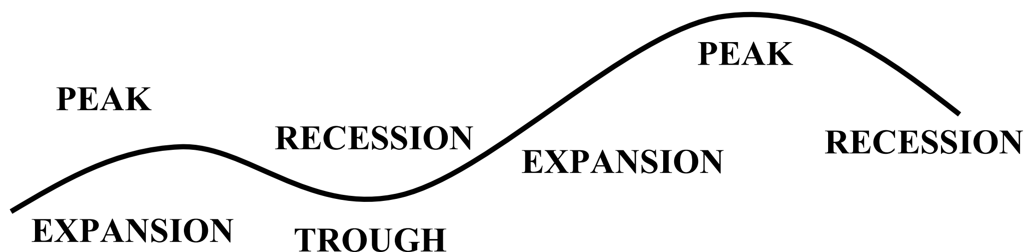
1.21. BUSINESS CYCLES

Ups and **downs** in an economy are called ***BUSINESS CYCLES***. Times of **prosperity** are above the mid-line, while difficult economic times are below.

These changes can be described by ***PEAKS***, ***RECESSIONS***, ***TROUGHS***, and ***EXPANSIONS***.



At the ***PEAK***, the economy is **booming**. Business is normally producing at or near capacity, and those looking for work can generally find jobs. Business investment and **consumer spending** are at a very high levels. But because the economy is at or near full employment and the demand for goods and services is increasing, prices are also increasing.

RECESSION is defined as two quarters (6 months) of declining real **GDP**.

After a period of "peak" business activity, consumers and businesses begin to reduce their spending levels. Businesses may **lay off** workers, reduce their purchases of raw materials, and reduce production because they have built up **excess inventories**.

TROUGH is a period of recession when the economy reaches the lowest point of a business cycle. Businesses operate at less than capacity and unemployment reaches high levels; **total output** of goods and services continues to **decline**. Jobs are difficult to find, and many businesses fail.

After some time the economy begins to **recover**. It enters the **EXPANSION** phase of the business cycle. Business and consumer spending begin to increase. Unemployment declines as additional workers are hired. This leads to higher levels of consumer spending and further expansion of employment, output, and **consumption**. Soon the cycle reaches a peak once again.

WHAT CAUSES BUSINESS CYCLES?

To explain business cycle **fluctuations**, economists often distinguish between ***EXTERNAL FACTORS*** (inventions and innovations, wars international trade agreements and other significant political and social events) and ***INTERNAL FACTORS*** (consumption, business investment, and government activity).