



# 5 Chapter

## BUSINESS CYCLES

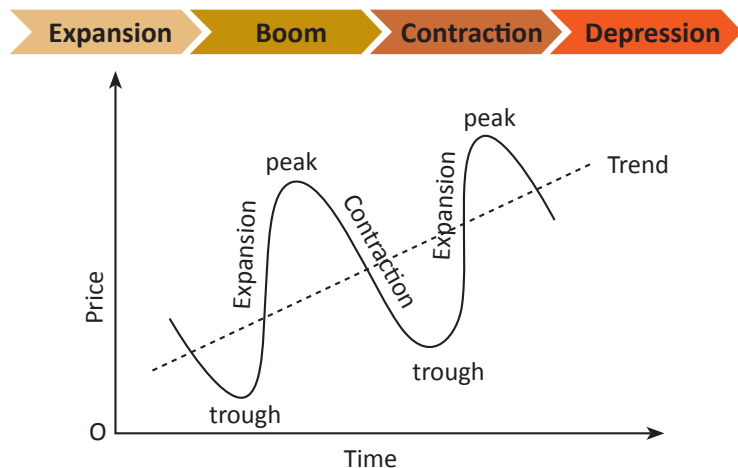
# 1 Chapter

# BUSINESS CYCLES

## 1. Meaning

- ❖ Business Cycles refer to periodic fluctuations in economic activities, alternating between growth and decline. Business cycles is also known as trade cycles.

## 2. 4 Phases of Business Cycles





## 2.1 Expansion- also known as upswing or boom

- ❖ Increase in output, employment, aggregate demand etc.
- ❖ This state exists till there is full employment of resources and production is at max. level.
- ❖ Involuntary employment is 0, and unemployment is frictional or structural.
- ❖ Price and cost rises faster.
- ❖ High level of consumer spending, business confidence, production, factor incomes, profit, investment, demand.

## 2.2 Peak/Prosperity

- ❖ Top/ highest point of business cycle.
  - Inputs are difficult to find and input price increase
  - Greater strain on fixed income earners
  - Actual demand stagnates
- ❖ End of expansion, economic growth stabilized for a short time, and then move in reverse direction.



### 2.3 Contraction/Downswing

- ❖ Once peak is reached, increase in demand is halted and starts to decrease.
- ❖ Producers do not instantaneously recognise the pulse of economy and continue to anticipate higher level of demand. Therefore, maintain the existing level of investment and production.
- ❖ Business firms become pessimistic.
- ❖ Fall in profit expectations.
- ❖ Hence reduce investment and economy over-heats and touches the recession.

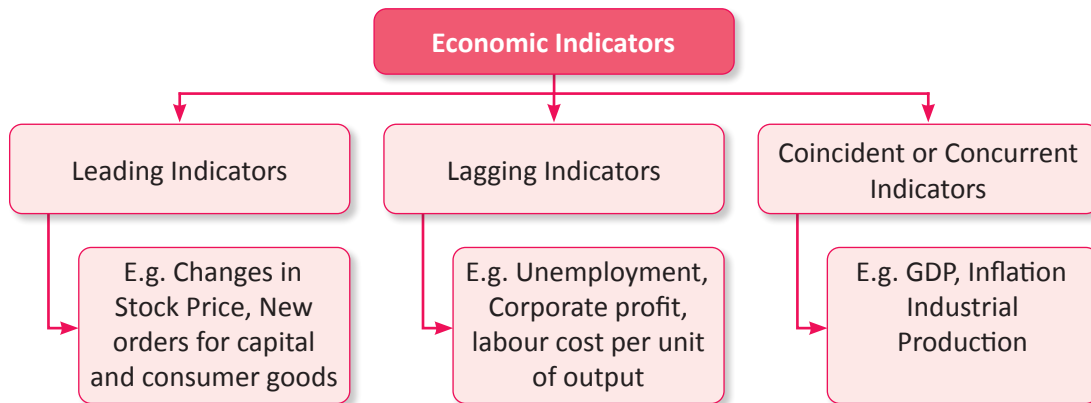
### 2.4 Trough/Depression

- ❖ Growth rate becomes -ve.
- ❖ Level of national income, expenditure declines rapidly.
- ❖ Price are at the lowest.
- ❖ Shut down of various production facilities.
- ❖ Fall in interest rate.
- ❖ Demand for holding money increases.
- ❖ Through generally lasts for some time and marks the end of pessimism and the beginning of optimism.

## 2.5 Recovery

- ❖ Economy starts rising from the lowest trough.
- ❖ Marks the shift from pessimism to optimism.
- ❖ Labour accepts lower wages initially.
- ❖ Businesses expect lower returns.
- ❖ Confidence gradually returns, leading to increased investment.
- ❖ **Capital goods industries (durable goods) are highly sensitive to business cycles.**

## 3. Economic Indicators



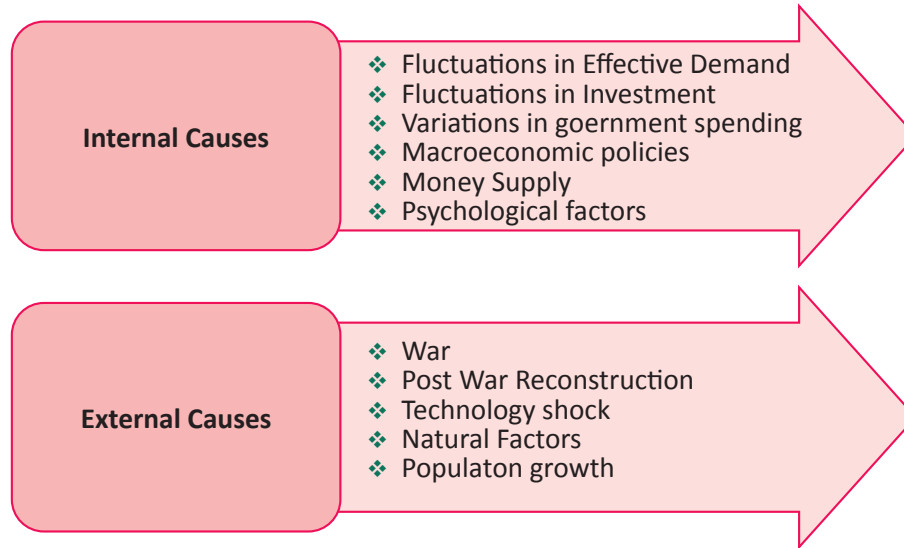


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| 1. <b>Leading:</b> Variable that changes before the real output changes.                 |
| 2. <b>Lagging:</b> Variable that changes after the real output changes.                  |
| 3. <b>Coincident:</b> Variable that occurs simultaneously with business cycle movements. |

#### 4. Features of Business Cycles

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| 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 the 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 and spreads via trade (e.g., Great Depression).  |
| 8. Significant consequences on well-being.   |

## 5. Causes of Business Cycles



## 6. Relevance of Business Cycle – Decision Making

- ❖ It affects the demand of products, and hence the profits.
- ❖ It affects the decision of entry of new firms.
- ❖ Important for success of new product launch.



- ❖ Surviving the sluggish business cycle, business plans policies with respect to products, prices etc.
- ❖ Business cycles do not affect all sectors uniformly.

## 7. Examples of Business Cycle

- ❖ Great Depression of 1930
- ❖ Information Technology bubble burst of 2000
- ❖ Global Economic Crisis (2008-09)
- ❖ Covid-19 Pandemic

## 8. Name of the Economists & their Quotations

- ❖ **J. M. Keynes:** Lower aggregate expenditure is the reason for massive decline in Income and employment.
- ❖ **Hawtrey:** Trade Cycle is purely Monetary phenomenon.
- ❖ **Schumpeter:** Trade cycle is result of innovation.
- ❖ **A. C. Pigou:** Business Activities are affected by wave of optimism & pessimism.