

Topic 6

Business Cycles

Econ 1102 sec 027 (whiteboard)



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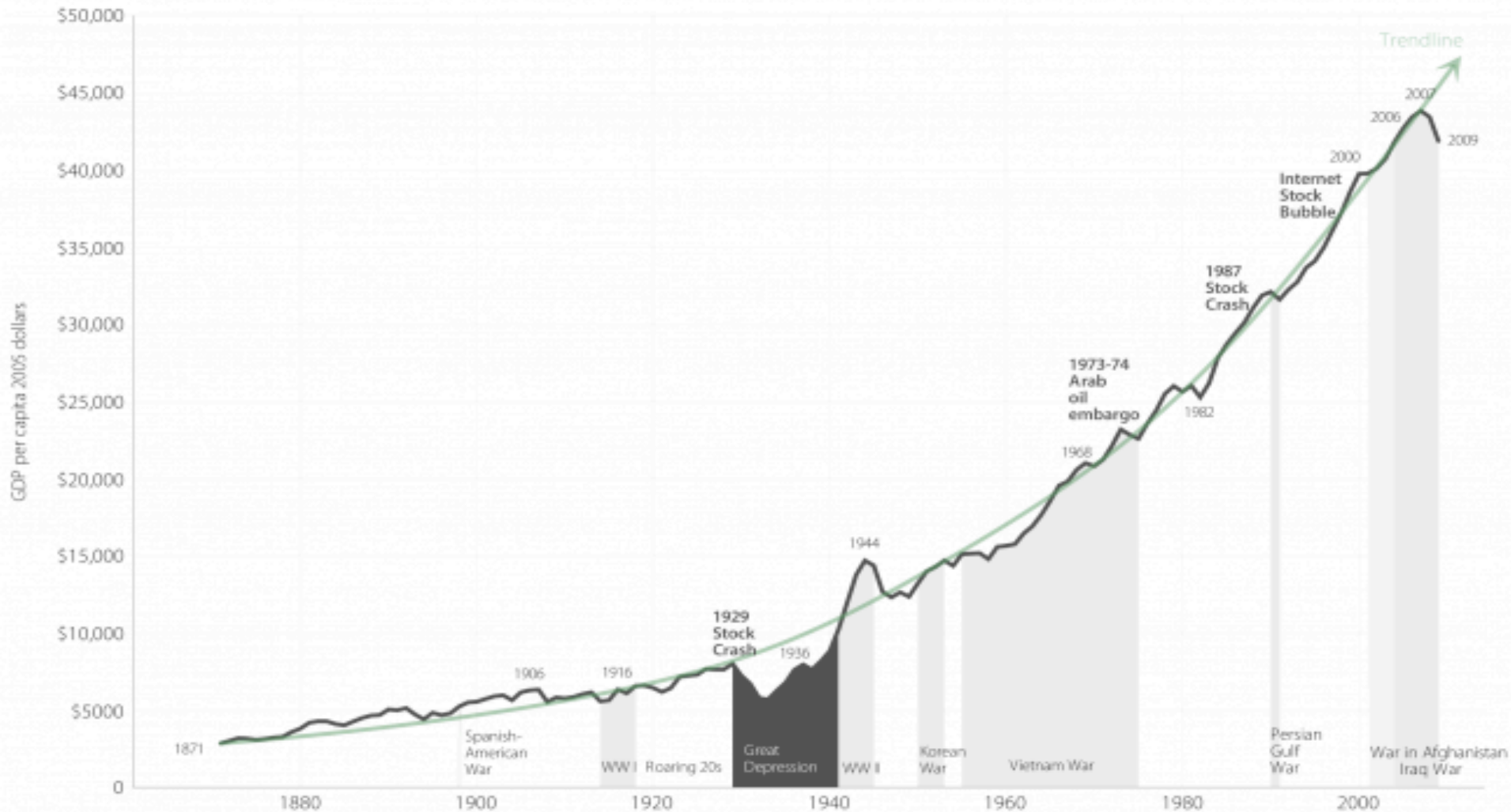
Agenda

- Recap and motivating questions
- Business Cycles (What are they?)
- The late 2000's recession
- What causes business cycles?
 - 4 broad theories
- Should policy makers try to stabilize the economy?



Long-term real growth in US GDP per capita 1871–2009

GDP per capita adjusted for inflation using 2005 dollars



Data from MeasuringWorth.com

VisualizingEconomics.com



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What are Business Cycles?

And what do they look like in the data?

Business
Cycles

Recent
recession

Causes

Stabilize?



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Zooming in....



Business Cycles

Recent recession

Causes

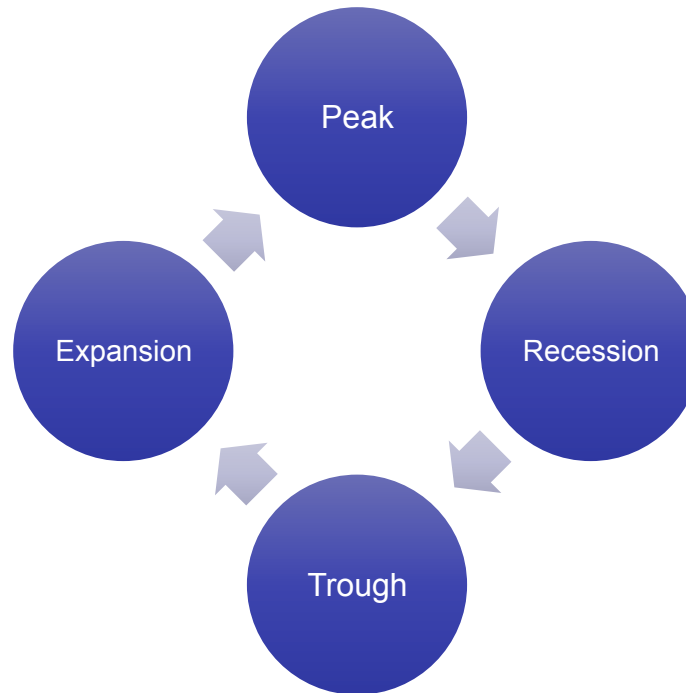
Stabilize?



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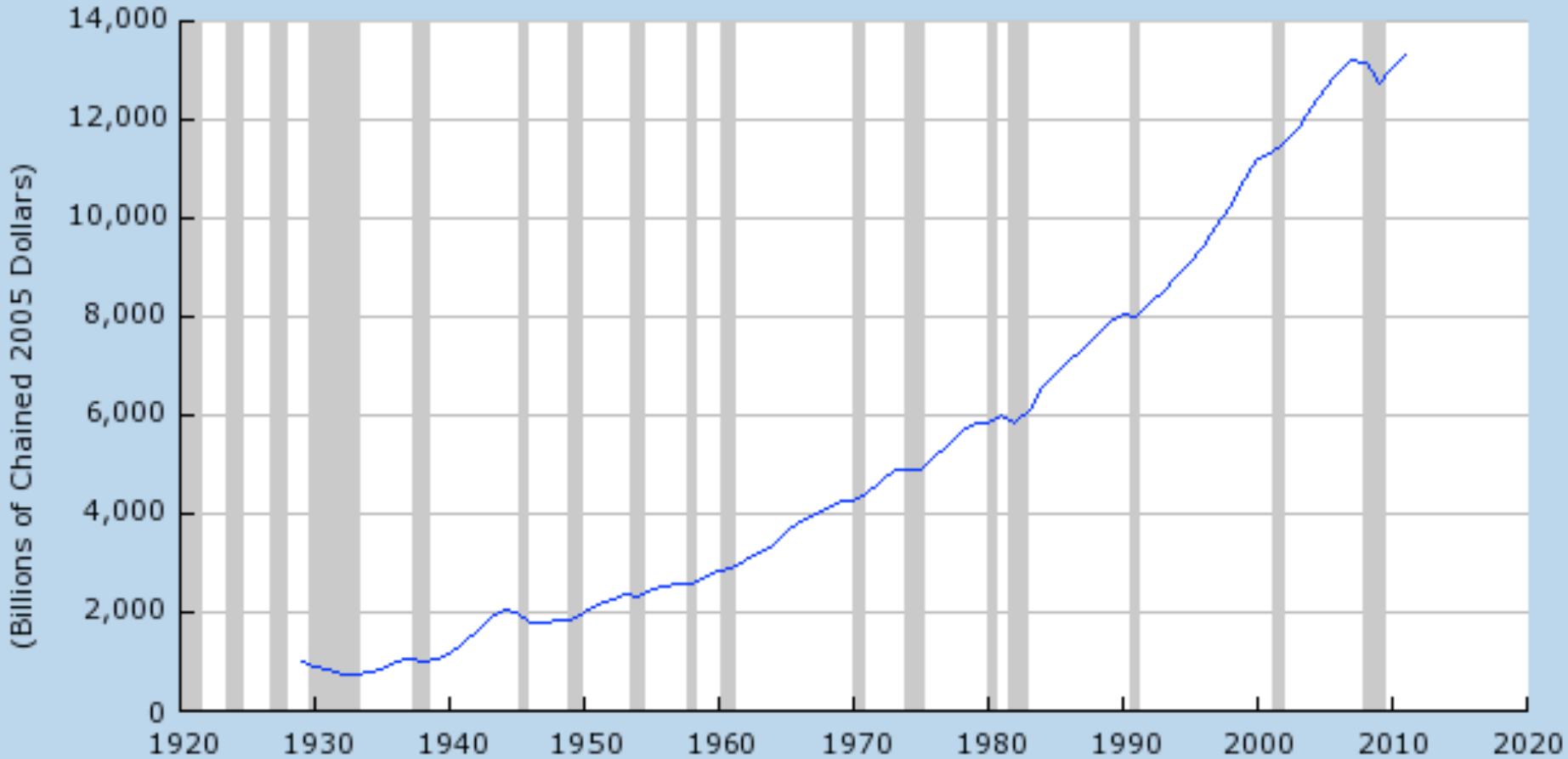
So what is one cycle?

- One cycle consists of one time around:



Real Gross Domestic Product (GDPCA)

Source: U.S. Department of Commerce: Bureau of Economic Analysis

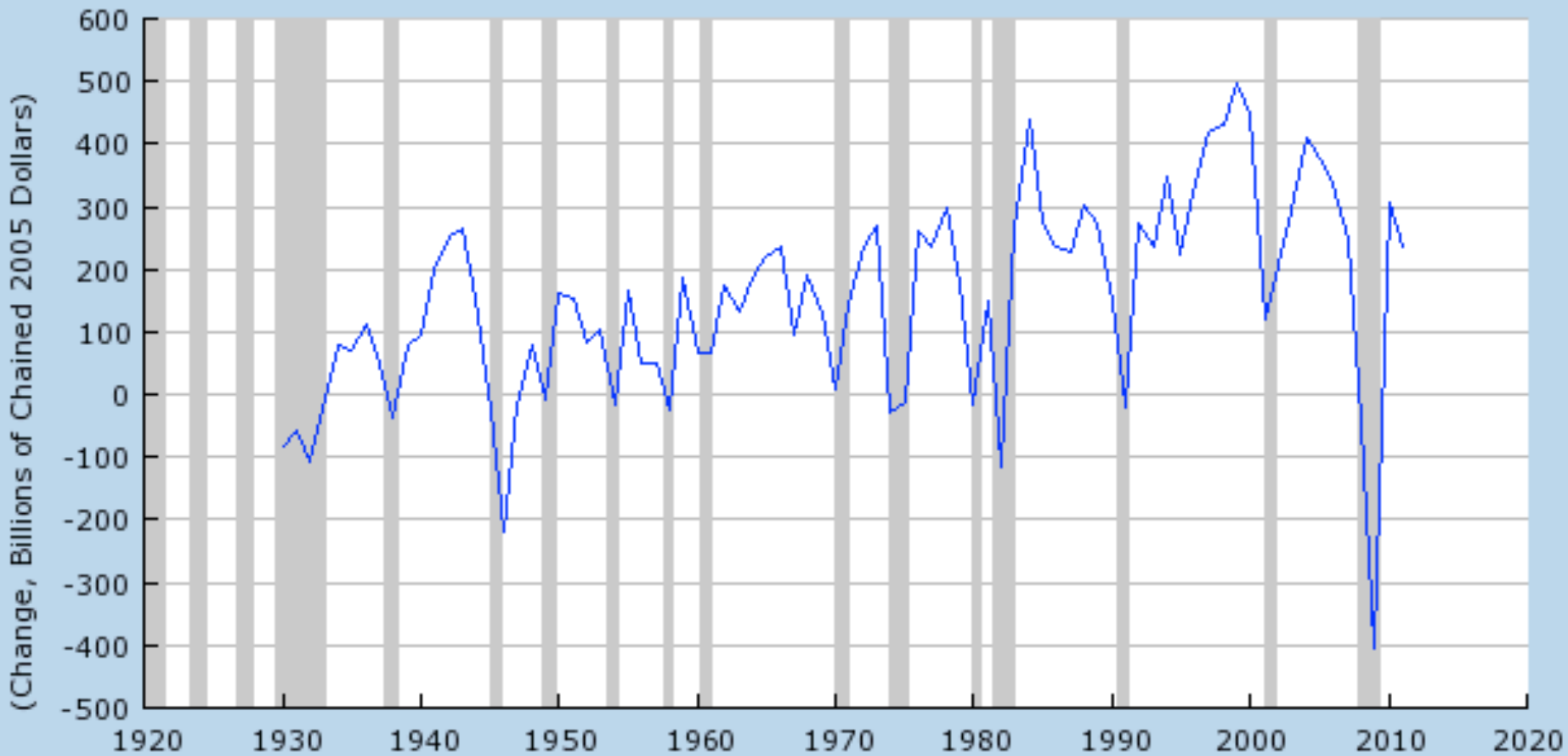


Shaded areas indicate US recessions.
2012 research.stlouisfed.org



Real Gross Domestic Product (GDPCA)

Source: U.S. Department of Commerce: Bureau of Economic Analysis



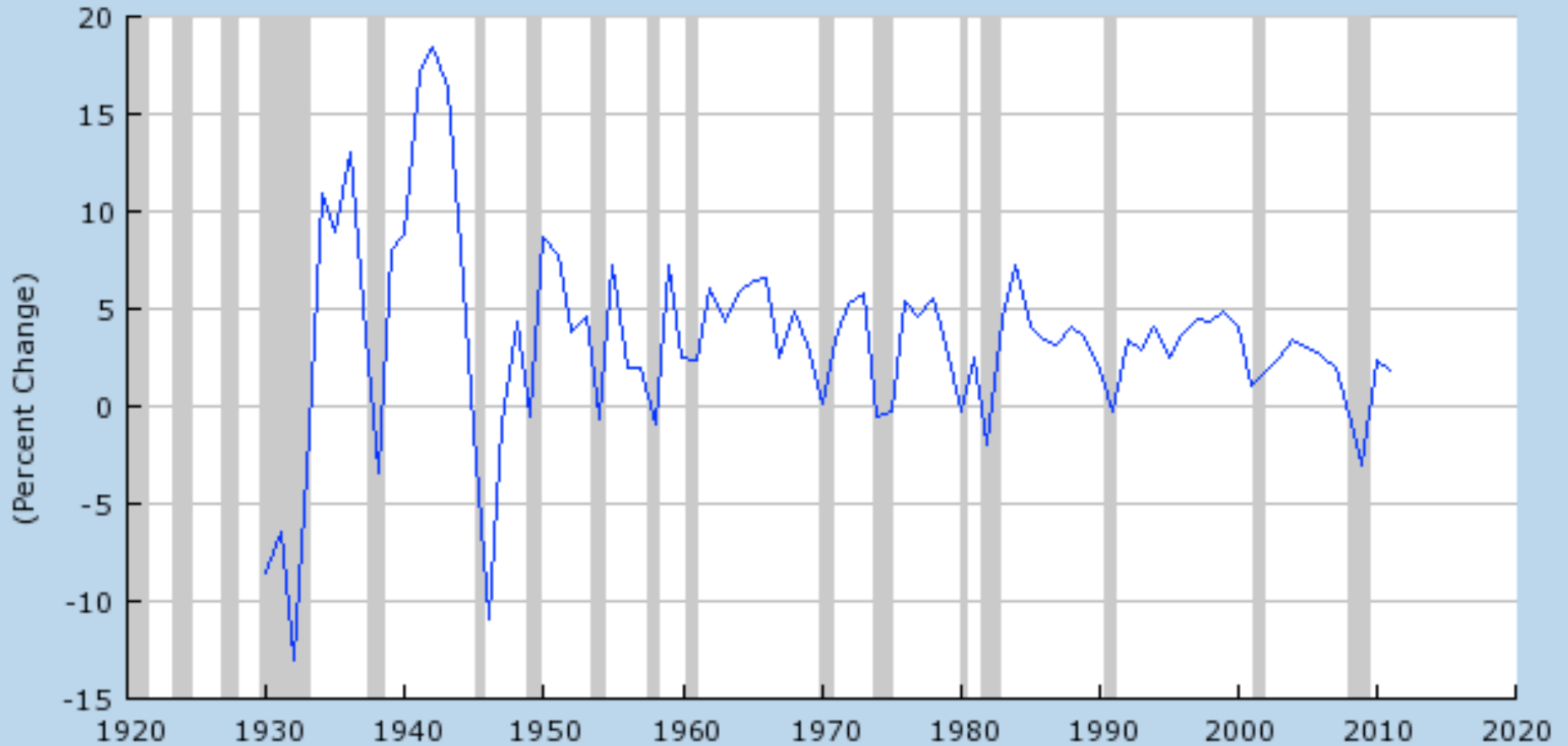
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The Late 2000's Recession

a.k.a. “the most recent recession,”
“The Great Recession,” etc.



How bad was the recent recession?

Period	Duration, Months	Depth (Decline in Real Output)
1929-1933	43	-26.7% (Great Depression)
1937-1938	13	-18.2% (post-New Deal)
A few more in between...		
1953-1954	10	-2.6% (post-Korean-War-bubble)
1957-1958	8	-3.7% (budget-balancing)
1960-1961	10	-1.6% (tight monetary policy)
1969-1970	11	-0.6% (fiscal, monetary policy post Vietnam)
1973-1975	16	-3.2% (oil crisis, stock market crash))
1980	6	-2.2% (really tight monetary policy, energy crisis)
1981-1982	16	-2.7% (see previous. "double-dip" recession)
1990-1991	8	-1.4% (oil crisis, 80s debt accumulation)
2001	8	-0.3% (dot-com bust, fall in investment, Sept. 11)
Dec. 2007-Mar 2009	18	-5.1% (subprime mortgage crisis leading to global financial crisis; oil prices)

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Additional observations from the table of recessions

Average of cycles	Peak to trough	Trough to peak	Trough to trough	Peak to Peak
1854-1919 (16 cycles)	21.6	26.6	48.2	48.9
1919-1945 (6 cycles)	18.2	35.0	53.2	53
1945-2009 (11 cycles)	11.1	58.4	69.5	68.5

- Recessions becoming less frequent

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- Recessions shorter in duration

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- Expansions lasting longer

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What causes business cycles?

Or, why can't we just drive the car in a straight line?



What caused the recent recession?

- Subprime lending
- Cheap credit b/c of low interest rates
- Over-leveraging, Collateralized Debt Obligations (CDOs), Credit Default Swaps (CDSs)
- Lack of Government Legislation
- With this factors in mind video: <http://vimeo.com/3261363>

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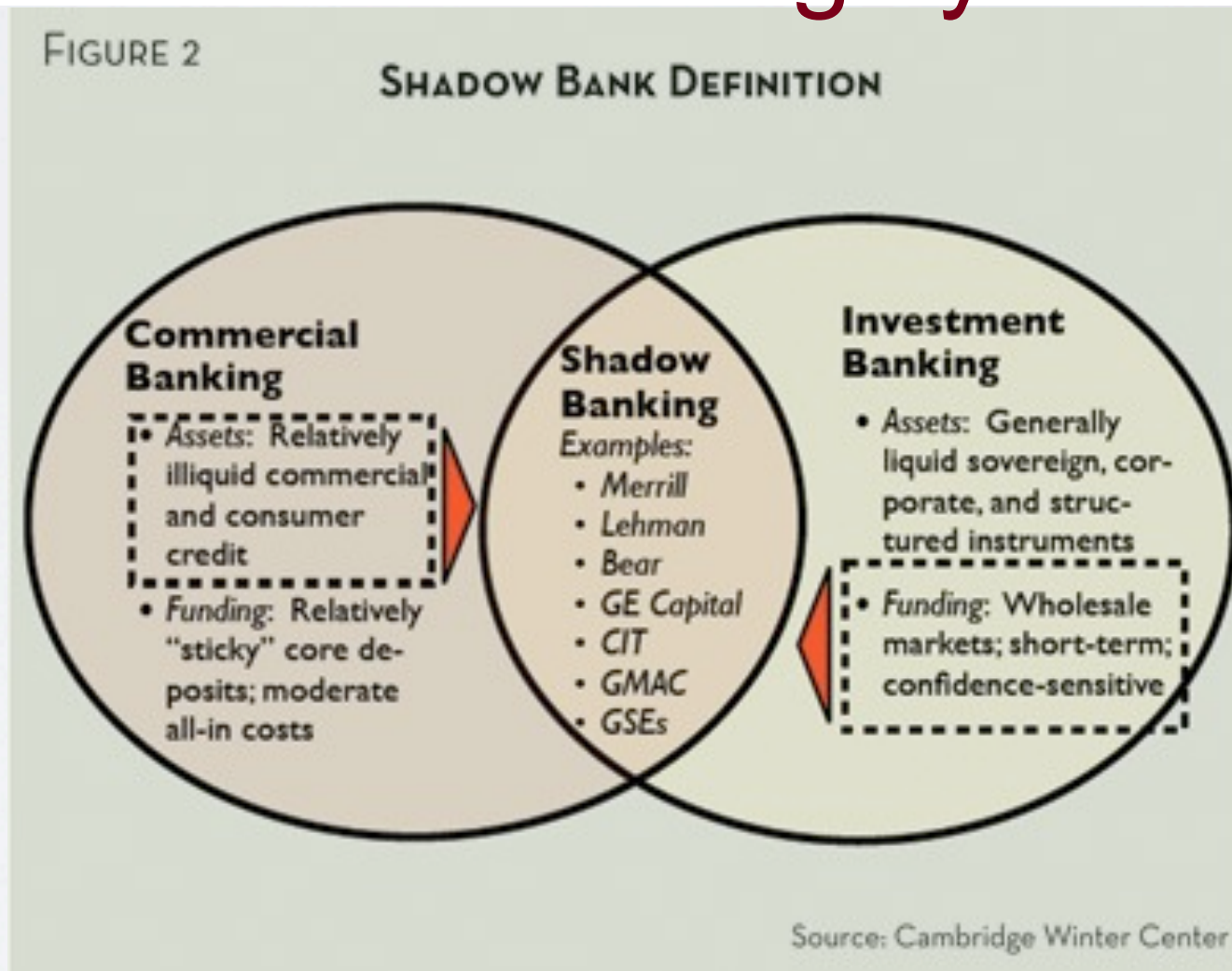
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“Shadow banking system”



Business Cycles

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What causes recessions in general?

- Four main groups: (implication) because they disagree on the cause of macro fluctuations, they recommend different policies for smoothing out business cycles:
 1. New Keynesians
 2. Monetarists
 3. RBC View
 4. Coordination Failure group

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Key Ideas and Things To Think About

Note: This is NOT a study guide – i.e. do not limit yourself to these items when studying



Key Ideas

- **Business cycles** are short-term divergence from the natural rate of output or long-term growth rate.
 - They are irregular and unpredictable
- Macroeconomists disagree about the exact causes (of B.C).
 - Its not clear how much sticky prices/wages are to blame



Key Ideas

- Different schools of thought propose different solutions on how to smooth (if we intervene) the business cycles.
- Stabilizing is a great idea, as long as it works the way you want it to



Things To Think About

- You heard my general explanation of how the recent recession happened. How would the 4 different groups of economists explain the recession?



Things To Think About

- When we come out of recessions, the rich get richer *faster* than the poor get richer. This increases inequality. Why might this be?

