Subject: Economics	Topic: The economic cycle	Year Group: 12

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The economic cycle

The economic cycle is the fluctuation of the economy between periods of expansion (growth) and contraction (recession). Factors such as gross domestic product (GDP), interest rates, total employment, and consumer spending, can help to determine the current stage of the economic cycle.

Characteristics of a boom and recession

BOOM	RECESSION
When the economy is in expansion, businesses generate profits, which leads to hiring more employees, and more disposable income and spending. It, in turn, leads to more profits for businesses, and it continues in a virtuous cycle.	When the economy is in contraction/recession, businesses lose profits, which leads to downsizing and laying off of employees. When employees lose their jobs, there is less disposable income and less consumer spending, which leads to even lower business profits. It continues in a vicious cycle.

What is Aggregate supply?

Aggregate supply measures the volume of goods and services produced each year. AS represents the ability of an economy to deliver goods and services to meet demand

Circular flow of income

1	The circular flow of income and spending shows connections between different sectors of an economy
2	It shows flows of goods and services and factors of production between firms and households
3	The circular flow shows how national income or Gross Domestic Product is calculated
4	Leakages (withdrawals) from the circular flow Not all income will flow from households to businesses directly. The circular flow shows that some part of household income will be: 1.Put aside for future spending, i.e. savings (S) in banks accounts and other types of deposit 2.Paid to the government in taxation (T) e.g. income tax and national insurance 3.Spent on foreign-made goods and services, i.e. imports (M) which flow into the economy
5	Injections into the circular flow are additions to investment, government spending or exports so boosting the circular flow of income leading to a multiplied expansion of output. Capital spending by firms, i.e. investment expenditure (I) e.g. on new technology The government, i.e. government expenditure (G) e.g. on the NHS or defence Overseas consumers buying UK goods and service, i.e. UK export expenditure (X)
6	An economy is in equilibrium when the rate of injections = the rate of withdrawals from the circular flow.

What is Aggregate Demand?

Aggregate demand is the total demand in the economy. Total demand comes from households, businesses, government and from abroad. It can be summarised with this equation: Ad = C + I + G + X - M

Factors affecting AD and AS

AD	AS
The aggregate demand curve tends to shift to the left when total consumer spending declines. Consumers might spend less because the cost of living is rising or because government taxes have increased.	Employment costs e.g. wages, employment taxes. Unit labour costs are also affected by the level of labour productivity
A large rise or fall in the exchange rate – affecting export demand and second-round effects on output, employment, incomes and profits of businesses linked to export industries.	Costs of other inputs e.g. commodity prices, raw materials. The exchange rate can affect the prices of key imported products
An unexpected cut or an unexpected rise in interest rates or change in government taxation and spending – for example deep cuts in government spending as part of fiscal austerity	Impact of government e.g. environmental taxes such as carbon duties & business regulations which affect the costs of production
An event such as the credit crunch (global financial crisis) – involving a fall in the amount of credit available for borrowing by households and businesses.	Natural disasters can have a negative impact on an economy's ability to produce goods and services.
A slump in the housing market or a big change in share prices	Improvements in productivity can shift the aggregate supply curve to the right
A recession in main trading partners affecting demand for exports of goods and services.	

Beckfoot

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Measures of unemployment

The claimant count is a measure of unemployment and counts only those people who are eligible to claim the Job Seeker's Allowance (JSA). One significant problem with the claimant count is that it omits many people who are interested in finding work but do not meet all of the criteria for claiming.

The ILO measure is designed to include all persons above a specified age who are, without work, currently available for work and seeking work.

Impacts of unemployment

1	Loss of income for unemployed which leads to lower consumption
2	Less tax revenue for government and higher government borrowing, budget deficit
3	Potential homelessness. Loss of income can leave people without sufficient income to meet housing costs. Rises in unemployment often exacerbate the rates of homelessness.
4	Lost human capital. If people are out of work, they miss out on 'on the job training' This is a vital component of human capital and labour skills; high rates of unemployment can reduce labour productivity. If someone is out of work for two years, they miss out on the latest working practices and trends. Being unemployed can also affect the confidence of the unemployed and they become less employable in the future.
5	Harms future prospects. Those who are unemployed will find it more difficult to get work in the future (this is known as the hysteresis effect)
6	ower GDP for the economy. High unemployment indicates the economy is operating below full capacity and is inefficient; this will lead to lower output and incomes. The unemployed are also unable to purchase as many goods, so will contribute to lower spending and lower output. A rise in unemployment can cause a negative multiplier effect.

Employment, underemployment and unemployment

1	Employment refers to the number of people in work
2	Unemployment refers to those who are willing and able to work but unable to work
3	Underemployment is defined as a situation where people are working fewer hours than they wish; e.g. you would like to work 40 hours a week, but the firm only gives you 30 hours. Underemployment may also refer to the fact workers accept jobs that don't utilise their skills. e.g. graduate working in McDonald's may be considered to be 'under-employed')

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Inflation

1	Inflation is a sustained rise in the average price level (usually retail prices) and a fall in the value of money.
2	Deflation is a sustained fall in the average price level (usually retail prices) and a rise in the value of money.
3	Disinflation is a fall in the rate of inflation – a decrease in the rate at which the average price level is rising.

COMMON MISTAKE: disinflation does not mean a fall in the average price

Causes of unemployment

Structural unemployment	unemployment occurs because the structure of the economy has changed; for example, the decline of whole industries such as coal mining.
Occupational immobility	when an unemployed person does not have the right skills or abilities to take up the employment on offer, this is often linked with structural change.
Geographical immobility	similar in that an unemployed person is prevented from taking a job because they cannot move to where the job is, perhaps because of family or the cost of moving.
Technological unemployment	caused by technological change. As technology improves it is often the case that fewer employees are needed, they can be replaced with machinery or computers.
Demand-deficient unemployment	also known as cyclical unemployment is where unemployment occurs because AD in the economy has fallen (in a recession), leading to a fall in the demand for labour.

RPI AND CPI MEASURES OF INFLATION

RPI includes the costs of housing (mortgage interest costs and council tax for example) while CPI does not.

The RPI is an arithmetic mean ie, the prices of everything to be included in it are simply added up and divided by the number of items.

The CPI is a geometric mean. It is calculated by multiplying the prices of all the items together and then taking the nth root of them, where 'n' is the number of items involved.

Real vs nominal values
The nominal value of something is its money value at different points in time.
Real values adjust for differences in the average price level over time. In other words, real values are nominal values but with inflation taken into account.

Demand pull and cost push inflation
Demand-pull inflation occurs as a result of increasing AD in an economy, resulting in prices rising as consumers try to buy increasingly scarce goods.
Cost-push inflation occurs as a result of an increase in the costs of production in an economy, resulting in rising prices as firms try to maintain profitability. The rising price of oil and other imported commodities can cause cost-push inflation.

Impact of inflation

Firms	Households
Uncertainty	Fall in real income
Higher costs of production	Less purchasing power
Loss of competitiveness	Uncertainty about future prices
Fall in demand due to households spending falling and lack of competitiveness	Pensioners, savers and those on fixed incomes lose out
	Borrowers benefit as inflation erodes the real value of their debt