Module 3 Article

What Are Business Cycles?

Key Terms

- **Bubble**: Market phenomenon which occurs when investors hike the price of a specific sector or industry due to extreme excitement and speculation. If a large enough bubble "bursts", it can lead to a recession.
- **Depression**: An extreme version of a recession that lasts at least three years.

The Cycle Of Business Never Ends

Business Cycles are fluctuations in national or global economic activity. They follow a pattern of expansion and contraction. An important concept to note is that the economy and the stock market are not synonymous. They are closely related, yet remain very separate entities. One of the most infamous stages of the business cycle is a recession.

It is a common misconception that a recession is defined as two straight quarters of decline in real GDP. However, a recession is actually defined as a cycle that causes cascading declines in output, employment, income and sales. This then feeds into a further decline in output, which spreads through the different industries in the economy. The key to it being a recession is the domino effect in which one industry is crippled and then quickly others fall because of that one sector's failures.,

When the recessionary cycle reverses it becomes a business cycle recovery. This happens when output increases again, which leads to higher employment, higher wages, and increased sales. The key to a business cycle recovery continuing and causing economic growth is for it to be self-sustainable.

Business Cycles Are Different Than Market Cycles

The business cycle refers to the economy and economic production. For looking at financial markets, market cycles are a more accurate metric as they are based on broad stock price indices. Historically, while business cycles do not directly correlate with the stock market and market cycles, the largest stock downturns are in tandem with business cycle downturns or recessions. The market crash of 1987 which was part of a 35% plunge in the S&P 500 that year did not correlate with an economic downturn.

The Bottom Line

Business cycles consist of upswings and downswings that alternate and create peaks and troughs. These periods of economic change result in output, employment, income and sales growing or contracting in tandem with each other.

A recession, or contraction, starts right at the peak of economic growth when the expansion has ended and it is starting to contract. Market and business cycles are distinct entities that are measured in different ways, but are frequently correlated.