DOWNLOAD PDF INFLATION AND BUSINESS CYCLE

Chapter 1 : Macroeconomics: The Business Cycle

A business cycle and inflation can be influenced somewhat by policymakers who seek to keep regional production growing while also preventing prices from becoming a threat to consumers. When an economic growth is expanding, it typically means that a region is generating greater output of goods and services.

Business cycles are the repetitive expansions and contractions of activity within economies. The unemployment level of an economy is the measurement of people who are looking for work but cannot find it. These two aspects of economic activity are intrinsically interrelated, as both have to do with the willingness and ability of businesses to expand their operations. General Trend When economies are expanding, businesses can grow, so they are more willing to hire workers. When economies are contracting, businesses must deal with reduced revenues and may actually have to lay off their workers. Even if a particular business has not seen any recent decreases in revenue, if its analysts project that revenue will decrease in the future as a result of a general economic slump, it may start laying off workers pre-emptively or at least halt all hiring processes. Exceptions While a slump in the economy in general causes the average company to lay off workers, some industries tend to resist such slumps, and others actually react with localized job growth. For example, since a contraction phase in the business cycle tends to result in higher levels of debt default, industries that benefit from excessive consumer debt become increasingly active. These may include debt consolidation firms, collections agencies and personal debt counseling services. Volatility The level of unemployment is not the only thing that is detrimental to an economy. Volatility of unemployment rate change can also be very detrimental. For example, a sudden surge of employment may cause the hopeful holders of new jobs to go accrue debts under the assumption that they will continue working at those jobs for some time. However, if they soon lose their jobs again, they and the economy are left in a worse case than before because they now have excessive debts that they cannot repay. In this way, an economy with a higher average unemployment level but lower levels of volatility may be in better shape than an economy with a lower average unemployment level and higher levels of unemployment volatility. This volatility in unemployment comes as a direct result of volatility in the business cycle. Solutions While business cycle volatility occurs as a result of countless contributing factors, volatility in unemployment levels tends occur primarily as a result of business cycle volatility. Because unemployment volatility has a more clearly identifiable origin, governments can rein it in more easily. A common method of doing this is by administering high levels of unemployment benefits. Such benefit programs tend to cause workers to remain unemployed for longer periods, but they also help workers to get the time they need to find jobs that match their skill sets. This tends to result in higher average unemployment levels but lower unemployment volatility.

Chapter 2 : How Business Cycles Affect Unemployment | calendrierdelascience.com

Chapter 9 - Business Cycles, Unemployment, Inflation This chapter provides an introductory look at the macroeconomic problems of unemployment and inflation. We will study economic growth in greater detail in two weeks when we study chapters 8 and 22 Web.

There were great increases in productivity , industrial production and real per capita product throughout the period from to that included the Long Depression and two other recessions. Both the Long and Great Depressions were characterized by overcapacity and market saturation. Productivity improving technologies historical. A table of innovations and long cycles can be seen at: There were frequent crises in Europe and America in the 19th and first half of the 20th century, specifically the period â€” This period started from the end of the Napoleonic wars in , which was immediately followed by the Post-Napoleonic depression in the United Kingdom â€”30 , and culminated in the Great Depression of â€—39, which led into World War II. The first of these crises not associated with a war was the Panic of The first declaration was in the late s, when the Phillips curve was seen as being able to steer the economy. However, this was followed by stagflation in the s, which discredited the theory. The second declaration was in the early s, following the stability and growth in the s and s in what came to be known as The Great Moderation. Notably, in , Robert Lucas , in his presidential address to the American Economic Association , declared that the "central problem of depression-prevention [has] been solved, for all practical purposes. Various regions have experienced prolonged depressions , most dramatically the economic crisis in former Eastern Bloc countries following the end of the Soviet Union in For several of these countries the period â€” has been an ongoing depression, with real income still lower than in Economic activity in the US, â€” Deviations from the long-term US growth trend, â€” In , economists Arthur F. Burns and Wesley C. Mitchell provided the now standard definition of business cycles in their book Measuring Business Cycles: The critical feature that distinguishes them from the commercial convulsions of earlier centuries or from the seasonal and other short term variations of our own age is that the fluctuations are widely diffused over the economy â€” its industry, its commercial dealings, and its tangles of finance. The economy of the western world is a system of closely interrelated parts. He who would understand business cycles must master the workings of an economic system organized largely in a network of free enterprises searching for profit. The problem of how business cycles come about is therefore inseparable from the problem of how a capitalist economy functions. An expansion is the period from a trough to a peak, and a recession as the period from a peak to a trough. The NBER identifies a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production". For example, Milton Friedman said that calling the business cycle a "cycle" is a misnomer , because of its non-cyclical nature. Friedman believed that for the most part, excluding very large supply shocks, business declines are more of a monetary phenomenon. The main framework for explaining such fluctuations is Keynesian economics. In the Keynesian view, business cycles reflect the possibility that the economy may reach short-run equilibrium at levels below or above full employment. If the economy is operating with less than full employment, i. Beside the Keynesian explanation there are a number of alternative theories of business cycles, largely associated with particular schools or theorists in heterodox economics. A common alternative within mainstream economics is real business cycle theory. Nowadays other notable theories are credit-based explanations such as debt deflation and the financial instability hypothesis. The latter two gained interest for being able to explain the subprime mortgage crisis and financial crises. These may also broadly be classed as "supply-side" and "demand-side" explanations: This debate has important policy consequences: This division is not absolute â€” some classicals including Say argued for government policy to mitigate the damage of economic cycles, despite believing in external causes, while Austrian School economists argue against government involvement as only worsening crises, despite believing in internal causes. Until the Keynesian revolution in mainstream economics in the wake of the Great Depression , classical and neoclassical explanations exogenous causes were the mainstream explanation of economic cycles; following the Keynesian revolution, neoclassical macroeconomics was largely rejected.

There has been some resurgence of neoclassical approaches in the form of real business cycle RBC theory. The debate between Keynesians and neo-classical advocates was reawakened following the recession of Mainstream economists working in the neoclassical tradition, as opposed to the Keynesian tradition, have usually viewed the departures of the harmonic working of the market economy as due to exogenous influences, such as the State or its regulations, labor unions, business monopolies, or shocks due to technology or natural causes. Keynesian[edit] According to Keynesian economics , fluctuations in aggregate demand cause the economy to come to short run equilibrium at levels that are different from the full employment rate of output. These fluctuations express themselves as the observed business cycles. Keynesian models do not necessarily imply periodic business cycles. However, simple Keynesian models involving the interaction of the Keynesian multiplier and accelerator give rise to cyclical responses to initial shocks. The amplitude of the variations in economic output depends on the level of the investment, for investment determines the level of aggregate output multiplier , and is determined by aggregate demand accelerator. The fluctuations in wages are almost the same as in the level of employment wage cycle lags one period behind the employment cycle , for when the economy is at high employment, workers are able to demand rises in wages, whereas in periods of high unemployment, wages tend to fall. According to Goodwin, when unemployment and business profits rise, the output rises. Credit cycle and Debt deflation One alternative theory is that the primary cause of economic cycles is due to the credit cycle: In particular, the bursting of speculative bubbles is seen as the proximate cause of depressions, and this theory places finance and banks at the center of the business cycle. A primary theory in this vein is the debt deflation theory of Irving Fisher , which he proposed to explain the Great Depression. A more recent complementary theory is the Financial Instability Hypothesis of Hyman Minsky , and the credit theory of economic cycles is often associated with Post-Keynesian economics such as Steve Keen. Post-Keynesian economist Hyman Minsky has proposed an explanation of cycles founded on fluctuations in credit, interest rates and financial frailty, called the Financial Instability Hypothesis. In an expansion period, interest rates are low and companies easily borrow money from banks to invest. Banks are not reluctant to grant them loans, because expanding economic activity allows business increasing cash flows and therefore they will be able to easily pay back the loans. This process leads to firms becoming excessively indebted, so that they stop investing, and the economy goes into recession. Real business cycle theory[edit] Main article: Real Business Cycle theory Within mainstream economics, Keynesian views have been challenged by real business cycle models in which fluctuations are due to technology shocks. This theory is most associated with Finn E. Kydland and Edward C. Prescott , and more generally the Chicago school of economics freshwater economics. They consider that economic crisis and fluctuations cannot stem from a monetary shock, only from an external shock, such as an innovation. Vernon stated that some countries specialize in the production and export of technologically new products, while others specialize in the production of already known products. The most developed countries are able to invest large amounts of money in the technological innovations and produce new products, thus obtaining a dynamic comparative advantage over developing countries. Recent research by Georgiy Revyakin proves initial Vernon theory and shows that economic cycles in developed countries overrun economic cycles in developing countries. In case of Kondratiev waves such products correlate with fundamental discoveries implemented in production inventions which form the technological paradigm: Simultaneous technological updates by all economic agents as a result, cycle formation would be determined by highly competitive market conditions: Politically based business cycle[edit] Another set of models tries to derive the business cycle from political decisions. The partisan business cycle suggests that cycles result from the successive elections of administrations with different policy regimes. Regime A adopts expansionary policies, resulting in growth and inflation, but is voted out of office when inflation becomes unacceptably high. The replacement, Regime B, adopts contractionary policies reducing inflation and growth, and the downwards swing of the cycle. It is voted out of office when unemployment is too high, being replaced by Party A. The political business cycle is an alternative theory stating that when an administration of any hue is elected, it initially adopts a contractionary policy to reduce inflation and gain a reputation for economic competence. It then adopts an expansionary policy in the lead up to the next election, hoping to achieve simultaneously low inflation and unemployment on election day. In recent years, proponents of the "electoral business cycle" theory[who? Marxian economics[edit] For Marx the economy based on production of commodities to be sold in the market is intrinsically prone to crisis. In the heterodox Marxian view profit is the major engine of the market economy, but business capital profitability has a tendency to fall that recurrently creates crises, in which mass unemployment occurs, businesses fail, remaining capital is centralized and concentrated and profitability is recovered. In the long run these crises tend to be more severe and the system will eventually fail. Henryk Grossman [33] reviewed the debates and the counteracting tendencies and Paul Mattick subsequently emphasized the basic differences between the Marxian and the Keynesian perspective: Goodwin formalised a Marxist model of business cycles, known as the Goodwin Model in which recession was caused by increased bargaining power of workers a result of high employment in boom periods pushing up the wage share of national income, suppressing profits and leading to a breakdown in capital accumulation. Later theorists applying variants of the Goodwin model have identified both short and long period profit-led growth and distribution cycles in the United States, and elsewhere. Austrian business cycle theory Economists of the heterodox Austrian School argue that business cycles are caused by excessive issuance of credit by banks in fractional reserve banking systems. According to Austrian economists, excessive issuance of bank credit may be exacerbated if central bank monetary policy sets interest rates too low, and the resulting expansion of the money supply causes a "boom" in which resources are misallocated or "malinvested" because of artificially low interest rates. Eventually, the boom cannot be sustained and is followed by a "bust" in which the malinvestments are liquidated sold for less than their original cost and the money supply contracts. Mainstream economists generally do not support Austrian school explanations for business cycles, on both theoretical as well as real-world empirical grounds. Yield curve[edit] The slope of the yield curve is one of the most powerful predictors of future economic growth, inflation, and recessions. A positively sloped yield curve is often a harbinger of inflationary growth. Work by Arturo Estrella and Tobias Adrian has established the predictive power of an inverted yield curve to signal a recession. Their models show that when the difference between short-term interest rates they use 3-month T-bills and long-term interest rates year Treasury bonds at the end of a federal reserve tightening cycle is negative or less than 93 basis points positive that a rise in unemployment usually occurs. All the recessions in the US since up through have been preceded by an inverted yield curve year vs 3-month. Over the same time frame, every occurrence of an inverted yield curve has been followed by recession as declared by the NBER business cycle dating committee.

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Chapter 3 : Business cycle, inflation and deflation - Lets Blogging

By Stephen Simpson The business cycle is the pattern of expansion, contraction and recovery in the economy. Generally speaking, the business cycle is measured and tracked in terms of GDP and.

He is also chief risk officer at investment management firm Salient Partners. As always, a transcript of the discussion is available for download below. Ben Hunt, author of Epsilon Theory and chief risk officer of Salient Partners As usual, we will add a few words here to expand a little on the discussion. A wide range of issues relevant to the markets was debated at the conference call, but we want to focus on just one particular point here that we only briefly mentioned in the discussion. Part II will be posted shortly as well. This reminded us of something George Soros first mentioned in a speech he delivered in the early s: Economic history is a never-ending series of episodes based on falsehoods and lies, not truths. It represents the path to big money. The object is to recognize the trend whose premise is false, ride that trend, and step off before it is discredited. This is undoubtedly a great insight and great advice for traders and investors. Soros appears to have a very similar view of speculators. The process speculators employ to arrive at their decisions has certainly more in common with what Mises called the understanding of the historian than with economic theorizing. Knowledge of theory can improve and refine said understanding though, and help constrain forecasts. This is something we can nowadays e. The reflexivity consists of the fact that these default rates depend to a substantial extent on their own willingness to refinance junk-rated companies, many of which would perish if they stopped doing so. As a rule these aim to convey the idea that one should expect the trend to continue, regardless of how outrageously distorted or extended it seems to be in terms of traditional metrics. Ben Hunt mentioned a specific narrative that has accompanied quantitative easing for almost a decade now even longer, if we take Japan into account. At first glance it appeared reasonable enough: This is of course unequivocally true in terms of monetary inflation, but they referred to consumer price inflation. Alas, both CPI and inflation expectations obviously failed to respond appreciably to their ministrations. Ben posits that this narrative may be set to falter in a rather unexpected manner, by continuing to defy widespread expectations. One cannot help but be sympathetic to this idea simply based on how contrarian it is. Meaningful consumer price inflation is pretty much the last thing anyone expects. At the moment we are still inclined to believe that a sizable future decline in asset prices is likely to create another deflation scare and will at least initially exert further downward pressure on inflation expectations. Of course all ABCT expositions are based on the same ideas in terms of monetary and capital theory: What is clear though is that for society at large, it means mainly one thing: This is to say, impoverishment relative to the satisfaction that could have been attained without the credit boom. Usually we still tend to end up more prosperous after a boom collapses than we were before it began in most cases, that is. But we could do a lot better than that and at the same time avoid heaps of stress and injustice. As an aside to this: One can simply refer to such activities as money printing, but renaming QE to DI might have more punch. Just think about the truthiness coefficient of future headlines, it would be downright awesome: Even though it is slightly dated, this seems an apposite cartoon on several levelsâ€¦ Anyway, the reason why no simple, singular account of ABCT is available is the sheer complexity of the events involved. Variations in the sequence of these events and their specific shape depend not only on economic laws, but also on concrete historical and institutional settings, and different authors have placed more emphasis on factors that seemed particularly relevant to their times and personal experience. Business Cycles and Consumer Prices â€" Some Basics Past booms were sometimes accompanied by very low consumer price inflation, usually when economic productivity rose significantly as new technologies became economically viable and enabled entrepreneurs to take large strides in improving production methods e. This type of boom was characterized by both malinvestment in the higher stages and widespread over-consumption, with the latter eventually giving way to forced saving and the former to liquidation once the boom began to turn to bust. The pernicious effects of credit expansion tended to be masked during these boom periods; the only immediately obvious warning signs consisted of unusually large increases in asset prices and rapid debt accumulation â€" both of which are widely regarded as harmless as long as the boom persists. Note that in such cases, a lot of genuine wealth creation will occur in parallel with the capital consumption fostered by boom conditions. On the opposite end of the spectrum we find crack-up booms such as the tragic hyper-inflation calamity of the Weimar Republic, during which prices obviously rose sharply. The cycle was strongly compressed in time, and some of the typical effects on the capital structure were particularly severe. Specifically, an extremely pronounced imbalance of investment in higher vs. While the owners of coal mines and steel mills still marveled at how great their businesses seemed to be doing, no-one could accuse the general citizenry of indulging in over-consumption. Wage earners had to involuntarily curtail consumption fairly early in the boom already, as their wages failed to keep up with rising prices. Business activities close to the consumer accordingly faltered, while investment in mines, factories, large piles of raw materials, inventories of highly non-specific capital goods, etc. Banks were forced to shift their business focus to stock market and currency speculation, as lending became an utterly suicidal proposition the central bank was lending directly to businesses to keep the show on the road. The rest of the chart depicts a credit boom characterized by both malinvestment in the higher stages of the capital structure and over-consumption, similar to what occurred in the booms of the s and s. The more temporally distant stages are from consumption, the greater their interest sensitivity. Artificial lowering of interest rates through credit expansion fosters capital malinvestment by drawing more and more resources toward higher order stages of production as their profitability appears to increase. As the illusory accounting profits of booming sectors begin to be distributed, over-consumption begins to pull resources toward lower order stages of the capital structure as well, and the Hayekian triangle becomes distorted in both directions the middle stages so to speak bear the brunt of the abuse. In the upper right hand quadrant we see the curve representing the production possibilities frontier PPF , on which all sustainable combinations of consumption and investment are located. Which combinations can in fact be sustained is determined by the volume of loanable funds provided by voluntary savings S and the associated natural interest rate i-eq in the lower right quadrant of the diagram. The hollow diamond outside the PPF represents the height of the boom. The various self-reinforcing phenomena during the bust entail temporary movements of both C and I to points below the PPF a. In this type of crisis the previously suffering sectors close to the consumer tend to recover with a fairly small time lag, usually well before the severe bust in the higher stages is over, but not to an extent sufficient to prevent common bust-related symptoms such as rising unemployment, waves of insolvencies and zombified banks. A close-up of the temporary movement of the economy beyond the PPF, and the subsequent movement toward a point below the PPF. At point 2, over-consumption reaches its maximum, at point 3 forced saving relative to the maximum level of consumption begins. At point 4, the maximum demand for resources to be allocated to higher order stages of the production structure occurs, at point 5 the liquidation of malinvested capital begins. Points 6 to 8 denote the bust â€” a movement below the PPF, i. A Third Possibility In the two types of boom-bust sequences discussed above, the bust periods traditionally tend to be accompanied by downward pressure on price inflation and inflation expectations. This happens even nowadays, although it is well-known that central banks will almost immediately implement heavy monetary pumping measures when the economy seems to be weakening. This response has become de rigeur in the fiat money era, especially over the past three decades, as the price inflation bugaboo has taken a remarkably persistent leave of absence. They are not the only types though: Even if it were possible, it would definitely not be a desirable state of affairs worth striving for. To be sure, we have a number of criticisms as well. As an example, Noam Chomsky is able to deliver a trenchant analysis of the war racket and the insidious propaganda that supports it and he clearly knows what he is talking about. For an extensive and fascinating study of the crack-up boom see Italian economist Costantino Bresciani-Turroni, The Economics of Inflation: Garrison, Time and Money: The book compares Austrian capital theory with Keynesian labor-based macroeconomics; we would not necessarily recommend it to beginners [here is a link to a PDF version].

Chapter 4 : Economic indicators and the business cycle | Khan Academy

The term business cycle or economic cycle refers to economy-wide fluctuations in production, trade and economic activity in general over several months or years in an economy organized on free-enterprise principles.

All persons who did any work for pay or profit during the survey reference week. All persons who did at least 15 hours of unpaid work in a family-operated enterprise. All persons who were temporarily absent from their regular jobs because of illness, vacation, bad weather, industrial dispute, or various personal reasons. All persons who were not working and were waiting to be called back to a job from which they had been temporarily laid off. Two factors cause the official unemployment rate to understate actual unemployment. Part time workers are counted as "employed. Calculating the Unemployment Rate The unemployment rate is defined as the percentage of the labor force that is not employed. To calculate the unemployment rate: What Is "Full Employment"? The unemployment rate in was 4. Remember that unemployed means not working but looking. It depends on how we define full employment. We have defined full employment as using all available resources so as to achieve the potential level of output for an economy. Full employment is achieving the potential level of output. So, with some types of unemployment an economy can still produce its potential level of output. Full employment means achieving the potential output As we learned in our AS-AD lesson "potential output" is NOT the absolute maximum, but it is the potential level of output under normal circumstances Graphically, the potential, or the full employment output can be illustrated three ways: This is called the "full employment rate of unemployment", or the "natural rate of unemployment" and it includes structural and frictional unemployment What? Types of Unemployment To understand how we can achieve the potential level of output and still have 4. The key to understanding what full employment means, is to consider what happens to output with each type of unemployment. Frictional unemployment is the type of unemployment caused by workers looking for their first job, voluntarily changing jobs, and by temporary layoffs. It is unemployed workers between jobs. Frictional unemployment is "good" unemployment because without it the economy could not be producing as much as possible i. How can the economy be achieving the potential level of output if some people are frictionally unemployed? Is this good for society? We need some frictional unemployment to get resources to the jobs where they produce the most so some frictional unemployment actually reduces scarcity. To produce as much as possible with our limited resources we need some frictional unemployment. Frictional unemployment tends to be short-lived, BUT we do not want it to last too long. Therefore programs to keep it low would help reduce scarcity and governments have such programs like state employment offices and career placement offices at universities. These programs help people find jobs quicker so that more can be produced. Structural unemployment is unemployment of workers whose skills are not demanded by employers. They are unemployed because they lack sufficient skill to obtain employment, or they cannot easily move to locations where jobs are available. Structural unemployment can result from changes in the structure of demand for labor; e. Structural unemployment results from people not having the necessary skills. If these people are unemployed, what happens to scarcity? Therefore we can still produce our potential level of output with our available resources even if there is structural unemployment. But, do we want these workers to just do nothing? We studied in the 5Es lesson that more workers or better workers results in economic growth. Economic growth is increasing out potential level of output. This is good for society since it also reduces scarcity. Therefore governments have economic growth programs to reduce structural unemployment like financial aid for school and job training programs. Cyclical unemployment is a type of unemployment caused by insufficient total spending or by insufficient aggregate demand. It is unemployment caused by the recession phase of the business cycle. If there is less aggregate demand firms respond by producing less. Output and employment are reduced. The extreme unemployment during the Great Depression 25 percent in was cyclical unemployment. If there is a recession and therefore an increase in unemployment associated with a decrease in output, this results in more scarcity. This is not good for society since it will be producing at a point inside its production possibilities curve point D on the graph below or at a level of output short of the full employment level. Therefore, governments have policies to reduce cyclical unemployment. These are the demand management policies discussed in our lesson on the AS-AD. Expansionary fiscal policies increasing government spending or decreasing taxes and easy money policies increasing the money supply are designed to increase AD, reduce cyclical unemployment, and and move the economy back to the full employment level of output. This is called the "full employment rate of unemployment", or the "natural rate of unemployment" and it includes: In other words, full employment is zero cyclical unemployment. If there is some frictional and structural unemployment in the economy can the potential level of output still be achieved? The "full employment rate of unemployment" is the unemployment rate occurring when there is no cyclical unemployment and the economy is achieving its potential output Changes in the Full Employment Natural Rate of Unemployment The natural rate of unemployment is not fixed but depends on the demographic makeup of the labor force and the laws and customs of the nations. Why did the full employment rate of unemployment increase? Or, another way of saying this is "why did the amount of frictional and structural unemployment increase? After World War II ended in the s the baby boom began. By the s this large increase in population was beginning to enter the labor force. As they begin looking for their first jobs they were frictionally unemployed. Also during these decades the roles of women were changing and more women entered the labor force for the first time frictional unemployment and many did not have the necessary skills structural unemployment. This is attributed to 1 the aging of the work force with fewer new entrants reducing frictional unemployment, 2 improved job information through the internet and temporary-help agencies which also reduces frictional unemployment, 3 new work requirements passed by congress with the most recent welfare reform which encourage those who are frictionally unemployed to try to get a job quicker, and finally, 4 the doubling of the US prison population since has removed from the labor force a group of people who have a high rate of unemployment.

Chapter 5 : What Is the Relationship Between Gross Domestic Product and the Business Cycle? | calendri

Monetary inflation is also the starting point for the business cycle story, instead of a stopping point for many, like price inflation. Before we can discuss the ups and downs of the business cycle, we have to gain an understanding of two connected concepts: the interest rate and production.

One popular conception of inflation focuses on prices â€” all prices, actually. The other conception of inflation focuses on the money supply. Economists with this focus think of inflation as an increase in the amount of money in the economy. Prices Can Rise for Many Reasons If the demand for something increases relative to its supply, or if the supply of something decreases relative to the demand for it, the price will increase. The fundamental reason for this is called diminishing marginal utility â€” increasing our stock of some good means that it will go toward the satisfaction of a lower-ranked end. Even though this sounds pretty limiting in terms of the reasons prices can rise, these two concepts â€” supply and demand â€” can and do channel all sorts of changes in the market. Preferences can change, goods can go in and out of fashion, accidents can happen that reduce our supply of a certain good, we can think of new and more efficient ways of producing goods, services that at one time could only be done with human labor can be replaced or complemented with new tools and machines, and so on. The list of things that affect supply and demand is infinite, depending on how specific you get, but the important thing to remember is that all of these sorts of changes are integrated into and channeled through our preferences and ideas, and therefore supply and demand. There Is No Good Way to Measure a General Rise in the Price Level You maybe familiar with indexes like the Consumer Price Index, which are calculated and compiled based on survey data and technical mathematical methods, but by their very nature they cannot appropriately capture the price level. They cannot do so because these sorts of indexes are one number. They try to boil the trillions of pieces of data on the prices of all goods and services in the economy down to just one piece of data. Market prices, which are a complicated phenomenon on their own, fluctuate not only year to year, but month to month, day by day, and even second to second. Also, there is no central repository of price information. Even in one country, prices emerge in a very scattered, decentralized way, from the halls of Washington, D. Inflation Is About More Than the Price Level A third issue with viewing inflation only as a rise in the price level is that it stops short of explaining the full consequences of monetary inflation. Many people correctly understand the relationship between the price level and the money supply â€” more money means higher prices â€” and they also understand that this relationship is bad for the average Joe. Salerno is not average by any measure, but we can say that if he is one of the later receivers of new money, he has to pay higher prices before his own salary increases due to inflation, however you define it. In this way, inflation is not harmless â€” it represents a wealth transfer to the first users of the new money from the later users of new money as it ripples through the economy. Even though most people know and understand this consequence of increasing the money supply, it stops short of explaining the full consequences of monetary inflation, which will be discussed in just a moment. But to summarize, viewing inflation as a rise in the price level has at least three main problems: It is ambiguous because almost anything can change prices; 2. Inflation is more appropriately viewed as an increase in the money supply, and this conception of inflation does not suffer the same problems as the other. Monetary inflation has a simple, well-defined cause, unlike price inflation. Monetary inflation is measureable because money is its own unit of account and can be counted up, unlike price inflation, which is not directly measureable. Monetary inflation is also the starting point for the business cycle story, instead of a stopping point for many, like price inflation. Before we can discuss the ups and downs of the business cycle, we have to gain an understanding of two connected concepts: The interest rate is a price, like any other price, but for present money. When you buy an Apple Watch or two you exchange money for the device. The relative difference between these two sums is the interest rate. And, just like any other good, the lower the price, the more people will want to buy. At lower interest rates, more people are willing to borrow. Banks use our savings to lend to prospective borrowers, and so the supply of loanable present money depends on how much people save â€” said another way, it depends on how much people consume, since saving is the opposite of consumption. The indirectness of borrowing and lending through banks does not complicate things too much; in fact it makes it easier for us to conceive of the supply of loans simply as savings. Entrepreneurs are some of the primary borrowers of present money. Entrepreneurs buy factors of production like land, labor, and capital to produce goods and services. They will only engage in production, though, if they expect to profit, that is, if their revenues exceed their costs. Entrepreneurs Must Consider the Cost of Debt Service If they borrow money to pay for the factors of production, then the profit would also have to exceed the interest they promise to pay for the borrowed funds. For this reason, the interest rate is a vital piece of information for entrepreneurs. If interest rates are high, then only high-revenue lines of production will be undertaken. If interest rates are low, then more lines of production become profitable. In an unhampered market, interest rates are determined by supply and demand. If people become more willing to part with their present money, or save, then the supply of loanable funds will increase relative to demand, and the interest rate will fall. At the lower interest rate, more lines of production will become profitable because now entrepreneurs can borrow more cheaply to purchase factors of production. Consumers have shown that they are willing to consume less, so now, more resources can be used by producers for production. Suppose Tim Cook has an idea for how to produce one million Apple Watches and expects revenues from his sales to exceed his costs by 10 percent. The current interest rate is 15 percent, unfortunately for Tim Cook, so he just holds on to his idea for the time being. However, a couple months later, due to the increased willingness for people to save and invest, the interest rate falls a whopping 10 percent, down to just 5 percent. Tim Cook reevaluates his plan and his expectations of profitability and decides to go for it. He borrows the money necessary to pay for laborers, machines, and factories and starts producing Apple Watches. He sells his product and gets revenue that exceeds his cost by 12 percent â€” a little more than he was expecting! He pays back his creditors the amount he promised, 5 percent, which left him with 7 percent all to himself for taking the risks and producing something consumers like. The lower interest rate in this example encouraged the entrepreneur to produce and also signaled to the entrepreneur that resources have been freed up in the economy for use in production. When Central Banks Get Involved When a central bank decides to increase the money supply, the new money enters the economy through the same markets that people borrow and lend. The new money increases the supply of present money available for lending, which, as we all know, will decrease the price, or the interest rate in this case. When the central bank increases the money supply and interest rates fall, it induces more borrowing and less saving. Entrepreneurs are more than happy to take out the loans at the lower interest rate, but everybody else is less willing to save at the lower interest rate. The newly printed money makes up the difference. Less saving means more consumption, and since the interest rate is so low, consumers may even borrow to finance even more consumption. Everybody is happy as they consume, invest, earn higher wages, start new projects, and enjoy the ride to the top. The Down Side This high cannot last forever, though. Even though spending is climbing on all fronts, no new resources have been created, just new green slips of paper. The economy has not allocated real resources away from consumption and toward production, it has just stretched the existing resources thin. The signals entrepreneurs rely on were falsified and based on the whims of a few powerful people, not the collective, voluntary interactions of individuals everywhere. The boom peaks and falls into a bust when some combination of these events unfolds: When the increasingly scarce factors of production become too expensive; 2. When the monetary spigot gets turned off and so consumption and investment run dry; 3. And when people start to realize the damage that has been done. The bust is characterized by under- and unemployment, falling prices, and a readjustment of capital throughout the economy. The bust is painful, but necessary and healthy. Capital and laborers have been misallocated, funds malinvested, and lines of production that appeared to be profitable are revealed to be unprofitable in hindsight. The correction happens during the bust. In fact, the bust is the correction. Resources need to go where they are most highly valued, and the only system capable of such a daunting task is the unhampered market economy. We can avoid the mess. People are getting into and developing currencies that are not tied to our fractional reserve and central banking system. Newer technologies are being adopted for loans to be processed at rates less affected by central bank manipulation. Many people are realizing the disastrous record of central banking and expansionary monetary policy. The same people are learning the way to real economic growth via real savings and economically sustainable uses of our resources.

Chapter 6 : What Is the Relationship between the Business Cycle and Inflation?

unemployment caused during the recessionary phase of business cycle by insufficient aggregate demand to employ all who want to work Full Employment Unemployment -the unemployment rate at which there is no cyclical unemployment of the labor force; equal to between 4 and 5 percent in the U.S. because some frictional and structural unemployment is.

The gross domestic product, or GDP, is the total market value of goods and services the country produces. As the economy goes through business cycle changes, these positively or negatively affect the GDP. Economic Contraction During a contraction, economic output slows, usually due to decreased demand for products and services, an increase in the cost of raw materials or both. This means that companies are not making as many products or offering as many services. As a result, companies will begin to lay off employees and the unemployment rate begins to rise. Since GDP is a measure of the value of economic output and during a contraction output decreases, the GDP also decreases. Even though the GDP decreases during a contraction, it is still positive. Economic Trough An economic trough occurs after a contraction. A historically high national unemployment rate and low economic output usually mark this trough, which often signals that the economy is already in or heading toward a recession. A negative GDP means that economic output does not grow at all. Economic Expansion After the "rock bottom" of an economic trough, expansion is its recovery. If the economy grows for two or three consecutive calendar quarters, it indicates that it is beginning its recovery and GDP begins to increase. The reason economists do not consider the economy to be in a recovery and an expansionary phase after only one quarter of growth is because some types of economic growth are temporary. Examples of temporary economic growth are the holiday shopping season or when the U. Economic Peak An economic peak is like a mountain summit. Once the economy reaches this peak, it must come down. This economic peak is the highest point of economic growth and output, resulting in an increase in the GDP. However, economic peaks often cause upward inflationary pressure and devaluation of the currency. Because of these factors, economists consider a peak as a negative economic event and a sign that the economy is heading toward a contraction, even with the increase in the GDP. Carty holds a Bachelor of Arts degree in business administration, with an emphasis on financial management, from Davenport University.

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Chapter 7 : Business Cycles and Inflation â€“ Part I |

Business cycle, as Joseph Schumpeter saw it, is the economic activity fluctuation that occurs over time, and that comes from the succession of expansionary and contracting seasons.

Using the table above, the unemployment rate is: Suppose more men decided to stay at home and raise their pre-school aged children. The labor force participation rate for males to increase. The labor force participation rate for males to decrease. The labor force participation rate for males to remain the same. The impact on the labor force participation rate for males to be unpredictable. The total population aged 16 and older of Pageland is 48 million. Of this total, 4 million are unemployed and 36 million currently hold jobs. What are the rates of unemployment and labor force participation of Pageland? The rate of unemployment is 11 percent, and the labor force participation rate is 83 percent. The rate of unemployment is 10 percent, and the labor force participation rate is 75 percent. The rate of unemployment is 10 percent, and the labor force participation rate is 83 percent. The rate of unemployment is 11 percent, and the labor force participation rate is 90 percent. Which of the following are consequences of unemployment? A rising price level, which reduces the purchasing power of consumers. A rising aggregate output and income. An increase in the money supply which increases inflation. A decline in output and income. The consumer price index is computed by comparing the cost of the typical market basket of goods purchased during a base year evaluated at base year prices with: The cost of the same market basket evaluated at current prices. The cost of the current market basket evaluated at base-year prices. The cost of the current market basket evaluated at current prices. The cost of the same market basket evaluated at base year prices. Is always greater than Is always less than Can be less than, greater than, or equal to If the CPI increased from 80 to 84, the rate of inflation is: If the consumer price index CPI at the end of was and the CPI at the end of was , then the rate of inflation over the time period was:

Chapter 8 : Unemployment and Inflation

Inflation and the Business Cycle When the inflation forecast is correct, the economy operates at full employment. If aggregate demand grows faster than expected, real.

Chapter 9 : Business cycle - Wikipedia

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