

# Structure of business cycle

Business



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## Abstract

Business cycle has four fluctuations that it exhibits. This is because an economy cannot be said to be on a steady growth throughout the period. Therefore, during periods of lots of economic activities such as investments, a country would witness a boom hence expand on its growth. However, during low economic activities, an economy slides towards recession hence contraction in the economy. In this study, we look at business cycle in US and at what stage it is at the moment.

## Business Cycle; GDP Growth, Inflation and Unemployment

### Business Cycle

This refers to the fluctuations in economic activities especially in production over a certain period of time usually months and to some extent years. It involves the economy witnessing a boom in production over a certain period of time and shifting to a recession during some other period of time characterized with low Economic activities. Economic growth is not a steady occurrence but rather involve fluctuations that are exhibited through the business cycle. Therefore, during growth, an economy would undergo the following fluctuations; an expansion, a peak, contraction (recession), and a trough (low point). The diagram below illustrates the fluctuations in a business cycle.

There are various economic variables that are used as indicators of business cycle. Among them is the Gross Domestic Product (GDP). However, it has been argued that GDP which is a quick and simple indicator of a contraction in an economy and that it does not provide sufficient data due to regular

revision made to it. Therefore, other indicators have been proposed to be used concurrently with it. They include employment rate, inflation rate and industrial production. From December 2007 to date, the US economy has been in a recession due to low economic activities and the global financial crisis that affected major economies of the world US inclusive.

### Gross Domestic Product

Gross Domestic Product (GDP) refers to total output of goods and services produced in a country in a given period of time. During the fourth quarter of 2008, GDP in the United States decreased at annual rate of 3.8 per annum. According to Bureau of Economic Analysis; real GDP of the third quarter decreased by 0.5 per annum. However, the data on fourth quarter estimates is based on incomplete data and a comprehensive estimate for the fourth quarter is set to be released on 27<sup>th</sup> February 2009 that would be based on a more comprehensive data.

Decrease in GDP in the fourth quarter is mainly attributed to low exports as a result of decrease in production, negative contribution of personal consumption spending and negative contribution of residential fixed investment. In addition, imports also decreased significantly. All these factors combined led to the decrease in GDP in US during the third and fourth quarter of the 2008 (Bureau of Economic Analysis 2009).

### Unemployment rate

According to Bureau of labor statistics, the unemployment was as high as 7.6% approximately 11.6 million people in January 2009. Over the past one year, unemployment rate is said to have risen by 2.7% points and continues

to rise. Among the unemployed persons, those who lost their jobs and temporary workers increased to 7 million. This tremendous fall in employment indicates that the economy is in a recession (contraction) as shown in the business cycle. Since the beginning of recession in late 2007, payroll employment has reduced by 3.6 million people (Bureau of Labor Statistics, 2009).

### Inflation rates

Inflation rates are normally computed using consumer price index and producer price index. In the second quarter of 2008, prices for goods and services rose sharply. On computation, Bureau of Economic Analysis found out that, gross purchase price index and personal consumption expenditure rose by 4.2%. On the other hand, consumer price index (CPI) a measure of inflation indicated that CPI had grown by 5.0%. This meant that inflation in the country rose by 5% thereby pushing up prices and in the long run discouraging consumption. This therefore produced a multiple effect to lead to a slow down in economic activities and therefore indicated that the country was falling into further recession.

### Implication to companies; Wal-Mart and Starbucks

As a result of the current recession in the US, most companies sales have been affected significantly thereby reducing on their annual profits. Consequently, they have opted to reduce on their cost of production in circumstances where they incur losses. This means that they reduce on their employees as a faster response to high cost of production. A case in point is Wal-Mart, the world largest retailer that has been able to successful fight

recession but as the recession persists, they have promised to cut on their employees by 800. This is an indication that their cost has increased and need to be reduced to some level for them to stay in business.

Another retailer FedEx also plans to cut down on its employees by 900 people. Basically, what this means is; reduction in GDP results into slow down in economic activities and as a result, production would be low in all sector of the economy. This consequently reduces on consumption that further reduces the production of those commodities and cutting off of employees for firms to maintain low cost of production. Consequently, price increases thereby reducing consumers' disposable income. With a reduction in disposable income, consumers' purchasing power reduces and the effect is felt by companies that would realize low sales.

Starbucks, has not been left behind, with the occurrence of recession, Starbucks has embarked on closing some of its store. This is a historical phenomenon in Starbucks history since it has never succumbed to recession. However, due to decrease in demand as a result of high inflation that has reduced the disposal incomes of consumers, Starbuck had to cut on its cost by closing down some of its store. Profits decline due to low sales and hence need to reduce on production.

Therefore, it can be clearly asserted basing on the indicators of business circle that US is actually in recession. Inflation measured using consumer price index in January indicate that CPI for urban consumers increased by 0.4% while CPI for urban wage earners also increased by 0.4%. This implies that inflation is still rising in US. The unemployment rate has also surged to a historic high thereby indicating the country is in recession.

## References

Bureau of Economic Analysis. (2009). Gross Domestic Product: Fourth Quarter 2008. [www. bea. gov](http://www.bea.gov)

Bureau of Labor Statistics. (2009). Overview of BLS Statistics on Inflation and Prices. [www. bls. gov](http://www.bls.gov)