

# Business Cycle

Is the economy getting better or worse?

# Micro vs. Macro

- **Microeconomics:** The study of personal, or small finances.
  - Individuals, families or businesses
- **Macroeconomics:** The study of economic systems on a large scale
  - National or Global economies

# Gross Domestic Product

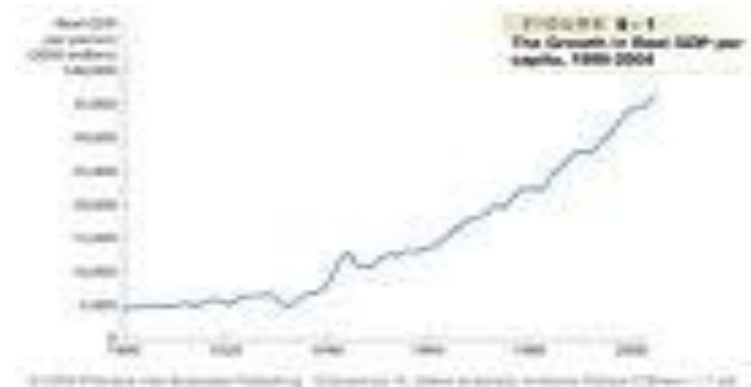
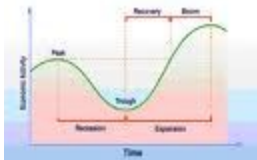
- Def. The total value, in dollars, of all final goods and services produced within the nation each year
- Abbreviated as the **GDP**

# What does the GDP tell us?

- If the GDP is **larger** than last year the economy is **expanding** (getting bigger)
- If the GDP is **smaller**, the economy is **shrinking** (getting smaller)

# Business Cycle

- The Business Cycle allows people to understand the direction the economy (GDP) is going (growing or shrinking) and plan accordingly.
- The economy follows the Business Cycle regularly.



# Phases of the Business Cycle

Expansion (Growing)

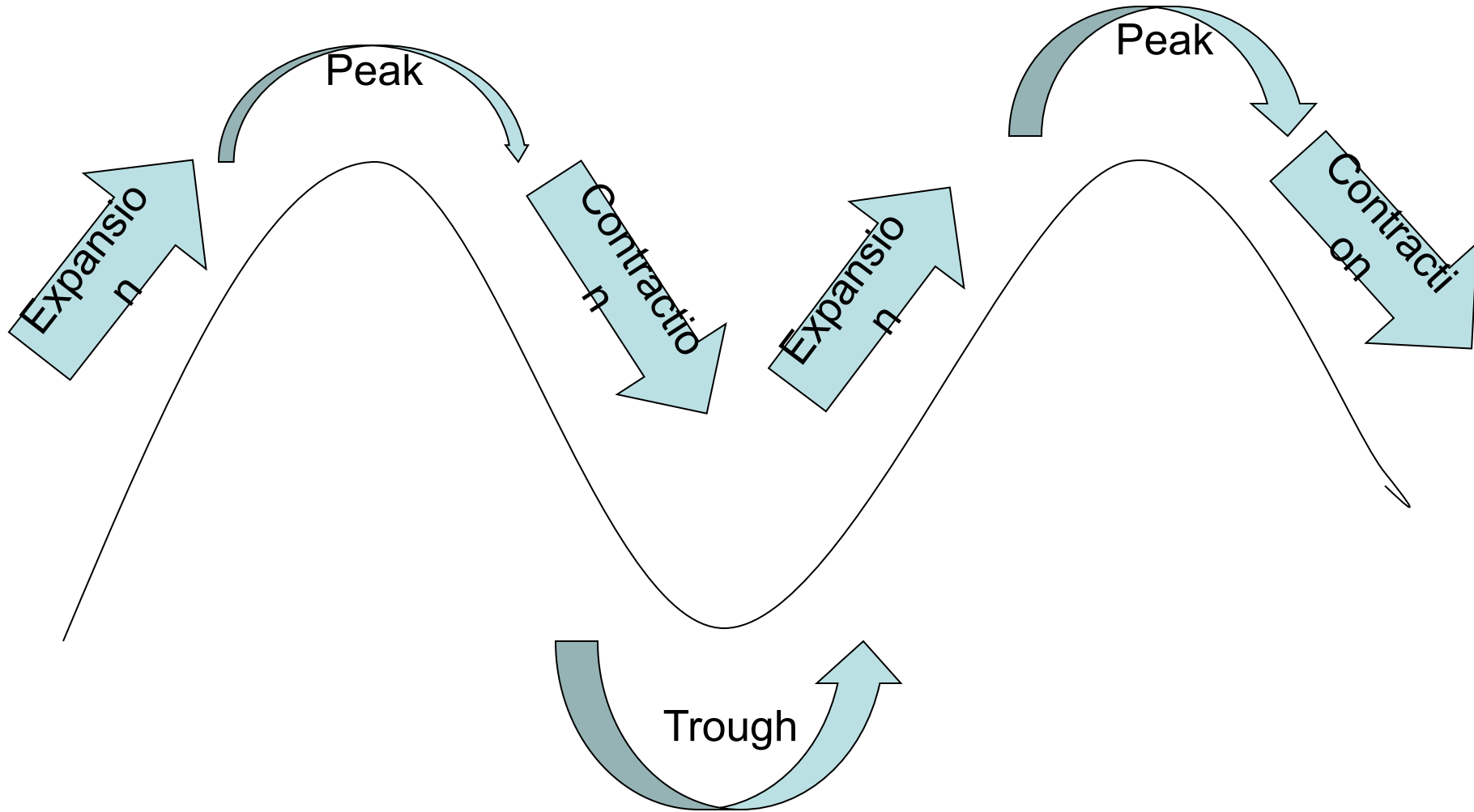
Peak (Top)

Contraction (Shrinking)

Trough (Bottom)



# Business Cycle



# Expansion



- During a period of expansion:
  - Wages increase
  - Low unemployment
  - People are optimistic and spending money
  - High demand for goods
  - Businesses start
  - Easy to get a bank loan
  - Businesses make profits and stock prices increase



# Peak

- When the economic cycle peaks:
  - The economy stops growing (reached the top)
  - GDP reaches maximum
  - Businesses can't produce any more or hire more people
  - Cycle begins to contract

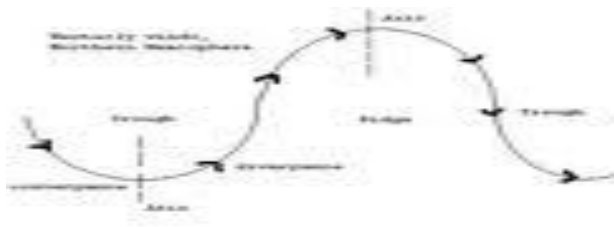




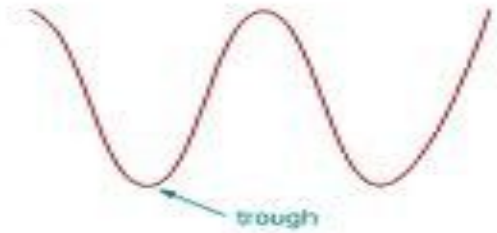
# Contraction



- During a period of contraction:
  - Businesses cut back production and layoff people
  - Unemployment increases
  - Number of jobs decline
  - People are pessimistic (negative) and stop spending money
  - Banks stop lending money



# Trough



- When the economic cycle reaches a trough:
  - Economy “bottoms-out” (reaches lowest point)
  - High unemployment and low spending
  - Stock prices drop

But, when we hit bottom, no where to go but up!

UNLESS.....



# Recession/Depression



- A prolonged contraction is called a recession (contraction for over 6 months)
- A recession of more than one year is called a depression



# What keeps the Business Cycle Going?

- 4 variables cause changes in the Business Cycle:

## 1. Business Investment

When the economy is expanding, sales and profit keep rising, so companies invest in new plants and equipment, creating new jobs and more expansion. In contraction, the opposite is true

# What Keeps the Business Cycle Going?

## 2. Interest Rates and Credit

Low interest rates, companies make new investments, adding jobs. When interest rates climb, investment dries up and less job growth

## 3. Consumer Expectations

Forecasts of an expanding economy fuels more spending, while fear of a recession decreases consumer spending

# What keeps the Business Cycle Going?

## 4. External Shocks

External Shocks, such as disruptions of the oil supply, wars, or natural disasters greatly influence the output of the economy

Ex. 1992-2000 was the longest period of expansion in U.S. history. Early in 2001, signs of contraction appeared, though the Bush administration denied it. The Sept. 11<sup>th</sup> 2001 terrorist attacks quickly caused the business cycle to shift into a contraction.

# Who Cares?????

- Why should you care about the business cycle and economy?
- Lots of reasons!



# “Don’t quit that job!”

- If the economy is going into a contraction, jobs will become more scarce. If you quit, you may not find another job!
- But, if the economy is in a period of expansion, jobs are readily available. It may be a good time to switch careers.

# “Should I make a big purchase?”

- Only if you know that you won't lose your job in a contraction. So, buy your house during an expansion.

HOWEVER,

- When the economy starts to slow down (contraction), interest rates will decrease. Wait to buy a house until the rates drop to a low point, if you are sure you won't lose your job.

# Quick Review!

- What phase of the business cycle do wages go up?
  - Expansion
- What phase of the business cycle do wages go down?
  - Contraction

# Review cont.

- When are wages at their highest?
- Peak
  
- When are wages at their lowest?
- Trough

# More Review

- When will borrowing decrease?
- Contraction
  
- When will borrowing increase?
- Expansion
  
- When will borrowing be at it's lowest?
- Trough

# Even More Review!

- When will unemployment be at its lowest?
- Peak
- When will business profits be the highest?
- Peak
- When should you look for a new job?
- Expansion