Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about the two terms and their significance in determining the status of the economy

News: The Indian economy is going through tough times with the advance estimates for the rate of growth for real gross domestic product (GDP) for 2019-20 being pegged at 5% compared to 6.9% in 2018-19.

What have been the trend so far?

- The GDP growth for the second quarter of 2019-20 came in at 4.5% as against 7.1% in the second quarter in 2018-19 and 5% in the first quarter of 2019-20.

- Inflation, on the other hand, showed an upward trend with the Consumer Price Index (CPI) rising 7.35% in December 2019 with November and October numbers coming in at 5.54% and 4.62%, respectively.

Does the combination of slowdown in the rate of growth of the economy and higher inflation mean that the economy is in recession or going through a period of stagflation?

1. Recession

- There is no standard definition for recession but a rule of thumb used by most economists and analysts is that an economy that is seeing negative growth rate or shrinking GDP for two consecutive quarters may be considered to be in a recessionary phase.

- Sometimes a period of contraction is followed by periods of growth before it turns negative again. The data on the fall in GDP is seen in conjunction with other indicators such as increasing unemployment, falling real income and fall in economic activity such as manufacturing and sales to confirm a
A recession may be the outcome of tight monetary and fiscal policies aimed at controlling inflation or a result of over-leveraging by companies and individuals and the cutback in consumption and investment as they try to meet their obligations.

A recession may be V-shaped where the economy sees a sharp decline followed by a strong recovery, or it may be W-shaped where there is a marginal recovery in the middle followed by a decline before the economy eventually recovers. Sometimes recessions are L-shaped where the economy goes down and then stagnates there.

When recession is severe in terms of the contraction in GDP and extends over a longer period of time, it turns into a depression.

2. Stagflation

Stagflation is another fear that comes up when inflation is high in a period of slow economic growth. The combination is unnatural because inflation is not a condition that is generally seen when the economy is slowing or stagnant and unemployment is high.

Typically, costs push inflation, caused by supply side issues, or excessive liquidity in the system cause inflationary conditions in such a situation. The high prices are likely to lead to a slowing demand that can further aggravate the economic slowdown. High prices even in one segment, say, food, can affect demand in other segments because the disposable income in the hands of the consumer comes down. High prices in a commodity like oil will have a cascading effect on the prices of other products, too, since transportation costs go up.

Policy prescriptions in a situation of stagflation can be tricky since increasing interest rates to control inflation will make it difficult for the economy facing slowing growth to recover. At the same time, keeping rates low to support recovery may exacerbate the inflationary situation.
The data is considered over a period of time and not just at one point or a few months for a contraction to be called an economy in recession or stagflation.