CENTRAL BANK OF NIGERIA

UNDERSTANDING MONETARY POLICY SERIES NO 14

ECONOMIC RECESSION

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Aims and Scope

Understanding Monetary Policy Series are designed to improve monetary policy communication as well as economic literacy. The series attempt to bring the technical aspects of monetary policy closer to the critical stakeholders who may not have had formal training in Monetary Management. The contents of the publication are therefore, intended for general information only. While necessary care was taken to ensure the inclusion of information in the publication to aid proper understanding of the monetary policy process and concepts, the Bank would not be liable for the interpretation or application of any piece of information contained herein.

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Central Bank of Nigeria

Mandate

- Ensure Monetary and Price Stability
- Issue Legal Tender Currency in Nigeria
- Maintain External Reserves to safeguard the international value of the Legal Tender Currency
- Promote a Sound Financial System in Nigeria
- Act as Banker and Provide Economic and Financial advice to the Federal Government

Vision

"By 2015, be the Model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development"

Mission Statement

"To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector"

Core Values

- Meritocracy
- Leadership
- Learning
- Customer-Focus

MONETARY POLICY DEPARTMENT

Mandate

To Facilitate the Conceptualization and Design of Monetary Policy of the Central Bank of Nigeria

Vision

To be Efficient and Effective in Promoting the Attainment and Sustenance of Monetary and Price Stability Objective of the Central Bank of Nigeria

Mission

To Provide a Dynamic Evidence-based Analytical Framework for the Formulation and Implementation of Monetary Policy for Optimal Economic Growth

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UNDERSTANDING ECONOMIC RECESSION[1]

SECTION ONE

Introduction

Every economy (country) is affected by business cycle (or economic cycle). Business cycle refers to economy-wide (nationwide) fluctuations in production, trade and general economic activities over medium-to-long-term in a free market system. Free market economy is one where there is no government intervention in economic activities; rather demand and supply interact to correct disequilibrium (anomalies) in the market. The business cycle is the upward and downward movements of levels of gross domestic product (GDP), and refers to the period of expansions and contractions in the level of economic activities (business fluctuations) around its long-term growth trend. These fluctuations involve shifts over time between periods of relatively rapid economic growth (boom), and periods of relative stagnation or decline (a contraction or recession).

Recession is a business cycle contraction, and it refers to a general slowdown in economic activity for two consecutive quarters. During recession, there is usually a decline in certain macroeconomic indicators such as GDP, employment, investment spending, capacity utilization, household income, business income, and inflation, with the attendant increase in the rate of unemployment. Technically, when an economy recorded two consecutive quarters of negative growth in real GDP, it can be said to be in recession. GDP is the market value of all legitimately recognized final goods and services produced in the country in a given period of time, usually one year.

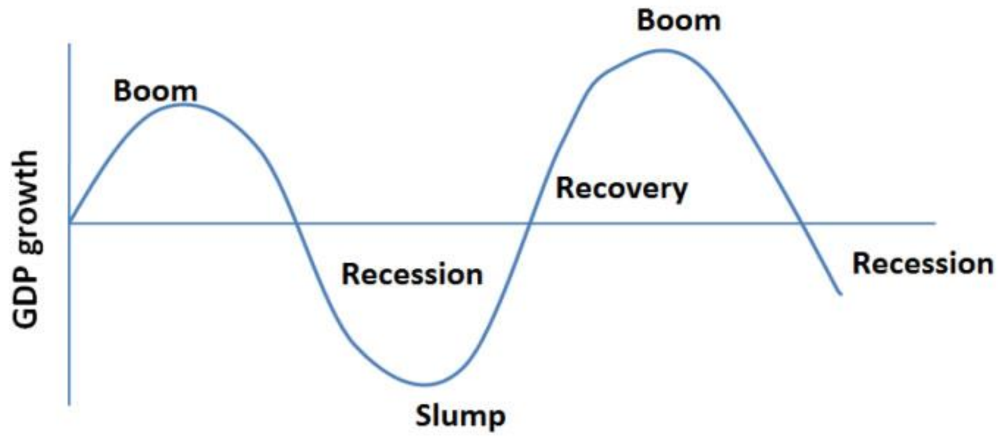
A typical business cycle, as demonstrated in Figure 1 has a period of booms (prosperity), followed by a period of recession, slump and recovery. During the boom period, there is minimal unemployment; high production and consumption; high standard of living; high inflation; and so on. It is a period when most macroeconomic indicators are positive. In a recession period, economic activities slowed considerably.

When economic activities reach the lower part of the chart (Figure 1), it is said to be in a slump (depression); a prolonged recession. Most macroeconomic indicators remained negative for a long time, usually more than two years. Subsequently, the cycle enters a recovery period. This is as a result of the impact

*1 Monetary Policy Department wishes to acknowledge the efforts of **Mr. Danladi Osude** in producing the initial draft of this paper*

of fiscal policy (the use of taxes and government expenditure) and monetary policy (the cost and availability of money) to stimulate economic activities. Demand and other macroeconomic indicators begin to pick up, leading to increased investment and production of goods and services in the economy. Gradually, the boom would be restored and the cycle continues.

Figure 1: Graphical Example of Business cycle



This paper discusses economic recession; concepts, causes and implications for the wider economy. Following the introduction, section II discusses the history of economic recession. Section III presents the causes of recession, while section IV contains the effects of recession. The cases of recession presented in section V and Section VI concludes the paper.

SECTION TWO

Economic Recession: Historical Perspective

The history of economic recession is as old as the history of humanity itself, dating back to the 3rd Century. This was the period of a Military Anarchy also known as imperial crisis (AD 235-284), during which the Roman Empire came close to collapse as a result of economic depression, civil crisis, invasion and diseases. The crisis culminated in the assassination of Emperor Alexander Severus by his own troops, resulting in the competition his successor. Consequently, the Empire split into three competing states by AD 258-260.

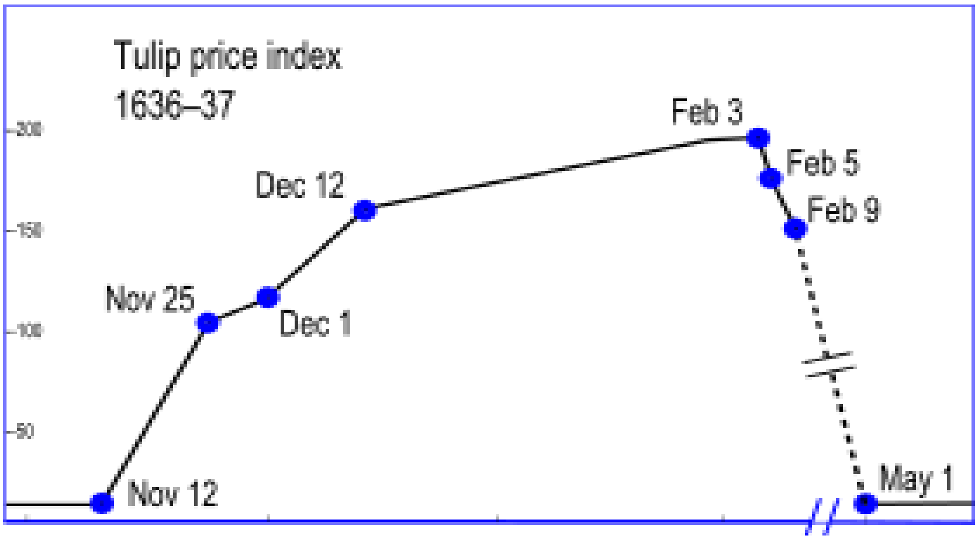
The resultant effect of the foregoing was hyperinflation in the Empire, necessitating years of coinage devaluation. During the period, fiat money was created to pay the salaries/bonuses of the Military, without accretion in the real economic activities. Also, there was serious disruption of Rome's extensive internal trade channels due to the crisis. The widespread civil unrest made it no longer safe for merchants to travel and the financial crisis that struck compounded the exchange with the debased currency. This produced profound changes that, in many ways, would foreshadow the much decentralized economic character of the coming Middle Ages.

The 14th Century economic crisis stemmed more or less from the banking crisis, when the Bardi family and Peruzzi family lent Edward III of England a total of 1,500,000 gold florins which he failed to repay. The situation led to the collapse of the two family banks. During the 15th Century, the Bardi family continued to operate in various European Centres, playing a notable role in financing some of the early voyages of discovery to America, including those by Christopher Columbus and John Cabot (Guidi-Bruscoli, 2012). Besides Edward III of England, other notable rulers were indebted to the Bardi family and most of them defaulted.

The economic recession of the 17th century was as result of a Dutch prosperous era, during which the price for the supply of bulb (from Tulip mania or Tulipomania) rose to a very high level and then suddenly collapsed. History stated that at the height of tulip mania around March 1637, one tulip bulb sold for over ten times the annual income of a trained artisan. The period was generally regarded as the first recorded speculative bubble, although, others argued that the Kipper-und Wipperzeit era of 1619 – 1622, when the whole of Europe experienced series of reduction in metal content of coins to finance war, was the first speculative bubble. Large economic bubbles are metaphorically referred to as Tulip mania in some quarters.

Tulip was different from other flowers due to its attractive petal colour, hence, its popularity began to spread to other parts of Europe. The emergence of non-peril tulip as a status symbol during the period coincides with the rise of newly independent Holland's trade fortunes, resulting in the rise of its golden age. Merchants made huge profit of up to 400 per cent exporting tulip to East Indies. As a result, the tulip became attractive luxury goods and other varieties of tulip were introduced through mosaic virus (tulip breaking virus). The virus added to the beauty of the tulip, and at the same time weakened its reproduction as it took longer time to produce. This led to the scarcity of tulip, resulting in a significant increase in the price of the product. This resulted in speculative trading over time.

Figure 2: Tulip Price Index, 1636-37



Source: Wikipedia.org

Recession in the 18th century started with the stock price bubble of the South Sea Company. The South Sea Company was a British Joint Stock Company, established in 1711 as a public-private partnership (PPP) with the sole responsibility of reducing the cost of national debt. The company was established during Britain's war against Spanish secession, hence there was no way it was going to make profit. This was because the company was given monopoly over South America, where Spain had greater influence. The value of the stock of the company rose principally on account of increased operations in dealing in government debt, peaking in 1720 before collapsing to a little above its original floating price; this became known as the South Sea Bubble. The share price crash affected many people at the time and reduced the value of the national economy. This was caused by several abuses including insiders trading, parliamentary lobby and margin trading.

Also, there was the peace time Credit Crisis of 1772 in London, which then spread to other places like Netherlands and Scotland. On June 8, 1772, Alexander Fordyce, a partner in the banking house Neal, James, Fordyce and Down in London, fled to France to avoid debt repayment, and the resulting collapse of the firm stirred up panic in London. Economic growth was dependent on the availability of credit, which mirrors peoples' confidence in the banking industry. The default resulted in a run on banks which led to the collapse of the industry.

In the 19th century, there was the post-Napoleonic depression known as post-war economic depression in Europe. In England, an agricultural depression led to the passage of the Corn Laws and placed great strain on the system of poor relief inherited from Elizabethan times. A major peacetime crisis was the Panic of 1819 that resulted in a financial crisis in the US and general collapse of the US economy over three years. The main characteristic of the panic was the transition of the US from its colonial commercial status with Europe toward a dynamic economy, characterized by the financial and industrial imperatives of laissez-faire capitalism. The crisis was compounded by high speculation in public lands, fueled by non-regulation of the issue of paper money by banks. The development led to general banking apathy and the belief that government economic policies were flawed. This raised greater involvement in politics by the Americans in order to defend their local interest. The development led to the signing of treaty between the US and Britain to end the war and other anti-trade regulations in 1812.

Following the situation in the US, was the Panic of 1825 that started in the Bank of England (BoE), which resulted in stock market crash arising from speculative investment in Latin America. The crisis led to the closure of six London banks and sixty country banks in England. The crisis also extended to Latin America, Europe and the US. It took the intervention from the Banque de France infusing gold reserves to save the BoE from total collapse. Economists term the crisis as the first modern economic crisis that was not exogenously induced by war. Thus, the particular crisis has been designated as the beginning of economic cycles.

In the US, a serious economic depression started in 1893, caused by excessive construction and faulty financing of rail construction. The resulting effect of the crisis was the failure of so many banks, and a run on gold supply. As a result of the Panic, stock prices declined. Five hundred (500) banks collapsed, 15,000 businesses failed, and many farms ceased operation. Timberlake et al, (1997) noted that unemployment rate rose significantly during this period; Pennsylvania (25 per cent), New York (35 per cent), and Michigan (43 per cent).

In the 20th century, there was the Panic of 1907 (1907 Bankers' Panic or Knickerbocker Crisis) in the US, where the New York Stock Exchange (NYSE) fell by over 50 per cent from the peak it attained in the previous year. The panic occurred during economic recession, and resulted in several runs on banks and trust companies. The panic spread to other states and local governments, and resulted in their bankruptcy. The panic was as a result of a failed attempt in October 1907 to corner the market on stock of the United Copper Company. The failed attempt to corner the market resulted in the crisis of confidence as there was a massive runs on the companies associated with cornering schemes and their affiliates.

Preceding the great depression of 1930, was the most devastating stock crash in the US in 1929. It is the Wall Street Crash of 1929 (Black Tuesday or Stock Market Crash of 1929). The crash marked the advent of 10 years of great depression, which did not spare any of the industrialized Western countries.

The great depression affected both the rich and the poor countries alike, as unemployment rose across the globe, world trade declined (due mainly to protectionist policies adopted by countries of the world), and demand for goods and services fell.

Other crises in the century include the black Monday (October 19, 1987) where stock market around the world crashed within a short space of time, the Mexican economic crisis (1994) caused by the sudden devaluation of the peso, and the Russian financial crisis (August 17, 1998) similar to that of Mexico.

In the 21st century, there was the global financial crisis (GFC), which started in 2007, caused principally by the housing bubble in the US that peaked in 2006. The complex interplay of policies that encouraged home ownership, providing easier access to loans for (lending) borrowers, overvaluation of bundled sub-prime mortgages based on the expectation that housing prices would continue to escalate triggered the crisis. Also, questionable trading practices on behalf of both buyers and sellers, compensation structures that prioritized short-term deal flow over long-term value creation and a lack of adequate capital holdings from banks and insurance companies to back the financial commitments, were other reasons for the crisis. The crisis has been adjudged the most severe since the great depression of the 1930s. The crisis resulted in the collapse of many big businesses, distressed banks, mergers and acquisitions in some cases, and bailouts in some countries.

SECTION THREE

The Causes of Recession

Recession can be caused by two broad factors: internal (endogenous) and external (exogenous). The former is usually as a result of conflict of ideas, misapplication of economic theory and regulatory negligence or policy inconsistency. The Asian financial crisis of 1997-1998 was caused partly by internal factors; banks were lending abroad in pursuit of high profit margin, due largely to slow downs at home, desire to pursue development without due consideration of economic fundamentals, corruption, and structural and policy distortions (Wong, 1999; Corsetti et al, 1999). Other factors were the overheating of private sector and excessive investments in real-estate with non-commensurate returns. In the same vein, the global financial crisis of 2007 and the ongoing recession was triggered by the United States housing bubble; excessive lending of banks into high-risk subprime and adjustable rate mortgages resulted in high default rates as well as downfall of banking sector. Defaults and losses on other categories of loans also rose considerably as the crisis expanded from the housing market to other sectors of the economy. Bankruptcy of several high rated investment banks started to panic on the inter-bank loan and stock markets and eventually, the bubble busted. This resulted in the fall of global GDP, rising unemployment and economic difficulties in many parts of the world (Kamar, 2012).

The external causes of recession have to do with factors that are exogenous to the economy over which policy makers have little or no control. Factors like natural disaster, climate change, revolution and wars. An agricultural economy could face crop failure resulting in general economic slowdown. Also, a mono-economy could suffer recession from international price shock for its product. The neoclassical economists are of the view that state interference in the market, labour union, monopolies and technological shocks are external causes of recession.

To another group, negative demand and supply shocks as well as deflationary macroeconomic policies are the main causes of recession. The negative demand-side shocks that affect the aggregate demand work through a global economic slowdown that impacts major trading partners of a country. In the case of Nigeria, when there is economic slowdown in the U.S., China, India and EU, it could have negative impact on the demand of Nigerian crude oil from these countries. As a result, government's revenue and spending would drop, taxes will rise, disposable income will fall and aggregate demand will fall, adversely impacting the production of goods and services. These developments would culminate in economic recession. Also, a crash in asset prices as was the case during the GFC, credit crunch, where financial institutions reduced the amount of credit to support production could occur. Another source of negative demand shocks could be sharp appreciation of the domestic currency, which encourages import and discourage export of goods and services, and causes disequilibrium in balance of trade and deterioration in the balance of payments position.

Supply side shocks causes of recession result mainly from general increases in commodity prices such as crude oil, metals and other non-fuel inputs, foodstuff prices, etc. These factors are inflationary in nature. Inflation, which is the persistent rise in prices of goods and services, results because of high cost of inputs, which are usually transferred to the final consumers who can only afford less quantity because of higher prices. This lowers demand for goods and services, and reduces the standard of living, and ultimately depresses production of goods and services by firms. The macroeconomic policies work more or less like the internal factors discussed above. Here, when monetary and fiscal policies are not well coordinated it results to recession. During contracting growth or economic slowdown, taxes ought to be lowered, and government also ought to spend more to stimulate the economy. On the other hand, monetary authority ought to encourage borrowing by households and businesses by lowering interest rate. However, when the above policy mixes are not properly synchronized, it could further stifle the economy. Macroeconomic policies need to be complementary to achieve the desired result.

SECTION FOUR

Effects of Recession

A slowdown in economic activities affects all aspects of national life. A lot of elections are won and lost as a result of bad economic conditions. For example, like the current American President (Obama) rode to electoral victory, because of the promised change to bring America out of the global economic crisis (GFC) prevailing at the time. Bank of America, Lehman Brothers and other major companies in the U.S. and other parts of the world went down as a result of the GFC. There were also a lot of mergers and acquisitions (M&As) during the period. Many jobs are usually lost families usually adjust budget during recession and in the process, social activities are also affected. This section discusses the impact of recession on politics, business, employment and social life.

4.1 Business

When household incomes are cut as a result of economic slowdown, they reduce their demand for goods and services. As a result of low demand from households, firms reduce their production of such goods and services in order to cut cost and profit will decline. As a consequence of production fall, workers would be laid off, there will be no buying of new equipment, no funding for research and development, no new product rollouts and general business activities would also fall. The experience of the recent GFC showed that many businesses such as Bank of America, Lehman brothers in America to some local banks in Nigeria were affected. Recession affects both small and large business. Specifically, recession results in one or more of the following consequences on businesses:

4.1.1 Falling Stocks and Dwindling Dividends

Stocks prices mirror the performance of a business because they move proportionately to the returns earned. As revenues decline on the statutory reports of businesses, lower dividends are declared. This will depress the price of stocks in the market. The incidence that happened when share prices crashed across the world during the GFC may not be blamed entirely on this factor; however, this is partly responsible for the event. So many businesses lost their viabilities because of the risks they were carrying at the moment. When dividends fall or vanish, it creates other problems such as the sacking of the board of directors and senior management of the company. The advertising/marketing unit may be affected, creating unemployment problem for the economy. When the manufacturer's stock falls and the dividends decline or stop, institutional investors, holding the stock may sell and reinvest the proceeds into betterperforming stocks. This will further depress the company's stock price and affect the entire equities market and the cycle continues. For instance, the All-Share Index of the Nigerian Stock Exchange lost 65.4 per cent of its value from 57,814.92 in July 02, 2008 to 19,814.92 in April 15, 2009.

4.1.2 Credit Default and Bankruptcy

Recession also has effect on the ability of customers to pay their debt to the creditors, leading to growing non- performing loans (NPL). In the heat of the GFC, so many subprime debts went bad, thereby impairing the ability of debtors to service their debts. As a result so many banks went bankrupt. Also, when debtors are not able to repay their debts, companies' ability to repay their creditors is hampered as a result of falling revenues. This leads to default in paying interest and the principal. The resulting consequence is debt downgrade and rescheduling. In the process, investors will lose confidence in the company and the company may not be able to raise money from the capital market again. When the source of funding ceases, the business will fold up resulting in employee lay-off, and increasing the unemployment in the economy.

4.1.3 Product Quality Compromise

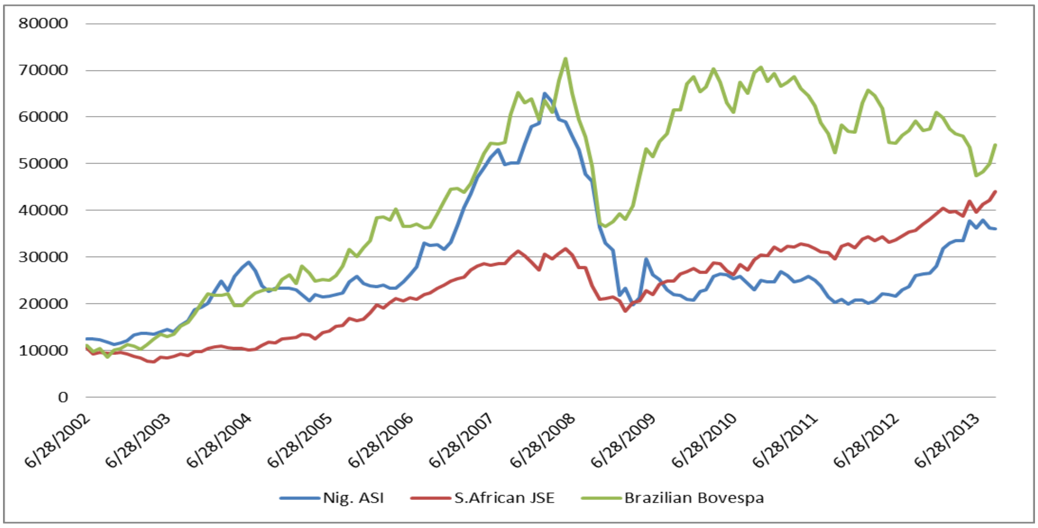
Recession affects the revenue of firms, and by extension, profitability. In an effort to cut costs and improve its bottom line, the company could compromise product quality, and in the process lose its market share. A baker could offer the same loaf of bread at the same price but reduce major ingredients such as milk, butter, etc. so as to cut cost and improve bottom line during recession. Recession could force airlines to lower their maintenance standards in order to cut cost and break even. They may cut flight to routes that are not profitable and frequently cancel flights when there are insufficient passengers for a particular flight. This could cause some inconveniences to passengers, leading to economic loss.

4.2 Financial Markets

The other sector that usually takes the heat during recession is the financial markets. Recession will lead to general fall in interest rate, crash of stock prices and rise in prices of some commodities (precious metal). Regulators usually lower interest rate in order to stimulate borrowing for investment that would lead to economic activities and growth. Most of the advanced economies of the world brought their interest rate to near zero during the GFC in order to stimulate economic activities through borrowing.

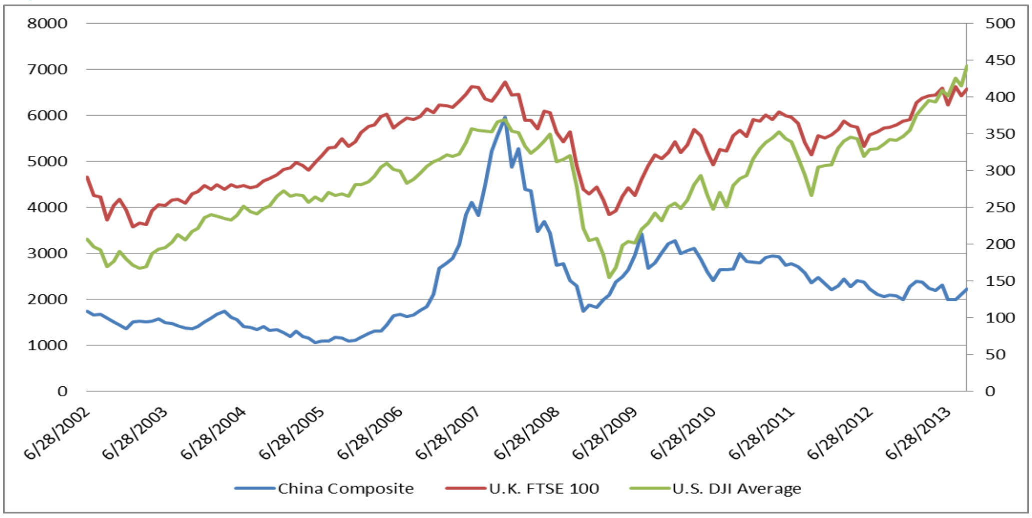
One noticeable event during the GFC was the crash of global equities markets. Equities prices mirror the performance of listed companies on the exchange. Any time investors noticed a dwindling fortune with such listed companies, they usually offloaded their shares. There was a massive share sell-off in 2008, resulting in the crash of stock markets across the globe. As of October 2008, stocks in North America, Europe, and the Asia-Pacific region had all fallen by about 30 per cent since the beginning of the year. The Dow Jones Industrial Average had dropped by 37 per cent since January 2008.

Figure 3: Stock Market indices for some selected countries



Source: Bloomberg

Figure 4: Stock market indices for some selected countries



Source: Bloomberg

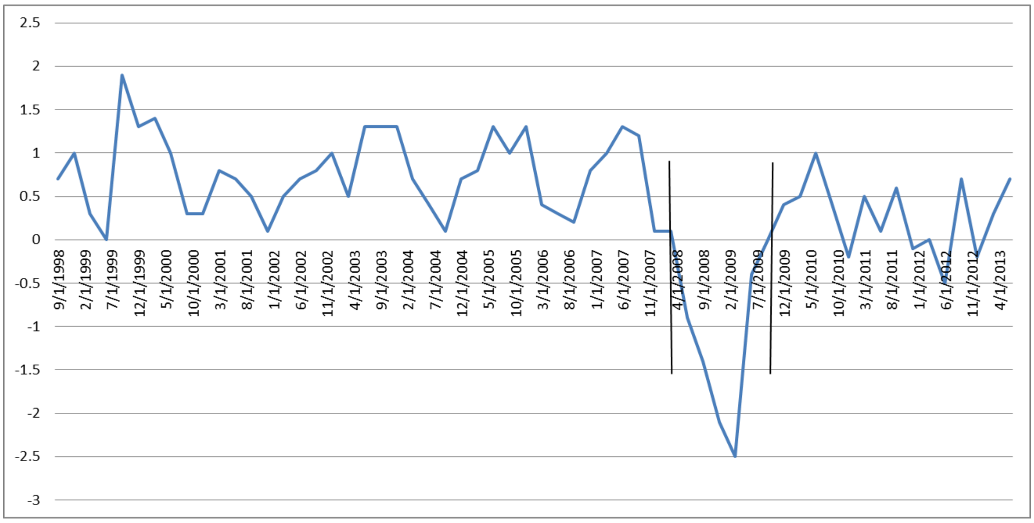
A common feature of the charts (figures 3 and 4) is that prior to the GFC, all the stock indices peaked; U.S., U.K. and China markets peaked in September 2009, while Nigeria, Brazil and South African indices peaked between the first and second quarters of 2008. Between the last quarter of 2008 and the first quarter of 2009 however, all the markets were brought to their knees and crashed as a result of the GFC. As is often the case, in times of financial turmoil and loss of investors' confidence, investors turned to assets which they perceived as tangible or sustainable. The price of gold gained 30 per cent from the middle of 2007 to the end of 2008.

4.3 Unemployment

Recession has a devastating impact on employment worldwide. According to the International Labour Organization (ILO), at least 20 million jobs were lost by the end of 2009 due to the impact of the GFC, mostly in construction, real estate, financial services, and the auto sector, bringing the world unemployment above 200 million for the first time.

In December 2007, the U.S. unemployment rate was 5.0 per cent and by October 2009, the unemployment rate rose to 10.0 per cent. The figure 5 shows clearly that the U.S. unemployment rose to its highest at the peak of the GFC. With improvement in the economy, employers began to hire workers again resulting in the falling rate of unemployment. As at July 2013, the U.S. unemployment stood at 7.4 per cent.

Figure 5: US unemployment rate, January 2005 – July 2013



Source: Bloomberg (2013)

Europe, perhaps remained the worst hit in terms of unemployment as a result of the GFC. This explains why the region remained in recession for a longer time than other regions of the world. The region's problems are compounded because of the sovereign debt crisis in Greece, Portugal, Spain, etc. As at July 2013, the euro zone unemployment rate stood at 12.1 per cent, the highest in history. Greece had the highest unemployment rate of 27.6 per cent (May 2013) in the zone, followed by Spain, 26.3 per cent.

4.4 Social

Recession affects social life in some respects, from tourism to certain consumption of household. According to Zagat's (2009), U.S. Hotels, Resorts & Spas survey, business travel has decreased in the past year as a result of the recession. Thirty per cent (30%) of travelers surveyed stated they travelled less for business today while only 21 per cent stated that they travelled more. Reasons for the decline in business travel include company travel policy changes, dwindled personal economic fortune, uncertainties and high airline prices. Hotels were responding to the downturn by dropping rates, ramping up promotions and negotiating deals for both business travelers and tourists.

According to the World Tourism Organization (2008), international travel suffered a strong slowdown beginning in June 2008, and this declining trend intensified during 2009. This resulted in a reduction from 922 million international tourist arrivals in 2008 to 880 million visitors in 2009, representing a worldwide decline of 4 per cent, and an estimated 6 per cent decline in international tourism receipts.

4.5 Politics

The recession led to electoral misfortune, though democratic institutions continue to exist. In the U.S. for instance, the Republican lost the 2008 elections partly as a result of the GFC that started in 2007. The GFC was an offshoot of some of the policies of the Republican government under President George W. Bush. Business Week in March 2009 stated that global political instability was rising fast due to the global financial crisis, creating new challenges that needed managing. The Associated Press reported in March 2009 that 'the United States Director of National Intelligence Dennis Blair has said the economic weakness could lead to political instability in many developing nations." Even some developed countries experienced political instability.

There were several civil unrests in Greece as a result of some conditions set by the trio of the International Monetary Fund (IMF), the European Commission (EC) and European Central Bank (ECB) to bailout the country from sovereign default. Greece found itself in the condition as a result of debt overhang that resulted in its sovereign default in 2012. The GFC and recession worsen the debt crisis of Greece, resulting in many failed elections.

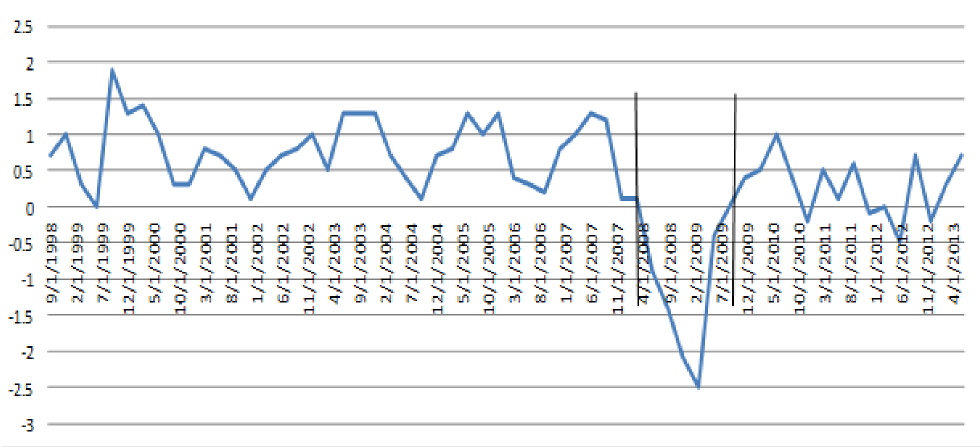
In January 2009, the government of Iceland was forced to call early elections two years ahead, after the people of Iceland staged mass protests and clashed with the police due to the government's handling of the economy. Hundreds of thousands protested in France against President Sarkozy's economic policies, and his eventually lost in his re-election bid in 2012 to the socialist candidate, François Hollande, who won with 51 per cent of total votes cast.

SECTION FIVE

Typical Case of Recession

In this section, effort is made to present the GDP of some countries to show how a recession affects general economic activities of a country, and to portray the technical definition of recession, which is a 2-quarter of consecutive negative declines in GDP of a country.

Figure 6: Quarterly GDP growth rate in the UK: Q3:1998 - Q2:2013



Source: Bloomberg 2013

The GFC affected the U.K. economy negatively as can be seen from figure 6. From the peak in the GDP growth of 1.3 per cent in second quarter of 2007, the economy growth rate plummeted to -0.9 per cent in second quarter of 2008 and remained in recession for five consecutive quarters till second quarter of 2009.

SECTION SIX

Conclusion and Policy Options

Recession is a business cycle contraction, referred to as a general slowdown in economic activities. During recession, there is usually a decline in certain macroeconomic indicators such as GDP, employment, investment spending, capacity utilization, household income, business income, and inflation, with attendant rising unemployment rate. Recession could be caused by two broad factors: internal (endogenous) and external (exogenous), and that recession has impact on the economy through its effect on business, financial markets, stocks and dividends, product quality, credit conditions and socio-political structures.

Instruments of monetary and fiscal policies can be used to counter recession and bring about economic growth. Monetary authority can pursue accommodating/easy monetary policy to stimulate economic activities. This is a situation where monetary authorities lower the cost of credit. This can be achieved by lowering interest rate, and lowering of eligibility conditions for banks to access the monetary authority's window. When monetary authority lowers interest rate, it is to encourage individuals and businesses to borrow more funds to finance consumption or expand productive capacity. Individuals and businesses pay less interest on borrowing thereby making it possible for them to repay the interest and the principal amount borrowed. When consumption increases, companies produce more, hire more workers and buy more raw materials for production, and in the process stimulate economic activities that would end recession.

At other times, monetary authority can also embark on unconventional monetary policy or quantitative easing (use of things other than interest rate and market forces to affect money supply) to stimulate the economy. This is done when monetary authorities inject money into the banking system to shore up banks' balance sheet or by buying government securities from the secondary market (market where securities like bonds are traded), thereby injecting money into the economy to stimulate activities.

Fiscal authority can pursue loose fiscal policy to bring economy back to growth from recession. Government can lower taxes on individuals and businesses thereby freeing additional resources to the household and businesses for consumption and investment. Another instrument at the disposal of government is to increase their spending in real activities during recession to bring about growth. When taxes are lowered for individuals and businesses, extra money is made available for consumption or investment. If consumption rises, businesses spend more to produce additional goods and services, which would result in more employment and results ultimately in increased economic growth. Government could also embark on essential structural reforms in order to improve transparency and stability of both financial system, and fiscal activities to restore confidence in the economy during recession.

Glossary

Acquisition: It is the expansion of a company through the purchase of others.

Balance of Payment (BOP): It is an overall statement of a country's economic transactions with the rest of the world over a period of time, usually one year.

Balance of trade: It is the difference in value of a country's visible exports over visible imports. It constitutess a major component of the balance of payments on current account.

Credit crunch: This is a state in which there is a short supply of cash to lend to businesses and consumers and interest rates are high.

Equilibrium: It is a situation where nobody (economic agent) has any immediate reason to change their actions, so as to allow the status quo remains temporarily.

Economic bubbles: Occurs when asset prices deviate from their inherent values

Fiscal policy: This involves the use of taxation and government spending to influence the economy.

Inflation: Is the general and persistent increase in prices of goods and services in an economy.

Mergers: It is the combination of two or more firms into a new one.

Monetary policy: This is the use of interest rate by monetary authorities to control the availability and cost of money.

Non-Performing Loan: This is a debt on which payment of interest and principal due are not made.

Recession: This is a situation when there is slowdown in demand, real output is falling and unemployment is increasing. Technically, it refers to a situation when gross domestic product (GDP) falls for two consecutive quarters.

Sovereign default: A sovereign default is the failure or refusal of the government of a sovereign state to pay back its debt in full. It may be accompanied by a formal declaration of a government not to pay (repudiation) or only partially pay its debts (due receivables), or the de facto cessation of due payments.

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