What is a recession?

KS3 KS4 Ages 11-18 ⏰ 3 min read

A recession is when the economy shrinks — when the total value of goods and services produced (called GDP, Gross Domestic Product) falls for two consecutive quarters (six months or more). During a recession, businesses make less money, some close, unemployment rises, and people generally have less to spend. It creates a downward spiral that can be hard to escape.

Why do recessions happen?

Recessions are usually triggered by a shock that disrupts the normal flow of spending and investment. The 2008 recession was triggered by the collapse of the US housing market and the banking crisis it caused. The 2020 recession was caused by COVID-19 lockdowns halting economic activity almost overnight. Some recessions build slowly — rising interest rates make borrowing expensive, businesses invest less, consumers spend less, growth stalls.

An economy is a bit like a game of pass-the-parcel where the parcel is money. My spending is your income; your spending is someone else's income. When people start to feel nervous and stop spending — saving instead, delaying purchases, cutting back — the parcel stops moving. Your income falls, so you spend even less, so my income falls, so I spend less too. A recession is what happens when fear causes enough people to stop passing the parcel at the same time that the whole game slows down.

What's a depression?

A recession that's particularly severe and long-lasting. The Great Depression of the 1930s saw unemployment reach 25% in the US, global trade collapse by 65%, and economic output fall dramatically for nearly a decade. The word "recession" is preferred by economists partly because it sounds less catastrophic — but a bad enough recession and a depression are the same thing in practice.

How do governments respond?

Two main tools. **Fiscal policy**: the government spends more (building infrastructure, paying benefits, cutting taxes) to pump money into the economy and restart the pass-the-parcel game. **Monetary policy**: the central bank cuts interest rates to make borrowing cheaper, encouraging businesses to invest and people to spend rather than save. Both have limits — and both create their own problems, including debt and inflation — which is why managing recessions is genuinely difficult.