

# Business Cycle

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## Concept of Business Cycle:

The concept of the business cycle refers to the natural rise and fall of economic activity that an economy experiences over time, typically measured by fluctuations in real GDP and other key indicators like employment, income, and output.

The business cycle is a fundamental principle in economics that describes the natural fluctuations in economic activity that an economy experiences over a period of time. This concept is central to understanding how economies grow, contract, and recover in a repetitive pattern.

### Definition

The business cycle describes recurring phases of expansion (growth) and contraction (decline) in aggregate economic activity. These cycles are observed in all economies and are marked by broad changes in output, employment, incomes, and consumer demand.

The business cycle is the pattern of economic growth and decline experienced by all economies over time, divided into four main phases: expansion, peak, contraction, and trough.

The business cycle, also known as the economic cycle, refers to the periodic expansion and contraction of economic activity measured in terms of gross domestic product (GDP), employment levels, industrial production, consumer spending, and other economic indicators. It represents the rise and falls of economic growth and is a normal part of economic life in market economies. The business cycle is not regular in its timing or magnitude but generally follows a sequence of stages that repeat over time.

### Phases of the Business Cycle:

The business cycle is typically divided into four main phases, expansion, peak, contraction (Recession), and Trough each signifying a different stage of economic activity:

1. **Expansion (Recovery and Growth):** During the expansion phase, the economy grows as businesses increase production, employment rises, incomes go up, consumer confidence improves, and spending expands. This is a time of economic optimism, higher investment, and rising demand for goods and services. The expansion continues until the economy reaches its capacity limits. Thus in this stage the economy grows—output, employment, and income rise. Consumer confidence is strong, businesses invest, and people spend more. For example, between 2009 and 2019, the US economy experienced an expansion phase after the global financial crisis, resulting in job growth and new businesses.
2. **Peak:** Peak is the point where economic activity is at its highest. The peak is the turning point where economic growth reaches its highest level before starting to decline. At this stage, resources such as labour and capital are fully utilized, inflationary pressures may build, and businesses might face rising costs. The economy is at or near full capacity. Output and employment reach maximum levels, but inflation may also rise. An example is the US economy at the end of the 1990s tech boom, just before the 2001 recession.

3. **Contraction (Recession):** The contraction, or recession phase, occurs when economic activity declines. Businesses reduce production, unemployment rises, incomes fall, and consumer spending decreases. Recession periods may shorten or extend depending on the causes and responses by governments and central banks. Severe or prolonged contractions are sometimes known as depressions. Economic growth slows. Output decreases, unemployment rises, and spending falls. The 2008 global financial crisis is a clear example, where markets slowed, companies laid off workers, and consumer spending dropped.
4. **Trough:** The lowest economic point in the cycle. Demand, production, and employment bottom out. After hitting the trough, recovery and new expansion begin as opportunities for growth emerge and businesses start to reinvest—like in 2009, when the US economy began recovering from recession. The economic trough occurred globally around mid-2020 during the COVID-19 pandemic when many countries faced shutdowns, followed by gradual reopening and recovery efforts.

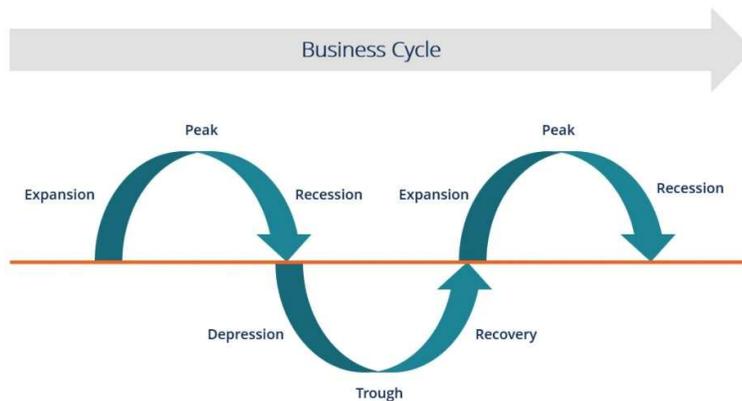


Fig 1: Business Cycle

### Characteristics of Business Cycles:

1. **Recurrent but irregular:** Business cycles occur repeatedly but do not follow a fixed schedule. The length and intensity of cycles vary.
2. **Measured by economic indicators:** GDP, unemployment rate, industrial output, consumer spending, and inflation rates provide data to identify cycle phases.
3. **Influenced by external factors:** Technological changes, political events, monetary and fiscal policy, and global economic developments can impact cycle dynamics.
4. **Affect all economic agents:** Businesses, consumers, investors, and governments experience the effects of each phase, impacting decisions and behavior.

### Causes of Business Cycles

Business cycles result from complex interactions between supply and demand, monetary and fiscal policies, external shocks, and psychological factors affecting consumer and investor confidence. Some common causes include:

- **Demand shocks:** Sudden changes in consumer or government spending can trigger expansions or contractions.

- **Supply shocks:** Changes in production costs or availability of raw materials impact economic output.
- **Monetary policy:** Central banks' interest rate adjustments influence borrowing, spending, and investment.
- **Technological innovations:** Advances can stimulate growth and productivity but may also disrupt industries.
- **External events:** Wars, pandemics, or international trade disruptions often cause economic volatility.

### Recent Business Cycle Phases in India

#### 1. Expansion (2014–2019)

- Following reforms like GST introduction and demonetization adjustments, India experienced a strong expansion phase.
- GDP growth averaged around 7% before slowing in late 2018–2019.
- Sectors like IT, manufacturing, and services grew steadily, employment increased, and consumer demand was robust.

#### 2. Contraction (2020 COVID-19 Impact)

- The COVID-19 pandemic triggered a sharp contraction phase.
- India's GDP shrank by about 6.6% in FY2020–21, the worst contraction in decades due to lockdowns and disrupted economic activity.
- Unemployment spiked as businesses closed and demand plummeted across sectors like travel, hospitality, retail, and manufacturing.

#### 3. Recovery and Early Expansion (2021–2025)

- The economy rebounded strongly post-pandemic with growth rates returning to 7–8% annually in 2022 and 2023.
- Government stimulus, vaccination drives, and pent-up consumer demand fuelled recovery.
- Manufacturing showed early signs of expansion, and sectors like financial services and technology attracted investment.

### Sectoral Business Cycles

Some sectors follow their own distinct cycles:

1. **Banking and financial services:** Currently in an expansion recovering from a long previous phase of stress on NPAs and credit growth.
2. **Automobiles and capital goods:** Influenced by consumer demand and interest rates, showing signs of early recovery and growth.
3. **Metals and mining:** Benefits from commodity price cycles and government policies promoting domestic production.

India's business cycle reflects a blend of global influences and domestic policy impacts, shifting from monsoon dependency pre-1991 to a more complex, market-driven growth dynamic today. Recent

cycles have been shaped by major crises like the 2008 financial crisis and COVID-19, followed by phases of recovery and government stimulus-driven expansion. This ongoing cycle means businesses, investors, and policymakers must remain adaptive to changing economic conditions in India.

Thus, the business cycle highlights how economies are dynamic, affected by both internal factors (like investment and confidence) and external shocks (such as technological changes or global events). Expansion: Characterized by increasing output, rising employment, higher income, and greater demand for goods and services. Peak: The point at which economic growth reaches its highest rate before slowing down; resources are fully employed and prices often rise. Contraction (Recession): Economic activity declines, output falls, unemployment rises, and demand weakens. If severe, it may become a depression. Trough: The lowest point of economic decline, after which recovery and a new expansion begin.

**Characteristics:**

1. Business cycles are not perfectly regular or predictable but are a key aspect of market economies.
2. They impact decision-making for businesses, policymakers, and investors as they influence profits, investment, and employment levels.
3. The duration and intensity of each phase can vary, typically ranging from one year to over a decade.

The main indicator for business cycles is real GDP, but factors like employment, sales, and industrial production are also significant.

Thus, the business cycle provides a framework to understand the dynamic nature of economic activity and helps guide strategic planning and policy decisions.

The business cycle is an unavoidable and natural part of economic life that involves periods of growth and decline. By comprehending its phases, causes, and effects, students gain a comprehensive understanding of how economies work over time. This knowledge enables them to anticipate changes, make better financial decisions, and appreciate the role of policies in stabilizing economies. Learning about the business cycle creates a foundation for better economic literacy and responsible citizenship.