

BUSINESS CYCLES

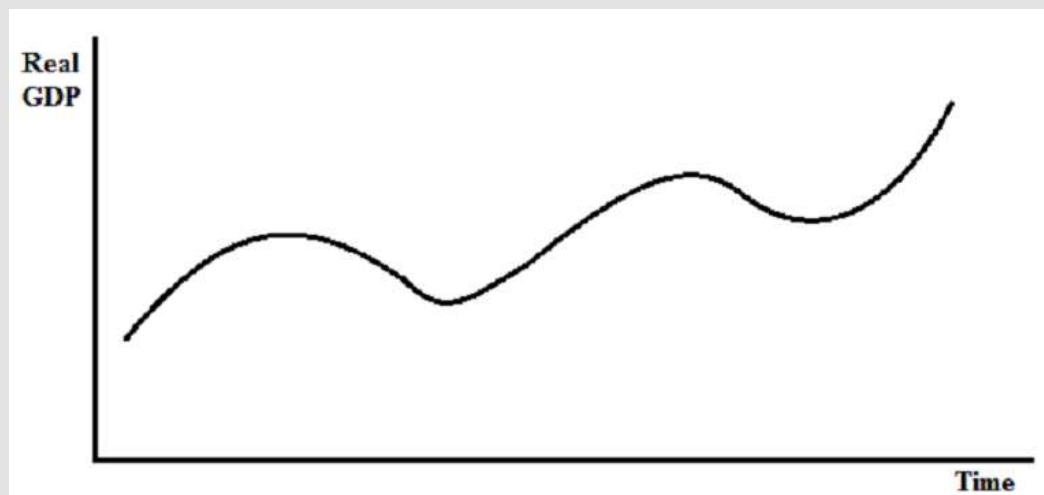


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What is business cycle?

The natural expectation is that production and income in the Slovak economy will increase over time. Unfortunately, however, as we have seen in the past few years, any economy is subject to market and environmental activities that can cause production and income to fall. In general, we think of an economy as following a business cycle of economic activity, with both positive and negative growth periods. Figure 1 shows a diagram of a reasonable growth path that an economy might take.

The three positively-sloped portions of the curved function are known as the expansion phases of the business cycle, where the economy is growing in normal fashion. The top of each growth period is known as a peak. Two peaks are shown in this diagram. These peaks are then followed by negative growth periods known as contractions, with the bottom of each contraction known as a trough. After each trough, a new business cycle begins with a new expansion period. The period of time from one peak to the next peak is one business cycle.



each expansion phase or each contraction phase. In addition, although we have shown the second peak as greater than the first peak, it is not necessarily the case that a later peak exceeds the former. An expansion period can be short-lived, leading to a lower second peak. Likewise, a second trough can be even lower than its preceding trough. This outcome is quite common when expansion periods are short. In recent years, worldwide economic activity took a long time before it attained to the peak of economic activity that it had enjoyed prior to the worldwide economic collapse in 2008.

What happens during business cycle?

Industrial production grows during expansion and declines during contraction. The same happens to employment. Almost everybody willing to work can find a job during expansion which means that unemployment is quite low and it is very difficult to get a job offer during contraction when unemployment is high. Wages and salaries tend to increase during expansion and decline during contraction. Workers should like expansions and hate contraction.

Firms invest a lot during growth of the economy and there is low investment during contraction. Similarly, households invest in durable goods like TV sets, autos etc. during expansion of the economy

and much less during contraction. This is not surprising because during expansion income of households increases and almost everybody has a job. Households are therefore optimistic and confident because they have good income. Firms are also optimistic and confident during expansion because of growing profits and pessimistic and depressed during contractions as their profits decline.

When growth of the economy is high, there is not enough people who could work at booming factories or small businesses and all production capacities are fully exploited so both workers and owners of capital can demand higher wages or rental prices and inflation (change of prices) increases. Interest rates which is price of the money also increases as central banks fight inflation. Businesses however enjoy expansions because their profits go up and hate recession when their profits decline.

Contraction is really bad for small firms. They do not have a lot of cash reserves or collateral and therefore it is difficult for them to survive recession as they do not have good access to credit from banks. Bankruptcies among small firms are very frequent during contraction especially if it is long-lasting. Firms that try to survive contraction need to lay off some workers and remaining workers need to work harder and longer hours. This situation is not good for workers which become dissatisfied.



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Can we do something about it?

Both households and firms should remember that there will be recession after current expansion and should prepare for the bad times that could occur in the future. In good times firms should prepare for decline of business orders and revenues in bad times. Flexible companies that can make changes are well prepared for the changes of economic environment. In contraction it is important to firms to make sure that they do not lose good employees or key consumers. In addition to economic benefits like better prices and terms firms should also have good communication with both employees and consumers. Sacrifices need to be made together in bad times, if possible. Good managers of businesses should be rational and base not their decisions on emotions and hopes. Do not be overly optimistic in good times. Similarly, households, do not be too optimistic in good times and make reserves, do not get too indebted when economy is rosy. People should also do your own research about the state of the economy, listen to opinions of economists and analysts which could help you to make good predictions about future. Trust also your own judgement, not emotions.

Without major cash reserves and large capital assets as collateral, however, and with more difficulty securing additional financing in trying economic times, smaller businesses may have a harder time surviving a recession. Bankruptcies among smaller businesses typically occur at a higher rate than among larger firms.

The bankruptcy or dissolution of a small business that serves a community — a franchised convenience store, for example — can create hardships not only for the small business owners but also for residents of the neighbourhood. In the wake of such bankruptcies or dissolutions, the entrepreneurial spirit which inspired someone to go into such a business may take a hit, discouraging, at least for a while, any risky business ventures. Too many bankruptcies may also discourage banks, venture capitalists, and other lenders from making loans for start-ups' until the economy turns around.

Businesses strongly and negatively affected by business cycles:

- Restaurants
- Construction
- Fashion shops
- Electrical goods

- International air and holiday travel
- Advertising and marketing

Businesses strongly and positively affected by business cycles:

- Discount stores
- Fast food restaurants
- Domestic travel and holidays providers
- Alcohol and cigarettes
- Employment assistance