Trade Cycle: 4 Phases of Trade Cycle

The four important features of Trade Cycle are (i) Recovery, (ii) Boom, (iii) Recession, and (iv) Depression!

The trades cycle or business cycle are cyclical fluctuations of an economy. A full trade cycle has got four phases: (i) Recovery, (ii) Boom, (iii) Recession, and (iv) depression. The upward phase of a trade cycle or prosperity is divided into two stages—recovery and boom, and the downward phase of a trade cycle is also divided into two stages—recession and depression.

Phases of Trade Cycle:

The phases of trade cycle are explained with a diagram:

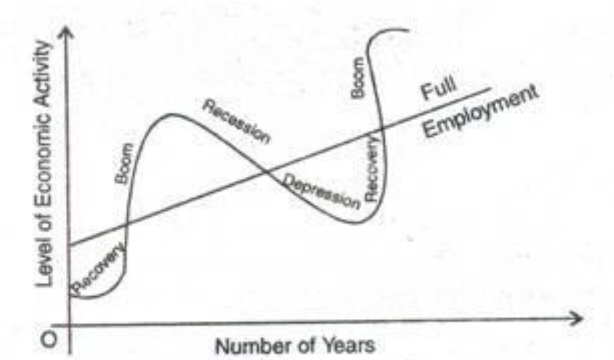

FIG. 2 : PHASES OF TRADE CYCLE

(1) Recovery:

In the early period of recovery, entrepreneurs increase the level of investment which in turn increases employment and income. Employment increases purchasing power and this leads to an increase in demand for consumer goods.

As a result, demand for goods will press upon their supply and it shall, thereby, lead to a rise in prices. The demand for consumer's goods shall encourage the demand for producer's goods.

The rise in prices shall depend upon the gestation period of investment. The longer the period of investment, the higher shall be the price rise. The rise of prices shall bring about a change in the distribution of income. Rent, wages, interest do not rise in the same proportion as prices.

Consequently, the margin of profit improves. The wholesale prices rise more than retail prices. The prices of raw materials rise more than the prices of semi-finished goods and the prices of semi-finished goods use more than the prices of finished goods.

(2) Boom:

The rate of investment increases still further. Owing to the spread of a wave of optimism in business, the level of production increases and the boom gathers momentum. More investment is possible only through credit creation. During a period of boom, the economy surpasses the level of full employment and enters a stage of over full employment.

(3) Recession:

The orders for raw materials are reduced on the onset of a recession. The rate of investment in producers' goods industries and housing construction declines. Liquidity preference rises in society and owing to a contraction of money supply, the prices falls. A wave of pessimism spreads in business and those markets which were sometime before sellers markets become buyer's markets now.

(4) Depression:

The main feature of a depression is a general fall in economic activity. Production, employment and income decline. The prices fall and the main factor responsible for it is, a fall in the purchasing power.