Chapter - 5
Business Cycle

- Periods of Trade

Periods of Good Trade

- Rising prices
- low unemployment %

Periods of Bad Trade

- Falling prices
- high unemployment %

Business cycle: there have been periods of prosperity followed by periods of downturns in economic activity.

These rhythmic fluctuations in aggregate economic activity that an economy experiences over a period of time are called business cycles or trade cycles.

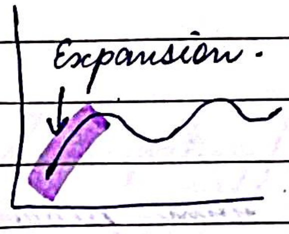
- Phases of Business Cycle

Expansion (Boom or upswing)	Peak or Prosperity	Contraction (downswing or Recession)	Trough or depression

→ fall in aggregate economic activity → Contraction

→ " " " " over a period of time → recession

1) Expansion Phase



→ Increase in national output, employment, aggregate demand, capital & consumer expenditure.

→ Increase in → sales, profit of business entities. resulting to rising stock prices, increased Cr. availability from banks.

→ Negligible involuntary unemployment (almost 0) Unemployment if any, then bcz of

Frictional Unemployment | Structural Unemployment

→ Investment happening is good → demand for goods & services (↗) high.
Result: Price & costs tend to rise faster

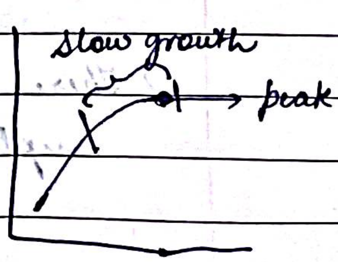
→ Increasing prosperity, people enjoy high standard of living, (↑) consumer spending, business confidence, (↑) profit & investment.

I.MP. →

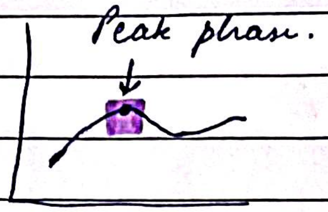
POINT TO BE NOTED

The stage of expansion continues till there is full employment of resources & production is at its max. possible level using the available production resources

The growth rate eventually slows down & reaches its peak.



2) Peak Phase.



The term peak refers to the top or the highest point of the business cycle

In other words, after this point, stage of expansion ends & stage of contraction starts.

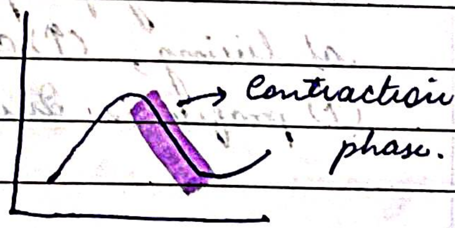
Reasons → In the later stages of expansion, inputs are difficult to find as they are short of their demand & therefore inputs prices increases.

→ Output prices also rise rapidly leading to (↑) cost of living & greater strain on → fixed income earner

→ Consumers begin to review their consumption expenditure on housing, durable goods etc.

Consequently actual demand stagnates

3) Contraction Phase



→ How contraction starts :

1) There is fall in the level of investment & employment

DEMAND DECREASING

2) Producers do not instantaniously recognize the pulse of the economy & continue anticipating/expecting higher levels of ~~income~~ demand.

therefore, they maintain their existing levels of investment & production → with the hopes of better future.

3) The consequence is a ~~discr~~ discrepancy or mismatch b/w demand & supply.

Supply > Demand

4) once this stage is reached, producers now realise that they have indulged in → excessive investment & over production.

Hence, they respond by holding back future investment plans, cancellation & stoppage of orders for equipment & all types of inputs including labour.

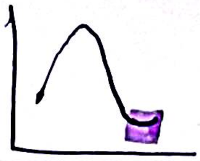
Supply side contracts.

5) As producers contract their supply, there is a chain of reactions in the input market as well

↓

Producers of cap. goods & raw materials in turn responds by cancelling & curtailing their orders.

FIRE OF CONTRACTION STARTS SPREADING ACROSS SECTORS NOW



4) Depression is the severe form of recession & it is ~~ca~~ characterized by extremely sluggish/bust economic activities

→ Main features of this stage are:

- Growth rate becomes -ve & level of national income & expenditure declines rapidly.
- Demand for products & services → (↓) prices are at their lowest and decline rapidly forcing firms to shutdown several production facilities.
- Companies are unable to sustain their work force, & hence job cuts.

↓

this ~~tests~~ leads to mounting unemployment & consequently the consumers are left with very little disposable income.

Banks → liquidate

Expansion ⇒ Peak ⇒ Contraction ⇒ Depression

loan ↑

Income ↓

Interest earner ↓

interest rate ↓

labour mkt.

↓

low wage

↓

output (↑)

Recovery

Expansion / Boom / upswing	Peak / Prosperity	Contraction / Recession / downswing	Trough / depression
Rising bank credit	Highest point / the top which marks the end of expansion	Fall in investor confidence	Bankruptcies of companies increases
Involuntary unemployment is zero.		Fall in employment.	Unemployment increases.
Any unemployment that exist is → Frictional / Structural		Rise in unemployment.	Liquidation increases
Everything +ve		Fall in output	Trough - when depression or aggregate economic activity touches its lowest point.
(↑) prosperity & standard of living		Everything -ve / Significant decline	Extremely sluggish economic activities
(↑) in GDP & National Output.		(↑) Demand is Halted	Growth rate -ve
(↑) in Employment		Demand starts (↓)	National Income, Expenditure, Interest Rate, Demand (↓)
(↑) " consumer & capital expenditure		Supply > Demand	Firms forced to shutdown
Rising sales & profit		(↓) in investments.	
Rising stock prices & rising business profits & rising business confidence		(↓) in income	

- Features of Business Cycle. → different business cycles differ in duration & intensity.

1) Occurs periodically, do not exhibit same regularity, duration varies, intensity of fluctuation also varies.

2) Indefinite length of phases (expansion, Boom, contraction & depression)

3) Disturbances in one / more sectors get easily transmitted to all other sectors.

4) Originates in free market.

5) Business cycles are complex phenomenon, effected by varying factors.

6) Affects output, employment, investment, trade prices etc.

7) Contagious & spreads via trade (eg. Great Depression)

8) Significant consequences on well being.

- Causes of business Cycle

INTERNAL Causes. or ENDOGENOUS FACTORS

1. Fluctuations in Effective demand
2. " " Investment
3. Variations in government spending
4. Macroeconomic policies
5. Money supply
6. Psychological factors.

EXTERNAL causes or EXOGENOUS FACTORS

1. War
2. Post war reconstruction
3. Technology shock
4. Natural factors
5. Population growth.

- **Examples of Business Cycle**

1) Great depression of 1930
2) Information Technology bubble burst of 2000
3) Global ~~Crisis~~ Economic Crisis (2008-09)
4) Covid-19 Pandemic.

- **Name of the Economists & their Quotations**

1) J.M. Keynes: Lower aggregate expenditure is the reason for massive decline in Income & employment.

2) Hawtrey: Trade Cycle is purely Monetary phenomenon.

3) Schumpeter: Trade cycle is result of innovation

4) A.C. Pigou: Business Activities are affected by wave of optimism & pessimism.

5) Nicholas Koldar: Price → Cobweb Theory

- **Economic indicators**

future	past	present
Leading indicators	Lagging indicators	Coincident or Concurrent Indicators
Eg: Changes in stock Prices, New orders for cap. & consumer goods	Unemployment, Corporate profit, labour cost per unit of output	GDP, Inflation, Industrial Production.

1) Leading : Variable that changes before the real output changes.
2) Lagging : Variable that changes after the real output changes.
3) Coincident : Variable that occurs simultaneously with the business cycle movements.

- Relevance of Business Cycle - Decision Making

1) It affects the demand of products, & hence the profits.
2) It affects the decision of entry of new firms.
3) Imp. for success of new product launch.
4) Surviving the sluggish business cycle, business plans policies with respect to products, prices etc.
5) Business cycles do not affect all sectors uniformly.