

BUSINESS CYCLES

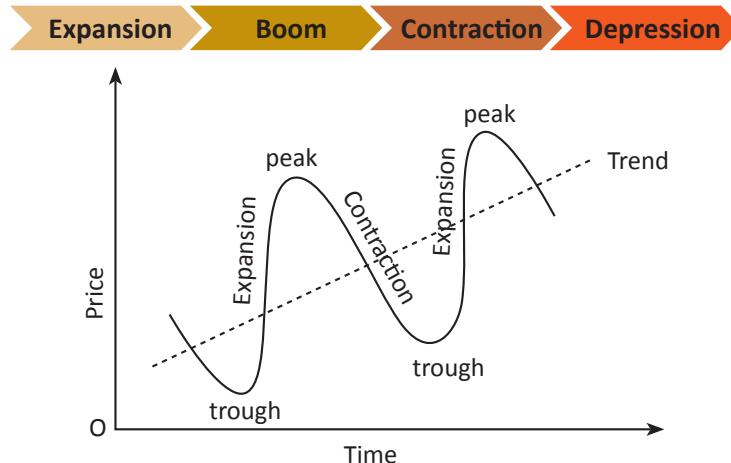
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Chapter

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.

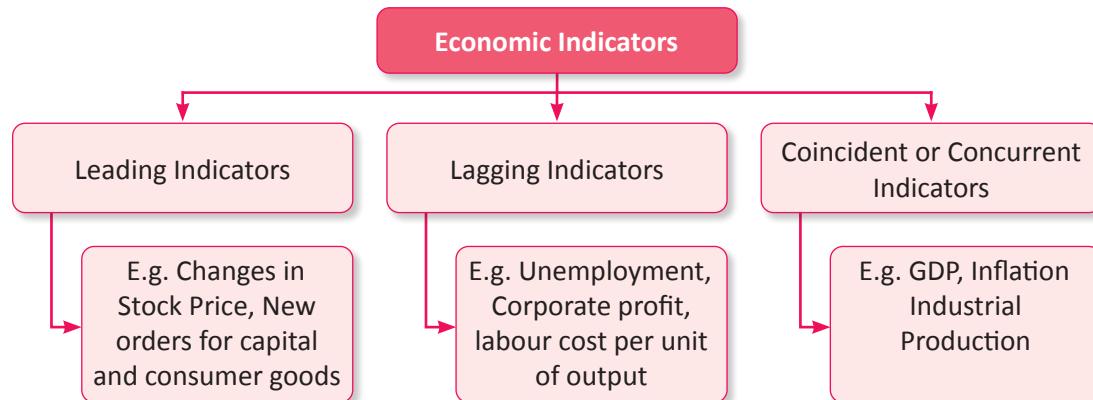
2.4 Trough/Depression

- ❖ 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

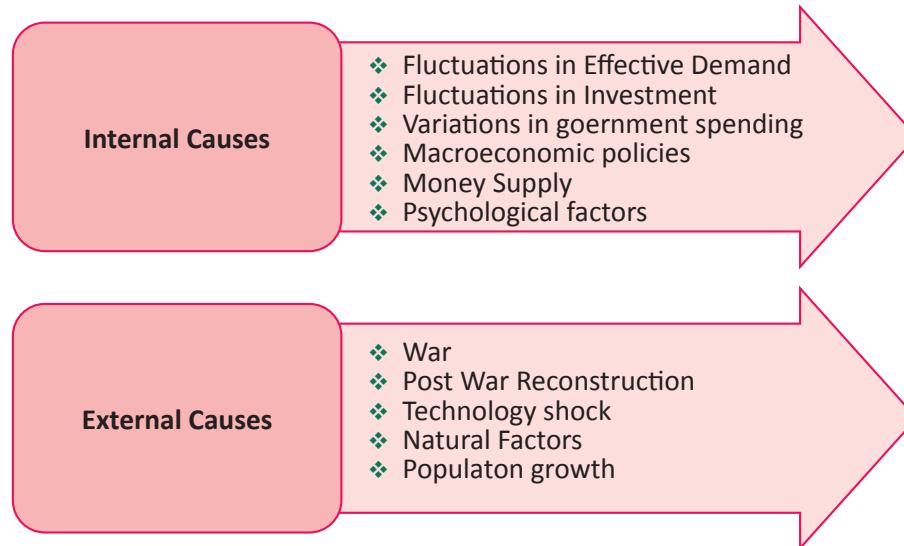


- 1. Leading:** Variable that changes before the real output changes.
- 2. Lagging:** Variable that changes after the real output changes.
- 3. Coincident:** Variable that occurs simultaneously with business cycle movements.

4. Features of Business Cycles

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.