MACROECONOMICS	PAPER I

TOPIC 4

Business cycles

Reasons for business cycles: explanation and illustration of their composition and noting their impact on the economically vulnerable.

2 weeks to cover content			
Week 7		**Week 8**	

Learners should cover the following:

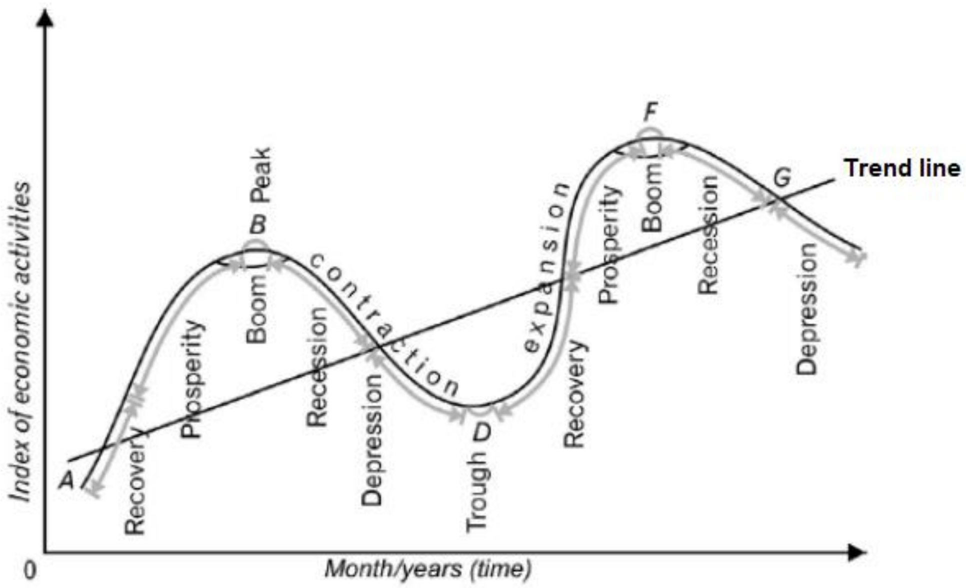
• The phenomenon: - indicators - South African business cycles	• Time series and Composition: - cyclical patterns - measuring business cycles	• Reasons - exogenous reasons - endogenous reasons	• Effects: - changes in aggregate supply and aggregate demand - changes in economic growth - changes in employment - changes in price levels - changes in exchange rates - impact on the economically vulnerable

Learners must first give an description of the following words in their notebook: **Vocabulary List**	

Definition of Business cycles

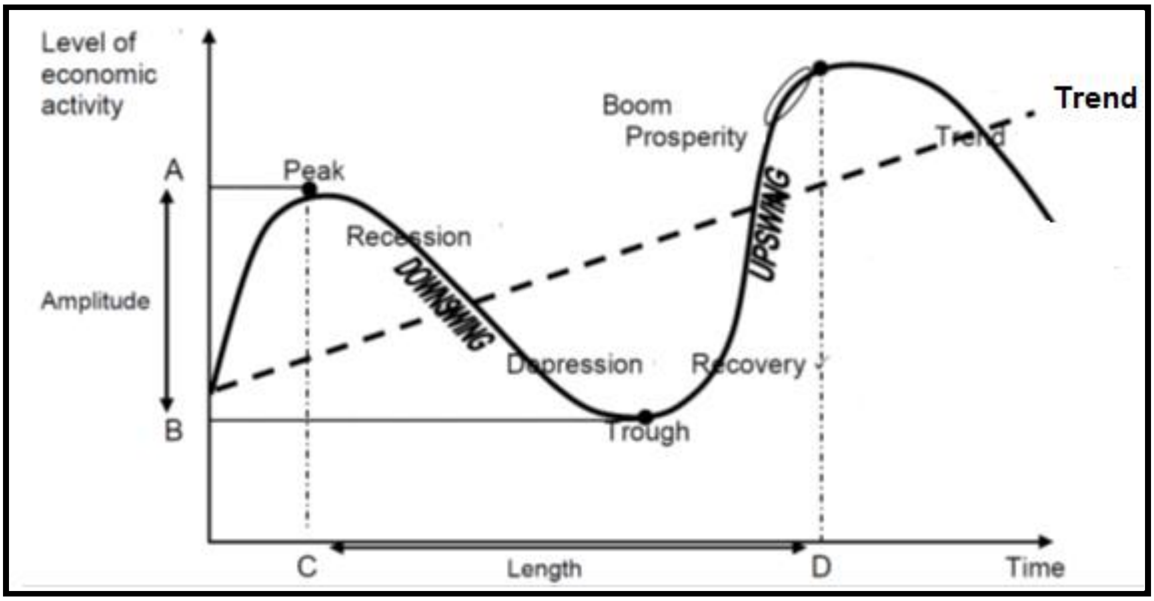
Business cycles refer to the phenomenon of successive periods of increasing and decreasing economic activity.

Composition of Business cycles



- Economic activity show the upward (**Recovery / Prosperity)** and downward **(Recession / Depression)** in the economy.
- A period where there is a general increase in economic activity is known as **UPSWING.**
- A period of general decline in the economic activity is called a **DOWNSWING.**
- The business cycle oscillates between the upper **(Peak)** and lower **(Trough)** turning points.
- The length of the business cycle is measured from **peak to peak** or from **trough to trough**.
- The entire period from the **peak to the trough** is known as the Downswing.
- The entire period from the **trough to the peak** is known as the Upswing.
- The period immediately before and through the upper turning point of the cycle is called the **BOOM.**
- The period immediately before and through the lower turning point is known as the **SLUMP**.
- The **trend line** shows the general direction of the economy. An upward trend line indicates that the economy is growing (economic growth).

Phases of the Business cycle



Period of Recovery

- Recovery is the period of renewed economic growth.
- During a recovery, more jobs are created, production increases and consumer spending increase.
- Business confidence rises and there is increased spending by firms.
- There is increased economic activity and the country enters into a period of prosperity.

Period of Prosperity

- There is a great degree of optimism in the economy.
- Entrepreneurs borrow more money to buy machines and equipment (Investment).
- Employment levels rise, salaries and wages rise and consumer spending increases.
- A peak is reached.
- There is a larger amount of money in circulation and this leads to an inflationary situation in the economy and this conditions lead to a recession.

Period of Recession

- A recession phase is when there is negative economic growth rate for two consecutive quarters.
- During a recession, jobs are being lost and there is a feeling of pessimism.
- Employment levels drop, and there is a decrease in economic activity and the economy slows down.

Period of Depression

- During a depression money is in short supply, leading to a further decline in spending.
- There is a negative impact on investment spending.
- When economic activity is at its lowest, a trough is reached.
- There is competition for jobs and the cost of production decreases.
- This encourages foreign trade and leads to a recovery.

Reasons for Business cycles	
Exogenous Reasons	Endogenous Reasons

Exogenous factors

- Factors that originate from outside the economic system and act as trigger mechanisms for contractions and expansion, e.g.:
- Weather (natural disasters) conditions, changes in weather conditions affect agricultural production and this has a major influence on the economy.
- Political shocks and technology shocks cause changes in productivity that causes business cycles.
- Structural changes cause economic resources to become unneeded in one sector and moves to another sector.
- Money supply refers to government either increasing or decreasing the money supply which alters equilibrium in the markets.

Endogenous factors

- They are factors that are part of the economic system.
- The expansion phase also contains mechanisms that eventually cause a contraction of economic activity.
- As the level of economic activity increase total spending in the economy increases as well.
- This causes an increase in imports which negatively affects the balance of payments and leads to a depreciation of the exchange rate.
- Increase in interest rates due to increased borrowing (negative effect on the economy).
- Positive perceptions of the economy will lead to an increase in spending and vice versa.

Indicators		
Leading Indicators	Coincidental Indicators	Lagging Indicators

Leading indicators

- Leading indicators change direction before the economy changes.
- Leading indicators predict what is going to happen in the following months in the economy.
- E.g. share prices, sale of new motor vehicles, the number of jobs advertise in the news papers.

Coincidental Indicators

- Co-incident indicators change direction the same time as the economy.
- They indicate the actual state of the economy.
- Examples: the number of people registered as unemployed, value of retail sales and real GDP.

Lagging Indicators

- Lagging indicators changes direction after the economy as a whole changed direction.
- They reach the turning point a few months after the actual economy has turned.
- They help to confirm how the economy has changed.
- Example: Employment rate in non-agricultural sector, Hours work in construction, etc.

Effects of business cycles

1. Changes in Aggregate demand and Aggregate Supply

Aggregate demand (AD)

- Aggregate Demand (AD) is the total spending on goods and services by households, businesses, government and the foreign sector in the economy.

Aggregate supply (AS)

- Aggregate Supply (AS) is the total quantity of goods and services supplied at every price level.

Expansion phase

AD: The economy speedup and the consumers spend more money on goods and services.
AS: Businesses increase the production of goods and services.

Contracting phase

AD: The economy slow down and there is a decrease in the spending by consumers on goods and services.
AS: Businesses decrease the production of goods and services.

2. Changes in Economic growth

- Economic growth is an increase in the total production of goods and services in an economy over a period of time.
- It is a change in the real GDP on the economy.

Expansion

- There is an increase in the production of goods and services in the economy.
- Real GDP in the economy increase which indicates that the economy is operating efficiently.

Contraction

- Businesses reduce their production of goods and services in the economy.
- Real GDP decreases.
- Production will drop to its lowest point during the trough.

3. Changes in employment

Employment is the use of labour with the view on earning an income.

Expansion
Business enterprise hires more employees to produce more goods and services. They also initiate new construction projects which, in turn, cause an economy's unemployment rate to decrease and the employment rate to increase.

Contraction
Businesses produce fewer goods and services and that is why they reduce the number of workers on their payroll.

4. Changes in Price levels

Price levels refer to any price of a given good or service in an economy.

Expansion
Total consumer spending increase but businesses cannot increase their production levels immediately to satisfy the demand of consumers. To prevent shortages to occur businesses increase their prices of goods and services.

Contraction
Total consumer spending decrease and business reduce their prices of goods and services to attract more consumers to come and buy.

5. Changes in exchange rates

Expansion

- There is a high demand for goods and services which cause an increase in imports.
- The domestic goods are more expensive and imported goods are relatively cheaper.
- There is an increase in the demand for the dollar.
- The value of our currency (Rand) weaken – (depreciate)
- The depreciation of the currency causes exports to become cheaper and Imports to become more expensive.
- Imports from other countries decrease and exports to other countries Increase.

Contraction

- There is a decrease in imports and an increase in exports of goods and services.
- The reason being that domestic goods and services are cheaper than foreign goods and services.
- There is a decrease in the demand for the Dollar.
- The value of the currency (Rand) strengthens – (Appreciates).
- The appreciation of the currency (Rand) causes imports to become cheaper and exports to become more expensive. Imports tend to increase and exports tend to decrease.

6. Impact on the economically vulnerable

It is people who have very little power to protect themselves against dangers in terms of their economic wellbeing, e.g. children, women, disabled, poor, elderly and rural people.

Expansion

- People have more discretionary money available to spend on goods and services.
- Government earn more revenue in the form of taxation.
- There government collect enough money to provide in the basic needs of people in the form of social grants.
- There are more job opportunities available and economically vulnerable people can find work to support their families.

Contraction

- Poor people struggle to find work and families struggle to survive.
- People will have less discretionary income available to purchase the goods and services that businesses produce.
- Government's tax revenue decreases.
- Government expenditure on services is cut due to economically difficulty times.
- Social grants may also be cut if government struggle to collect enough tax money.