Economic [recessions](https://www.thebalancemoney.com/what-is-a-recession-3306019) are caused by a loss of business and consumer confidence. As confidence recedes, so does demand. A recession is a tipping point in the business cycle when ongoing economic growth peaks, reverses, and becomes ongoing economic contraction.

**12 Typical Causes of a Recession**

A decline in the [gross domestic product growth](https://www.thebalancemoney.com/what-is-the-gdp-growth-rate-3306016) is often listed as a cause of a recession, but it's more of a warning signal that a recession is already underway. The GDP is only reported *after*a quarter is over, so the recession has probably already been underway for a couple months by the time the GDP turns negative.

**Note**

Recessions have generally been defined as two or more successive quarters of GDP declines. However, the National Bureau of Economic Research (NBER), which is often used to date recessions, does not abide by that rule. Instead, NBER uses three different criteria—depth, diffusion, and duration.1

**1. Loss of Confidence in Investment and the Economy**

Loss of confidence prompts consumers to stop buying and move into defensive mode. Panic sets in when a critical mass moves toward the exit. Businesses run fewer employment ads, and the economy adds fewer jobs. Retail sales slow. Manufacturers cut back in reaction to falling orders, so the unemployment rate rises. The federal government and the central bank must step in to restore confidence.

**2. High Interest Rates**

Interest rates limit [liquidity](https://www.thebalancemoney.com/liquidity-definition-ratios-how-its-managed-3305939)—money that's available to invest or spend—when they rise. The Federal Reserve has often raised interest rates to protect the value of the dollar. For example, it did so to battle the stagflation of the late 1970s, and this contributed to the 1980 recession.23

**Note**

The Fed did the same thing decades ago to protect the dollar/gold relationship, worsening the Great Depression.

**3. A Stock Market Crash**

A sudden loss of confidence in investing can create a subsequent [bear market](https://www.thebalancemoney.com/what-is-a-bear-market-difference-from-a-bull-3305814), draining capital out of businesses.

**4. Falling Housing Prices and Sales**

Homeowners can be forced to cut back on spending when they lose equity and can no longer take out second mortgages. This was the initial trigger that set off the [Great Recession](https://www.thebalancemoney.com/the-great-recession-of-2008-explanation-with-dates-4056832) of 2008. Banks eventually lost money on complicated investments that were based on underlying home values, which were in decline.4

**5. Manufacturing Orders Slow Down**

One predictor of a recession is a decline in manufacturing orders. Orders for durable goods began falling in October 2006, long before the 2008 recession hit.5

**6. Deregulation**

Lawmakers can trigger a recession when they remove important safeguards. The seeds of the S&L crisis and the subsequent recession were planted in 1982 when the [Garn-St. Germain Depository Institutions Act was passed](https://www.thebalancemoney.com/savings-and-loans-crisis-causes-cost-3306035).6 The law removed restrictions on [loan-to-value ratios](https://www.thebalancemoney.com/loan-to-value-ratio-315629) for these banks.

**7. Poor Management**

Bad business practices often cause recessions. The savings and loans crisis caused the 1990 recession.7 More than 1,000 banks, with total assets of $500 billion, failed as a result of land flips, questionable loans, and illegal activities.8

**8. Wage-Price Controls**

The imposition of wage and price controls has occurred many times in history, but it's only led to a recession once.

President Richard Nixon froze wages and prices to stop inflation in 1971, but employers laid off workers because they weren't allowed to reduce their wages.9 Demand fell, because families had lower incomes. Companies couldn't reduce prices, so they laid off still more workers, which led to the 1973 recession.10

**9. Post-War Slowdowns**

The U.S. economy slowed down after the Korean War, which caused the 1953 recession.11 Similar reductions after World War II caused the 1945 recession.

**10. Credit Crunches**

A credit crunch occurred in 2008 when [Bear Stearns](https://www.thebalancemoney.com/bearn-stearns-collapse-and-bailout-3305613) announced losses due to the collapse of two hedge funds it owned.12 The funds were heavily invested in collateralized debt obligations, and banks that were in a similar over-invested condition panicked when Moody's downgraded its debt. They stopped lending to each other, creating a massive credit crunch.

**11. When Asset Bubbles Burst**

[Asset bubbles](https://www.thebalancemoney.com/asset-bubble-causes-examples-and-how-to-protect-yourself-3305908) occur when the prices of investments such as gold, stocks, or housing become inflated beyond their sustainable value. The bubble itself sets the stage for a recession to occur when it bursts.13

**12. Deflation**

Prices falling over time have a worse effect on the economy than inflation. Deflation reduces the value of goods and services being sold on the market, which encourages people to wait to buy until prices are lower. Demand falls, causing a recession. Deflation caused by trade wars aggravated the Great Depression.14