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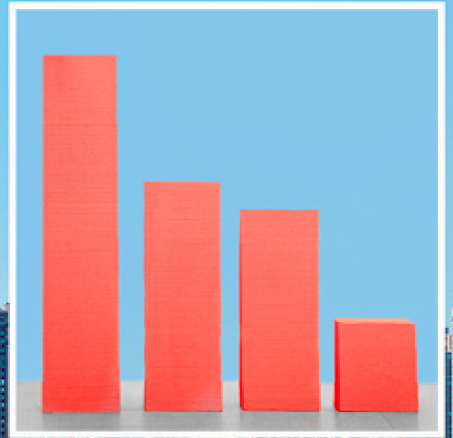


Deconstructing economic stagnation

How events across the globe could lead to economic slowdown

Growth is an imperative pillar in the economy for both consumers and businesses; if a country finds itself with a growth of less than 2%, the situation can be classified as economic stagnation. When circumstances align, a slump can become sustained and widespread, with regional and even global effects.

With a stagnation looming on the horizon it's easy to feel concerned about the long-lasting scars of a rut in the economy. To help you understand the cascading effects of a stagnation, and how you can stay vigilant to its impacts, we've developed a timeline that shows what a decline in economic growth could look like and how you can stay prepared.

Picture the scene: The global economy slips into systemic stagnation

The beginning – An event of national or global significance puts a huge strain on national finances; bail-out funds drain and interest rates plummet. The fall-out weakens the economy and consumers spend less.

Company collapse – A large company that feeds into the national economy loses a major contract, causing great financial shock. This rocks confidence in the company and the sector.

Shockwaves – Markets respond to the uncertainty and investments become more scrutinised. Confidence in the sector falls, and a regional crisis ensues as concern spreads to connected sectors and countries.

Reaction – To avoid mass losses, investors switch strategies which sparks a financial collapse across the global banking system. Major industries see their financing shut off and growth slows worldwide.

Escalation – The public act to protect their interests by securing their savings and spending less. This leads to businesses going bust, taking auxiliary services and jobs with them.

Slowdown and halt – Global economies enter crisis mode, with economic growth slowing or even reversing, and low interest rates and austerity measures becoming entrenched

How severe could the situation get?

Our scenario explores three potential levels of severity, listed in the table below. Each varies depending on the level of economic fragility already experienced, the size and nature of the event that initiated stagnation and the number of countries caught up in the event accompanied with their economic condition.

Level	Scenario severity descriptions	Historical reference
Major	**Temporary or cyclical stagnation:** Three consecutive quarters of limited growth, also known as a growth recession, as it creates a temporary economic shock before recovery occurs. Unemployment is high during this period, but job growth rebounds.	**1973 Stagflation**
Severe	**Prolonged stagnation:** Five consecutive quarters of restricted growth, creating high unemployment and reduced share price growth, with slow recovery. Two quarters of stagnation followed by three quarters of recession.	**None**
Extreme	**Structural stagnation:** Seven quarters of sluggish population growth, reduced economic growth and unchanging economic and political institutions in advanced economies leads to a long-term structural condition of the economy and society. Advanced economies are more affected than developing economies. Four quarters of stagnation followed by three quarters of recession.	**None**

$5.2trn

Global economic impact from a major stagnation

How vulnerable is the economy?

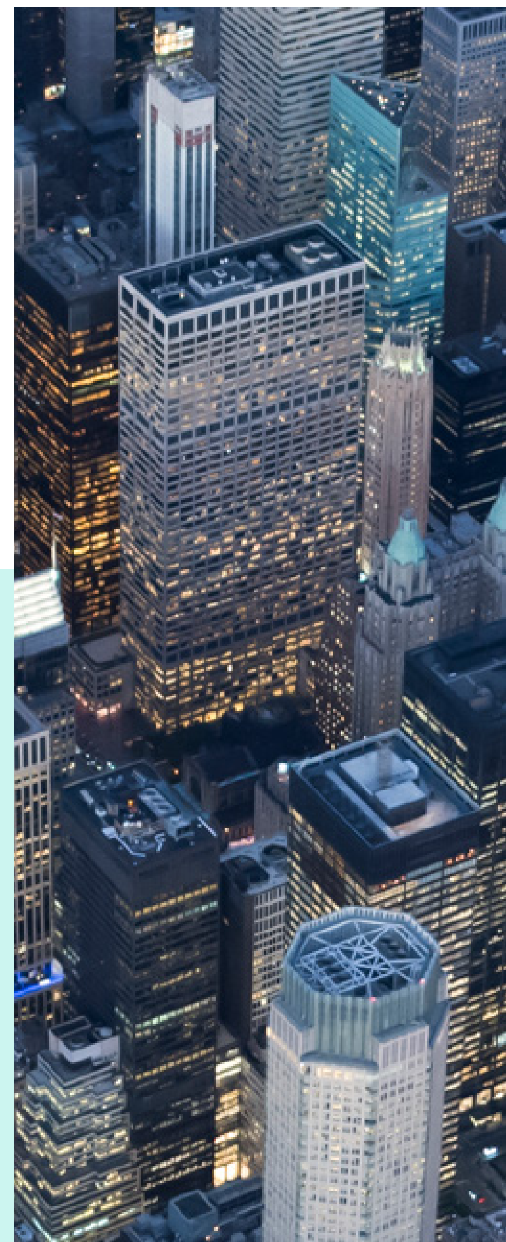
If a major stagnation were to take place, the global economic impact to GDP could reach **$5.2trn** over a five-year period (averaged across the three severities we have modelled), with an expected loss of **$62bn.**

Which sectors might be most at risk?

Financial services: This sector is most at risk from the impacts of stagnation as both market activity and investor growth drop. In February 2008, Northern Rock experienced a 'run on the Rock', resulting in financial support from the Bank of England.

Real estate: Property and construction sectors can suffer in a stagnant economy. Following progress through the 1980s, Japan's equity and real estate markets collapsed. This led to a growth rate of only 1.14% between 1991 and 2003, later coined the **"Lost Decades".**

Industrials and utilities: Slow growth in the manufacturing and energy sectors causes capacity to exceed demand, forcing companies to cut corners. Major investments are paused in light of the economic state, and competition in the sector is created as consumers shop for better prices.



What can businesses do?

Stress testing: It's impossible for our time-tested economic models to be fully accurate; unforeseen inflation and growth have made way for soaring prices and recession. This is why looking beyond model outputs and stress-testing, or scenario modelling, is crucial for both your sector and other sectors that impact yours.

Cashflow: Companies with high debt and low cashflow may struggle to access credit to see through a crisis. Preparing for a recession is a challenge for many businesses, but prioritising reservation of equity and or establishing an equity swap system is a pivotal strategy for any organisation facing an economic crisis. Increasing the levels of cash reserves could also help organisations mitigate the risks.

Operating model: Working to cut costly business practices, and improve efficiencies, help reduce reliance on financial support during a long-term crisis. Building in diversification or contingencies, for example, supply chains can help organisations manage any localised disruption that could arise from the economic situation.

Next steps

Work proactively to build resilience in your risk management against these threats and connect with your broker to understand how insurance could help.

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