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CA-FOUNDATION

CRASH COURSE MATERIAL

Business Economics

Chapter 5 – Business Cycle

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Economics Chapter 5

Business Cycle

It is also known as Economic cycle or Trade cycle.

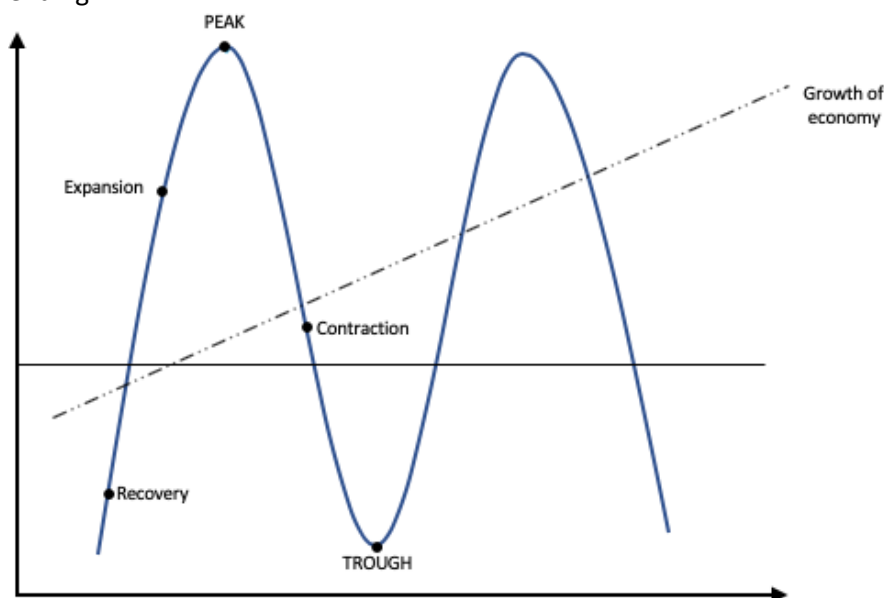
Each and every country has to go through fluctuation in trade cycle, due to which if effects

- | | |
|---------------|----------------------|
| • Output | • Un-Employment |
| • Price level | • Bank Credit |
| • Profit | • Interest Rate |
| • Demand | • Standard of Living |
| • Income | • GDP |

Factors effect by BS

Business Cycle is recurrent & occurs periodically i.e. occurs again & again but not always at regular intervals.

Business Cycle doesn't have specific duration of time, few BC have short ending & few BC have long ending.

Phases of Business Cycle

1. Expansion (Also Called BOOM or UPSWING)
2. Peak or Prosperity
3. Contraction (Also called DOWNSWING or RESESSION)
4. Trough or Depression

Every business cycle starts from TROUGH (lowest point or bottom point of business cycle) and passes through Recovery stage followed by a period of EXPANSION and reached PEAK.

After reaching PEAK position there is a declining phase of Contraction & finally reached TROUGH. Again the Business Cycle continues with similar ups & downs.

EXPANSION PHASE

When there is an expansion of Output, income, employment, price & profit there is also a raise in Standard of leaving.

- High level of Output & trade
- High level of effective demand
- High level of income & Employment
- In-voluntary un-employment is almost Zero

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- Raising interest rate
- Large expansion of bank credit
- Effective utilisation of Capital & Investment
- Overall Business optimisation.

Note:

In this phase an Economy faces **Inflation**.

Due to full employment of resources, the level of production is maximum & there is a raise in GDP.

PEAK

Due to high level of economic activity, it causes a raise in price & profit, there is an Up-swing in an economic activity & economy reaches its Peak position, It is also called as BOOM period.

It is the top level or highest level of business cycle, where a manufacturer will end-up in gaining high profit level, It usually occurs for the short term.

CONTRACTION

The turning point from peak to depression is treated as Contraction/ Recession Phase.

During this phase the economic activity slowdowns, where demand starts falling, the overall production reduces & further investment plans are given up.

- There is a steady decline in output, income, employment & profits.
- It reduces bank credit & Investment opportunities
- Expansion of business stops, stock market falls, business creations will reduce & people starts loosing there job.
- The business man loses confidence & becomes pessimistic (Negative mindset)
- The increase in un-employment causes a sharp decline in income & aggregate demand.

TROUGH / DEPRESSION

When there is a continues decrease of output, income, employment, price & profit there is a fall in standard of living & Depression sets in.

- Fall in volume of output & trade
- Fall in Income & raise in un-employment
- Decline in consumption & demand
- Contraction of Bank credit (financial crisis)
- Interest rates will fall
- Firm shutdowns several production facilities
- Underutilisation of resources & fall in GDP

Aggregate economic activity is at the lowest, Causing a decline in price & profit until the economy reaches its TROUGH(lowest point)

Note :

In this phase an Economy faces **Deflation**.

Due to less interest rate in bank & un-employment, People starts holding liquid money & availability of bank credit decreases.

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RECOVERY/ RIVIVAL

- The turning point from depression to expansion is treated as recovery phase.
- During the period of recovery, there will be expansion & raise in economic activity, demand starts raising, production increases & causes an increase in investment (Business expansion takes place)
- Stock markets are activated
- Business man becomes **optimistic (positive minded)**
- Employment starts increasing and slowly revival emerges into expansion.

Economic Indicators

Business cycle involves periodic fluctuations of economic activity, such as production & employment. Economist uses statistical tools to predict the further performance of business cycle & analyse it, they are called as **Indicators**.

They try to predict the next phase of business cycle.
They are not always accurate.

Types of Indicators

1. **Leading Indicator :**
It is a measurable economic factor that changes before the economy starts to follow a particular change/trend/pattern.
2. **Lagging Indicator:**
It is a measurable economic factor that changes only after the economy starts to follow a particular change/trend/pattern.
3. **Co-incident Indicator:**
It is a measurement that shows the current state of economy, this economic indicator move along with the economy but it does not show which way the economy is heading, but it tells us where we are at present.

Features of Business cycle

1. Occur periodically
2. It has distinct phases
3. It generally originates in Free market economy or Capitalistic economy.
4. Secondary & tertiary sector is more prone to business cycle then Primary sector/Agriculture.
5. It is difficult to predict Business cycle before they occur.
6. It effects to all the economic activities
7. It starts in one nation & effects other nation
8. It effects the well-being of a society

Note :

Business cycle is used in decision making purpose of an organisation like

- Policies creation
- Profit & wealth maximisation
- To take right decision at right time

Businesses whose fortune are closely linked to the rate of economic growth are referred to as "Cyclical business"

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Causes of Business Cycle

A. Internal Cause

- Fluctuation in effective demand
- Fluctuation in Investment
- Change in Government spending's & tax rate
- Money Supply – Inflation & deflation
- Psychological factors of business man – Pessimistic & Optimistic mind set

B. External causes

- War
- Post war re-construction
- Populational growth
- Technological changes
- Natural factors – Drought, famine, earthquake etc.