Business Cycles

TEXT SUMMARY

A **business cycle** is a period of economic expansion followed by a period of contraction. Business cycles are major changes in GDP above or below normal levels. Business cycles have four phases. **Expansion** is a period of economic growth, as measured by a rise in real GDP. The **peak** is the height of expansion, when real GDP stops rising. A **contraction**, marked by falling real GDP, follows the peak. The **trough** is the contraction's lowest point, when real GDP stops falling. A contraction that lasts for at least 6 months is called a **recession**. A **depression** is a long and severe recession.

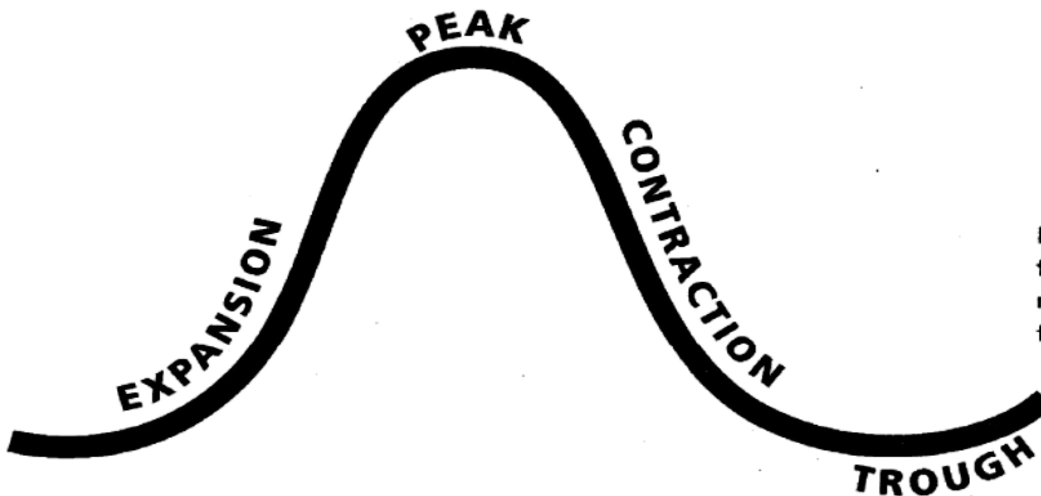
Business cycles are affected by four main factors: business investment, interest rates and credit, consumer expectations, and external shocks that are unexpected. For example, increased business investment usually leads to increased output and jobs, helping to increase GDP and expand the economy. However, a drop in business spending reduces output and income, which may lead to a decline in GDP. Economists study these factors in order to predict the next turn of the business cycle.

Economic activity in the United States has followed a pattern of cycles. The Great Depression, which began in 1929, was the most severe economic downturn. Since then there have been several recessions, including short ones in 1991 and 2001. Following the 2001 recession the economy entered a period of slow and uneven growth.

THE BIG IDEA

Policymakers study business cycles to try t predict the next phase of the economy.

GRAPHIC SUMMARY: *Tracking a Business Cycle*



Business cycles have four phases, which are measured by the rise or fall of the GDP.

Directions: Answer all questions completely.

1) **What are the four phases of a business cycle?**
2) **Explain how business investment may affect the business cycle.**
3) **Using the diagram – What happens after a peak in a business cycle?**

Working of the Business Cycles

-The Business Cycles-
The business cycle, the series of changes in economic activity, has four stages—expansion, peak, contraction, and trough. Expansion is a period of economic growth: GDP increases, unemployment declines, and prices rise. The peak marks the end of an expansion and the beginning of the next stage, the contraction. During the contraction, GDP decreases, unemployment rises, and prices remain steady or fall. When a contraction lasts 6 months or more, it becomes a recession. Although rare, a contraction may be so extreme that it becomes a depression, such as the Great Depression of the 1930s. The trough marks the end of a contraction and the beginning of the next expansion.

4. **When does a contraction become a recession?**

-Factors that Affect Business Cycles-
Four main factors contribute to changes in the business cycle: business decisions; interest rates; consumer expectations; and external issues. When businesses increase production, they increase aggregate supply and help fuel an expansion. When they decrease production, supply decreases and a contraction may result. When interest rates rise, businesses and consumers are less likely to take out loans for purchases, and the economy slows down. When interest rates go down, loans are less expensive, and an economic expansion is more likely. The way consumers feel about the economy affects how much they spend, which is a major component of aggregate demand. Sometimes external issues, such as natural disasters or foreign wars, can affect aggregate supply.

5. **Name the four main factors that affect business cycles.**

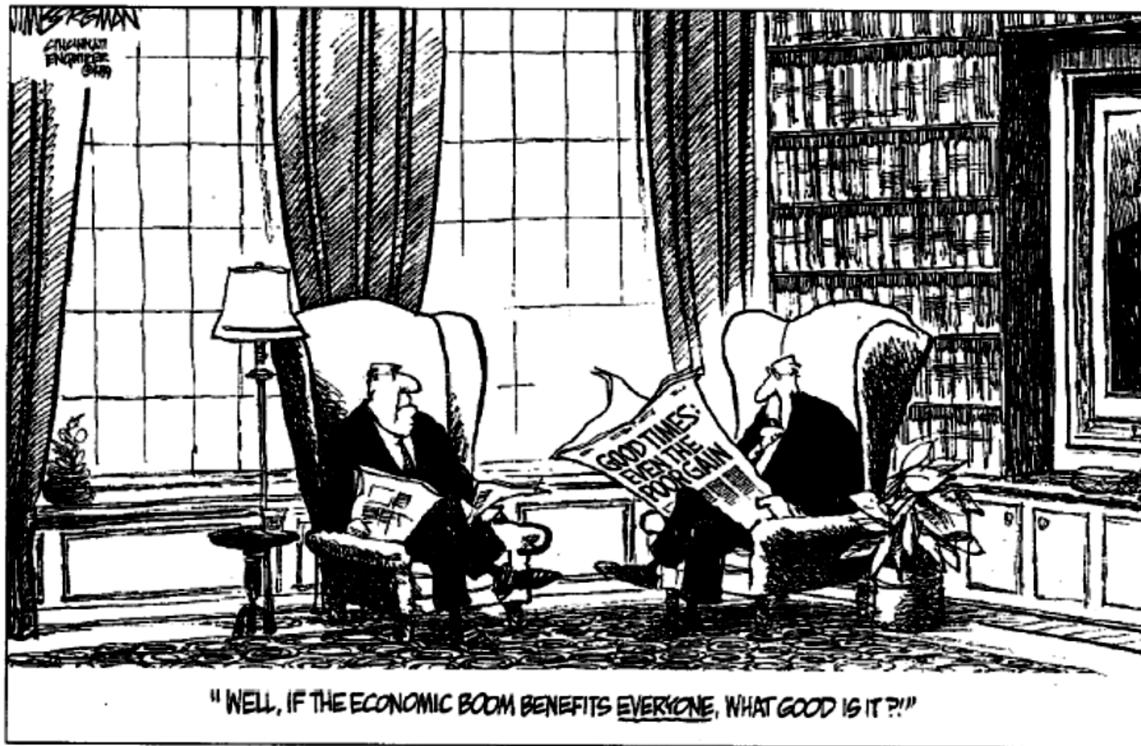
-Predicting Business Cycles-
Economists try to determine changes in business cycles using leading, coincident, and lagging economic indicators. Leading indicators–such as new building permits, orders for consumer and capital goods, and stock prices–usually change before real GDP changes. Coincident indicators–such as employment, sales volume, and personal income–change at the same time as changes in real GDP. Lagging indicators–such as length of unemployment–usually change after real GDP changes.

6. **Which type of economic indicator predicts a change in the business cycle? Explain.**

-Business Cycles in U.S. History-
The National Bureau of Economic Research (NBER) tracks business cycles in the United States. The Great Depression was the worst of about 20 contractions during the 20th century. From 1929 to 1933, real GDP declined by about a third and the unemployment rate more than doubled. President Franklin D. Roosevelt's New Deal programs focused on federal spending to stimulate the economy. When the United States entered World War II, spending on the war effort helped the economy grow. More recent recessions in the United States have been less severe. A contraction in the mid-1970s was caused in part by the 1973 Oil Embargo. Growth in information technology led to a period of strong economic expansion in the 1990s.

7. **What coincident indicator showed that the 1930s was a period of contraction?**

Directions: Study the cartoon and then answer all questions completely.



"WELL, IF THE ECONOMIC BOOM BENEFITS EVERYONE, WHAT GOOD IS IT?!"

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1. **Drawing Inferences** **(a)** What is the economic status of the two men in the picture?

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   (b) How can you tell? ____

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2. **Synthesizing Information** **(a)** At what stage is the business cycle in this cartoon?

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   (b) Is the GDP rising or falling? ____

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3. **Drawing Inferences** Why are the wealthy especially likely to gain during an economic boom?

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4. **Drawing Conclusions** Why are the poor also likely to gain during an economic boom?

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5. **Recognizing Points of View** What does the cartoonist suggest is the attitude of the rich toward the rest of the population? ____

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