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Business cycle

Technical box extracted from:

Inflation Report no.3, August 2013 [1]

The **business cycle** is the upward and downward movements of levels of GDP and refers to the period of expansions and contractions in the level of economic activities around its long-term growth trend. These fluctuations typically involve shifts over time between periods of relatively rapid economic growth (expansion), and periods of relative stagnation or decline (recession).

Business cycles are usually measured by considering the growth rate of real gross domestic product and these fluctuations in economic activity are not regular or mechanical.

Due to the slow adjustment of nominal rigidities, the economic cycles are possible, so that the monetary discrepancies that may affect only the demand lead to causing fluctuations in economic activity. Fluctuations can be explained by the markets that are not without imperfections and asymmetries. The shocks that can impact business cycles are technological shocks and the aggregate fluctuations are generated by the optimal decisions of businesses and households.

Business cycles present deviations of real output from its long term trend.

Macroeconomic variables can have multiple types of actions on business cycles. Classification of macroeconomic variables in relation to their relationship with business cycles has the following form:

- *Procyclical - are the variables that typically increase during economic expansion and decreases during economic recession. For example, productivity is a cyclical variable.*
- Counter*cyclical* - are the variables that typically decrease during economic growth and increase during the recession. For example, the unemployment rate is countercyclical variable.
- *Acyclic - are variables that do not have a systematic relationship with the business cycle.*

Table no.1. Macroeconomic variables relationship with business cycles

Variable	Direction
Production **Industrial production** Sustainable industrial goods are more volatile compared to Consumer goods and services	**Procyclical**
Expenses — **Consumption** — **Investment in fixed capital** — **Investment in housing** — **Investing in stocks** — **Government procurement** Investments are more volatile than consumption	 **Procyclical** **Procyclical** **Procyclical** **Procyclical** **Procyclical**
Labor market variables — **Employment rate** — **Unemployment rate** — **Average labor productivity** — **Real wage**	 **Procyclical** **Countercyclical** **Procyclical** **Procyclical**
Money supply and Inflation — **Money supply** — **Inflation**	 **Procyclical** **Procyclical**
Financial variables — **Share price** — **Nominal interest rate** — **Real interest rate**	 **Procyclical** **Procyclical** **Acyclic**

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