Heading for an Economic Recession in 2020

What is the issue?

- Nobel laureate Paul Krugman has warned that the US (and the world too) could be heading for a recession late in 2019 or in 2020.
- With hopes that the global economy was recovering from the 2008 global financial crisis, Krugman's statement has raised new concerns.

What is financial crisis, recession, depression?

- A **financial crisis** would be a signal of the unhealthy condition of the economy in general, with following indications:

i. asset prices see a steep decline in value
ii. businesses and consumers are unable to pay their debts
iii. financial institutions experience liquidity shortages

- A financial crisis is often associated with a bank run where investors sell off assets or withdraw money from savings accounts.
- This is driven by the fear that the value of those assets would drop if they remain in a financial institution.
- If left unchecked, a financial crisis can cause an economy to go into a **recession** or depression.
- In the event of a recession, there would be a widespread decline in economic activity, lasting more than a few months.
- The slowdown is normally visible in real gross domestic product (GDP), real income, employment, industrial production and wholesale-retail sales.
- An economic **depression** would mean a more severe version of a recession. E.g. the Great Depression in the U.S. (as well as the world) starting in 1929 and continuing to the early 1940s

What is the post-2008 scenario?

- An overview of the decade since the global financial crisis of 2008 signals global recovery and rebound in the United States economy.
- The bounce-back was strong enough and the US Federal Reserve even

signalled two rate hikes in 2019.
- Many global central banks also gave notice that the prolonged phase of easy money was coming to an end.
- [Following the 2008 crisis, central banks worldwide cut interest rates to historic lows in order to overcome recession.]
- Despite this, Paul Krugman has warned of a recession in the world's biggest economy, the US, on certain grounds.

What are the recessionary factors?

- **Debt** - The US is in worse fiscal condition than it was in 2008.
- U.S. has a huge public debt at a little over $22 trillion and has been growing over the last few years.

- The debt-to-GDP ratio (a measure of the ability of a country to repay debt) is rising to 104% now.
- Besides, the current leadership in the U.S. favouring too much protectionism is also a cause of worry.
- **Europe** - There is an economic slowdown in Europe due to various factors.
- These include economic powerhouse Germany being hit because of tariff wars involving the US and China, a recession in Italy, slowing growth in France, etc.
- The European central bank (ECB) cannot cut rates to address these because they are negative already.
- Evidently, Europe is clearly experiencing a slowdown to recessionary levels already and has no recourse.
- **China** - For China, the trade war with the US, if not settled, could hamper growth or result in a recession.
- Growth in the rest of the world will likely slow down, and more so as other countries will retaliate against US protectionism.

Why is it riskier than 2008 crisis?

- The ongoing trade disputes and an unsustainable fiscal stimulus will limit the options for boosting the economy in the event of another crisis.
- The top central banks have already massively bought bonds and other assets during the 2008 global financial crisis to ensure easy money.
- Given this, the space for fiscal stimulus is limited by the massive public debt.
- So they may not have the policy tools to provide easy liquidity, given the liabilities on their existing balance sheets.
- So unlike in 2008, the policymakers may not have the sufficient capacity to balance the impact of another recession now.
- Possibly, the next crisis and recession, if it comes, could be even more severe

and prolonged than the one in 2008.

What is the U.S.'s stance?

- In contrast to the above predictions, there is optimism among the financial circles in the U.S.
- Inflation is in balance and the jobs or labour market is still strong.
- The US Federal Reserve is said to be prepared to adjust policy quickly and flexibly, and to use all its policy tools to support the economy.
- It is quite certain of keeping economic expansion on track, the labour market strong and inflation close to 2%.

Should India be worried?

- Oil prices, a major threat to macroeconomic stability, have been relatively low.
- Foreign flows have moved out a little but domestic investors are putting money into stocks and mutual funds.
- If the current scenario continues with low interest rates, an accommodative policy of central banks, and low inflation, the RBI could cut interest rates further.
- In all, there is not much cause of worry for India at present.

Source: Indian Express