

Business Cycle

Study the chart below, then complete the following exercise.

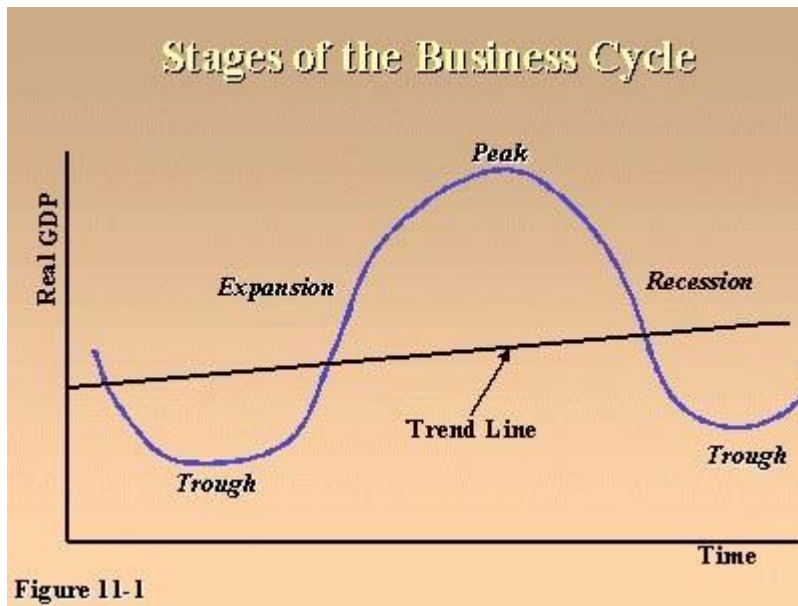


Figure 11-1

business.semo.edu/redmond/CH11a/sld025.htm. Permission pending.

Exercise. Write a brief description, based on what you see in the chart above, of the following phases of the business cycle:

1. **Trough:**
2. **Expansion:**
3. **Peak:**
4. **Recession:**

Business Cycles and Economic Indicators

Exercise. Be prepared to give a one-minute talk describing conditions in the phase of the business cycle you were assigned to study.

	PHASE OF BUSINESS CYCLE			
INDICATOR	Trough	Expansion	Peak	Recession
Interest rates				
Stock prices				
Consumer confidence				
Business profits				
Consumer spending				
Industrial production				
Housing construction				
Business investment				

Causes of Business Cycles

Assume that your VE leadership team was interested in learning more about business cycles, specifically what causes them. You bring in four economists to speak about their ideas about the causes of the business cycle.

VE President: *Ladies and gentlemen, thanks for coming here today. We are interested in learning more about what causes business cycles. Having this knowledge, perhaps we can avoid their most harmful effects. Dr. Talman, will you start, please?*

Dr. Talman: I believe that you, the business leaders of this country, cause business cycles by either investing or not investing in capital goods. Let me explain. Good economic times come about when you people, expecting strong future sales, purchase large amounts of new equipment and machinery or build or expand your plants. These investments lead your businesses to produce more, resulting in a stronger economy. However, after a while you stop spending on capital goods. These cutbacks lead to recessions.

VE Vice President: *Dr. Jonas, do you agree with Dr. Talman?*

Dr. Jonas: I have focused my studies on inventory adjustments. Quite often, your businesses start building inventories at the first sign of an upturn and start cutting back inventories when you think there will be a downturn. It's these readjustments in inventories that lead to recessions and expansions.

VE Treasurer: *We are eager to hear your views on the issue, Dr. Lukas.*

Dr. Lukas: It's the commercial banks and the Federal Reserve that lead to changes in the business cycle. When the Fed lowers interest rates and loans are easy to get, that stimulates the economy. Generally, when the economy really gets going the Fed raises interest rates. This eventually leads to less borrowing and eventually the economy slows down.

VE Secretary: *Finally, Dr. Winters. What's your thinking on the issue?*

Dr. Winters: I think my colleagues have overlooked the effects of external shocks to our economy. By that I mean actions that create sudden problems for the economy, like increases in oil prices or wars. Not all shocks are bad for the economy. For example, the unexpected discovery of huge amounts of a resource like natural gas or oil can lead to an economic boom.

1. Describe one cause of business cycles according to economists in this reading.
2. What are some conclusions about the business cycle that you can draw from listening to this play?
3. Which is the most important cause of the business cycle?
4. Suggest an action that government or business can take to prevent the harmful changes in the business cycle.

Business Cycle

Business cycles are repeated fluctuations in economic activity. Cyclical changes arise from the interaction of many economic factors, including changes in capital investment, monetary or fiscal policy, consumer spending, and events such as war or international crises.

Each phase of the business cycle has certain characteristics. During peak or prosperity, businesses expand and employment is high. Creditors lend money freely; wages, consumer spending, and prices rise.

Contraction begins when production begins to slow some because most people who want a good have already purchased the good. As the business cycle moves downward a recession might occur. During a recession, businesses readjust to reduced demand, unemployment rises, consumer spending and prices fall, and creditors restrict loans. If the recession continues or worsens, it becomes a depression. The lowest point of a depression is called a trough. Eventually, technology, government programs, international developments, or low depression prices cause an increase in demand. As business adjusts and begins to expand again, the cycle moves upward through a recovery or expansion phase – back to peak or prosperity.

Identify the phase of the business cycle described in each statement below.

- _____ 1. Stores continue to place large orders to keep up with growing demand.
- _____ 2. Business surpluses accumulate because consumer demand has fallen off.
- _____ 3. Depression prices lead to increased demand for certain goods and services.
- _____ 4. Consumers begin to cut back on spending for luxuries such as entertainment.
- _____ 5. There is a boom in vacation real estate investments.
- _____ 6. Car dealers lower prices and offer rebates to attract customers.
- _____ 7. A large number of major corporations and banks go out of business.
- _____ 8. New high tech businesses begin hiring many of the unemployed.
- _____ 9. The number of banks loaning money to prospective homeowners reaches an all-time high.
- _____ 10. Stock prices plummet and unemployment is widespread.

Read the case study below, and then on the line next to each time of life, write the letter of the business cycle phase that corresponds with the time. You will use one of the phases twice.

My grandfather has many memories. When he was a child, everyone was singing “Happy Days Are Here Again.” His mother had a fur coat; the family had a new car and a nice house. As a teenager, Grandpa tried to get a job, but the local factories were decreasing production. By the time Grandpa graduated, his family could not pay the mortgage on its house and had to move in with friends. There were no jobs for my grandfather or for anyone else. Later, when Grandpa was married, the economy was improving; he found a part-time job. After Mom was born, Grandpa got a good full-time job, and he was able to buy his first car.

Time of Life: Phase of Business Cycle:

- | | |
|---------------------|-----------------------|
| _____ childhood | a. recovery |
| _____ teenager | b. depression |
| _____ graduate | c. peak or prosperity |
| _____ newly married | d. recession |
| _____ parent | |

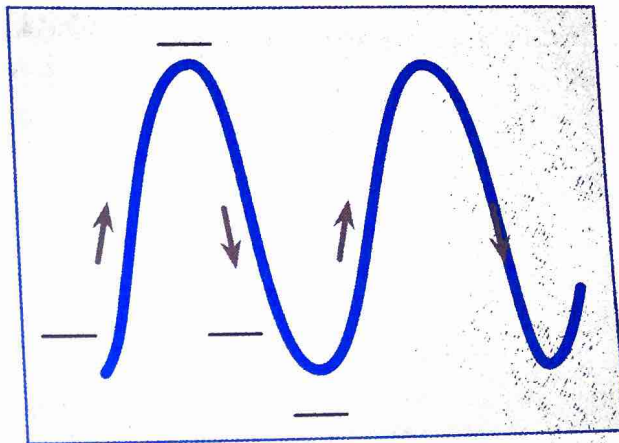
III. Ups and Downs

➔ Find Out

A. Read each description. Label the business cycle graph with the number of the scenario that describes an expansion, a peak, a contraction, or a trough.

1. Unemployment is high, interest rates are high, and many businesses are not investing, but real GDP is no longer falling.
2. Business production is down and unemployment is rising. Real GDP has been falling in recent months.
3. Unemployment has been dropping and businesses are doing well. Real GDP is experiencing a long-term increase.
4. Business is doing well and unemployment is low, but real GDP is no longer rising.

Business Cycle



👤 What Do You Think?

B. Do you think consumer confidence plays a major role or a minor one in the business cycle? Explain.

C. At the beginning of the Great Depression, how might President Herbert Hoover have changed his actions if information from the Conference Board had been available to him?

D. Suppose that the leading economic indicators, such as stock prices and interest rates, all show positive news about the national economy. However, you have been looking for a summer job for over a month without any luck. What do you think are the possible economic reasons that might explain your lack of success?
