Recession is officially defined as a period of negative economic growth for two consecutive quarters. As opposed to a period of growth when indicators like jobs, production and sales are all growing in real terms, discounting the effects of inflation, recessions are periods when the economy is shrinking or contracting. Such a period of recession, also sometimes referred to as a trough, is indicated by a declining stock market, reduced levels of buying, selling, production, business profits and investment spending, an increase in unemployment, fall in inflation rates and a slump in the housing market. It is the most unwelcome stage of the business cycle both for the owners of business as well as consumers. A more severe recession is also known as a depression which is characterised by price deflation, high fluctuations in currency value, large increases in unemployment, business bankruptcies and bank failures. Difference between a depression and a recession is in their severity. Depression always starts with a phase of recession having the same starting dates and different ending dates. The Great Depression (1929-39) was the longest lasting recession in the history of the Western industrialised world when the stock market crashed in October 1929 in the United States wiping out millions of investors, sending Wall Street into a panic. There was negative economic growth for many years in the UK with unemployment averaging over 20% of the workforce. [(1)] Since World War II there were four global recessions in 1975, 1982, 1991 and 2009, each lasting around a year. [(2)]

Recession, as already stated, is basically a contraction in business cycle. There are four primary types of recession;

1. V-shaped recession: In this type of recession mirroring the letter 'V,' the economy takes a fairly acute downturn triggered by an imbalance in the economy showing unusually high interest rates and hyperinflation but is quick to bounce right back when inflation subsides and interest rates fall.
2. W-shaped recession: In this type the recession also known as 'doubled dipped recession' the chart resembles the letter 'W' indicating a sharp dip in employment, GDP, industrial output, etc followed by an interim recovery in these metrics back to the previous peak, after which the economy declines again ending with a final complete recovery. This is a painful type of recession as the middle section of 'W' may represent a significant bear market rally inducing many investors to jump back into the markets after they believe the economy has found a bottom only to end up getting burned twice, when the recovery gets stifled by an additional economic crisis.
3. U-shaped recession: U-shaped recessions imply a prolonged period of recession (up to 24 months) possibly triggered by an imbalance involving a combination of a collapse in consumer and business demand and a credit crunch that tanks the economy down, holds it there briefly, then allows it to

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rebound. There are no quick and sharp recoveries from the trough. The recession in the USA of 1980 that double dipped in 1981 and 1982, is a good example of this type.

4. L-shaped recession: As the shape of the letter 'L' indicates L-shaped recession shows a sharp decline in GDP followed by several recessionary years (up to a decade). The imbalance in the economy here is a market downturn during a credit boom that results in a credit crunch bringing down the economy, then keeping a lid on it for years. This type of recession the world tries to avoid. The Japanese recession of the early 1990s following the bursting of the Japanese asset price bubble is considered an example of L-shaped recession.

The tipping point at the peak of a business cycle is marked by irrational exuberance in the economy when investors show over confidence in continuous price rise of an asset losing sight of its intrinsic value. This is when the recession sets in.

Factors that Cause Recessions:

High interest rates are a cause of recession because they limit liquidity or the amount of money available for investment. They severely inhibit borrowing and investment leading to a series of cyclical effects on GDP, employment, consumer spending etc.

Inflation on the increase is another factor which refers to a general rise in the prices of goods and services, over a period of time. As inflation increases real wages fall. It means the percentage of goods and services that can be purchased with the same amount of money declines.

Reduced consumer confidence is another prime factor bringing in recession. As consumer confidence recedes, so does demand. When consumers start believing the economy is bad, they are less likely to spend money. Though consumer confidence is psychological it can have a real impact on any economy.

Reduced real wages, consequent upon inflation, is another factor for recession. The purchasing power of workers gets eroded despite earning the same amount of money.

Stock market crash is an outcome of sudden loss of investors' confidence in the future earnings of companies. This leads to declining stock values. Failure to restore confidence leads to recession.

A **Slowdown in manufacturing orders** makes much of the manufacturing capacity idle. This affects profitability of companies, another cause for recession.

Asst bubbles formed by sharp rise in prices of securities or other assets like real estate beyond their sustainable value, not justified by fundamentals, sets the stage for occurrence of recession when these bubbles finally burst.

Recessions do not suddenly happen; rather they throw up portentous signs that announce approaching of an imminent recession. The various signals are:

1. Rate of joblessness rise steeply over months.
2. Large companies, across sectors, announce depressing sales and profit figures, over quarters.
3. Borrowers start defaulting to pay off their debts
4. Credit Card Purchases by card holders, facing the cash crunch, shoots up
5. Prices of Essential Commodities are on steady rise.
6. There are no takers for repossessed homes and stocks despite prices declining drastically.
7. Companies stop hiring to fill vacancies and sometimes start offering voluntary retirement to

non-essential employees.

8. Individuals start liquidating fixed deposits and other term investments to meet daily expenses.
9. The country's GDP or Gross Domestic Production registers a continuous downward trend.

In the world economy of today, through trade and transactions, recession in one country easily spreads to another country. Depending upon relative strength and economic power, each country starts the adjustment process. Developed countries may adopt protectionist measures to insulate their economies from external dangers. Developing countries may have to borrow heavily from international agencies like the IMF for short term and medium term structural adjustments. Remedial measures to fight recession include use of fiscal policy; increased government spending and/ or tax cuts is the most common way of boosting aggregate demand which will help an economic expansion. Central Banks are advised to liberalise terms of credit availability. Since present day recessions mostly go with inflation selective credit control should be preferred over general credit control.

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