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Economic growth and Business Cycle

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Introduction

The four stages of the economic cycle are also referred to as the business cycle. These four stages are expansion, peak, contraction, and trough. During the expansion phase, the economy experiences relatively rapid growth, interest rates tend to be low, production increases, and inflationary pressures build

Business cycles are intervals of expansion followed by recession in economic activity. They have implications for the welfare of the broad population as well as for private institutions. Typically business cycles are measured by applying a band pass filter to a broad economic indicator such as Real Gross Domestic Production. Here important problems may arise with a commonly used filter called the "ideal filter". For instance if a series is a purely random process without any cycle, an "ideal" filter, better called a block filter, a spurious cycle is produced as output. Fortunately methods such as [Harvey and Trimbur, 2003, Review of Economics and Statistics have been designed so that the band pass filter may be adapted to the time series at hand [Harvey and Trimbur, 2003, Review of Economics and Statistics] have been designed so that the band pass filter may be adapted to the time series at hand.

Economic cycles of developing countries, low-income countries in particular, were long thought to be by and large 'decoupled' from those of advanced economies in the United States and Western Europe. Conventional wisdom was that exactly those factors keeping the poorest countries in deadlock, like limited financial development and integration, would insulate them from financial and economic troubles in the West. However, by late 2008, when initial liquidity problems in the financial sectors of the United States and Europe turned into wider solvency concerns about global financial institutions and worldwide market confidence eroded rapidly hopes of decoupling had proven overly optimistic. The global crisis, under the form of multiple shocks16 propagated throughout the developing world.

Business cycles refer to the regular cyclical pattern of economic boom (expansions) and bust (recessions). Recessions are characterized by falling output and employment; at the opposite end of the spectrum is an "overheating" economy, characterized by unsustainably rapid economic growth and rising inflation. Capital investment spending is the most cyclical component of economic output, whereas consumption is one of the least cyclical. Government can temper booms and busts through the use of monetary and fiscal policy. Monetary policy refers to changes in overnight interest rates by the Federal Reserve. When the Fed wishes to stimulate economic activity, it reduces interest rates; to curb economic activity, it raises rates. Fiscal policy refers to changes in the federal budget deficit. An increasing deficit stimulates economic activity, whereas a decreasing deficit curbs it. By their nature, policy changes to influence the business cycle affect the economy only temporarily because booms and busts are transient. In recent decades, expansions have become longer and recessions shallower, perhaps because of improved stabilization policy, or perhaps because of good luck.

Economic growth can be caused by random fluctuations, seasonal fluctuations, changes in the business cycle, and long-term structural causes. Policy can influence the latter two.

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