

Business Cycles

What Is a Business Cycle?

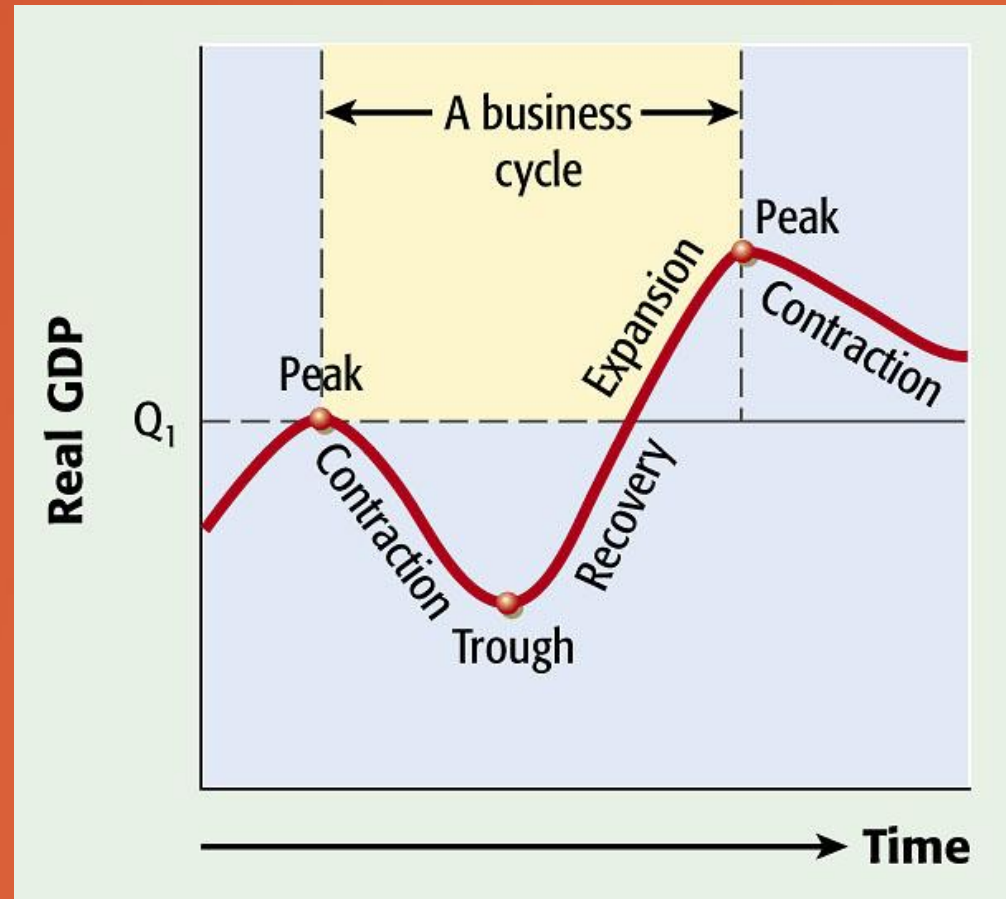
- A **business cycle** includes recurrent swings (up and down) in real GDP of an economy. Economists usually talk about five phases of a business cycle. (See Transparency 12-3.)
 1. *Peak*. At the peak of a business cycle, real GDP is at a temporary high.
 2. *Contraction*. If real GDP decreases, the economy is said to be in contraction. A **recession** occurs when real GDP falls for two consecutive quarters.



TRANSPARENCY 12-3: The Phases of the Business Cycle

Business cycles can be caused by several types of events:

- Changes in money supply
- Changes in business investment, residential construction, and government spending
- Politics
- Innovation
- Dramatic changes to supply



3. *Trough*. The low point in real GDP, just before GDP turns up, is called the trough.
4. *Recovery*. The recovery is the period when real GDP is rising.
5. *Expansion*. The expansion refers to increases in real GDP beyond the recovery.



Forecasting Business Cycles

- Let's compare the economy to your health:
 1. In the first stage, you feel a little sluggish and tired. These feelings are *leading* indicators, letting you know that something may be wrong. In an economy, leading indicators precede economic upturns or downturns.
 2. When you are ill, you might have a bad headache or a stuffed-up nose. These are *coincident* indicators, or indicators that coincide with your illness. In an economy, coincident indicators will accompany economic upturns or downturns.

3. When you are recovering from an illness, you may continue to experience a slight headache or a runny nose. These are *lagging* indicators of your previous condition. The same holds true for members of an economy: they may notice indicators that lag behind economic upturns or downturns.



What Causes the Business Cycle?

- Between 1945 and 2005, the United States went through 10 business cycles. What causes a business cycle?
- One possible reason for business cycles is changes in the money supply. Some economists say that the ups and downs of business cycles are caused by the erratic behavior of the monetary authorities or the Fed.
- Other possible reasons for business cycles are changes in business investment, residential construction, or government spending. A reduction in these fields may result in less income, causing further reduced spending on consumer goods. The cycle will continue, as goods-producing firms must then reduce expenses.

- Some business cycles may be caused by politicians pushing legislation through Congress in the hopes of gaining reelection.
- Major innovations can result in business cycles, as business firms invest resources in hopes of profiting from a new product or technology.
- Business cycles can also result from dramatic changes to supply. A supply disruption caused by hurricane or war can temporarily disrupt business practices.

