Exercise walk-through

Business Cycles ▪ 2.7

eXercise

You must be able to

- identify the four phases of the **business cycle 经济周期**: expansion, peak, contraction, trough
- relate movements in **real GDP** to unemployment and inflation over the cycle
- distinguish the **output gap 产出缺口** between actual and potential GDP
- define a **recessionary gap 衰退缺口** and an **inflationary gap 通胀缺口**

Method — The four phases

Expansion (rising output) $\rightarrow$ **peak** $\rightarrow$ **contraction** / **recession** (falling output) $\rightarrow$ **trough** $\rightarrow$ recovery.

Method — Over the cycle

In an **expansion** unemployment falls and inflation tends to rise; in a **recession** the reverse happens.

Method — Output gaps

The **output gap** is actual minus potential real GDP. Below potential is a **recessionary gap**; above potential is an **inflationary gap**.

Practice 2.1 ▪ 2 marks

Name the four phases of the business cycle.

Solution 2.1

Method: The four phases

Worked steps

expansion, peak, contraction (recession), trough **B1** **B1** *for any two; for all four.*

Practice 2.2 ▪ 1 mark

Define a recessionary gap.

Solution 2.2

Worked steps

the gap when actual real GDP is below potential (full-employment) GDP B1.

Practice 2.3 ▪ 1 mark

State what happens to unemployment during an expansion.

Solution 2.3

Method: Over the cycle

Worked steps

it falls **B1**.

Exam-style 3.1 ▪ 1 mark

The lowest point of the business cycle is the

A peak

B trough

C expansion

D boom

Solution 3.1

A peak

B trough ✓

C expansion

D boom

Worked steps

B.

Exam-style 3.2 ▪ 1 mark

An inflationary gap occurs when actual GDP is ________ potential GDP.

A below

B above

C equal to

D unrelated to

Solution 3.2

Method: Output gaps

A below

B above ✓

C equal to

D unrelated to

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

An economy's actual real GDP is below its potential.
(a) Name this type of output gap.
(b) State what is likely to be high in this phase.
(c) Name the phase of the business cycle.

Solution 3.3

Method: Output gaps

Worked steps

(a) a recessionary gap **B1**. (b) unemployment **B1**. (c) contraction / recession **B1**.