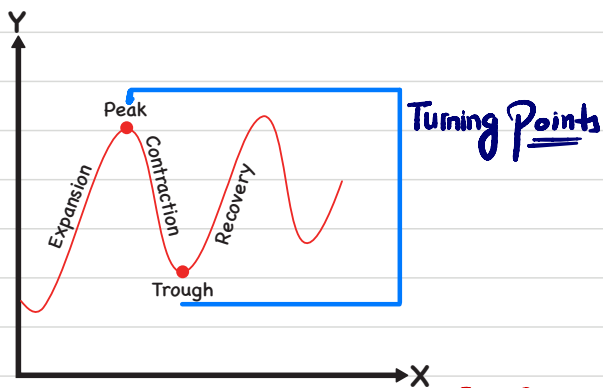


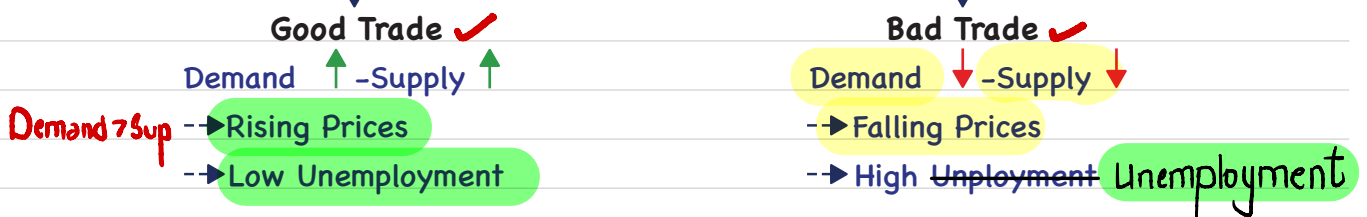
UNIT 1: BUSINESS CYCLES



GDP, NI

→ Rhythmic fluctuations in aggregate economic activity that an economy experiences over a period of time are called **Business Cycles** or **Trade Cycles**.

Composed of Periods ✓



→ The economic fluctuations are **Recurrent** & occur **periodically**.

Occur again & again - not at regular intervals
- not of same Length

Phases



1] Expansion:



1. This stage continues till there is full employment of resources.

Production is at its max possible level.

2. Involuntary unemployment is zero.

↳ [Job chahiye but hain hi nahi]

Unemployment is either :-

a) Frictional : Due to change in jobs, suspended work due to strikes.

b) Structural : Structural changes in the economy.

- Mismatch between skill workers have & skills required in the Market.

3. Prices & Cost tends to rise faster.

↳ Demand of inputs ↑

High demand [Demand > Supply]

4. People enjoy high standard of living.

5. Growth rate eventually slows down & reaches its peak.

2] Peak:

Resources are fully utilised.

Input prices ↑

-->

Cost ↑

Output prices ↑

Fixed income earners will review consumption expenditure on Durable goods.

Actual Demand Stagnates.

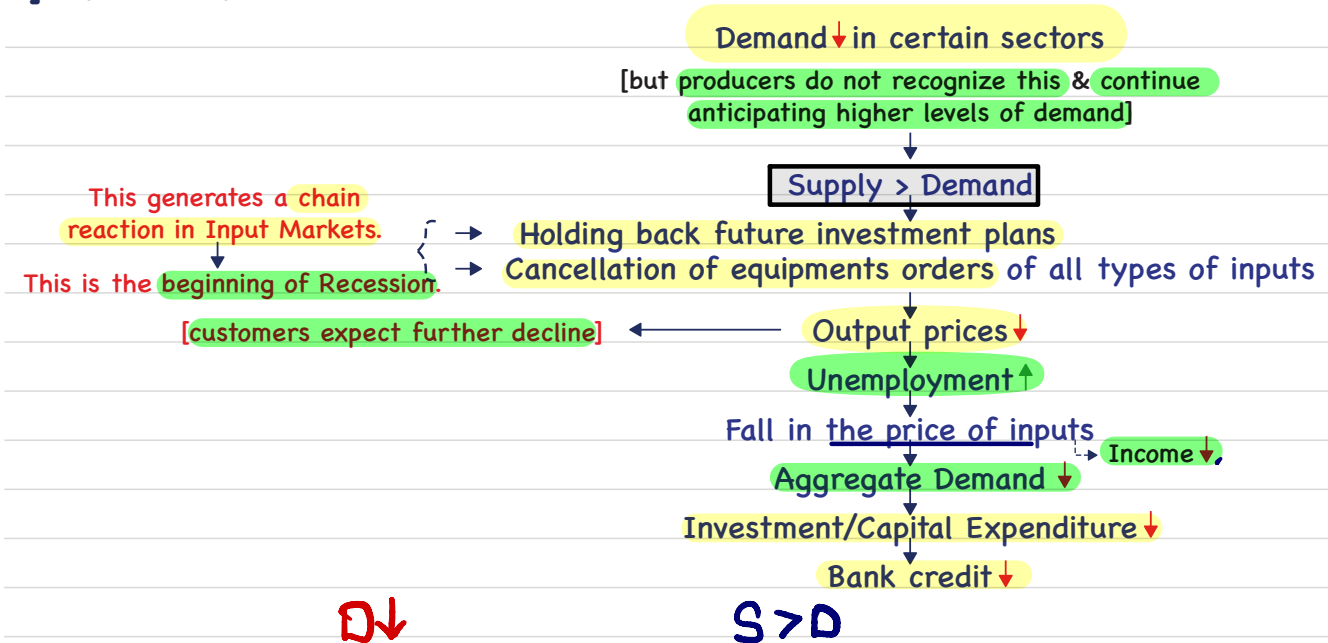
1. Highest point of Business cycle.

2. In later stages of Expansion: Input prices increases [Demand > Supply]

↳ Output Prices rise rapidly.

3. End of Expansion: It occurs when economic growth stabilizes for a short time & then move in reverse direction.

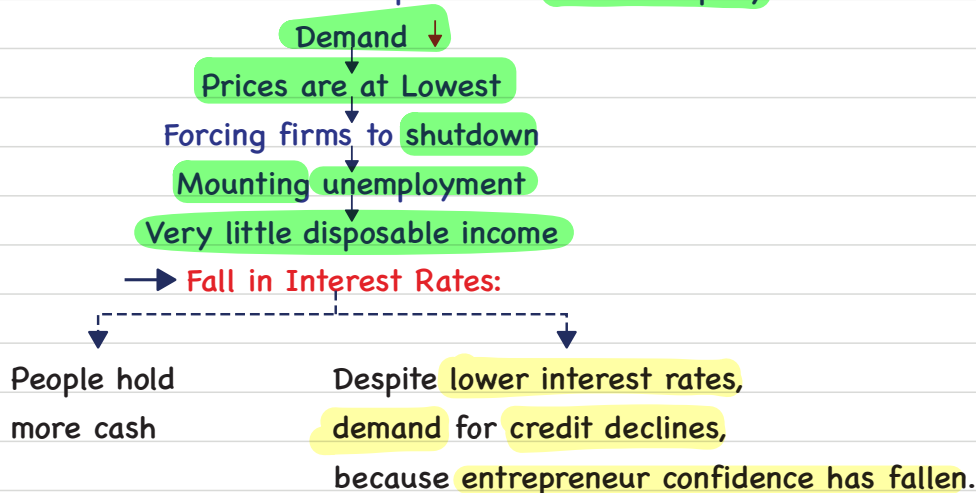
3] Contraction:



1. With reduced consumer spending, gap between Demand & supply widened further.
2. Business firms become **pessimistic** about future state of economy & there is fall in profit expectation.
Investment ↓ negative
3. Bank credit **shrinks**
↳ Borrowings ↓
4. **Investor confidence** is at lowest.
↳ Stock prices ↓
5. Severe contraction pushes economy into **depression**

4] Depression or Trough:

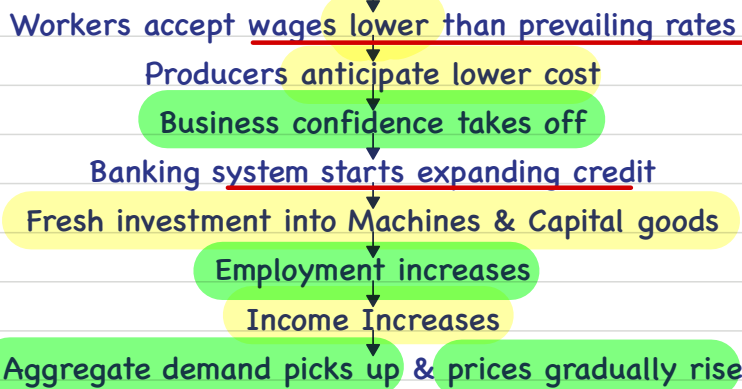
- > Depression is **severe form of Recession**.
- > **Growth rate becomes negative**.
- > Level of **National income** & expenditure **declines rapidly**.



- > Possible Banking or Financial crisis. ✓
 - > Excess capacity in capital & consumer durable goods industry
 - > Large no. of Bankruptcy & Liquidation reduce magnitude of trade & commerce.
- Eg:- Great Depression of 1930.

5] Recovery:

→ Process of Recovery in initially felt in
Labour Market

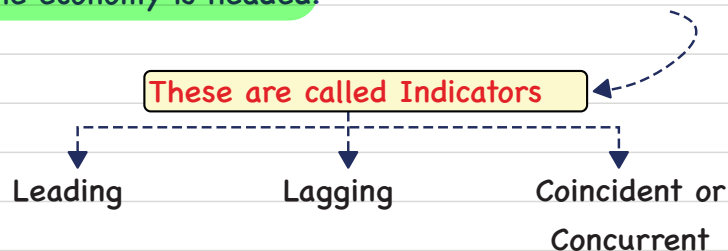


- encouragement to invest
- > The spurring of Investment causes recovery of economy.
- This acts as turning point from depression to expansion.

→ Economic Indicators

of

Economist use changes in a variety of activities to measure the business cycle & to predict where the economy is headed.



1. Leading Indicators

- > Measurable economic factors that change before economy starts to follow a particular pattern or trend.

Eg:- 1] Change in stock prices.

2] Value of new orders for plant & equipment.

3] Building permits for private house.

4] Index of consumer confidence.

5] Fraction of companies reporting slower deliveries.

Multiple Reading

2. Lagging Indicators

- > Reflect economy's historical performance.
- > Changes in these indicators are observable only after economic trend/pattern has already occurred.

Beginning

- Leading indicators **Signal onset of business cycle,**
- Lagging indicators **confirm these trends.**

- Eg:-
- 1] Unemployment. ✓
 - 2] Corporate profits. ✓
 - 3] Consumer price index. ✓
 - 4] Labour cost p.u. ✓
 - 5] Interest/Prime rates. ✓
 - 6] Commercial lending activity. ✓

3. Co-incident Indicators

- > Coincident indicators occur simultaneously with business cycle movement.
- > Describe the current state of business cycle.
- > Gives information about rate of change of expansion or contraction at same time it happens.

- Eg:-
- 1] GDP. ✓
 - 2] Industrial production. ✓
 - 3] Personal income. ✓
 - 4] Retail sales.
 - 5] Inflation.

Features of Business Cycle:-

- 1] Occur periodically but do not exhibit same regularity. Duration & intensity varies
Length of each phase is also not definite.

- 2] Business cycles originates in **Free Market Economies.**

They are **pervasive** as well.

Capitalist

- > Disturbance in one or more sectors transmitted to other sectors.

- 3] Some sectors such as **capital goods industries, durable consumer goods industry** are **disproportionately affected.**

- > Industrial sector is more affected as compared to agricultural sector.

- 4] Business cycles are **complex phenomena**, they are caused by varying factors.
It is difficult to make accurate prediction of trade cycles before their occurrence.
- 5] Repercussions of business cycles are **felt on nearly all economic variables**.
Output, Investment, employment, etc.
- 6] Business cycles are **contagious & International** in character.
--> They begin in one country & spread to other countries.
- 7] Business cycles **have serious consequences on the well being of society**.

Causes of Business Cycle:-



1. Internal causes or Endogenous:

$$C + I + G + [X - M]$$

→ a] **Fluctuation in Effective Demand:**

J.M. Keynes

Fluctuation in economic activities are due to fluctuations in aggregate effective demand.

→ Higher level of AD → Production ↑ → More Employment

When, AD > AS → Inflation

↓

More Income

→ Low AD → Production ↓ → Low Employment → Low Income → Downward Spiral

This cycle stops when prices are so low that investors start buying again.

→ **Net foreign demand for Goods [Exports - Import] is a component of AD.**
--> Variations in export & Import leads to fluctuations as well



→ b] **Fluctuation in Investments:**

J.M. Keynes

Investment is considered to be the **most volatile component of AD.**

→ Investments ↑ because of : a] New inventions which are profit inducing.
b] Interest rate is Low.

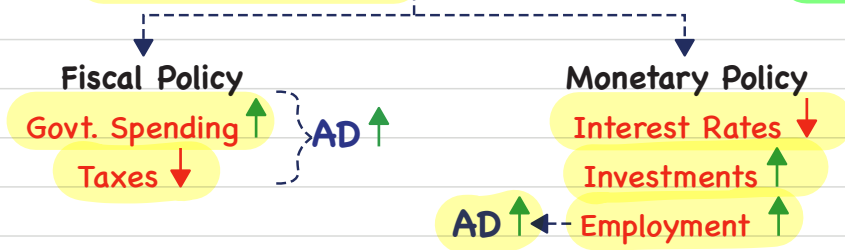
→ ↑ in Investment → Rightward shift in AD → Expansion
→ ↓ in Investment → has opposite effect

→ c] Variation in Government Spending:

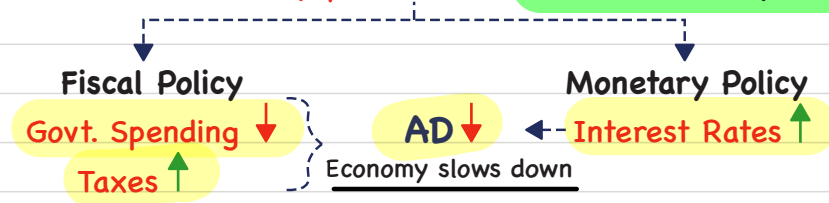
Government Spending, especially during & after war has destabilizing effects on economy.

→ d] Macro-economic policies:

1. Expansionary policies [Jisse Expansion aaye] → Inflation ↑ D > S



2. Contractionary policies → Anti Inflationary Measures



→ e] Money Supply:

→ Hawtrey → Trade cycle is a purely monetary phenomena.
→ Unplanned changes in Supply of money may cause fluctuations.

→ ↑ in Money Supply → AD ↑ → Expansion
→ ↓ in Money Supply → Initiates recession in the economy.

→ Pigou → Business activities are based on anticipation of Business community.
→ affected by waves of optimism or pessimism.

→ f] Psychological Factors:

→ Optimistic → Investments ↑ → AD ↑ → Expansion
→ Pessimistic → Investments ↓ → Employment & Income ↓ → Contraction

→ g) Theories:

(i) **Schumpeter's Innovation Theory**: Trade cycles occur as a result of Innovation.

(ii) **Cobweb Theory**: Business cycles result from the fact that present prices influence the production & employment at some future date.

Nicholas Kaldor

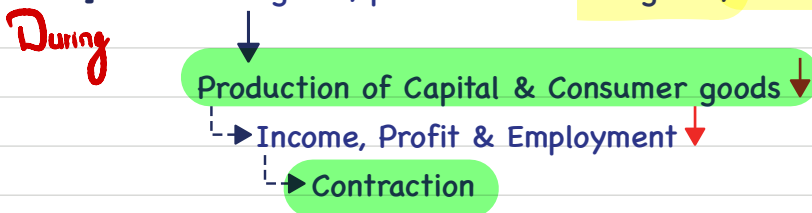
2021-22 : ₹100/- Kg [D>S]

2022-23 : ₹20/- Kg [S>D]

2023-24 : ₹80/- Kg [D>S]

2. External causes or Exogenous:

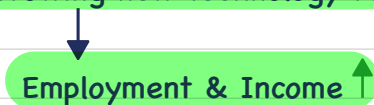
→ a) War: During war, production of war goods, like weapons & arms etc. ↑



→ b) Post War Reconstruction: After war, Houses, roads, bridges, etc are built.



→ c) Technology shocks: Growing new technology requires huge investment ↑

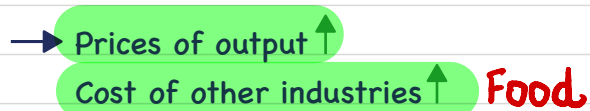
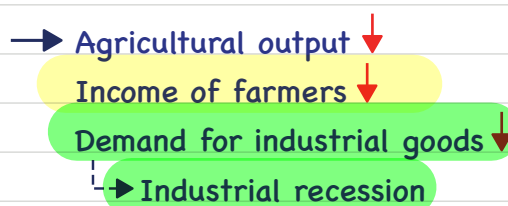


Eg:- Due to advent of Mobile phones, the telecom industry underwent a boom.

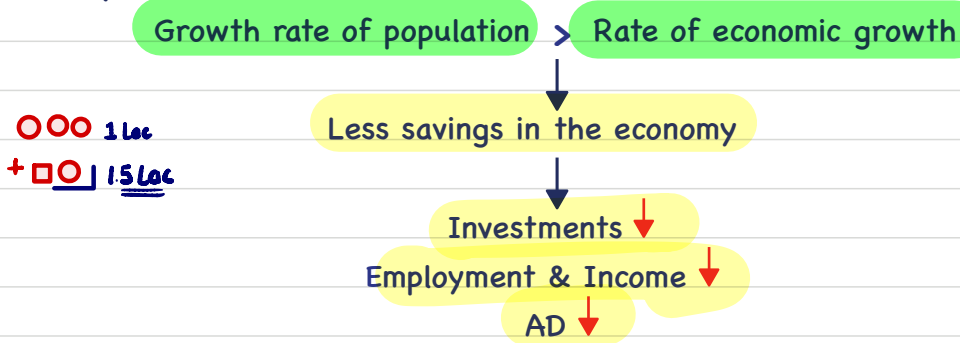
→ d) Natural Factors: Weather cycles cause fluctuations in agricultural output.

causes instability in agrarian economics

--> Droughts or excessive floods



→ e] Population Growth:



→ Relavance of Business Cycle in Business Decision Making

1. Knowledge regarding business cycle is important for business to frame appropriate policies

Expansion phase: New opportunities for Investments

Recession phase: Reduces business opportunities & profits

2. Different phases of cycle requires fluctuating level of input use especially labour input.

③ Business whose fortune is closely linked to rate of economic growth.

→ Cyclical Business

Eg:- Fashion retailers, electrical/white goods, house builders, Restaurants, advertising, overseas tour operators, construction & other infrastructure firms.

During Boom - Strong demand

During Slump - Sharp drop in demand
contraction

4. Some business benefit from economic downturn

Cheaper alternative compared to more expensive products

Products which provide good value for money

5. Phases of business cycle is important for new business to decide on:

a] Entry into the Market

b] New product launch