The great recession of 2008

Economics, Macroeconomics

An economy which grows over a period of time tends to slow down the growth as a part of the normal economic cycle. An economy typically expands for 6-10 years and tends to go into a recession for about six months to 2 years. A recession normally takes place when consumers lose confidence in the growth of the economy and spend less. This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment. Investors spend less as they fear stocks values will fall and thus stock markets fall on negative sentiment.

The economy and the stock market are closely related. The stock markets reflect the buoyancy of the economy. In the US, a recession is yet to be declared by the Bureau of Economic Analysis, but investors are a worried lot. The Indian stock markets also crashed due to a slowdown in the US economy. The Sensex crashed by nearly 13 per cent in just two trading sessions in January. The markets bounced back after the US Fed cut interest rates. However, stock prices are now at a low ebb in India with little cheer coming to investors.

The defaults on sub-prime mortgages (homeloan defaults) have led to a major crisis in the US. Sub-prime is a high risk debt offered to people with poor credit worthiness or unstable incomes. Major banks have landed in trouble after people could not pay back loans (See: Subprime pain: Who lost how much) The housing market soared on the back of easy availability of loans. The realty sector boomed but could not sustain the momentum for long, and it collapsed under the gargantuan weight of crippling loan defaults. Foreclosures spread like wildfire putting the US economy on shaky ground.

This, coupled with rising oil prices at $100 a barrel, slowed down the growth of the economy. Tax cuts are the first step that a government fighting recessionary trends or a full-fledged recession proposes to do. In the current case, the Bush government has proposed a $150-billion bailout package in tax cuts. The government also hikes its spending to create more jobs and boost the manufacturing and services sectors and to prop up the economy. The government also takes steps to help the private sector come out of the crisis.

The US economy has suffered 10 recessions since the end of World War II. TheGreat Depressionin the United was an economic slowdown, from 1930 to 1939. It was a decade of high unemployment, low profits, low prices of goods, and highpoverty. The trade market was brought to a standstill, which consequently affected the world markets in the 1930s. Industries that suffered the most included agriculture, mining, and logging. In 1937, the American economy unexpectedly fell, lasting through most of 1938. Production declined sharply, as did profits and employment.

Unemployment jumped from 14. 3 per cent in 1937 to 19. 0 per cent in 1938. The US saw a recession during 1982-83 due to a tight monetary policy to control inflation and sharp correction to overproduction of the previous decade. This was followed by Black Monday in October 1987, when a stock market collapse saw the Dow Jones Industrial Average plunge by 22. 6 per cent affecting the lives of millions of Americans. The US saw one of its biggest recessions in 2001, ending ten years of growth, the longest expansion on record.

From March to November 2001, employment dropped by almost 1. 7 million. In the 1990-91 recession, the GDP fell 1. 5 per cent from its peak in the second quarter of 1990. The 2001 recession saw a 0. 6 per cent decline from the peak in the fourth quarter of 2000. The dot-com burst hit the US economy and many developing countries as well. The economy also suffered after the 9/11 attacks. In 2001, investors' wealth dwindled astechnologystock prices crashed. Indian companies have major outsourcing deals from the US.

India's exports to the US have also grown substantially over the years. The India economy is likely to lose between 1 to 2 percentage points in GDP growth in the next fiscal year. Indian companies with big tickets deals in the US would see their profit margins shrinking. The worries for exporters will grow as rupee strengthens further against the dollar. But experts note that the long-term prospects for India are stable. A weak dollar could bring more foreignmoneyto Indian markets. Oil may get cheaper brining down inflation.

A recession could bring down oil prices to $70. Between January 2001 and December 2002, the Dow Jones Industrial Average went down by 22. 7 per cent, while the Sensex fell by 14. 6 per cent. If the fall from the record highs reached is taken, the DJIA was down 30 per cent in December 2002 from the highs it hit in January 2000. In contrast, the Sensex was down 45 per cent. The whole of Asia would be hit by a recession as it depends on the US economy. Asia is yet to totally decouple itself (or be independent) from the rest of the world, say experts.