

What are the stages of the economic cycle?

[Economics](#)



The economic cycle is a fundamental economic understanding of the phases that an economy may experience during certain climates. This can be understood by the basic economic cycle diagram, which shows the different periods combined with a line representing trend growth. Governments ideally wish for uniform growth, close to or on the trend line, this is where the economy is continually expanding and growing at a rate which the government perceives to be sustainable. For example, the UK aim for 2.5% trend growth, however due to the economic cycle we can understand that it rarely stays at one point for a long period of time.

When the actual growth line is above trend rate, this is known as a positive output gap and when the actual growth line is below trend, a negative output gap. A boom period is a period on the economic cycle whereby the curve surpasses trend growth; this represents substantial economic growth and is represented by a peak in the economic cycle. Recessionary periods are stages in the economic cycle when growth falls, this occurs most commonly after a boom period and will lead to the next 'trough' in the economic cycle, or bust.

Bust is whereby the economy is suffering a low point, they are at their lowest in terms of economic growth, operating much below the trend rate and is seen as a trough in the economic cycle. A recovery can be seen on the economic cycle diagram by the encroachment of actual growth to trend growth, and is therefore where the economy is growing gradually and 'recovering' from the bust period they have just suffered. The economy is likely to experience a boom period often in times when supply side policies exceed their time lag and their productivity can be seen.

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Or perhaps in the short term through a boost in demand side policies, such as a decrease in interest rates to encourage consumer spending, however such demand side policies are short-lived due to the accompanied inflation and therefore are unlikely to be the sole cause of a boom period. Similar to the causes of a boom period are the causes of a recovery, this can be induced by the government's willingness to encourage spending or potentially increase labour productivity via methods such as training and education. Similarly to this, a recession can be combatted and forced into recovery by both monetary and fiscal policy.

Monetary policy would focus on decreasing the money supply in order to stimulate the economy whereas fiscal supply focuses on government spending and tax. A reduce in taxes such as income tax would work in theory to get people back to work and therefore push out the PPB to potentially develop economic growth. As previously mentioned, it is possible for the government to stimulate aggregate demand using monetary policy, via a reduction in interest rates, however this does not come without its own problems, it leads to potential speculation of increasing price levels and inflation.

However recessions and potential busts can be created in many numerous different ways, one of which previously just mentioned in terms of speculation. Speculative bubbles work via the communication of the consumer, for example, the Housing market was massively published and conversed about to rise dramatically over the coming years. This forced people to purchase houses there and then in the hope that they will be

provided with a better price now than they would in the future, due to speculation they were correct in doing so.

Such speculation skyrockets demand and with it too comes price levels, this is a common cause of a recessionary period. In addition to this demand-side shocks such as the credit crunch of 2008 in the USA, result in massive contractions of AD. Such demand side shocks come unpredictably in the economy, and thus make it very difficult for the government to prepare adequately for. Such negative demand shocks are expressed in the diagram below, whereby the shift from AD1 to AD2 can be seen.

Supply side shocks are also uncontrollable and come normally with little preparation time for an economy, for example, due to the BP oil crisis of 2009, prices rose massively as BP prepared to lose millions of gallons of wealthy resources in the form of oil. On the other hand, a positive supply side shock could potentially be experiencing now, as a result of the Libyan crisis, negotiations are underway between the UK government and the Libyan government to set up an oil partnership. This could affect the supply of oil massively, and potentially be a positive for the economy.

Climatic Factors must also be mentioned with reference to the economic cycle, and often result in the further diminishing of the world's smaller economies. For example the wildfires in Canada resulted in the global price of grain being bolstered largely, and therefore has the potential to put the economy into a recessionary period as one of their large exports suffered a major loss. Political Factors should also be mentioned when discussing the progress of an economic cycle, for example to make the appearance of a

certain government positive, prior to an election they may attempt to boost employment in the UK.

This is a last ditch effort from the politicians in order to sway the votes of their citizens. However, these jobs could be short-lived and are often not sustainable, therefore do more harm to the economy than good. To conclude, there are many causes of the economic cycle, some positive and some negative, however it depends on potential government preparation and intervention to prevent damage exceeding what it needs to, and recessionary periods to be continued for long periods of time. Economies must be well equipped to deal with unexpected occurrences in order to prevent long term suffering of economic growth.