

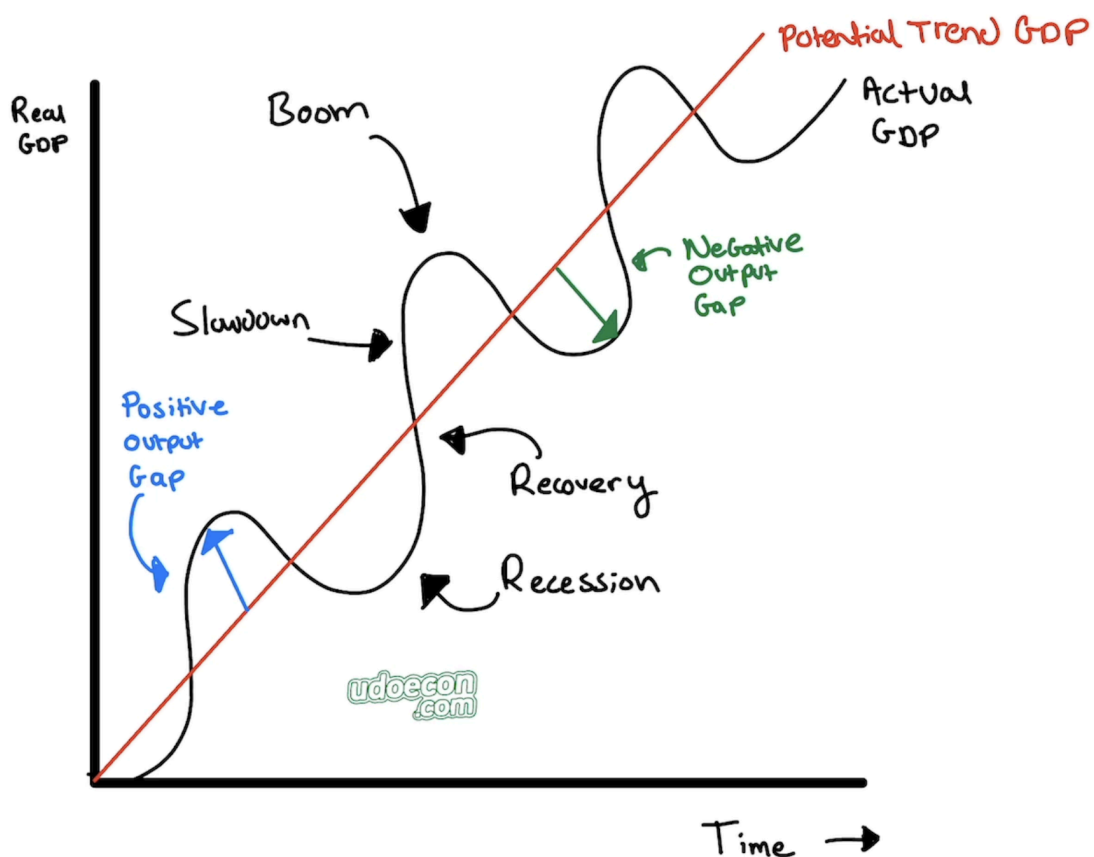
Trade (Business) Cycle

The trade (business) cycle refers to **changes in real GDP over time**. This is **actual growth**, and it tends to move **above and below the long-term trend growth rate**.

Key points on the cycle

There are four recognisable points in the cycle:

- Peak / Boom
- Slowdown / Downturn
- Recession
- Recovery



Output gaps and what they mean

Positive output gap

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A positive output gap happens when **real GDP is above the trend**, suggesting the economy is operating **above normal capacity**(**unsustainable.e.g over using machinery**).

Negative output gap

A negative output gap happens when **GDP is below the trend**, implying **spare capacity** and weaker demand.

The flow through phases

Economies often move through a repeated pattern: **boom** → **slowdown** → **recession** → **recovery** → **boom**. In reality, the cycle is not smooth or automatic.

Boom

A boom is a period of **rapid economic growth** and **high economic activity**.

Characteristics of a boom

- **High/increasing real GDP growth**
- **Falling unemployment** and more job vacancies
- **Spare capacity reduced** (the negative output gap shrinks, or a positive gap appears)
- **High household and business confidence**, encouraging risk-taking
- **Rising inflation**, usually demand-pull

Real-world example

During the late 1990s tech boom in the US, growth was strong, unemployment was low, and investment in new technology rose sharply due to optimism about future profits.

Recession

A recession is two or more consecutive quarters of negative economic growth. For example after the 2008 recession (due to the financial crisis) the UK economy shrunk by 6%.

Characteristics of a recession

- **Negative economic growth** for two consecutive quarters (6 months) or more

- **Rising unemployment**
- **A widening negative output gap** and more spare capacity
- **Low confidence** among households and firms - animal spirits
- **Lower inflation**, and sometimes deflationary pressure if demand falls sharply
- **Weak investment**, as firms delay expansion due to uncertainty