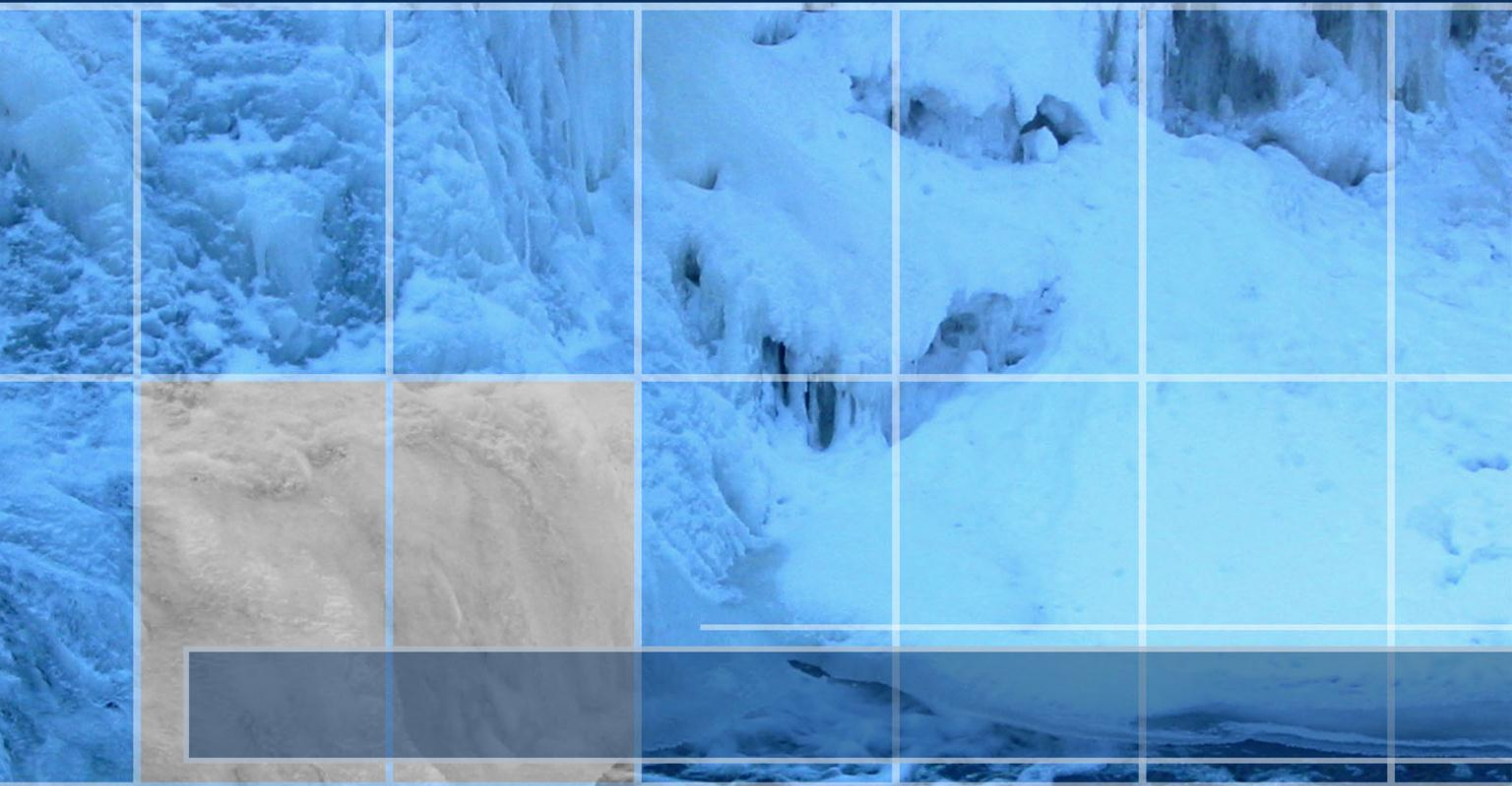
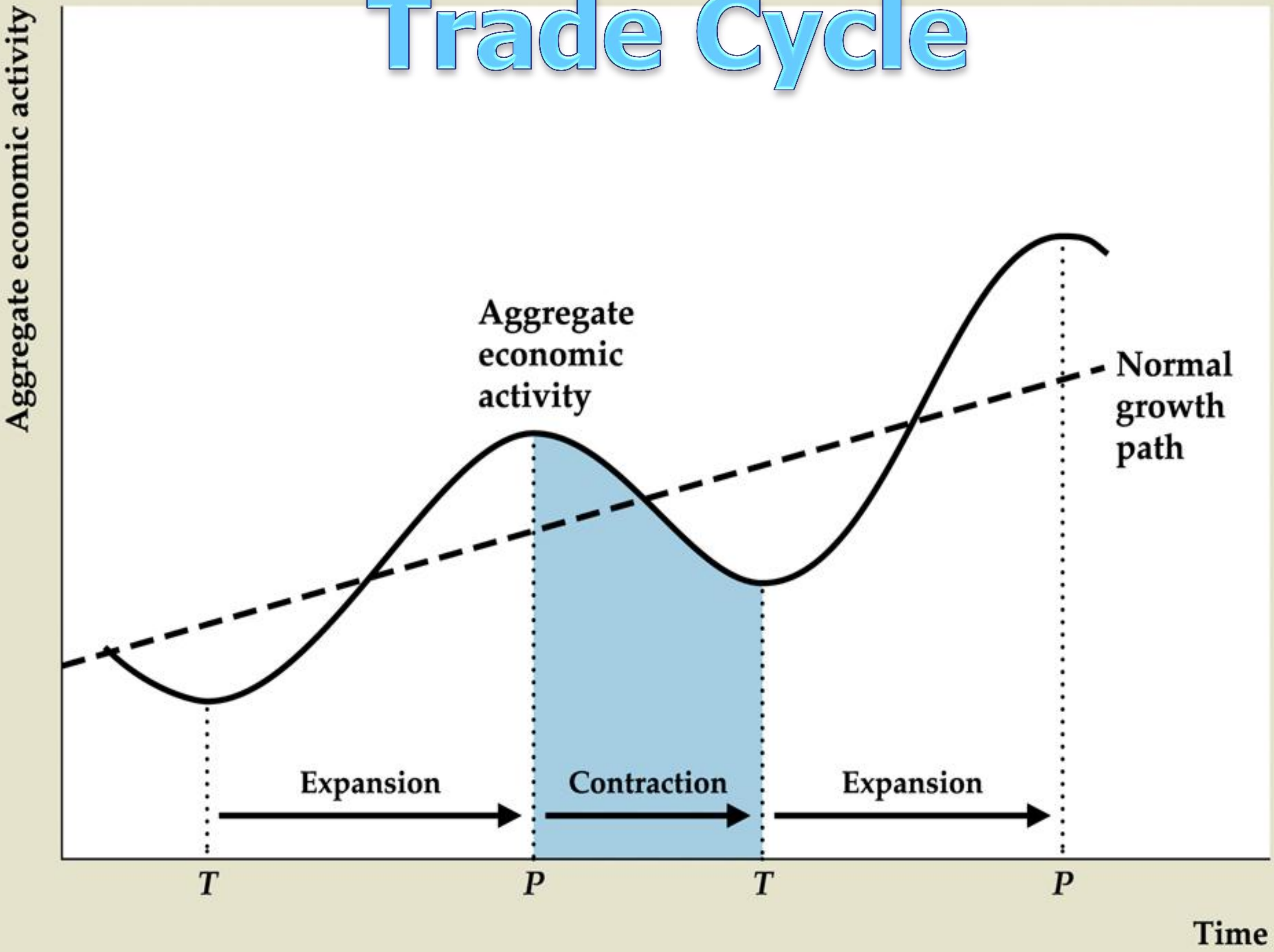


TRADE CYCLES

What is a Trade Cycle?

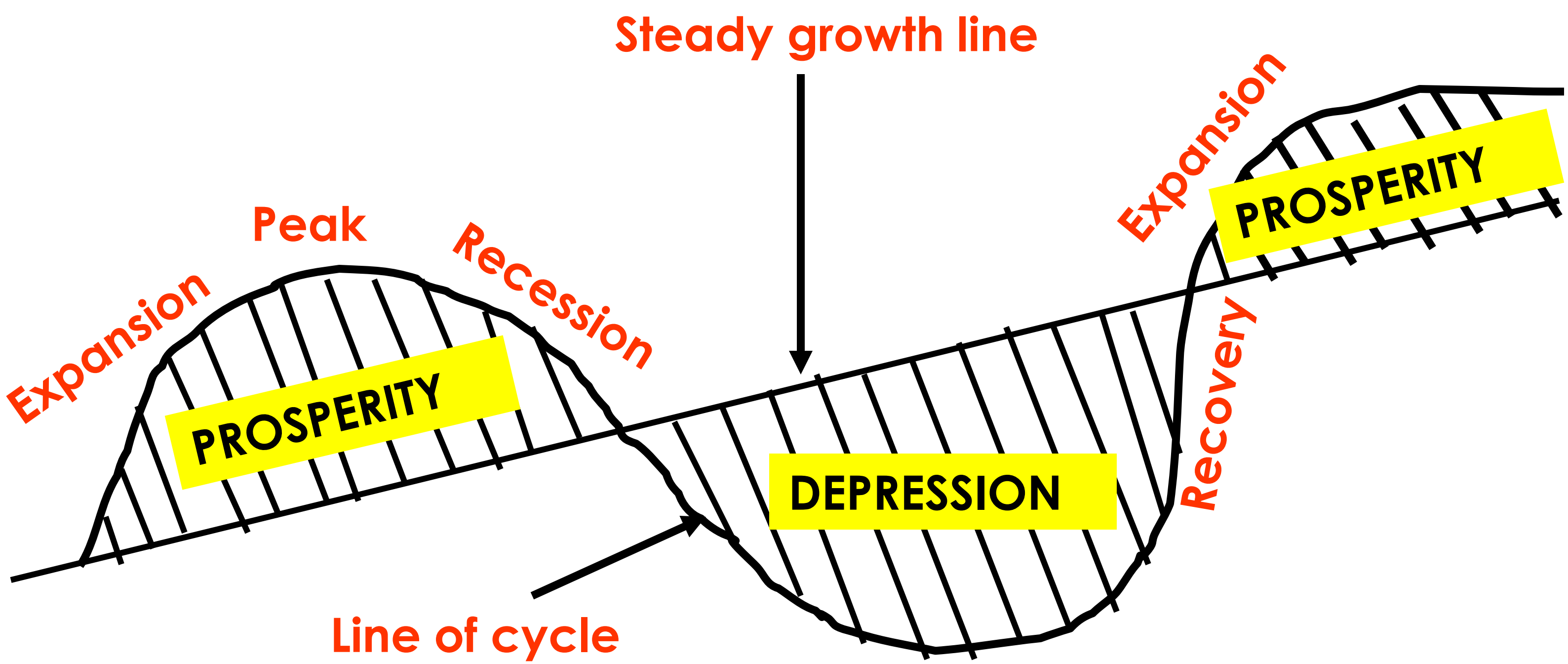
- **A business cycle refers to periods of expansion and contraction. A peak is the high point following a period of economic expansion. A Depression is the low point following a period of economic decline. The recurring and fluctuating levels of economic activity that an economy experiences over a long period of time.**

Trade Cycle



Aggregate economic activity
Aggregate
economic
activity
Normal
growth
path
Expansion
Contraction
Expansion
T
P
T
P
Time

PHASES OF BUSINESS CYCLE



Boom

- The business outlook is extremely optimistic.
- The important features of prosperity are:
  - a high level of output ,trade, employment and income,
  - a high level of effective demand and high marginal efficiency of capital,
  - a large expansion of bank credit, and
  - a rising trend in prices, profits and interest rates.

PEAK

Characterized by

Slackening in expansion rate

Highest level of prosperity

Downward slide in economic activities

The phase of recession begins

Recession

- During recessions, many macro economic indicators vary in a similar way.
- Production, as measured by gross domestic product (GDP), employment, investment spending, capacity utilisation, household incomes, business profits, and inflation all fall
- while bankruptcies and the unemployment rate rise.

RECESSION

- Downward slide in growth rate becomes rapid and steady
- Output, employment, prices etc. register a rapid decline
- When the growth rate goes below the steady growth rate depression sets in

Depression

- The phase of depression economic activity is at its low . Wages, cost, price are very low.
- There is massive unemployment leading to a fall in the aggregate income of the people.
- This brings down the purchasing power of the community.
- General demand falls faster than production.
- The piled-up stock are sold at very high rates of discount leading to heavy loss to the firms.

DEPRESSION

Depression begins when

Growth is less than zero

Total output, employment, prices, bank advances etc. Decline during subsequent period

Depression lasts as long as growth rate stays below the stagnated growth rate

Recovery

- The rising price of an asset
- Increased economic activity during a business cycle, resulting in growth in the gross domestic product.
- Collection of all or a portion of a debt previously considered uncollectible.
- Valuable materials remaining after processing.
- Proceeds from the sale of an asset that represent depreciation that has already been taken.

EXPANSION

Increase in

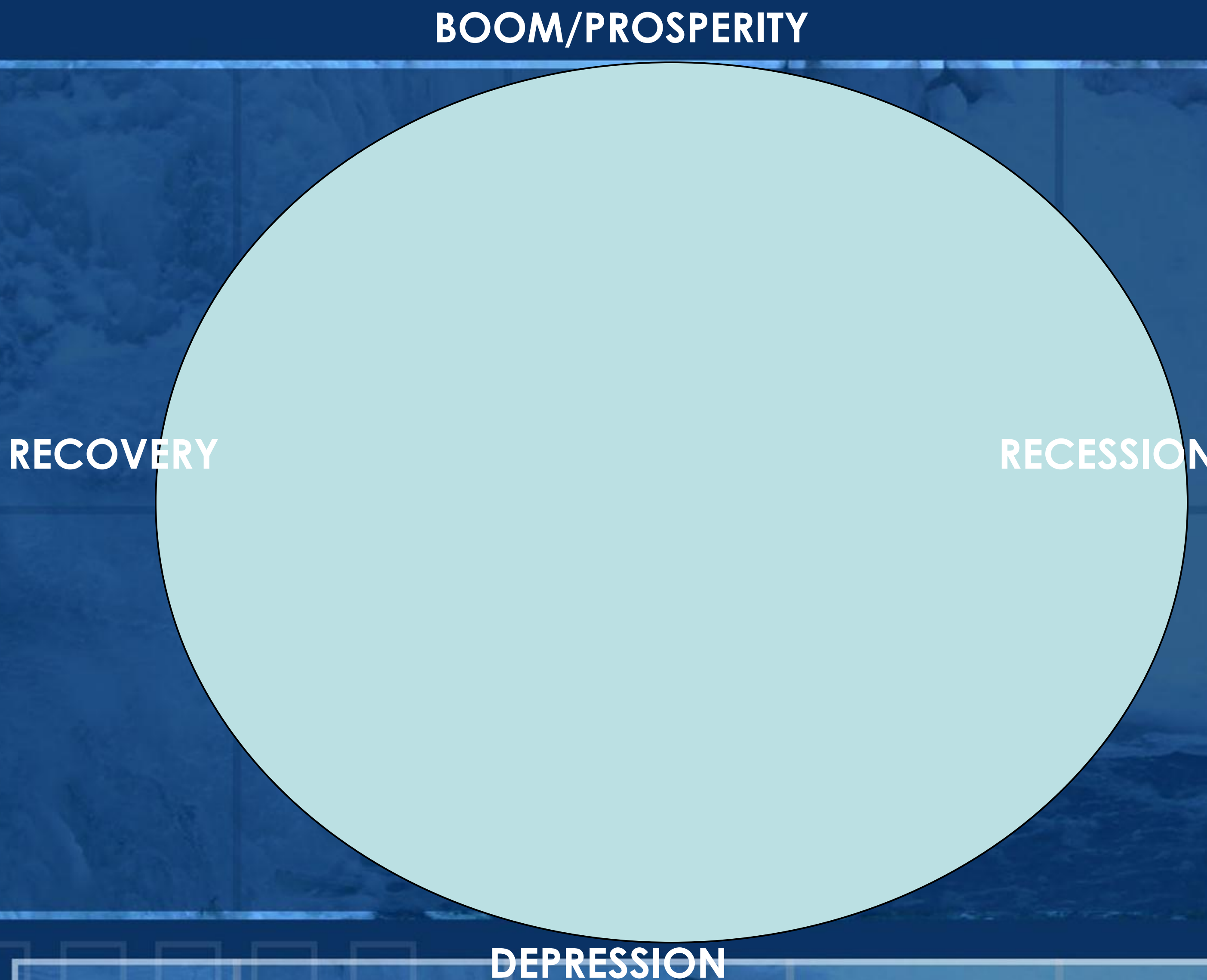
- Output
- Employment
- Investment
- Aggregate demand
- Bank credits
- Wholesale & Retail prices
- Per capita output
- Standard of living

RECOVERY & EXPANSION

In the recovery phase the growth rate may still remain below the steady growth rate.

When it exceeds this rate, the economy enters the phase of expansion And prosperity

TRADE CYCLE



DEPRESSION

PRICE LEVEL FALLS

↓

PRODUCTION DECREASES

↓

UNEMPLOYMENT INCREASES

↓

PURCHASING POWER DECREASES

→

DEMAND FALLS

↑

PRODUCTIVE ACTIVITY SLOWS DOWN

↑

PRODUCTION FALLS

↑

STOCKS ACCUMULATE

RECOVERY

DURING DEPRESSION ONLY CONSUMER GOODS ARE PURCHASED

DURABLE GOODS REMAIN UNSOLD

OLD DURABLE GOODS EITHER GET CONSUMED OR BECOME OBSOLETE

PURCHASE OF GOODS AGAIN BECOMES NECESSARY

PRODUCERS PURCHASE THESE GOODS

PRODUCTION IS ENCOURAGED

INCREASE IN EMPLOYMENT

INCREASE IN DEMAND FOR CONSUMER GOODS

GREATER PRODUCTION OFCAPITAL GOODS

ENCOURAGEMENT TO PRODUCE CONSUMER AS WELL PRODUCTIVE GOODS

PROGRESS IN BOTH INDUSTRIES

FULL EMPLOYMENT

BOOM

EMPLOYMENT INCREASE

WAGES RISE

DEMAND INCREASES

PRICES RISE

PROFITS RISE MORE THAN WAGES

LEVEL OF INVESTMENT INCREASES

AS A RESULT THE LEVEL OF EMPLOYMENT, INCOMES AND TRADE ALSO RISE

THERE IS OVERALL PROSPERITY

RECESSION

INCREASED DEMAND DURING BOOM

BRINGS IN LESS EFFICIENT MEANS OF PRODUCTION

MONEY MARKET ALSO BECOMES COSTLIER

DEMAND FOR LOANS PUSHES UP INTREST RATES

QUANTITY OF INVESTMENT BEGINS TO DECREASE

COST OF PRODUCTION GOES UP

PRICES OF COMMODITIES RISE SHARPLY

BEGINNING OF DEPRESSION

What causes recession?

Decrease in spending by consumers due to lack of faith in the economy

Less consumption would mean decline in demand for products

Which leads the manufacturers to cut down on production

Lower production would lead to job cuts

Which leads to high levels of unemployment

Which perpetuates the cycle due to limited spending

NEED FOR CONTROLLING BUSINESS CYCLES

Business Cycles

- Harm to business community
- Create unemployment and poverty

↓

Hence, there is a need to create stabilization

↓

Through Government Intervention

FISCAL POLICY

- Fiscal policy refers to the government's choices regarding the overall level of government purchases or taxes.
- Fiscal policy influences saving, investment, and growth in the long run.
- In the short run, fiscal policy primarily affects the aggregate demand.

MONETARY POLICY

- A credit policy through which RBI seeks to ensure price stability in the Economy.
- Controls on the supply of Money, the Cost and the Availability of credit in the country

INSTRUMENTS OF MONETARY POLICY

Instruments of monetary policy are :

1. General Methods
2. Selective Methods

General Credit Control

- The general methods affect the total quantity of credit and affect the economy generally.
- There are three general or quantitative instruments of credit control.
  1. The Bank Rate
  2. Open Market Operations
  3. Variable Reserve Requirements
- The use of one instrument rather than another at any point of time is determined by the nature of the situation and the range of influence.

Tools of Monetary Policy

- Cash Reserve Ratio
- Repo Rate
- Reverse Repo Rate
- Bank Rate
- Statutory Liquidity Ratio

Cash Reserve Ratio

- Cash reserve Ratio (CRR) is the amount of funds that the banks have to keep with RBI.
- If RBI decides to increase the per cent of this, the available amount with the banks comes down.
- RBI is using this method (increase of CRR rate), to drain out the excessive money from the banks.

Repo Rate

- Repurchase agreement (or repo) is an agreement between two parties whereby one party sells the other a security at a specified price with a commitment to buy the security back at a later date for another specified price.

- Whenever the banks have any shortage of funds they can borrow from RBI. Repo rate is the rate at which our banks borrow rupees from RBI.

- A reduction in the repo rate will help banks to get money at a cheaper rate. When the repo rate increases borrowing from RBI becomes more expensive.

Reverse Repo Rate

- Reverse repo is a term used to describe the opposite side of a repo transaction.
- The party who sells and later repurchases a security is said to perform a repo. The other party—who purchases and later resells the security—is said to perform a reverse repo.

Bank Rate

- Bank rate, is also referred to as the discount rate.
- The rate of interest which a central bank charges on the loans and advances that it extends to commercial banks and other financial intermediaries.
- Changes in the bank rate are often used by central banks to control the money supply.

Statutory Liquidity Ratio

Statutory Liquidity Ratio or SLR refers to the amount that all banks require to maintain in cash or in the form of Gold or approved securities.

To fight the cyclical fluctuations effectively, government and the Central Bank should come together with a combo package of monetary and fiscal measures


THANK YOU
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