The concept and components of business cycles

Literature, Russian Literature

In economics, the term business cycle in basic terms refers to the economic growth fluctuations that are witnessed in the country. That is, it relates to the periodic, but irregular up and down movements in the nation's economic activities as measured by the fluctuations in macroeconomic variables such as the real gross domestic product (GDP) (Parkin & Bade, 2001). The nature of the business cycle is that it is not predictable, regular or repeating but that its timing is random and unpredictable. According to Parkin & Blade (2001), the patterns of contraction, expansion, recovery, and growth in the economy are often observed through four periods/components.

Understanding the concept of the business cycle

Whenever talks are made concerning the economic or business fluctuations, notions of aggregate economic income or output is anticipated. This is because, while business cycles are expressed in terms of fluctuations in GDP, there is usually an accompaniment by labor unemployment rate fluctuations too (Parkin, 2012).

However, economists have often noted that there is variation in the lengths of a complete business cycle, as the duration may range from between two to twelve years, but averagely six years. Business cycles are significant in the sense that they highlight the economic relationships that exist in the economy. For instance, while growth in the economy will fall and rise with cycles, it generates a long-term trend line for growth. Economic growth above the trend line would result in a fall in the unemployment rate. Based on Okun's Law, a 1% rise in GDP above the trend line would result in a 0. 5% decline in employment (Parkin & Bade, 2001).

Components of the business cycle

The expansion and recovery phase relates to the period in which the business is rising, and consumer confidence is growing in the economy. As such, companies seize the opportunity to expand, and incomes and spending rates increase. This period is often associated with a significant aggregate increase in factors such as total income, output, trade and employment rates. It persists for approximately six months and is characterized by a widespread expansion of economic units/sectors in the economy. An extended period of this phase results in a boom in which the aggregate economic activities are extraordinary and rising.

The recession (trough) phase is the period in the cycle where the economic activity in the economy is reduced for an extended period, unemployment rises, and production declines. Due to the jolt in economic confidence, consumers tend to spend less during the period. In severe cases, the phase turns into a depression.

The growth (peak) phase is characterized by sustained expansion due to increased consumer confidence translating to higher business activity levels. However, as the economy will tend to operate at full or near full capacity, inflationary pressures often accompany this phase.

Factors that contribute to expansion and contraction

Expansion and contraction in the business cycle may be influenced by factors such as the volatility of investment spending, technological innovations, economic momentum, and economic fluctuations in government spending (Altug, 2010). Subsequently, variations in the inventory levels may also influence the expansion and contractions, in addition to political influences, and exports and imports fluctuations.