BUSINESS ECONOMICS

MODULE – 1

CHAPTER -4

TRADE CYCLE

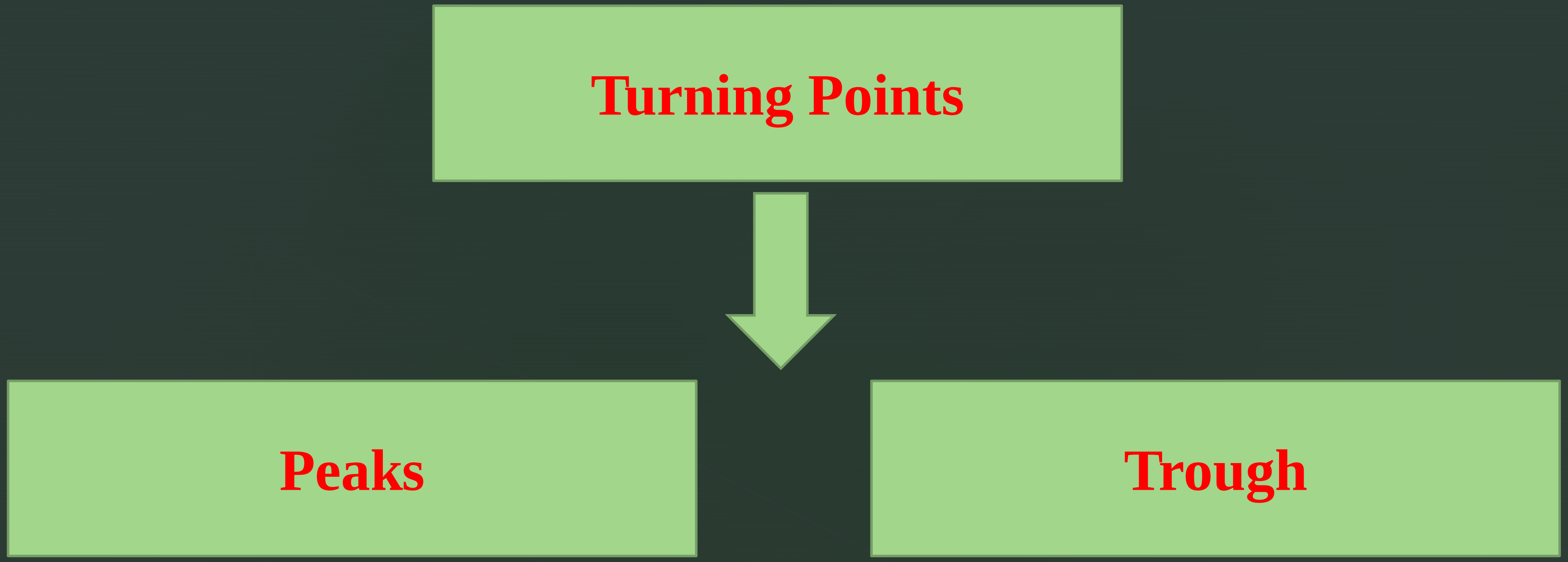
According to Keynes,

"A trade cycle is composed of periods of good trade characterized rising prices and low unemployment percentages, altering with periods of bad trade characterized by falling prices and high unemployment percentages”

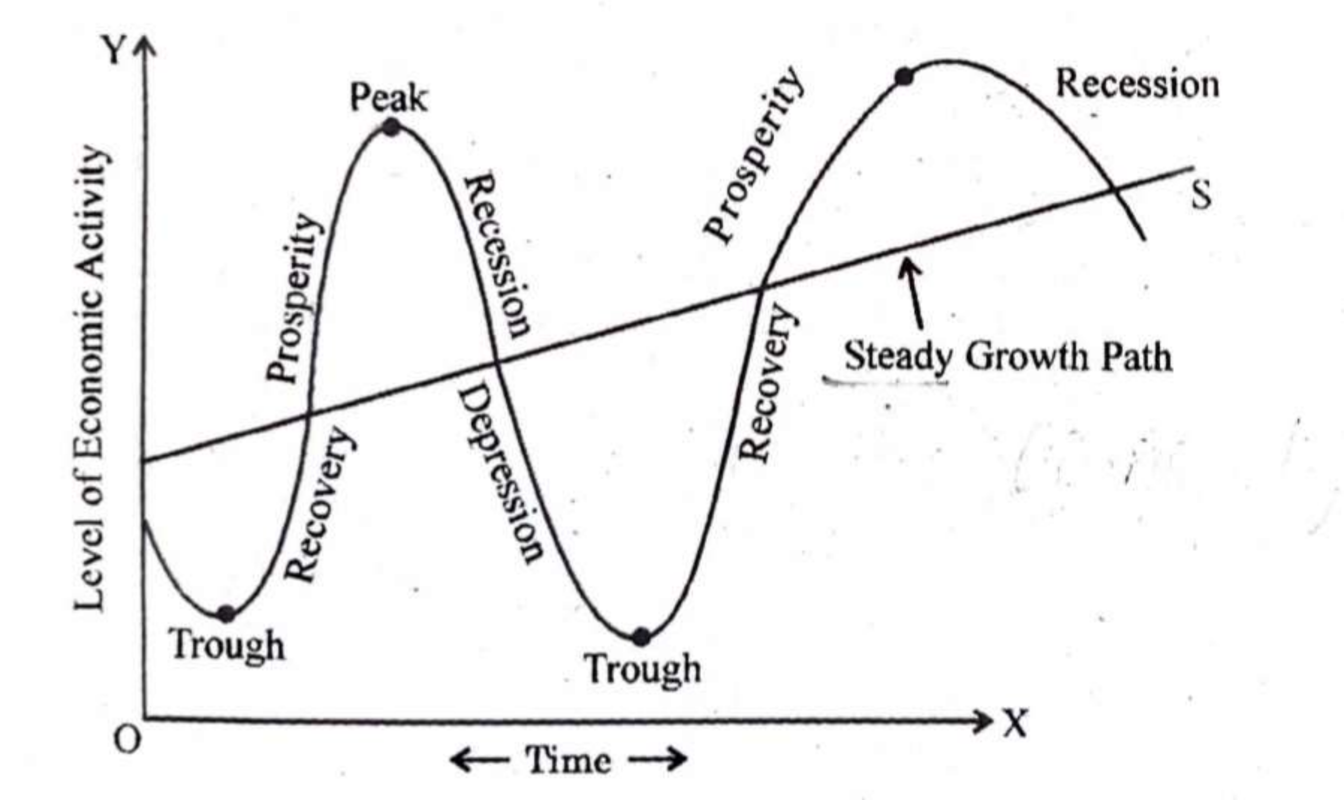
Phases of Trade Cycle

Recession

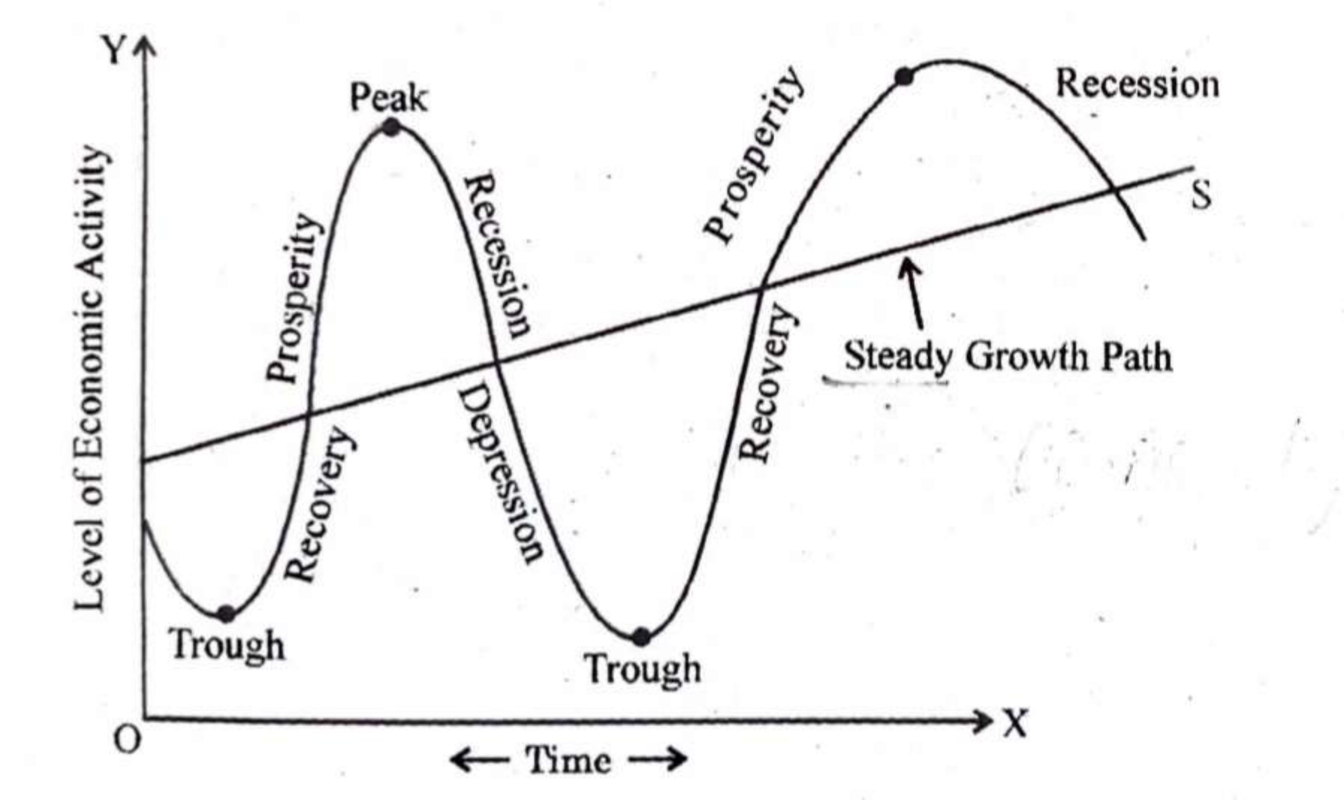
Expansion


Turning Points
Peaks
Trough

Expansion:- It begins at trough and ends at peak. The expansion is a period in which economic activity is rising.

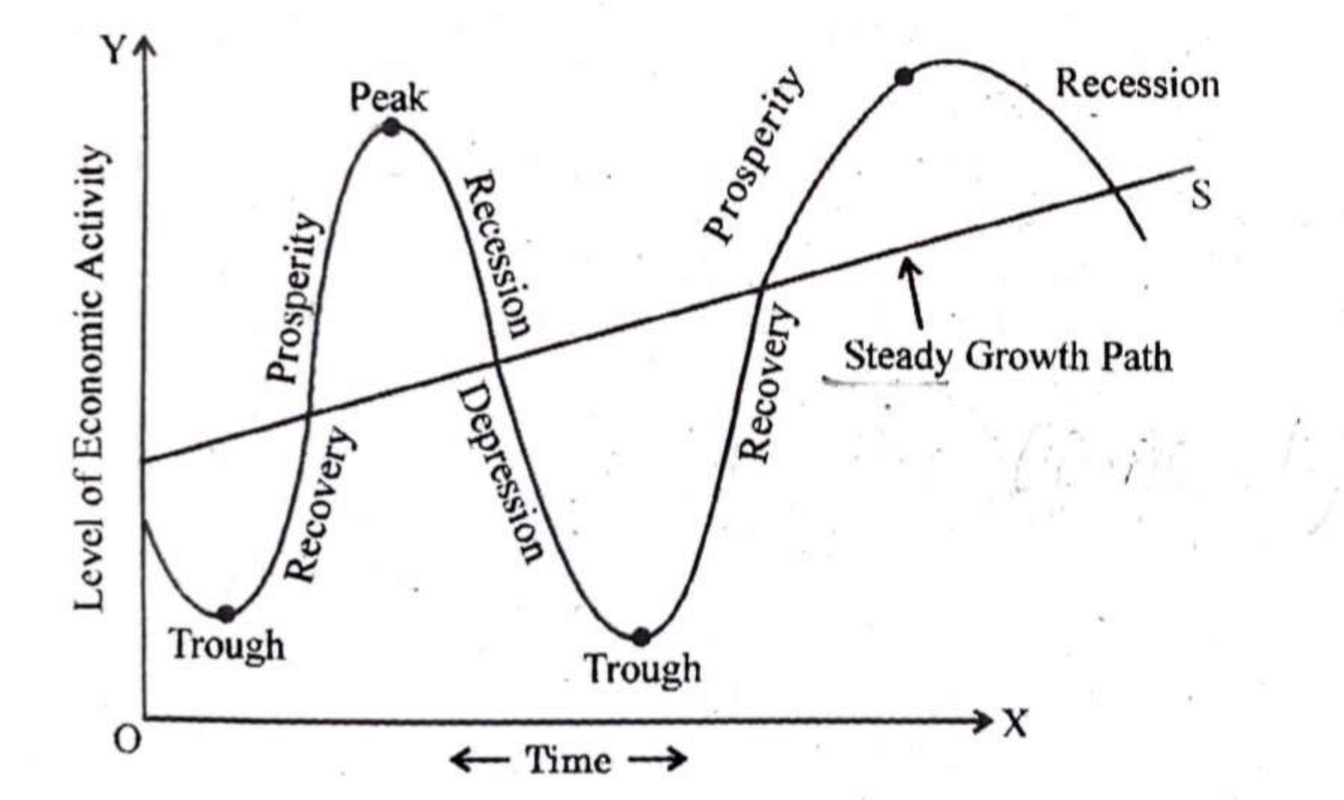


Recession- **The downturn of trade cycle is called contraction. It is period when economic activities are declining. The recession begins at peak and ends at trough.**



The **Trough** is a turning point where economic activity is at **Lowest.**

Peak is upper turning point where the level of economic activity is at its **High.**



Features

1. Fluctuations in Aggregate Economic Activity : Trade cycles are fluctuations in the level of "aggregate economic activity" rather than fluctuations in a single, specific economic variable. It involves changes in many variables such as GDP, employment, investment, profits as well as financial market variables.

Features

2. A) Expansion: Characteristics are (a) Rising Consumption, Production and Real GDP (b) Increase in employment (C) Rise in prices. (d) Rise in profits, demand for credit and stock prices.

B) Contraction: Characteristics are (a) Falling Consumption, production, and Real GDP (b) Increase in Unemployment (C) Fall in prices. (d) Fall in profits, demand for credit and stock prices.

Features

3. Peak: The expansionary process reaches a very high level of production known as the peak. It is a symptom of the end of the prosperity phase and the beginning of the contraction or the recessions.

Features

4. Trough : The trough is the tuning point where the economic activity is at its lowest. The contractionary forces come to a standstill known as trough. It is the end of the contractionary phase. The trough may be short-lived or may continue at the bottom for sometime. The forces at the trough pave the way for the revival of the economy.

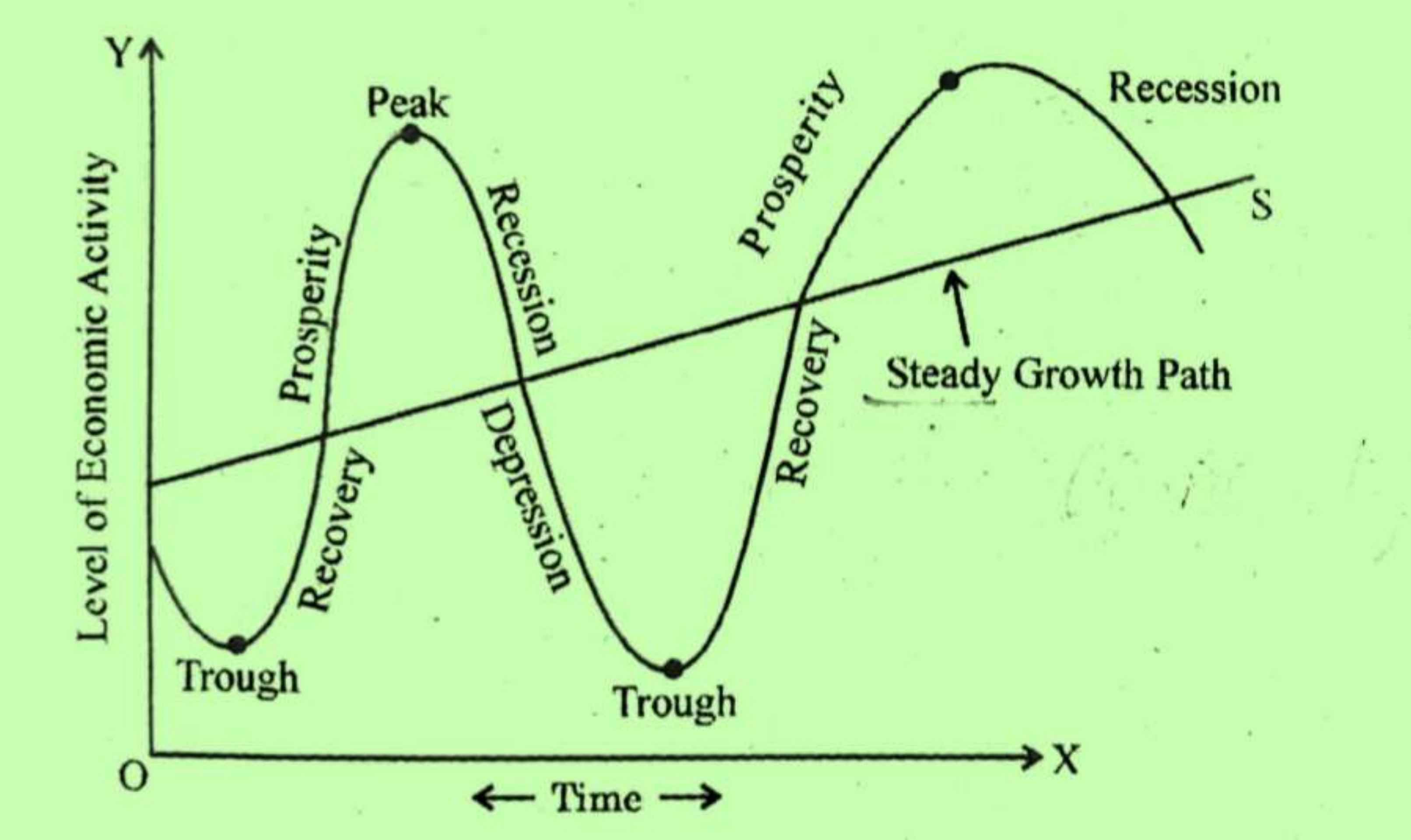
Features

5. Comovement of Variables.• The tendency of many economic variables to move together in a predictable way over the business cycle is called comovement of variables. Many economic variables such as output' employment, prices, investment, profits, stock prices, etc. have regular and predictable patterns Of behaviour over the course of the business cycle. Generally, they tend to fall during recession and rise during expansions.

Features

6) Recurrent but not Periodic : The business cycle is not periodic. It does not occur at regular, predictable intervals and does not last for a fixed or predetermined length of time. Even though the pattern of cycle is irregular, it is recurrent, that is, the standard of pattern of contraction - trough - expansion - peak recurs again and again in industrial

Phases of Trade Cycle



1) Depression
2) Recovery
3) Prosperity
4) Recession

1. Depression

A depression is a period of low economic activity. Growth rate goes below the steady growth. There is considerable reduction in the production, employment, income, investment, demand and price during this phase. Bank deposits and credit shrink due to general decline in economic activity. Investment in stock becomes less profitable and least attractive. Business profits would be low or even negative.

At the depth of depression all economic activities touch the bottom point called trough. The trough may be short lived or it may continue for a long time. But gradually limiting forces are set in motion which tends to bring this to an end.

Sometimes a major depression may last for nearly a decade and in some cases it may last for 3-4 years as The Great Depression of 1929.

How is the process reversed ?

The exact nature of the factors reversing the depression varies from cycle to cycle. Some of the factors are discussed below.

1) The producers may offer jobs to workers anticipating better future. They try to maintain their capital stock.

2) Consumers may start purchasing - postponed consumption items expecting no further decline in prices leading to gradual increase in demand.

3) Banks and private investors start investing in securities and bonds from accumulated excess liquidity so stock prices begin to rise.

4) It should be noted that generally prices of inputs fall faster than that of finished products. Therefore, some profitability always remains there. It increases after the trough. As a result investment and employment increase which in turn increases output, income, demand etc. and the phase of recovery starts.

5) Monetary and fiscal policies also lead to recovery.

Recovery

Various exogenous and/or endogenous factors are responsible for reviving the economy. When the economy enters the phase of recovery, the economy registers upward trend in output, income, employment, etc. But the growth rate may still remain below the steady growth rate .

There may be a replacement of semi-durable goods or capital stock which will lead to increase in the demand. To meet this increased demand investment and employment increase result output and income also start to rise. Once the revival starts, e process becomes cumulative.

It should be noted that in the early stages of the recovery phase, output increases without proportionate increase in the total costs due to excess capacity in the economy. But later costs rise and output becomes less elastic which may result into rise in prices and profits. Business optimism prevails as the recovery gathers momentum, some firms plan additional investment and some undertake renovation programme. This tends to raise the demand for bank credits which leads to credit expansion. When the cumulative expansion of income, expenditure, investment prices etc. exceed the steady rate, the economy enters the phase of prosperity.

Prosperity

Increases in output, employment, investment demand, profits, bank loans, prices, standard of living, etc. are main features of the phase Of prosperity. We can observe the following important features during this phase.

i) Bank credits grow rapidly even though rate of interest is higher. There is a general expansion of credit.

ii) Idle funds are channelized into productive areas since stock prices are higher due to high profitability.

iij) Money supply increases and it continues to flow in all kinds of economic activities.

Excess capacity gradually disappears creating shortage of labour and raw materials.)After the full employment is achieved, a further increase in demand leads to an increase in prices. But factor remuneration like wages, interest rates, rents, taxes etc. do not rise in proportion to the rise in prices so business continues to remain profitable. This increases

.

Excess capacity gradually disappears creating shortage of labour and raw materials.)After the full employment is achieved, a further increase in demand leads to an increase in prices. But factor remuneration like wages, interest rates, rents, taxes etc. do not rise in proportion to the rise in prices so business continues to remain profitable. This increases investment especially of inventories. Demand for bank credit Increases.

In this way, the expansionary process becomes cumulative and the economy reaches the Peak

The peak point is generally characterized by stagnation in demand. This is the period of the highest level of prosperity in which increase in demand is halted. It is the end of prosperity and beginning of the recession. Factors like shortage of inputs, rise in prices, rise in interest rate, stagnant demand etc. lead to fall in profits, fall in investment and piling up of inventories. This is the beginning of the upper turning point and the economy enters into the recessionary phase.

4. Recession

The recession is a period of contraction or slowing down of economic activity. This phase begins when the downward process in the growth rate becomes rapid and output, employment, prices, etc. register a decline. The growth rate may still remain above the steady growth line. Recession is generally of a short duration.

After the peak, in some sections the demand starts declining. The existing production thus becomes excess and investment results into over investment. As a result, future investment plans are given up which leads to fall in demand for inputs. This ultimately causes demand recession.

During this phase, business profits fall. This will lead to fall in share prices. Due to lack of investment opportunities, the demand for bank credit falls This leads to fall in rate of interest. Employment, investment, incomes and demand decline.

Recession may be mild or severe. The severe recession might lead to a sudden crisis arising out of the banking system or the stock exchange. If recession continues for long, investment reduces to a very low level‘. Ultimately this reaches to a period of full depression.

THANK YOU