

## Lecture 16: The Business Cycle

Irregular ups and downs in growth rate of real GDP

Terms:

Expansion: real GDP is growing

Peak: real GDP reaches its local top

Recession: real GDP is declining

Trough: real GDP reaches its local bottom

Recently, one complete cycle has lasted about 8 to 9 years

Many economic measures follow the business cycle, such as profits, employment, the stock market, interest rates, inflation, bankruptcies, and household net worth. These measures improve during expansions and get worse during recessions.

Recessions have become milder since WW. II

What causes the business cycle - alternative explanations

- 1) "shock" to consumer buying
- 2) over-supply
- 3) rise in a key price
- 4) volatility in investment markets (speculative bubbles)

Why does real gross domestic product periodically decline – that is, why do we periodically have recessions?

- a) *suppliers get ahead of buyers and produce too much* – thus, reduce production and reduce employment until inventories are lowered
- b) *price of some key input* in the economy increases (oil)
- c) *consumers become pessimistic* about the future and reduce purchases – this in turn causes businesses to reduce production and employment
- c) *dramatic changes in laws that reduce profitability or reduce trade* (1986 tax law changes, and increases in tariffs in the early 1930s)