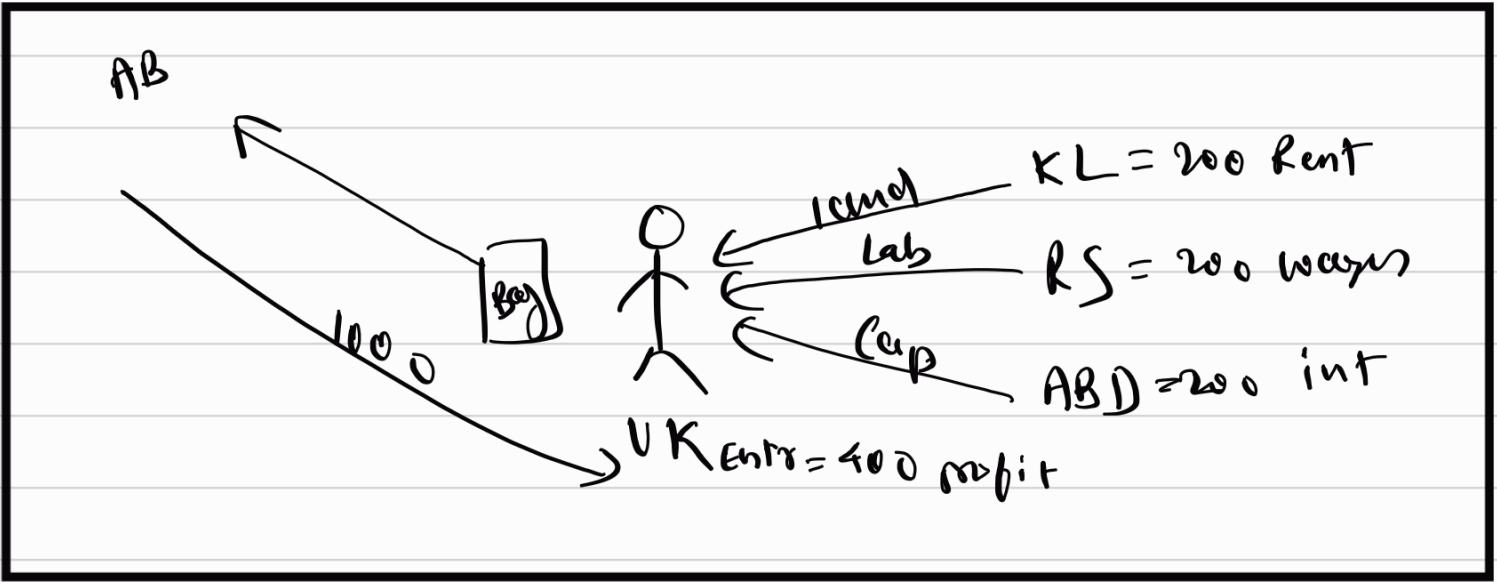


# CHAP # 5 Business Cycle

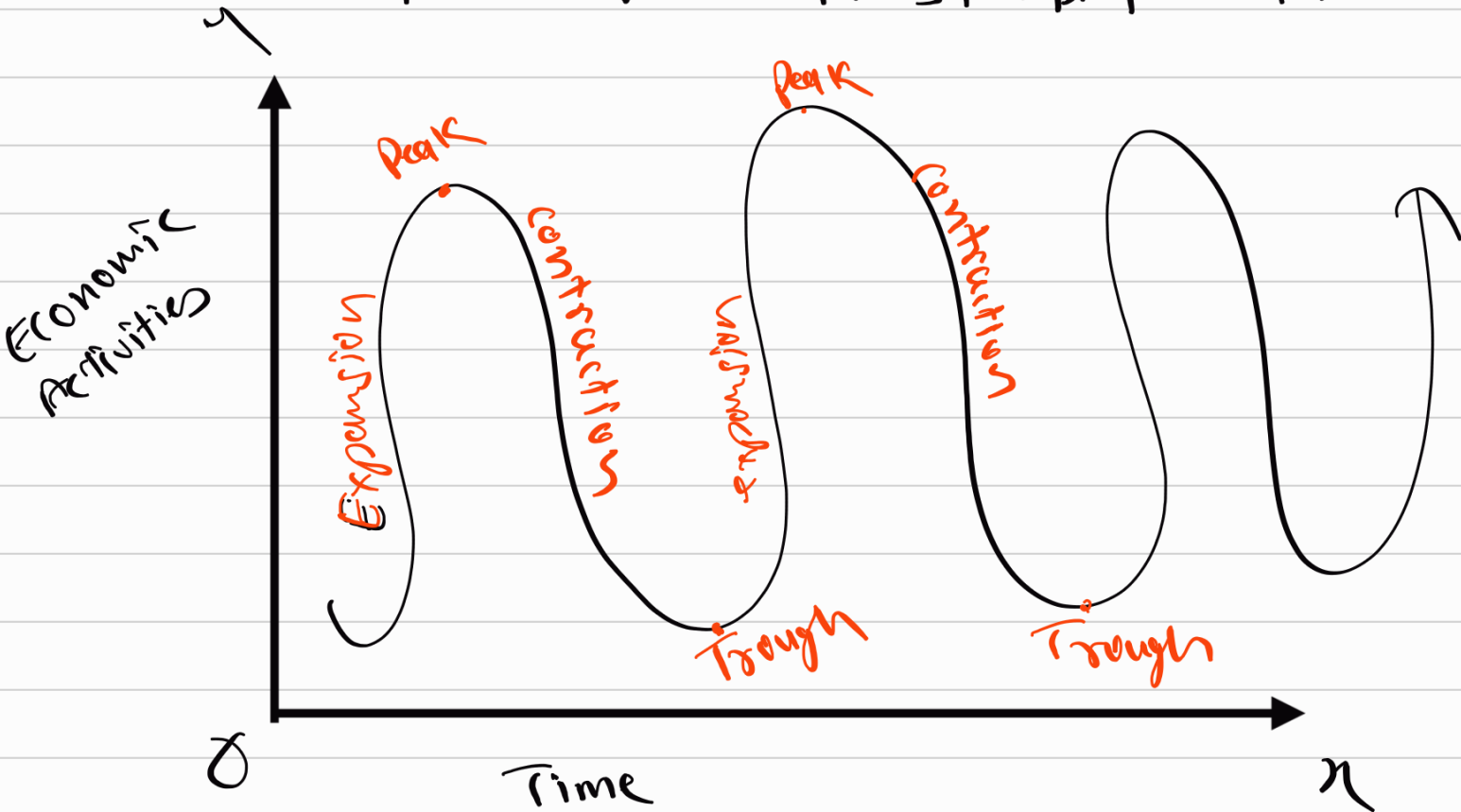


$1 \times 1000 = 1000$

USA      B'Desk

NI ↑

E.A ↑ = inv ↑ = prod ↑ = emp ↑ = S ↑ = Cap ↑ = EG & C...



National Income = Money Value of all

Goods & Services produced in the economy

during given period of time.

## Business Cycle :-

- It refers to fluctuations in economic activities
- It is wave-like behaviour of economic activities like production, investment, employment, etc.

### PHASES OF BUSINESS CYCLE

#### ① Expansion

- AKA Prosperity & Boom
- During this phase economic activities are increasing. initially at high rate & later on at diminishing rate
- At early stage of expansion
  - Available resources are more - cost ↓ - profit margin ↑ = ↑ invt - ↑ prod<sup>n</sup> - ↑ emp etc
  - DD > SS - price ↑ = profit ↑ = invt etc ↑
  - Optimism is increasing.

— But at later stage

- Available resources  $\downarrow$  = cost  $\uparrow$  = Profit  $\downarrow$
- $SS > DD$  = price  $\downarrow$
- Optimism is decreasing.

## (ii) Peak :-

- At peak resources are fully utilised.
- NO open unemployment
- Economic activities are stagnant.
- Profit margin is all time low  
& cost of production all time high
- People's income is not rising. but standard of living is very high so they stopped demand or  $\downarrow$  Demand
- But producers continue to produce & supply same quantity. & contraction starts

## (iii) Contraction :-

- During this phase, economic activities are falling.

are falling

- $SS > DD$ , price  $\downarrow$  = profit margins  $\downarrow$
- At initial stage of contraction resources are less Available = cost  $\uparrow$  = profit margin  $\downarrow$
- Pessimism starts increasing among business firms.

### iv) Trough :-

- AKA Depression
- Significant fall in economic activities
- invt, production, empl etc are all time low.
- Pessimism is very high.

### v) Recovery :-

- Economic activities can not go down continuously. from "trough" it starts rising, it's called "Recovery".
- Optimism start rising

- Resource availability  $\uparrow$  - cost  $\downarrow$
- profit margin  $\uparrow$
- $SS < DD =$  price starts rising.

## Features of Business Cycle

- (i) Differs in regularity, but "Periodical"
- (ii) starts from free economy.
- (iii) Contagious in nature, international
- (iv) Adversely affect all sectors.
  - but industries are more affected than Agriculture
  - Capital goods & consumer durable industries are more affected than FMCG goods
- (v) Complex phenomena; do not have uniform characteristics.
- (vi) Serious effect on welfare of Society

<u>Yr</u>	<u>Qty</u>	<u>Price</u>	<u>= GDP</u>	
1	1000	$\times 10$	$= 10000$	↑ = Economic Growth
2	2000	$\times 10$	$= 20000$	
2	800	$\times 20$	$= 16000$	↑ = EG <del>✓</del>

↓  
Current yr. = Nominal GDP

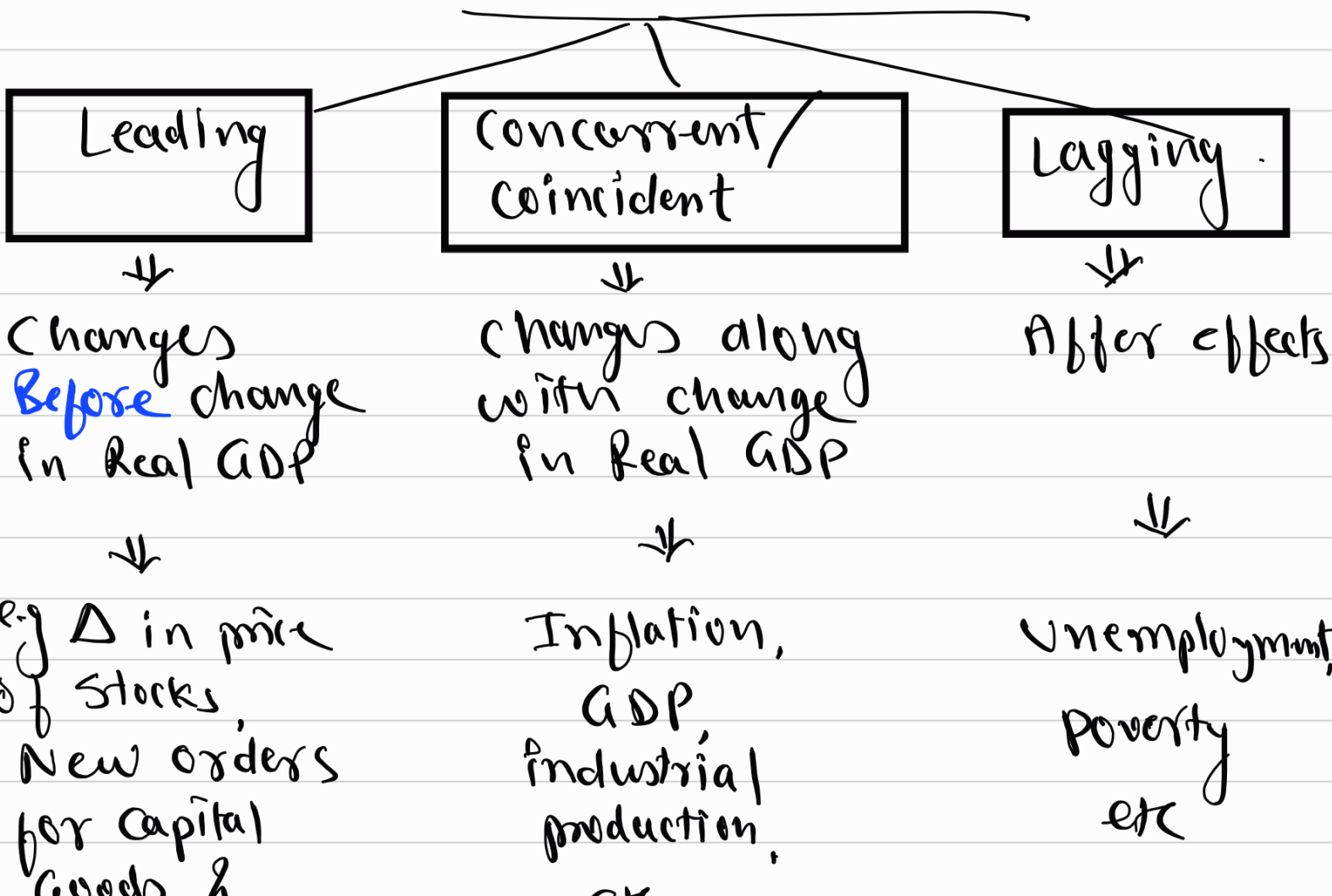
$$800 \times 10 = 8000 = \text{Real GDP}$$

↓  
Constant price

"Eco cycle is fluctuations in Real GDP"

## Economic Indicators

- It is difficult to predict turning points.
- Certain changes in economic activities helps to understand where economy is heading towards; they are called "Economic Indicators".



Consumer durables  
etc.

# Causes of Business Cycle

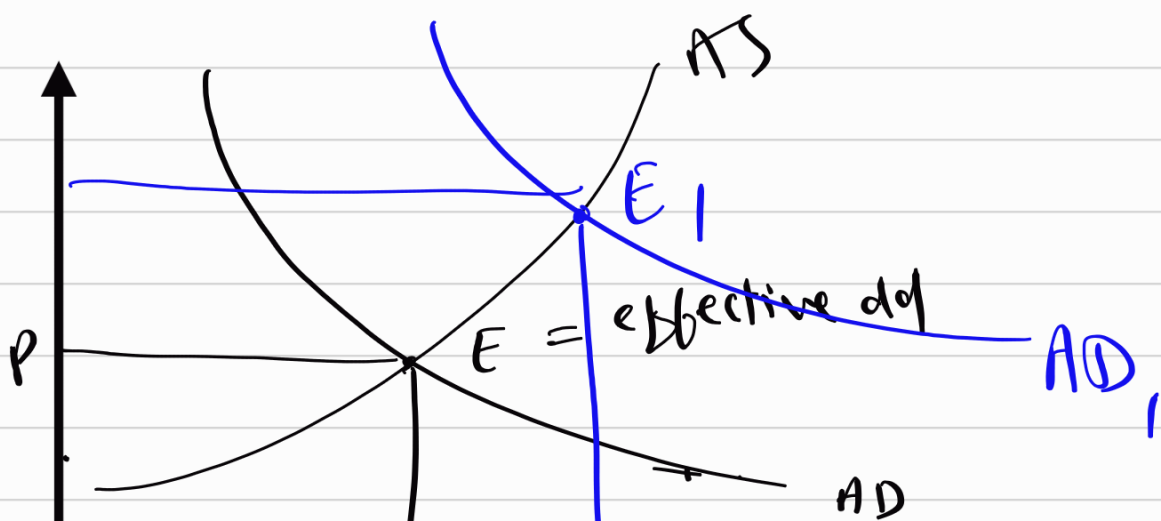
## # Internal Causes :-

(i) change in Effective Demand (J.M Keynes)  
↓  
interaction between Aggregate demand  
& Aggregate Supply

Aggite Demand = Expected total purchase  
at different prices.

Aggite Supply = Expected total Supply  
at different price

Effective Demand = Actual Amount  
realised (or) total production (or) total  
Expenditure (or) total income (or)  
total employment.





$$AD = C + I + G + (X - M)$$

cons<sup>n</sup> exp

inv<sup>t</sup> exp

gov<sup>t</sup> exp

if  $AD \uparrow =$  expansion

$AD \downarrow =$  contraction

②  $\Delta$  in Level Inv<sup>t</sup> =

Inv<sup>t</sup>  $\uparrow =$  expansion

Inv<sup>t</sup>  $\downarrow =$  contraction

③  $\Delta$  in gov<sup>t</sup> exp

Current

Regular  
exp like

repairs,  
maint, wages

Salaries etc

Capital

constr<sup>n</sup>  
of Assets.

Transfer exp

Donations, Charities,

Scholarship, Pension etc

$$\uparrow AE = \uparrow AD = \uparrow = \text{inv}^t \uparrow = \text{Output} \uparrow =$$



empl'  $\uparrow$  = GDP  $\uparrow$  = expansion & vice versa.

#### ④ $\Delta$ in money supply

Money supply  $\uparrow$  = int rate  $\downarrow$   
= Loans  $\uparrow$

Consumers

Producers

Home, Automobiles,  
electronics, Home appliance  $\uparrow$

int  $\uparrow$

AD  $\uparrow$  = expansion & vice-versa

#### ⑤ psychological factors

$\uparrow$  Optimism = Expansion

$\uparrow$  Pessimism = Contraction

#### ⑥ Macroeconomic policies

Tax  $\uparrow$  = Disposable income  $\downarrow$  = AD  $\downarrow$  = contraction & vice versa

# External causes :-

① War :- Destruction - War financing

mod ↓ = Depression.

(ii) Post-war reconstruction :- Recovery.

(iii) Technical shocks :-

e.g Green Hydrogen

(iv) Population Growth = Shortage of  
certain goods = import ↑ = contraction

(v) Natural calamities

Business cycle  
Due to

Authors.

- |  |                                     |
|--|-------------------------------------|
| (i) money supply   | Hawtrey                             |
| (ii) Effective Demand  | J. M. Keynes                        |
| (iii) innovations  | Schumpeter                          |
| (iv) Speculation -<br>present prices affect<br>future demand | Nicholas Kaldor<br>(cob-web-theory) |
| (v) Psychological factors                                    | A. C. Pigou                         |

