

The Business Cycle

As we have discussed, to measure fluctuations in economic output, also known as short-run economic growth, we measure increases and decreases in the quantity of goods and services produced in the economy from one year to year, or quarter to quarter. Gross domestic product is commonly used to measure this growth. GDP is the dollar value of all final goods and services produced in the economy during a stated period, and real GDP is adjusted for changes in the price of goods.

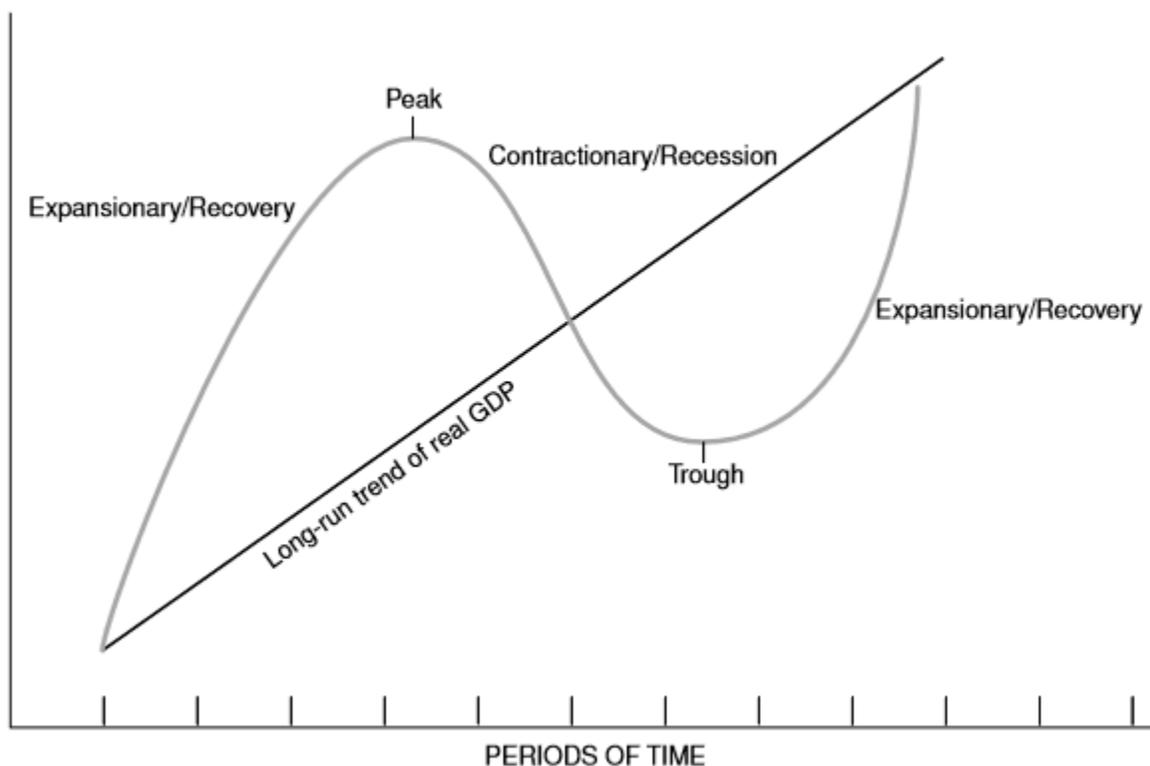
The **business cycle** refers to the ups and downs, or fluctuations, in an economy, as measured by fluctuations in real GDP and other macroeconomic variables. To put it simply, the business cycle is defined as the real fluctuations in economic activity and GDP over a period of time, or in the long-run.

The fact that the economy experiences these ups-and-downs in activity should be no surprise. In fact, all modern industrial economies like that of the United States endure considerable swings in economic activity over time. The ups may be marked by indicators like high growth and low unemployment while the downs are generally defined by low or stagnant growth and high unemployment.

The business cycle can conveniently be divided into four phases:

1. **Expansionary** or recovery phase. Real output in the economy is increasing and the unemployment rate is declining. As the economic expansion continues, inflation may begin to accelerate, interest rates increase, and credit increases. Production, trade, and investment are also increasing as well. Usually, the early part of the expansionary phase is also called recovery.
2. **Peak**. Real output (GDP) is at its highest point of the business cycle.
3. **Contractionary** or recession phase. Real output in the economy is decreasing, and the unemployment rate is rising. As the economic contraction continues, wages and incomes may decrease, prices may decrease (deflation), interest rates and credit may decrease. Production, trade, and investment are also decreasing. If the contraction continues for two consecutive quarters or longer (6 months), it is known as a *recession*.
4. **Trough**. The lowest point of real GDP reached during the business cycle is known as the trough. Troughs can be for varying amounts of time.

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Historic Business Cycles

Answer the following questions using the information from this handout and the business cycle dates/information that can be found at <http://www.nber.org/> (go to the link “Data” and then “Business Cycle Dates”).

1. What is a **peak**?
2. During what month and year did the first recorded peak of a business cycle occur in the US?
3. During what month and year did the most recent peak of a business cycle occur in the US?
4. What is a **trough**?
5. During what month and year did the first recorded trough of a business cycle occur in the US?
6. During what month and year did the most recent trough of a business cycle occur in the US?
7. What is the **expansionary** phase?
8. In what years was the longest recorded expansion in the US? Historically, what could have caused such a long period of expansion?
9. Another long period of expansions occurred between 1938 and 1945. What important historical event occurred during this period?
10. What is the **contractionary** phase?
11. In what years was the longest recorded contraction in the US? What is the period called in United States history? What were some of the causes of this contraction?
12. How does the average number of months of expansion compared to the average number of months of contraction in the period of 1945-2001?
13. Do you see any pattern of when contractions and expansion occur in the data? Explain.
14. In the space below, draw a diagram that represents the business cycle from July 1990 to November 2001. Draw the expansions and contractions as accurately as possible using the data. Add dates for peaks and troughs.

Size of the
Economy



Time in Months