

Economic Recession and the Viability of Commercial Real Investments in Akwa Ibom State, Nigeria

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A b s t r a c t

Commercial real investments refer to those properties mainly used for commercial undertakings, which include shops, offices, shopping malls, specialized office properties, etc. These types of investments have very close tie with the macro economy's turns through expansion and contraction. Recession being a business cycle contraction as experienced in Nigeria today, which results in a general slowdown in economic activities driven by the cyclical components of the gross domestic product (GDP), affects the viability of these types of investments. Hence, this research as its aim sought to analyse the impact of economic recession on the viability of commercial real investments in Akwa Ibom State, Nigeria. Three research objectives were formulated to aid in achieving the aim of the research. These were: to assess the relationship between recession and void level in real commercial investments; to investigate if recession could cause returns from commercial real estate to dwindle; and, to examine the effect of recession on the viability of commercial real estate developments. These objectives were later turned to research questions to facilitate analysis of the results - what is the relationship between recession and void level in real commercial investments in recent past? Does recession caused returns from commercial real estate to dwindle for the past few months? And, what is the effect of recession on commercial real investment Development recently? The research adopted a survey design, with fifty Estate Surveyors and Valuers randomly sampled to administer questionnaire for the study. Data obtained from the field were analysed using simple percentage, and the result revealed that economic factor of recession plays a major role in the viability of commercial real investment options. However, bench marking, adequate insurance, even to cover vacant properties and proper diversification of real investment portfolios were recommended as potential remedy for the present situation.

Keywords: Recession, Viability, Commercial real investments, development

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Background to the Study

Economic recession is a significant decline in activity across the economy, lasting for a period longer than a few months (two consecutive quarters) or a year. It is always visible in industrial production, employment, real income and wholesale-retail trade, as well as real estate businesses. According to The World Book Encyclopaedia, recession, also known as contraction as part of business cycle, is a recurring rise and fall in economic activity. Many economists consider a nation's economy to be in recession if the output of goods and services falls for six consecutive months. A recession lasts an average of about a year. A recession that grows worse and lasts longer becomes a depression. A recession may also hit an industry or a region (as is the case in Nigeria as a country currently). Price does not always fall during a recession because of the lack of demand, production of some goods may become more expensive, and price may rise. Recession hurts countless people, especially the workers who lose their jobs or whose take home may not afford them their basic needs. During a nationwide recession, a country suffers a drop in buying, selling, and production, and a rise in unemployment. Therefore, this research was furthered to investigate the viability of commercial real investments during recession in Nigeria.

Methodology

The research design adopted was the descriptive design. The population was made up of registered estate surveyor and estate agents in Akwa Ibom State. These estate surveyors and agents were considered the most suitable in the study as they understood and responded accurately to the items of questionnaire used for the research. The sample involved fifty respondents from the population. Frequencies and percentages were used to present the responses in series. Series 1 represents Strongly Agreed, series 2 – Agreed, series 3 – Disagreed and series 4 – Strongly Disagreed. Only the items which scored up to 40 per cent and above were accepted to have answered the research question, while those that had below 40 percent were rejected.

Conceptual Amplifications

The Concept of Recession

Recession is a decline in real output that persist for more than two consecutive quarters of year (Colander, 2004). In April 2009, the International Monetary Fund (IMF) changed their Global recession definition to:

A decline in annual per-capita real world gross domestic product (purchasing power parity weighted), backed up by a decline or worsening for one or more of the seven other global macro-economic indicators: industrial production, trade, capital flows, oil consumption, unemployment rate, per-capita investment, and per-capita consumption.

The American National Bureau of Economic Research (NBER) formally defines recession as a significant decline in economic activity spread across the entire economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. Gross domestic product (GDP) refers to the monetary value of all the finished goods and services produced within a country's borders in a specific time period, usually one year. Recessions have occurred throughout history, and vary in severity and length, but all typically affect income and employment levels, inflation, industrial production, wholesale and retail trade, stock market prices and volatility, and the residential and commercial real estate markets. Each recession has its unique causes, and differs in the relative degree to which each economic sector is affected.

Causes of Recession:

According to The World Book Encyclopaedia (1992), the following can be stated as possible causes of recession in an economy:

- (a) Most recessions occur because the total amount of spending in the economy drops. For example, if sales rise more slowly than usual, businesses may reduce their orders for new goods. The manufacturers that supply the goods cut back on production. They need fewer workers, so redundancies are made and unemployment increases. Workers have less money to spend, which further decreases the demand for goods. As this pattern spreads through the economy, a recession begins, as is the case presently in Nigeria today.
- (b) Government action may trigger the drop in spending. For instance, cuts in government spending could reduce the nation's total spending enough to start a recession. Reduced spending also may result if the government conducts a tight money policy, which makes bank loans more expensive and harder to obtain.
- (c) Other recessions result from shortages of vital products rather than from decreased spending. For example, the interruption in crude oil shipments has caused recession in most countries today. Nigerian situation with reduced export of crude oil due to pipeline vandalism aside the fall in oil price in the oil market is a clear illustration.
- (d) People expectations also play an important role in the decline of economic activity. If manufacturers or consumers believe that economic condition will worsen, they may cut back on their buying. By doing so, they could help bring on the slump they were to avoid. This process is called self-realizing expectation.
- (e) High interest rates. This causes recession because they limit liquidity, or the amount of money available to invest.
- (f) Inflation. Inflation refers to a general rise in the prices of goods and services over a period of time. As inflation increases, the percentage of goods and services that can be purchased with the same amount of money decreases.
- (g) Reduced consumer confidence is another factor that can cause a recession. If consumers believe the economy is bad, they are less likely to spend money. Consumer confidence is psychological but can have a real impact on any economy.
- (h) Reduced real wages. This refers to wages that have been adjusted for inflation. Falling real wages means that a worker's pay check is not keeping up with inflation. The worker might be making the same amount of money, but his purchasing power has been reduced.

Basic Types of Recession

The basic types of recession include the under mentioned:

(I) Recession with Psychological Aspects:

Recessions have psychological and confidence aspects. For example, if companies expect economic activity to slow, they may reduce employment levels and save money rather than invest. Such expectations can create a self-reinforcing downward cycle, bringing about or worsening a recession as stated by Samuelson, R. J. (2010). Consumer confidence is one measure used to evaluate economic sentiment. The expression, animal spirits has been used to describe the psychological factors underlying economic activity. Economist R. J. Shiller explained the expression thus "... refers also to the sense of trust we have in each other, our sense of fairness in economic dealings, and our sense of the extent of corruption and bad faith. When animal spirits are on ebb, consumers do not want to spend and businesses do not want to make capital expenditures or hire people." (Shiller, 2009).

(ii) Balance Sheet Recession:

High levels of indebtedness or the bursting of a real estate or financial asset price bubble can cause what is called a "balance sheet recession." This is when large numbers of consumers or corporations pay down debt (save) rather than spend or invest, which slows the economy. The term balance sheet derives from an accounting identity that holds that assets must always equal the sum of liabilities plus equity. If asset prices fall below the value of the debt incurred to purchase them, then the equity must be negative, meaning the consumer or corporation is insolvent. Economist Paul Krugman wrote in 2014 that "the best working hypothesis seems to be that the financial crisis was only one manifestation of a broader problem of excessive debt that was a so-called "balance sheet recession." In Krugman's view, such crises require debt reduction strategies combined with higher government spending to offset declines from the private sector as it pays down its debt (Krugman, 2014)(b). For example, economist Richard Koo wrote that Japan's "Great Recession" that began in 1990 was a "balance sheet recession." It was triggered by a collapse in land and stock prices, which caused Japanese firms to have negative equity, meaning their assets were worth less than their liabilities. Despite zero interest rates and expansion of the money supply to encourage borrowing, Japanese corporations in aggregate opted to pay down their debts from their own business earnings rather than borrow to invest as firms typically do. Corporate investment, a key demand component of GDP, fell enormously (22% of GDP) between 1990 and its peak decline in 2003. Japanese firms overall became net savers after 1998, as opposed to borrowers.

Koo argues that it was massive fiscal stimulus (borrowing and spending by the government) that offset this decline and enabled Japan to maintain its level of GDP. In Koo's view, this avoided a U.S. type Great Depression, in which U.S. GDP fell by 46%. He argued that monetary policy was ineffective because there was limited demand for funds while firms paid down their liabilities. In a balance sheet recession, GDP declines by the amount of debt repayment and un-borrowed individual savings, leaving government stimulus spending as the primary remedy (Gregory, 2010). Krugman discussed the balance sheet recession concept during 2010, agreeing with Koo's situation assessment and view that sustained deficit spending when faced with a balance sheet recession would be appropriate. However, Krugman argued that monetary policy could also affect savings behaviour, as inflation or credible promises of future inflation (generating negative real interest rates) would encourage less savings. In other words, people would tend to spend more rather than save if they believe inflation is on the horizon. In more technical terms, Krugman argues that the private sector savings curve is elastic even during a balance sheet recession (responsive to changes in real interest rates) disagreeing with Koo's view that it is inelastic (non-responsive to changes in real interest rates) - Richard, K. (2011).

(iii) Recession Induced by Liquidity Trap

A liquidity trap is a Keynesian theory that a situation can develop in which interest rates reach near zero (zero interest-rate policy), yet do not effectively stimulate the economy. In theory, near-zero interest rates should encourage firms and consumers to borrow and spend. However, if too many individuals or corporations focus on saving or paying down debt rather than spending, lower interest rates have less effect on investment and consumption behaviour; the lower interest rates are like "pushing on a string". Economist P. Krugman described the U.S. 2009 recession and Japan's lost decade as liquidity traps. One remedy to a liquidity trap is expanding the money supply via quantitative easing or other techniques in which money is effectively printed to purchase assets, thereby creating inflationary expectations that cause

savers to begin spending again. Government stimulus spending and mercantilist policies to stimulate exports and reduce imports are other techniques to stimulate demand (Krugman, 2009)(a)

(iv) Recession as Paradoxes of Thrift and Deleveraging:

Behaviour that may be optimal for an individual (example, saving more during adverse economic conditions) can be detrimental if too many individuals pursue the same behaviour, as ultimately one person's consumption is another person's income. Too many consumers attempting to save (or pay down debt) simultaneously is called the paradox of thrift and can cause or deepen a recession. Economist Hyman Minsky also described a "paradox of deleveraging" as financial institutions that have too much leverage (debt relative to equity) cannot all de-leverage simultaneously without significant declines in the value of their assets (Yellen, 2009).

General Effect of Economic Recession

The general effect of economic recession includes the following:

- (a) Unemployment: Unemployment is particularly high during a recession. Many economists working within the neoclassical paradigm argue that there is a natural rate of unemployment which, when subtracted from the actual rate of unemployment, can be used to calculate the negative GDP gap during a recession. In other words, unemployment never reaches 0 percent, and thus is not a negative indicator of the health of an economy unless above the "natural rate," in which case it corresponds directly to a loss in gross domestic product (GDP). The full impact of a recession on employment may not be felt for several quarters. Research in Britain shows that low-skilled, low-educated workers and the young are most vulnerable to unemployment in a downturn. (Mauldin, 2009). After recessions in Britain in the 1980s and 1990s, it took five years for unemployment to fall back to its original levels. Many companies often expect employment discrimination claims to rise during a recession (Vaitilingam, 2009).
- (b) Business effect: Productivity tends to fall in the early stages of a recession, and then rises again as weaker firms close. The variation in profitability between firms rises sharply. Recessions have also provided opportunities for anti-competitive mergers, with a negative impact on the wider economy: the suspension of competition policy in the United States in the 1930s may have extended the Great Depression.
- (c) Social effect: The living standards of people dependent on wages and salaries are not more affected by recessions than those who rely on fixed incomes or welfare benefits. The loss of a job is known to have a negative impact on the stability of families, and individuals' health and well-being. Fixed income benefits receive small cuts which make it tougher to survive (Vaitilingam, 2009).

Commercial Real Investments and their Viability

Commercial real investments refer to properties used solely for business purposes. Examples of commercial real investments include malls, offices, parks, restaurants, gas stations, convenience stores and office towers, shopping centres, etc. Commercial real investment is one of the three primary types of real investments; the other types being residential real investment and industrial real investment. As its name implies, commercial real investments or estates are used for commerce.

The viability of commercial real investments can be assessed both qualitatively and quantitatively. The qualitative method considers the viability in a more holistic approach by assessing the level of demand, both from owner occupiers and tenants, the number of vacant units in the market, considering rental values in relation to capital values and recent evidence of leased and sale transactions. The quantitative approach considers the viability for the continued existing use of a building through recognised valuations methods. In this approach we consider the financial viability of the investment required to keep the building in its existing use. It must be made clear that there are many variables that will affect the viability assessment of any particular property at any time. The most obvious being costs, end values, market conditions and the rate of return required by a particular owner; these are often influenced by economic phenomenon of recession as the factors themselves are economic factors.

The Impact of Economic Recession on the Viability of Commercial Real Estate Investment in Akwa Ibom State

Akwa Ibom State as one of the states in the south-south region of Nigeria cannot be exempted from being touched by the economic wind that is currently blowing through the country since the last quarter of 2015. The pangs of the recession became harder since the second quarter of 2016. This impact of recession has raised its ugly head mostly in the commercial real investment business in the state, making the same not to be viable as it used to be in time past in the following ways:

(a) Vacancy Rates Soar: Demand for office space has nosedived as private sector employers especially banks are forced to trim their payrolls in this economic turmoil. A building is considered vacant when less than thirty one percent of its square meter floor area is leased. This situation has really discouraged investors in commercial real investments to retreat (Krugman, 2009) (a).

(b) Defaults Rate Rise: Amid the downturn, decreasing rents also pushed properties owners into bankruptcy, default and foreclosure. Many property developers have defaulted on loans, causing real estate wars between developers and lenders. When developers fail to pay their loans, they run the risk of facing foreclosures from lenders. An added pressure comes in the form of insurance coverage implications that may arise from this trend. Bankruptcies and foreclosures increase the likelihood of claims and suits. The risk of damage to unoccupied commercial property, as well as potential expensive losses, also goes up as foreclosures create more empty spaces.

(c) Lower Property Values: The commercial real estate market is witnessing a sharp drop in property values amid the crisis, leaving property owners struggling as values slid to levels lower than those of their mortgages.

Discussion/ Findings:

Research Question I: What is the relationship between recession and void level in real commercial investments in recent past in Akwa Ibom State?

Table 1: Frequency and percentages of the relationship between recession and void level in commercial real investments.

S/N	Questionnaire Items	SA	%	A	%	SD	%	D	%
1	Void rate decrease in commercial properties during recession compared to other times	3	6	7	14	4	8	36	72
2	The demand for commercial real estate investments among other properties has fallen in recent times.	27	54	16	32	6	12	1	2
3	Intending clients who are ready to let commercial properties are high.	3	6	17	34	5	10	25	50
4	Low patronage caused by recession has made many commercial properties stayed longer in portfolio before being let or sold recently.	24	48	7	14	9	18	10	20

Source: Field Survey (2016)

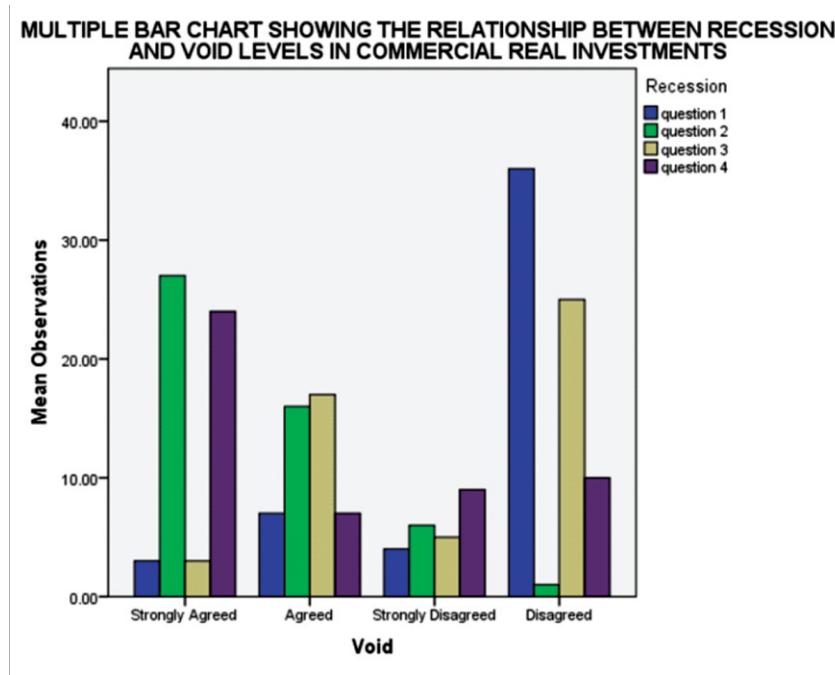
From table 1 above, it was opined in questionnaire item one that void level in commercial real investments decreases during recession than other times. Six percent of the respondents strongly agreed to this assertion; fourteen percent agreed; seventy two percent disagreed; while eight percent of the respondents disagree strongly. The above showed that majority of the respondents had the opinion that void level soar during recession than at other times.

The second questionnaire item stated that the demand for commercial real investments fall during recession. Fifty four percent of the respondents strongly agreed to this assertion; thirty two percent agreed; only two percent disagreed; while twelve percent disagreed strongly. This result indicted that the respondents accepted the fact that the demand for commercial real investments fall during recession period.

Questionnaire item three stated that clients who intend to let commercial real investments during recession are generally high. Six percent of the respondents strongly agreed to this; thirty four percent agreed; fifty percent disagreed; and ten percent of the total respondents disagreed strongly. The responses showed that clients do not let commercial properties during recession.

Questionnaire item four had the opinion that low patronage associated with recession makes commercial real investments remain in a portfolio longer before being sold or let. Forty eight percent of the respondents strongly to this statement; fourteen percent agreed; twenty respondents disagreed; while eighteen strongly disagreed. This result attributed the low patronage of commercial real estate investments to the ongoing recession, and manifested in such properties staying in portfolios longer than necessary before being let or sold. The above results are further pictured in the bar chart demonstrated below in figure 1.

Figure 1:



From table 1 and figure 1 above, it was clearly shown that there was a strong relationship between recession and the void rate in commercial investments in Akwa Ibom State in recent past. This was indicated by the percentage of respondents who disagreed that void rate decreases during recession going up to 72; those who agreed that the demand for commercial real investments falls during recession was 54 percent; the respondents who disagreed to the assertion that intending clients who are ready to let commercial properties during recession are high were 50 percent; while 48 percent of the respondents strongly agreed that recession caused low patronage to commercial real investments and makes the same to stay long in a portfolio before being let. By this, research question 1 was answered that the hike in void rate in commercial real investments in the state could be linked to the prevailing recession.

Research Question II: Does recession caused returns from commercial real estate to dwindle for the past few months in Akwa Ibom State?

Table 2: Frequency and percentages showing the effect of recession on the returns from commercial real investments

S/N	Questionnaire Items	SA	%	A	%	D	%	SD	%
5	The values of commercial real investments are nose-diving presently	28	56	16	32	3	6	3	6
6	The returns from commercial properties are currently declining due to recession	29	58	2	4	11	22	8	16
7	Lettings from commercial properties are currently high.	8	16	10	20	1	2	31	62
8	The defaults rate on rent in commercial properties are low	4	8	9	18	12	24	25	50

Source: Field survey (2016)

Table 2 above depicted the responses to questionnaire items which bothered research objective II. Questionnaire item five stated that the values of commercial real investments nose-dive at recession. Fifty six percent of the respondents consented and agreed strongly to this statement. Thirty two percent agreed. Three percent disagreed, as only six percent disagreed strongly. The result pointed to the fact that during to recession, the value of commercial real investments seems to be going down.

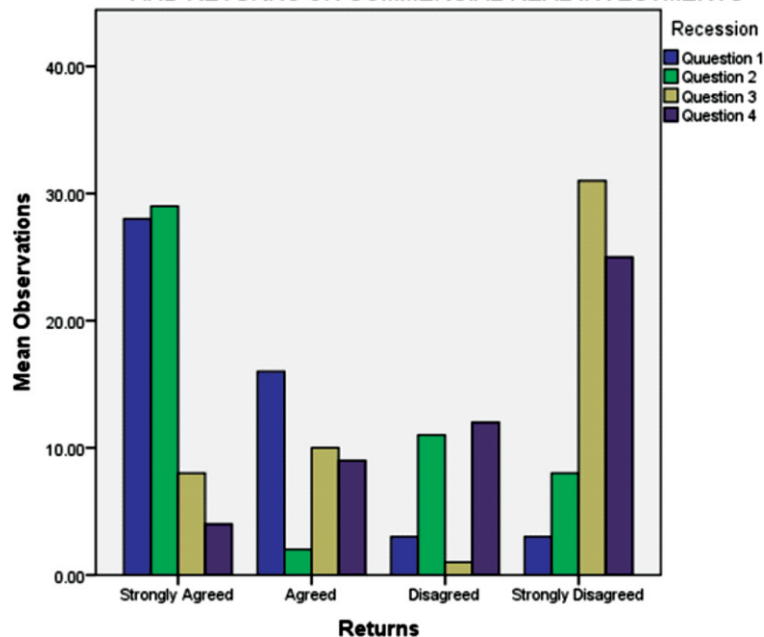
Questionnaire item six says - the returns from commercial real investments are currently declining due to recession. This opinion attracted fifty eight percent of the respondents who strongly agreed; four percent agreed; sixteen percent disagreed; while twenty two percent disagreed strongly. This showed that the majority of the respondents accepted the fact that returns from commercial investments are dwindling due to recession.

According to questionnaire item seven, letting from commercial real investments are currently high at this time of recession. Sixteen percent of the respondents agreed strongly to this opinion; twenty percent agreed; sixty two percent disagreed; while twenty percent strongly disagreed. From the general result here, the idea displayed concluded that lettings from commercial real investments are low during recession.

Questionnaire item eight stated thus 'the default rate in rent on commercial real investments is low'. Eight percent of respondents accepted this assertion and agreed strongly; eighteen percent agreed; fifty percent disagreed; as twenty four percent disagreed strongly. The result concluded that defaults rate in rent payment during recession is found to be very high. The overall results relating to research objective II is displayed below in the bar chart in figure 2.

Figure 2:

MULTIPLE BAR CHART SHOWING THE RELATIONSHIP BETWEEN RECESSION AND RETURNS ON COMMERCIAL REAL INVESTMENTS



From table 2 and figure 2 as shown above, it was seen that recession has caused returns from commercial real investments to dwindle in the study area. This was evident by 56 percent of the respondents strongly agreeing to the fact that the value of commercial real investments nose-dived at this period of recession; 58 percent strongly agreed that the returns from commercial properties declines at recession; 62 percent strongly disagreed that lettings from commercial properties are presently high; as 50 percent of the respondents strongly disagreed that the default rate on rent payment on commercial properties are low at this time of recession. All these contributed to answering research question 11.

Research Question III: What is the effect of recession on commercial real investment development recently in Akwa Ibom State?

Table 3: Frequency and percentages showing the effect of recession on commercial real estate investment viability and developments

S/N	Questionnaire Items	SA	%	A	%	SD	%	D	%
9	There is higher number of newly developed commercial real investments recently in your portfolio.	9	18	2	4	29	58	10	20
10	Investment in residential properties dominates the market than commercial investments.	32	64	11	22	5	10	3	6
11	High cost of building materials have brought in short fall in commercial real developments in recent times in Akwa Ibom State.	38	76	3	6	2	4	7	14
12	Low property values discourage the development of commercial real investments during this time of recession.	46	92	2	4	1	2	1	2

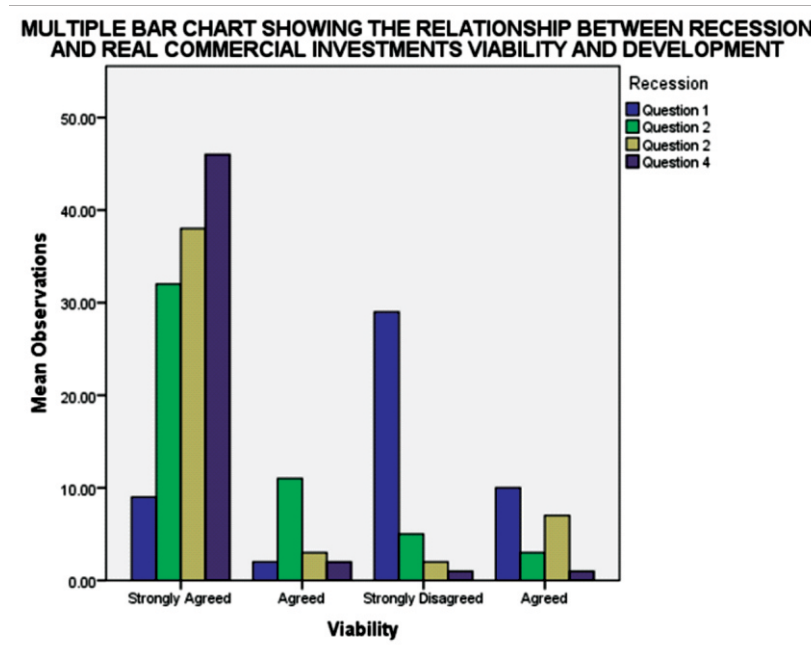
Source: Field survey (2016)

Table 3 above represented data on the effect of recession on commercial real investments viability and development. Under this research question, questionnaire item nine stated that there is a high number of newly developed commercial real investments in respondents' portfolios. Eighteen percent of the respondents strongly agreed to this opinion. Four percent agreed. Ten percent disagreed, while fifty percent strongly disagreed. This meant that the number of newly developed commercial real investments was not high at this time recession.

Questionnaire item ten indicated that investment in non commercial investments such as residential investments dominated the property market during recession. Sixty four percent of the respondent strongly agreed to this point; twenty two agreed; six percent disagreed; and ten percent disagreed strongly. The result here affirms the questionnaire item. Questionnaire item eleven - high cost of building materials have brought in short fall in commercial investments developments in recent times. Seventy six strongly agreed to the statement. Six percent of the respondents agreed. While fourteen percent disagreed, only four percent disagreed strongly to the opinion. This then shows the acceptance of the questionnaire item opinion.

As stated in the questionnaire item twelve, thus - low property values during recession discourage the development of commercial real investments. Ninety two respondents agreed strongly to this statement. Four percent agreed to questionnaire item; two respondents disagreed; while two percent equally disagreed strongly. The results here showed an agreement with the questionnaire item that low property value during recession discourages the development of commercial real investments. The relationship between recession and commercial real investments viability and developments as depicted in the above questionnaire items are as portrayed in the bar chart in figure 3 below.

Figure3:



As indicated above in table 3 and figure 3, the effect of recession on commercial real developments recently in Akwa Ibom State was clearly demonstrated. This was confirmed as 58 percent of the respondents strongly disagreed to the opinion that there is high number of newly developed commercial real investments currently in the management portfolios of estate surveyors in the study area; 64 percent strongly agreed that investments in residential properties dominates property market compared to commercial properties; 76 percent strongly agreed that high cost of building materials occasioned by the prevailing recession has brought in a short fall in commercial real developments; equally, 92 percent strongly agreed that low property values evident under recession discourage the development of commercial real investments by investors. The above analysis contributed in no small in answering research question 111.

Conclusion and Recommendations

From the discussion above, it is observed that the viability of commercial real investments hangs on the interplay of the major attributes of a given economy, one of which is recession at a time and a given region like Akwa Ibom State, Nigeria. Research has shown that real investment market usually weakens before a recession while its declines can last much longer

than recessions. In order to provide a way forward for investors, certain recommendations are suggested as pre-recession strategies. Bench marking is one of such options recommended to succour the situation. This is the process of comparing one's business processes and performance metrics at regular intervals to best practices of peers within the industry. Recession has amplified the many risks faced by the commercial real investments market. As the economy sees gradual improvement, it is believed that business activities in commercial real investments and other sectors are expected to pick up.

Businesses must ensure they have a comprehensive insurance programmes that fully addresses their needs. Certain recessionary indicators have clearly demonstrated that very large losses can occur in the real estate industry. A huge settlement spells nightmare for any business, and companies do not need to discover after the fact that they did not purchase enough limits to cover the loss. Buyers should take into consideration the interplay of a number of factors such as the limits available in the marketplace, the types of cases that may be filed and the practices of peers. Review coverage should be made for vacant properties, that is, owners of vacant buildings must look carefully at the risks involved in owning such property. Moreover, they should examine the conditions, terms and restrictions that apply to their insurance policy, since insurance companies feel that they are assuming a greater risk when insuring vacant buildings. Some companies insert "vacancy clause" in their policy, meaning that there is no coverage for loss caused by damages when a building is vacant for more than 60 consecutive days before the loss occurs. It also reduces the amount normally paid for loss or damage caused by fire, rain or wind storm. Ultimately, diversification of real estate portfolio is greatly emphasized to include other property types in order to reduce risk at times like what we are currently experiencing in Nigeria.

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