

Business Cycle

Periods of Trade

Periods of Good Trade

Rising Prices

Low unemployment

Periods of Bad Trade

Falling Prices

high unemployment

Business cycle: These are periods of prosperity followed by periods of downturns in economic activity.

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

Phases of Business cycle

Expansion
(Boom or upswing)

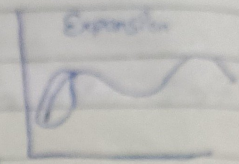
Peak or prosperity

Contraction
(downswing or Recession)

Trough or depression

→ Fall in aggregate economic activity → contraction
→ Fall in aggregate economic activity over a period of time → recession

1) Expansion Phase



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

→ Sales and profits of business enterprise rise, resulting in rising stock prices and increased credit availability from banks.

→ Negligible involuntary unemployment (almost) unemployment of any, then business cycle of

↓
Frictional
unemployment

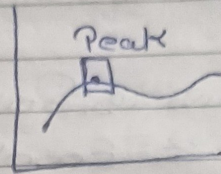
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Structural
unemployment

→ Investment happening is good → demand for goods & service (↑) high.

Result: Price & costs tend to rise faster.

→ Increase prosperity, people enjoy high standard of living, (↑) consumer's spending, consumer confidence, (↑) Profit & Investment

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.

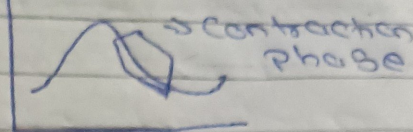
Reasons → In the later stage of expansion, inputs are difficult to find as they are short of their demand & therefore inputs price increases.

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

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

Consequently actual demand stagnates.

3) Contraction phase



→ How Contraction starts:

- 1) This is fall in the funds of investment & Employment

DEMAND DECREASING

- 2) Producers do not instantaneously recognise the pulse of the economy & continue anticipatory / expecting higher funds of demand

therefore, they maintain their existing funds of investment & production → with the hope of better future

- 3) The consequence is a discrepancy or mismatch between 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 & stepping of orders for equipment & all type of input including labour.

Supply Side Contracts

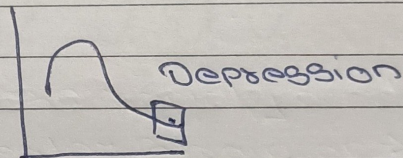
5] As producers contract their supply, there is a chain of reactions in the input market as well.



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

FIRE OF CONTRACTION STARTS SPREADING ACROSS SECTORS NOW

4] Depression



Depression is the recover form of recession & it is characterised by extremely sluggish / Sustained economic activities.

→ Main features of this stage are:

- Growth rate become -ve & level of national income & expenditure decline rapidly.

• Demand for products & services $\rightarrow$ ($\downarrow$)
prices are at their lowest and declining
rapidly forcing prices to shutdown
survival several production facilities.

• Companies are unable to sustain
their work force & hence job cuts.

$\downarrow$

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

Expansion / Boom / upswing	Peak / Prosperity	Contraction / Recession / Depression	Trough / Depression
- Everything positive - Increasing Prosperity & standard of living - Increase in GDP and National output. - Increase in Employment - Increase in Consumer and Capital Expenditure - Rising sales and profit - Rising bank credit - Involuntary unemployment is zero - Any unemployment that exists is frictional and structural	Highest point / the top point which marks the end of Expansion.	- Everything negative / significant decline - Increasing Demand and halted - Demand starts decreasing - Supply Exceeds Demand - Fall in profits - Fall in Investment - Fall in Income - Fall in Investor confidence - Fall in Employment - Rise in unemployment - Fall in output Ex: Great Recession from 2007-2009 IT Bubble burst 2000	- Extremely sluggish economic activities - Growth Rate Negative - Expenditure falls - Interest rate falls - Demand Decreases - Firms forced to shut down - Bankruptcies of companies increase - unemployment increases - Liquidation increases - Trough - When depression or sluggish economic activity touches its lowest point. Ex: Great depression of 1930 (1929-1933)

• Name of the Economist & th^os 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 Kaldor : Price $\rightarrow$ Cobweb Theory

• Features of Business cycle $\rightarrow$ different business cycle differ in duration & intensity.

- 1] Occurs periodically, do not exhibit some regularity, duration varies, intensity of fluctuation also varies.
- 2] Indefinite length of phase (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 (e.g. Great Depression)
- 8] Significant consequences on well-being.

• Causes of Business cycle

INTERNAL

causes or

ENDOGENOUS FACTORS

- 1] Fluctuation in Effective Demand
- 2] Fluctuation in Investment
- 3] Variation 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

• Example of Business cycle

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

• Economic indicators

↓	↓	↓
Leading indicators (Future)	Lagging indicators (Past)	Coincidence indicators (Present)
Ex: change in stock price, New orders for capital or consumer expenditure	Ex: unemployment Corporate profit, labour cost per unit of output	Concurrent indicators Ex: 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 decisions of entry of new firms
- 3] Important 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.