Impending Global Recession

Introduction

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During a recession, the economy struggles, people lose work, companies make fewer sales and the country's overall economic output declines. The point where the economy officially falls into a recession depends on a variety of factors.

In 1974, economist Julius Shiskin came up with a few rules of thumb to define a recession: The most popular was two consecutive quarters of declining GDP. A healthy economy expands over time, so two quarters in a row of contracting output suggests there are serious underlying problems, according to Shiskin. This definition of a recession became a common standard over the years.

The National Bureau of Economic Research (NBER) is generally recognized as the authority that defines the starting and ending dates of U.S. recessions. NBER has its own definition of what constitutes a recession, namely "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."

The NBER's definition is more flexible than Shiskin's rule for determining what is a recession. For example, the coronavirus could potentially create a W-shaped recession, where the economy falls one quarter, starts to grow, then drops again in the future. This would not be a recession by Shiskin's rules but could be under the NBER's definition.

Causes of a Recession

A sudden economic shock: An economic shock is a surprise problem that creates serious financial damage. In the 1970s, OPEC cut off the supply of oil to the U.S. without warning, causing a recession, not to mention endless lines at gas stations. The coronavirus outbreak, which shut down economies worldwide, is a more recent example of a sudden economic shock.

- **Excessive debt:** When individuals or businesses take on too much debt, the cost of servicing the debt can grow to the point where they can't pay their bills. Growing debt defaults and bankruptcies then capsize the economy. The housing bubble in the mid-aughts that led to the Great Recession is a prime example of excessive debt causing a recession.
- **Asset bubbles:** When investing decisions are driven by emotion, bad economic outcomes aren't far behind. Investors can become too optimistic during a strong

economy. Former Fed Chair Alan Greenspan famously referred to this tendency as "irrational exuberance," in describing the outsized gains in the stock market in the late 1990s. Irrational exuberance inflates stock market or real estate bubbles—and when the bubbles pop, panic selling can crash the market, causing a recession.

- **Too much inflation:** Inflation is the steady, upward trend in prices over time. Inflation isn't a bad thing per se, but excessive inflation is a dangerous phenomenon. Central banks control inflation by raising interest rates, and higher interest rates depress economic activity. Out-of-control inflation was an ongoing problem in the U.S. in the 1970s. To break the cycle, the Federal Reserve rapidly raised interest rates, which caused a recession.
- **Too much deflation:** While runaway inflation can create a recession, deflation can be even worse. Deflation is when prices decline over time, which causes wages to contract, which further depresses prices. When a deflationary feedback loop gets out of hand, people and businesses stop spending, which undermines the economy. Central banks and economists have few tools to fix the underlying problems that cause deflation. Japan's struggles with deflation throughout most of the 1990s caused a severe recession.
- **Technological change:** New inventions increase productivity and help the economy over the long term, but there can be short-term periods of adjustment to technological breakthroughs. In the 19th century, there were waves of labor-saving technological improvements. The Industrial Revolution made entire professions obsolete, sparking recessions and hard times. Today, some economists worry that AI and robots could cause recessions by eliminating whole categories of jobs.

Case Studies

Pakistan: Over the past few months, with the change of government, the Pakistani economy has been sent into a downward spiral. Inflation and the prices of everyday necessities have reached their peak, with the end to this suffering not seeming near. Pakistan's current economic struggles exemplify the little fires everywhere set alight across the global economy by a war during a pandemic. Like others in countries dependent on imported commodities — for example Ghana and Sri Lanka — Pakistanis are seeing food and fuel prices soar. Foreign exchange reserves – used to pay for imports such as food and fuel – have shrunk.

Pakistan is using up its foreign exchange reserves more quickly than previously anticipated because prices of foreign goods are going up. If the situation doesn't change, the country faces bankruptcy.

In April, a litre of petrol cost about 150 rupees (£0.60), but by July 1 the price had risen to nearly 250 rupees. And the price of cooking oil increased by 40% just between May and June. At present the country has only enough foreign currency to pay for five weeks of imports. Pakistan is heavily dependent on imported fuel and cooking oil, but also on machinery and food grains from overseas.

All of this has made day-to-day activities more challenging. Power outages are not uncommon in the country, even when the economy is strong – they become frequent and long when the economy is under duress. This happens because energy companies struggle to operate when the costs of power generation are higher than the revenue they collect. Over the past few weeks, residents of major cities have had to go without electricity in their homes for as much as 10 hours a day – in rural areas for even more. The discomfort of the public is compounded by an intense heatwave in many parts of south Asia that has caused temperatures in some places to hit 51°C.

Sri Lanka: Sri Lanka's economy fell back into contraction last quarter as the country battled its worst economic problems since independence, with emergency aid to stabilise the island nation proving elusive.

Gross domestic product declined 1.6 per cent in the quarter ended March from a year earlier, the Department of Census and Statistics said in a statement on Tuesday. That's shallower than a 3.6 per cent contraction seen by economists in a Bloomberg survey and compares with a revised 2 per cent expansion in the previous quarter.

The contraction likely marks the beginning of a painful and long recession for the country, whose Prime Minister Ranil Wickremesinghe last week said the economy had "completely collapsed." The crisis follows years of debt-fueled growth and populist fiscal policies, with the Covid-19 pandemic's hit to the dollar-earning tourism industry serving as the last straw.

Absence of foreign exchange to pay for import of food to fuel led to red-hot inflation, the fastest in Asia, triggering protests against the government led by the Rajapaksa clan that eventually led to the resignation of Mahinda Rajapaksa as premier. While the months-long protests hurt business activity in parts of the country, the government on Monday imposed new curbs, which includes a call to residents to stay home until July 10 to conserve fuel.

United States of America: The Commerce Department of the United States of America reported that the economy shrank at an annual rate of 0.9% in the April-June quarter, marking the second consecutive quarter of negative GDP, or gross domestic product. A back-to-back drop in GDP is considered by many to be an unofficial barometer for a recession.

Days ahead of the release of the latest numbers gauging economic health, President Biden had insisted that low unemployment numbers, record job growth and foreign business investment signalled a strong economy.

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Treasury Secretary Janet Yellen also avoided clinging to the R-word in a recent appearance on NBC's Meet the Press. Although two consecutive quarters of negative growth generally defines a recession, she said, "When you're creating almost 400,000 jobs a month, that is not a recession."
The White House has pushed back against calling the current economy a recession. It is no doubt aware of the role the economy is going to play in the midterm elections.

President Biden cited record job growth and foreign business investment as signs of strength in the economy. "That doesn't sound like a recession to me," Biden concluded.
As the midterm elections approach, the White House is acutely aware of the optics of a country in recession, where Americans are struggling financially. But with the cost of so many things skyrocketing and inflation running at a multi-decade high, a lot of Americans are already taking it on the chin.

Russia: Since the start of the Russia-Ukraine war, a plethora of sanctions have been imposed on the Russian Federation in an attempt to isolate the nation diplomatically and cripple the economy. Russia's central bank assets have been frozen to stop it using its $630bn (£470bn) of foreign currency reserves. This caused the rouble to fall 22% in value, pushing up the price of imported goods and leading Russia's inflation rate to rise to 14%. The rouble has since recovered, mainly due to measures by Moscow to prop it up, but inflation has risen above 17%.

The United States has barred Russia from making debt payments using the $600m it holds in US banks, making it harder for Russia to repay its international loans. Major Russian banks have been removed from the international financial messaging system Swift, which will delay payments to Russia for energy exports. The UK has excluded key Russian banks from the UK financial system, frozen the assets of all Russian banks, barred Russian firms from borrowing money, and placed limits on deposits Russians can make at UK banks.

More than 1,000 international companies have either suspended trading in Russia, or withdrawn altogether - including McDonalds, Coca-Cola, Starbucks, and Marks & Spencer. McDonald's is leaving Russia and selling off its 850 restaurants, 30 years after setting up there. Food giant Nestle has withdrawn some of its brands including KitKat and Nesquik, but will still sell "essential foods". However, some brands including Burger King, and hotel groups Marriott and Accor say they can't pull out because their businesses operate under complex franchise deals.
The US, EU, UK and other countries have sanctioned more than 1,000 Russian individuals and businesses, including:

- Wealthy business leaders, so-called oligarchs, who are considered close to the Kremlin, including the former Chelsea FC owner Roman Abramovich
- Russian government officials and family members - including President Vladimir Putin's adult children and relatives of Foreign Minister Sergei Lavrov

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- Assets belonging to President Putin and Foreign Minister Sergei Lavrov are being frozen in the US, EU, UK, and Canada.

The UK has also stopped the sale of "golden visas", which allowed wealthy Russians to get British residency rights.

Because Russia is now cut off from the SWIFT international banking system and blocked from trading internationally in dollars and euros, it's been left to essentially trade with itself, Hess said. That means that while Russia's built up a formidable volume of foreign reserves that bolster its currency at home, it can't use those reserves to serve its import needs, thanks to sanctions.

The ruble's exchange rate "is really a Potemkin rate, because sending money from Russia abroad given the sanctions — both on Russian individuals and Russian banks — is incredibly difficult, not to mention Russia's own capital controls," Hess said.

Conclusion: Still reeling from the COVID pandemic and Russia's invasion of Ukraine, the global economy is facing an increasingly murky and uncertain outlook, according to the latest report released on Tuesday by the International Monetary Fund (IMF). "The outlook has darkened significantly since April," said Pierre-Olivier Gourinchas, IMF Economic Counsellor and Director of Research.

"The world may soon be teetering on the edge of a global recession, only two years after the last one".

The baseline forecast for global growth is for it to slow from 6.1 per cent last year, to 3.2 per cent in 2022 – 0.4 per cent lower than forecast in the last Outlook update in April.

In the US, reduced household purchasing power and tighter monetary policy will drive growth down to 2.3 per cent this year and one percent next year, according to the outlook. China's slowdown has been worse than anticipated amid COVID-19 outbreaks and lockdowns, with negative effects from Russia's invasion of Ukraine continuing. Moreover, further lockdowns and a deepening real estate crisis there has pushed growth down to 3.3 per cent this year – the slowest in more than four decades, excluding the pandemic. And in the Eurozone, growth has been revised down to 2.6 per cent this year and 1.2 percent in 2023, reflecting spillovers from the Ukraine war and tighter monetary policy.

"As a result, global output contracted in the second quarter of this year," said Mr. Gourinchas.

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“In a plausible alternative scenario where some of these risks materialise...inflation will rise and global growth decelerate further to about 2.6 per cent this year and two per cent next year, a pace that growth has fallen below just five times since 1970,” said the IMF economist.

“Under this scenario, both the United States and the Euro area experience near-zero growth next year, with negative knock-on effects for the rest of the world”. If global action is not taken to combat the pending global recession, it can have disastrous consequences on the citizens of the world.