

Chapter - 5 Business Cycles

Rhythmic fluctuations in ^{macro} aggregate economic activity that an economy experiences over a period of time are called business cycles or trade cycles.

Business cycles are recurrent and occur periodically.

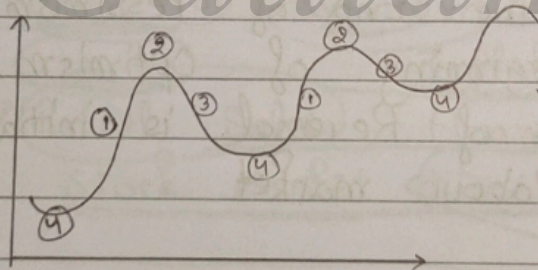
Phases of Business Cycle

1. Expansion or Boom or Upswing

2. Peak or Prosperity

3. Contraction or Recession or Downswing

4. Trough or Depression



- Expansion ÷
 - Increase in Bank credit
 - Involuntary Unemployment is 0.
 - Unemployment that exists is frictional or structural [Due to shift in Job]
 - Ex ÷ UK, 1920's
- ★ Peak ÷
 - End of Expansion
 - Highest / Top point

Great Recession = 2007-2009

Great Depression = 1930

- ★
- ★ Contraction ÷
- Economy is Overheated
 - Producer don't recognise the pulse of the economy.
- Phase
- Leads to Mismatch between demand & Supply.
 - Involuntary Unemployment is large.
 - Ex - Great Recession from 2007-2009 & IT bubble burst 2000.

- ★ Trough ÷
- It is Extremely Sluggish ^{low} Economic activity.
 - forcing firms to shut down various production facilities.
 - Increasing Bankruptcies and Liquidations.
 - Ex - The Great Depression 1930 (1929-1933).

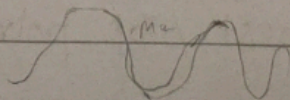
- ★ Recovery ÷
- It is the End of Pessimism & Beginning of Optimism.
 - Process of Reversal is initially felt in labour market.

Imp Points

- * Peak & Trough are turning Points

- ★ MCD *
- * Capital goods & Durable goods are more sensitive to Business Cycle.

★ MCD



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are used
Economic Indicators to predict the turning point of Business Cycle.

<u>Leading</u>	<u>Lagging</u>	<u>Coincident</u>
Pehle hi bata dega konsa Phase anne wala hai	Konsa Phase chal Raha Tha	Konsa Phase chal Raha hai

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Leading Ex ÷ Housing Index, Index of Consumer Confidence, Stock Price, Interest Rate,
 * New orders for consumer goods & Plant & Equipment.

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Lagging Ex ÷ Unemployment, Corporate profits, Labour Cost, Interest Rate, Consumer Price Index, Commercial lending Activity.

Coincident or Concurrent ÷ GDP, Industrial Production, Inflation, Personal Income,
 * Retail Sales, financial Market Trend such as Stock Market Prices *

FEATURES

- 1) Occur Periodically, Intensity Varies
- 2) Length of Each Phase is not Definite
- * 3) Generally Originate in Free Market Economy.

MCA

capitalist

capital, durable

4) As compared to Agriculture sector, Industrial sector is more prone to trade cycle.

5) It is Complex & is difficult to predict

★ MCO

6) BC are Contagious and international in character.

Ek Jagah hai, To Sab Jagah Effect Krega

7) BC have serious consequences on the well being of the society.

Causes of Business Cycle & MCO

(endogenous)

Internal

- Demand
- Investment
- Govt Spending
- Macro Policies
- Money Supply

External (exogenous)

- war
- Post war reconstruction
- Technological Shock
- Natural Factor
- Population

1) Internal ÷ 1) • Fluctuations in Effective Demand

* Net Foreign Demand = Export - Import

* Acc to Keynes, Fluctuation in Eco Activity is due to Fluctuation in Demand

Keynes ÷ Due to Demand

2) • Fluctuations in Investments

Hawtrey ÷ Monetary Phenomenon

3) • Variation in Govt Spendings

4) • Macro Economic Policies (monetary & Fiscal)

Pigou ÷ Based on Anticipation

* Ex- Govt Spending, Taxes, Interest Rates

Affected by Optimism & Pessimism

5) • Money Supply

Schumpeter ÷ Innovations

* According to Hawtrey Trade cycle is a purely Monetary Phenomenon

6) • Psychological factors

* Pigou ÷ Modern business Activities

are based on anticipations, thus affected by optimism & pessimism.

Nicholas Kaldor

cobweb Theory

Present Prices Influence Production at Future Date

Business Fluctuations are the outcome of Psychological state of mind of Businessmen.

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* Schumpeter \div Trade cycle occur as the result of Innovation.

* Nicholas Kaldor (cobweb theory) \div BC result from the fact that Present prices substantially influence the production at some future date.

- 2) External \div
- 1) Wars
 - 2) Post war Reconstruction
 - 3) Technological shocks (Advancements)
 - 4) Natural factors
 - 5) Population Growth

Relevance of Business cycle in Business Decision Making

• Businesses whose fortunes are closely linked to the rate of economic growth is referred to as 'cyclical' businesses.

MCA It means, business that are Extremely affected by business cycle are referred as 'cyclical' businesses.

• The phase of business cycle is important for a new business to decide entry into the market.

New Business \rightarrow Entry Decision