


THE BUSINESS CYCLE



What is a business cycle?

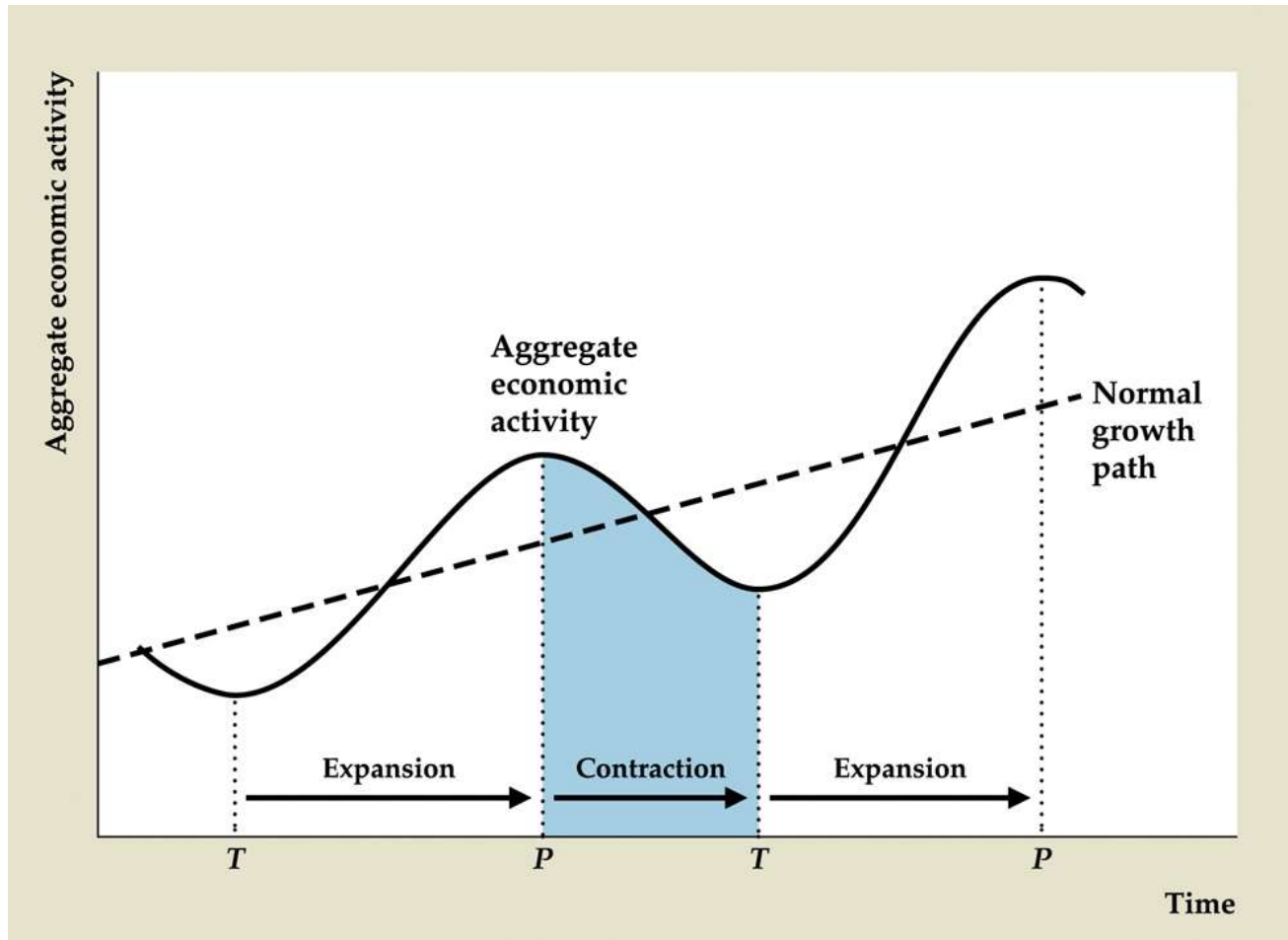
- ▶ A business cycle refers to periods of expansion and contraction. A peak is the high point following a period of economic expansion. A trough is the low point following a period of economic decline.
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Cont.....


The recurring and fluctuating levels of economic activity that an economy experiences over a long period of time.




Business Cycle...



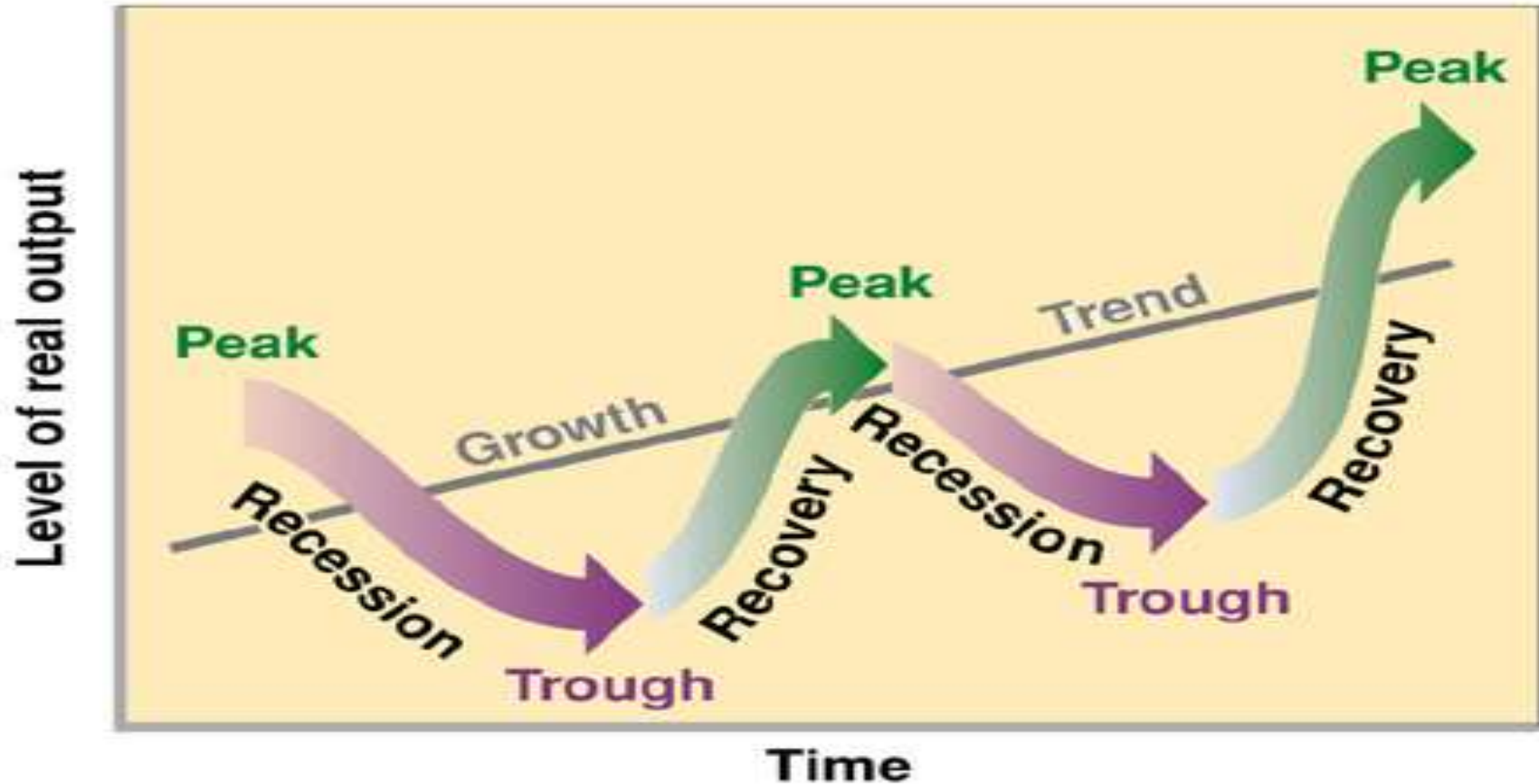
According to Arthur F. Burns and Wesley C. Mitchell..

- ▶ Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises.
 - ▶ A cycle consists of:
 - Expansions.
 - General recessions.
 - Contractions
 - And revivals which merge into the expansion phase of the next cycle.
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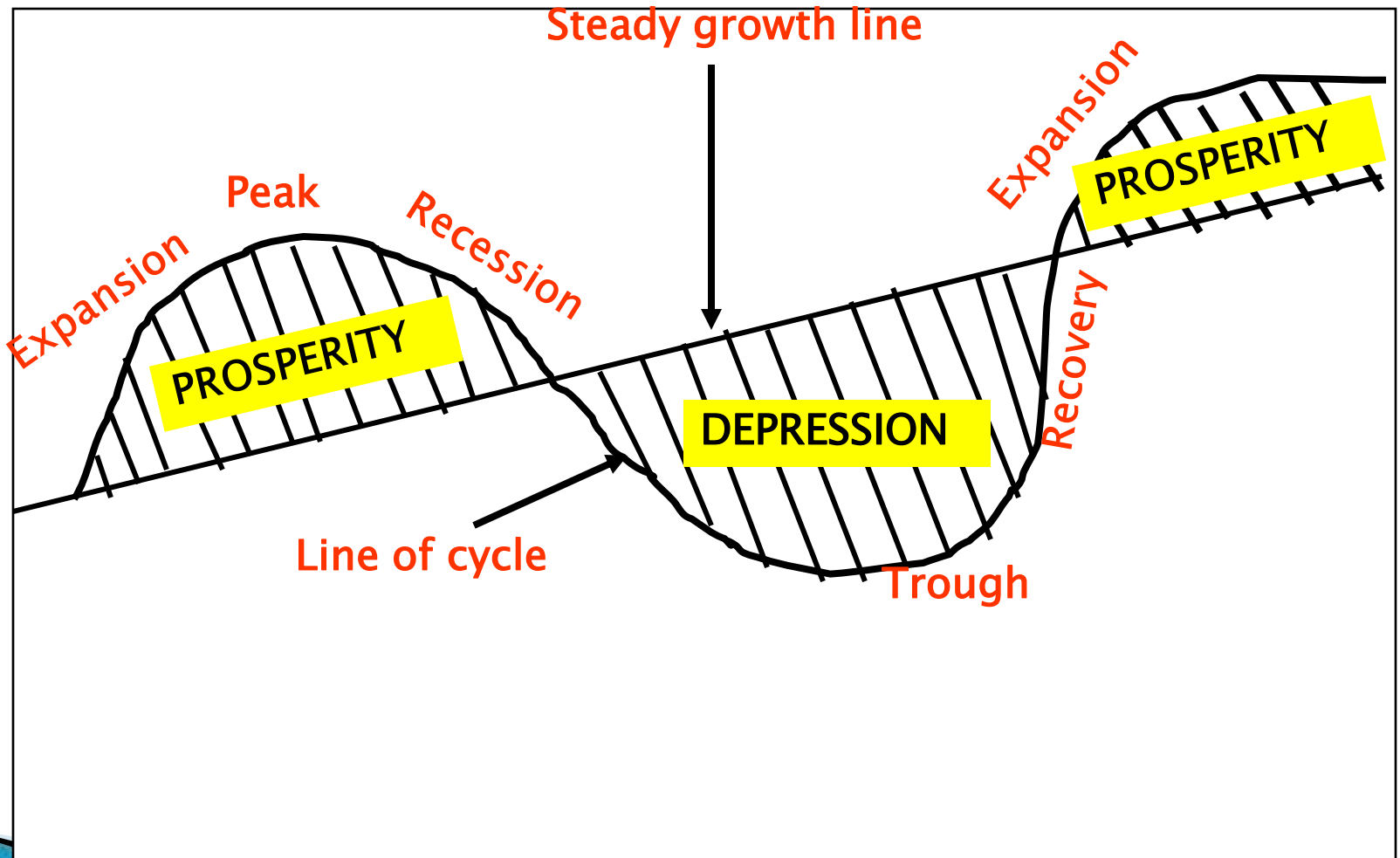
According to Joseph Business Cycle has 4 steps.....

- ▶ **Expansion:** Increase in production and prices, low interests rates.
 - ▶ **Crisis:** Stock exchanges crash and multiple bankruptcies of firms occur.
 - ▶ **Recession:** Drops in prices and in output high interests rates.
 - ▶ **Recovery/Revival:** Stocks recover because of the fall in prices and incomes.
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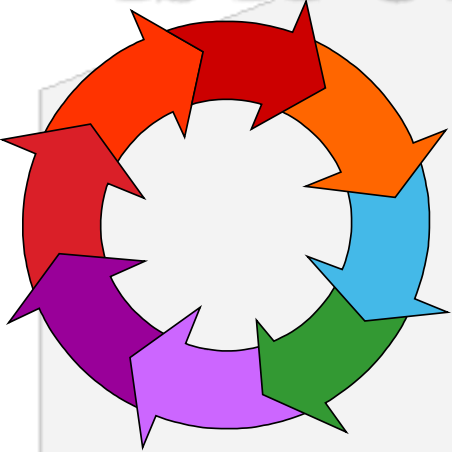
Business Cycle...



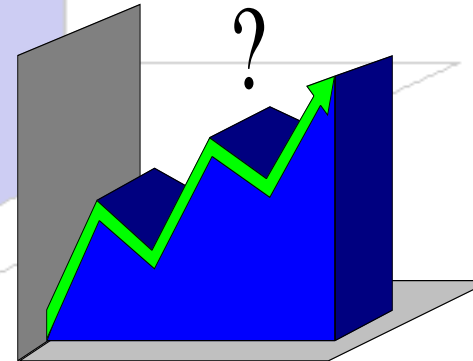
PHASES OF BUSINESS CYCLE




IS IT CYCLE OR FLUCTUATION?



In recent years economic theory has moved towards the study of economic fluctuation rather than a business cycle.



Boom

- The business outlook is extremely optimistic.
 - The important features of prosperity are:
 - a high level of output ,trade, employment and income,
 - a high level of effective demand and high marginal efficiency of capital,
 - a large expansion of bank credit, and
 - a rising trend in prices, profits and interest rates.
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PEAK



Characterized by


Slackening in expansion rate

Highest level of prosperity

Downward slide in economic activities

The phase of recession begins

Recession

- ▶ During recessions, many macro economic indicators vary in a similar way.
 - ▶ Production, as measured by gross domestic product (GDP), employment, investment spending, capacity utilisation, household incomes, business profits, and inflation all fall
 - ▶ while bankruptcies and the unemployment rate rise.
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RECESSION

Downward slide in growth rate becomes rapid and steady

Output, employment, prices etc. register a rapid decline

When the growth rate goes below the steady growth rate depression sets in

Depression

- ▶ The phase of depression economic activity is at its low . Wages, cost, price are very low.
 - ▶ There is massive unemployment leading to a fall in the aggregate income of the people.
 - ▶ This brings down the purchasing power of the community.
 - ▶ General demand falls faster than production.
 - ▶ The piled-up stock are sold at very high rates of discount leading to heavy loss to the firms.
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DEPRESSION



Depression begins when
Growth is less than zero

Total
output, employment, prices, bank
advances etc. Decline
during subsequent period

Depression lasts as long as
growth rate stays below the
stagnated growth rate

TROUGH

Phase during which the downward trend in the economy slows down and eventually stops


Economic activities once again register an upward movement

Period of severe strain on the economy

Economy registers a continuous and rapid upward trend in output, employment, etc.

It enters the phase of recovery

Recovery

- The rising price of an asset
 - Increased economic activity during a business cycle, resulting in growth in the gross domestic product.
 - Collection of all or a portion of a debt previously considered uncollectible.
 - Valuable materials remaining after processing.
 - Proceeds from the sale of an asset that represent depreciation that has already been taken.
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EXPANSION



Increase in
Output
Employment
Investment
Aggregate demand
Bank credits
Wholesale & Retail
prices
Per capita output
Standard of living

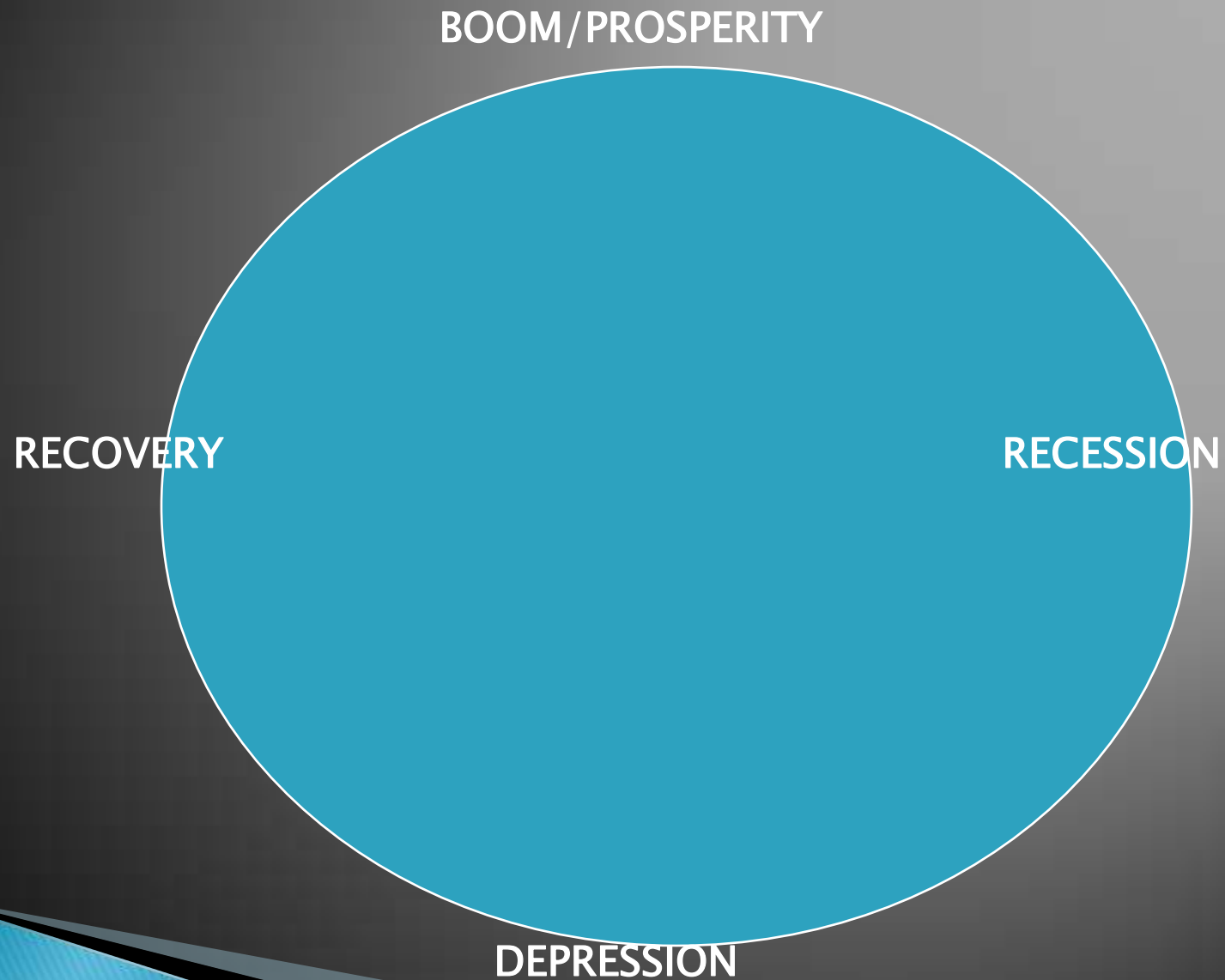
RECOVERY & EXPANSION



In the recovery phase the growth rate may still remain below the steady growth rate.

When it exceeds this rate, the economy enters the phase of expansion And prosperity

BUSINESS CYCLE



DEPRESSION

PRICE LEVEL
FALLS



PRODUCTION
DECREASES



UNEMPLOYMENT
INCREASES



PURCHASING
POWER DECREASES



STOCKS
ACCUMULATE



PRODUCTION
FALLS



PRODUCTIVE
ACTIVITY SLOWS
DOWN



DEMAND
FALLS

RECOVERY

**FULL
EMPLOYMENT**

**DURING DEPRESSION
ONLY CONSUMER GOODS ARE
PURCHASED**

**DURABLE GOODS
REMAIN UNSOLD**

**OLD DURABLE GOODS
EITHER GET CONSUMED
OR BECOME OBSOLETE**

**PURCHASE OF GOODS
AGAIN BECOMES
NECESSARY**

**PRODUCERS PURCHASE
THESE GOODS**

PROGRESS IN BOTH INDUSTRIES

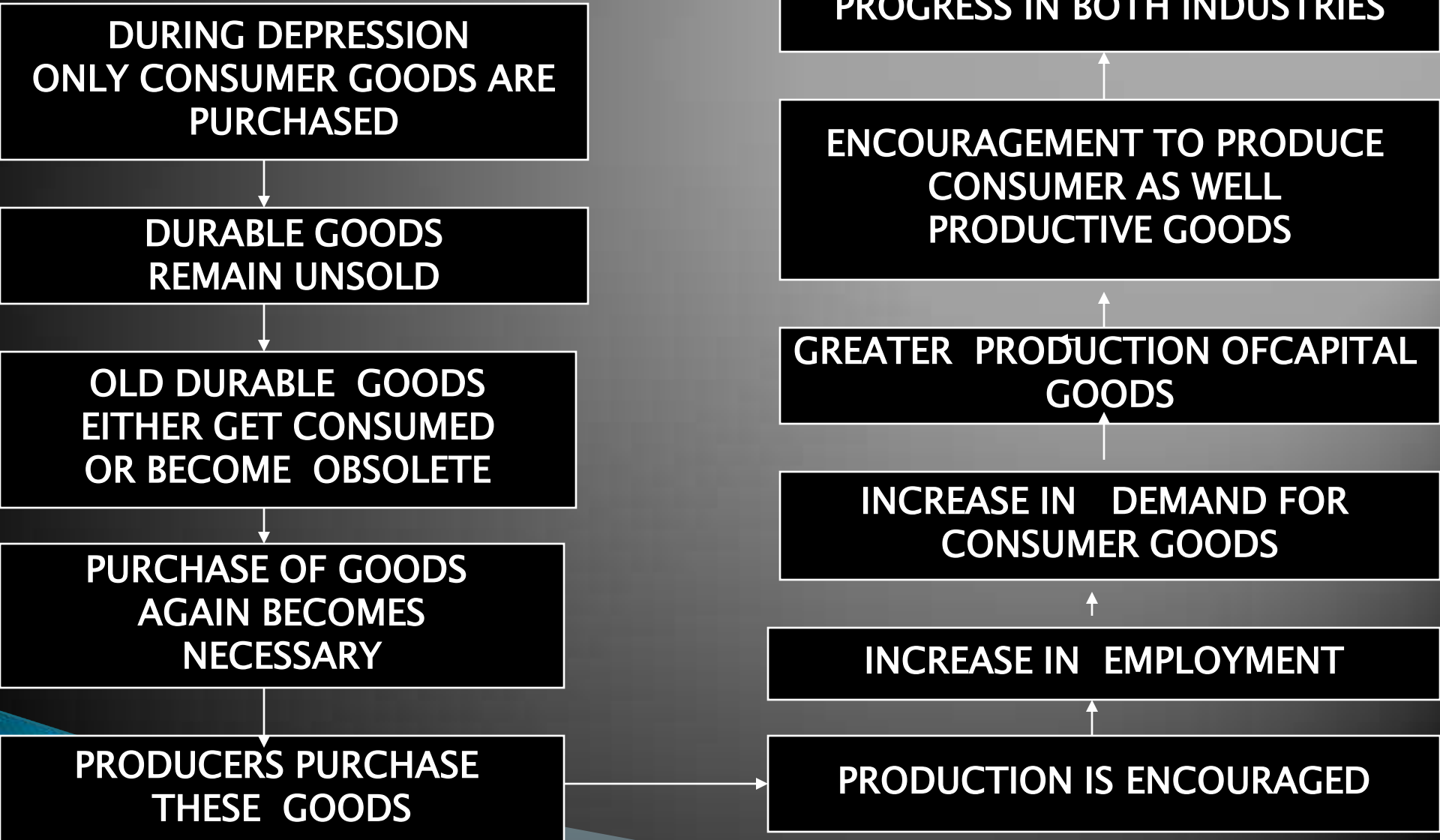
**ENCOURAGEMENT TO PRODUCE
CONSUMER AS WELL
PRODUCTIVE GOODS**

**GREATER PRODUCTION OF CAPITAL
GOODS**

**INCREASE IN DEMAND FOR
CONSUMER GOODS**

INCREASE IN EMPLOYMENT

PRODUCTION IS ENCOURAGED



BOOM

EMPLOYMENT INCREASE



WAGES RISE



DEMAND INCREASES



PRICES RISE



PROFITS RISE MORE THAN
WAGES



LEVEL OF INVESTMENT
INCREASES



AS A RESULT THE LEVEL OF
EMPLOYMENT, INCOMES
AND TRADE ALSO RISE



THERE IS OVERALL
PROSPERITY

RECESSION

INCREASED DEMAND
DURING BOOM

BRINGS IN LESS
EFFICIENT MEANS
OF PRODUCTION

MONEY MARKET ALSO
BECOMES COSTLIER

DEMAND FOR LOANS PUSHES
UP INTEREST RATES

BEGINNING OF DEPRESSION

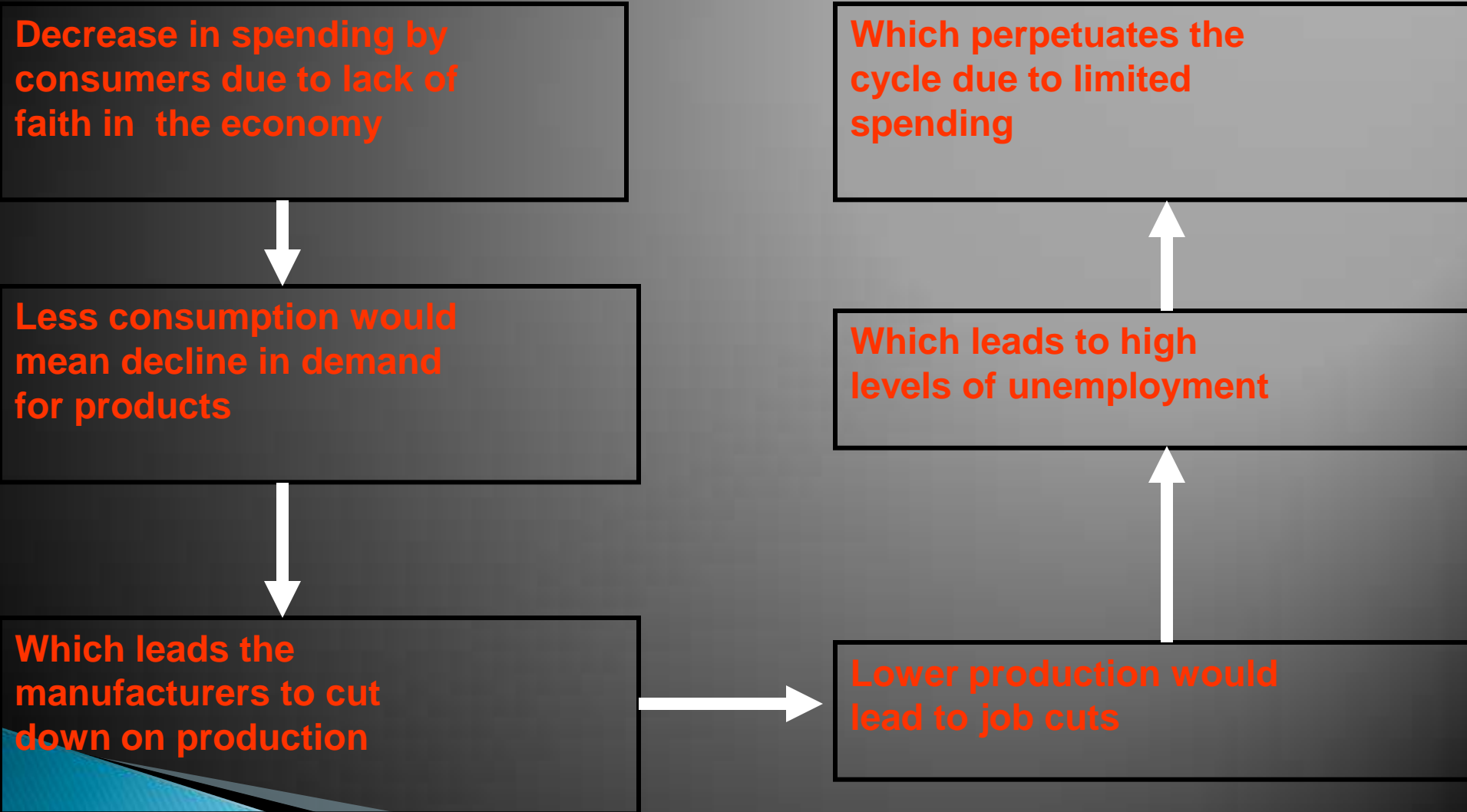
PRICES OF COMMODITIES
RISE SHARPLY

COST OF PRODUCTION
GOES UP

QUANTITY OF
INVESTMENT BEGINS
TO DECREASE



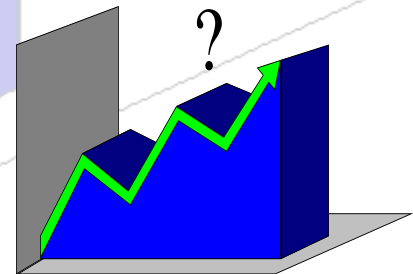
What causes recession



Theories of Business Cycle...

- **Keynesian Theory**

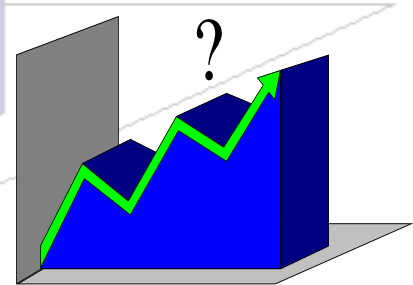
Fluctuations in aggregate demand cause the economy to come to short run equilibrium at levels that are different from the full employment rate of output. These fluctuations express themselves as the observed business cycles.



Theories of Business Cycle...

- ▶ **Real business cycle theory..**

Economic crisis and fluctuations cannot stem from a monetary shock, only from an external shock, such as an innovation.



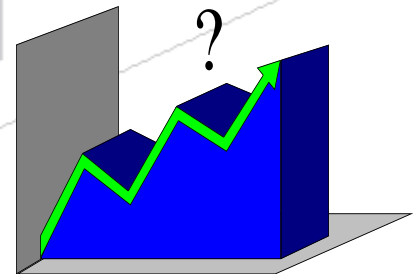
Theories of Business Cycle...

- ▶ **Politically based business cycle....**

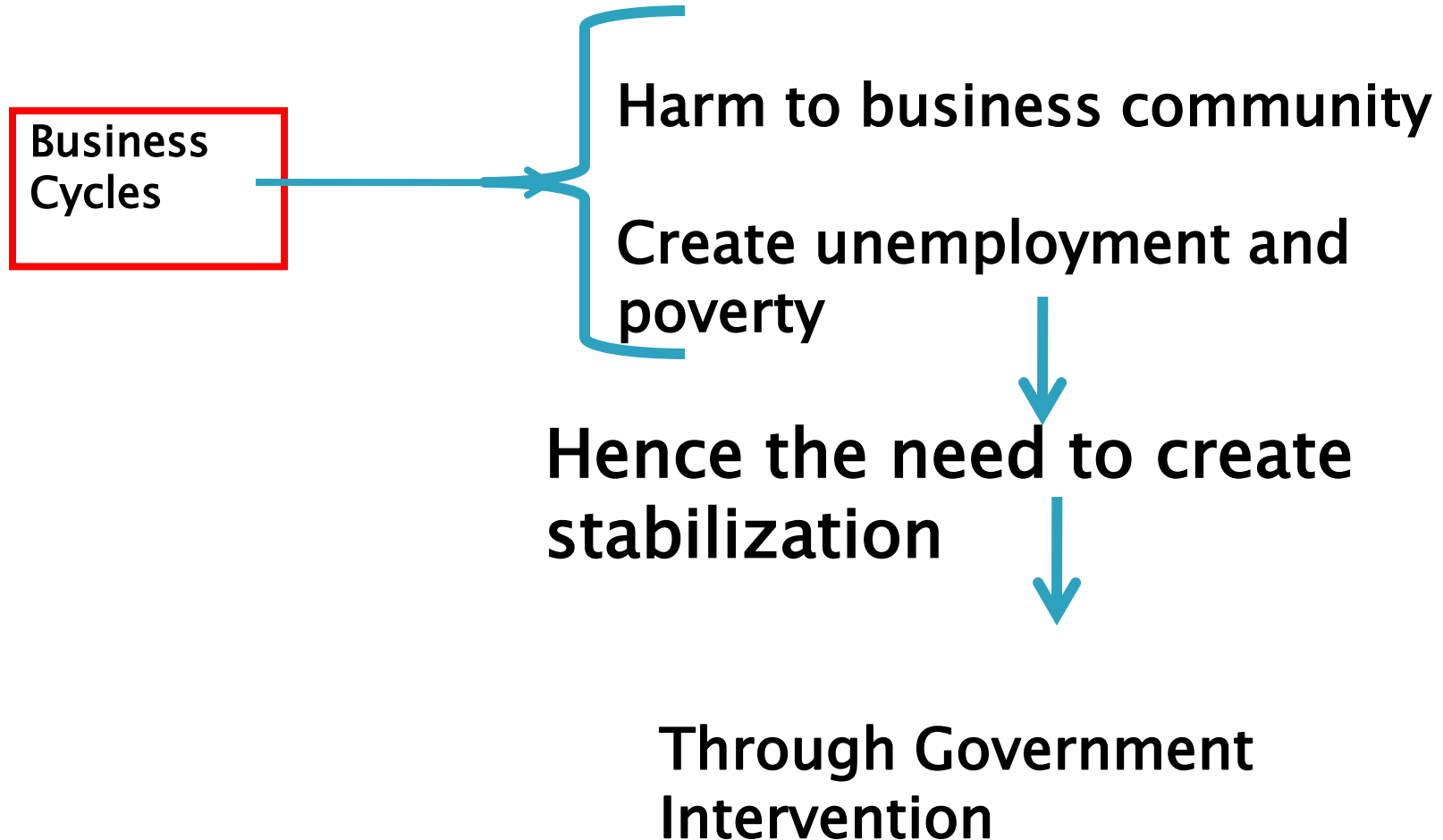
The political business cycle is an alternative theory stating that when an administration of any hue is elected, it initially adopts a contractionary policy to reduce inflation and gain a reputation for economic competence. It then adopts an expansionary policy in the lead up to the next election, hoping to achieve simultaneously low inflation and unemployment on Election Day.

How we measure business cycle ?

- ▶ The business cycle is the periodic but irregular up-and-down movements in economic activity, measured by fluctuations in Real GDP and other macroeconomic variables.



NEED FOR CONTROLLING BUSINESS CYCLES



▶ THANKS