Possible causes of a recession in the uk

Economics, Macroeconomics

recession is a period of negative economic growth for 2 consecutive economic quarters. In the post war period UK economic growth has been characterized by the boom and bust economic cycles. A period of growth is followed by high inflationary growth and then a downturn in the economy. However since 1992 the UK has experienced a long period of economic growth, the longest period of uninterrupted growth this century. It appears the UK has temporarily avoided the threat of recession, but although forecasts remain positive there are many factors that could push the UK into recession. Possible causes of a recession could include: 1. Fall in house prices. The UK economy has a strong dependency on the housing market. Most people own a house, renting is not common like on the continent. Borrowing costs are a high % of income because people take out large mortgages. If house prices were to fall there would be a negative wealth effect which would adversely affect consumer spending and cause a fall in AD. Some people say house prices are overvalued because of speculation. However others argue the UK market remains strong because of shortage of supply and constant demand. However the housing market is very susceptible to even a small rise in interest rates. If interest rates rise it would increase mortgage costs and there would be a big fall in demand and therefore consumer spending. 2. In addition record levels of consumer borrowing means the economy is likely to be significantly affected by any rise in interest rates. The savings ratio is at an all time low. If interest rates were to rise then it would cause great pain to consumers. 3. Decline in Manufacturing sector. For a long time the UK manufacturing sector has becoming more uncompetitive with the rest of the world. Mainly because of competition from Asian countries with lower labour costs. In this sector the UK is experiencing rising unemployment, causing unemployment to go back above 5% (ILO Labour Force Survey) 4. Government borrowing is high. To meet the shortfall the Govt may have to increase taxes. This would have the effect of reducing consumer spending. 5. Global downturn. If the world economy slows down there will be less demand for British exports and also reduced economic confidence. This is very significant with increased globalisation of the world economy. 6. It is argued interest rates are being kept artificially low by the demand by China and other Asian countries to buy UK and especially US debt. If for whatever reason this was to end. Interest rates would rise to try and combat the imbalances in the current account and domestic levels of savings. 7. Rising price of oil. In the past 2 years the price of oil has surged ahead in the past this was often sufficient to cause a recession. This time has been different because the rising price has been caused by high demand rather than supply shocks. However if the price of oil was to continue to rise (as is predicted by many oil analysts) this would put pressure on business costs, causing inflation. To maintain the governments inflation target the MPC may increase interest rates. Thus triggering a fall in AD However growth in the UK is forecast to be 3% for next year. This is because consumer spending is forecast to remain steady against a backdrop of low interest rates and low inflation. However if there was to be a moderate rise in interest rates the growth rates could prove to be over optimistic (as they were last year). This could be sufficient to reduce consumer and business confidence. Thus starting a recession.