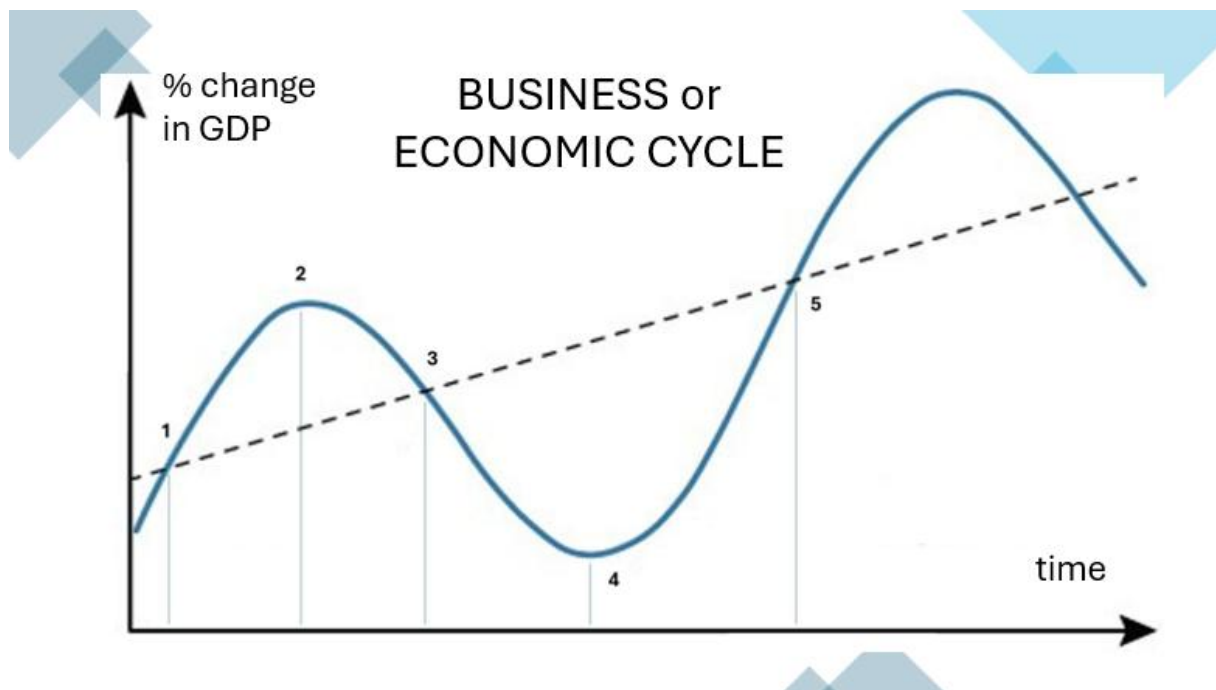


# FREQUENTLY RECURRING QUESTION

## ORAL EXAM

The graph below frequently appears as a question in the oral economics exam, either as a written preparation question or as a non-prepared question.

The intention is always that the student can explain a part of the graph, but is also able to draw the entire graph!



In the graph above, you can see the two types of economic growth together:

The straight line is the **TREND LINE** and represents long-term economic growth.

The wavy line is the **BUSINESS CYCLE LINE** and represents short-term economic growth.

Expressed in GDP terms, we also refer to the trend line as **THEORETICAL GDP** and to the wavy line as **REAL GDP**.

The business cycle line fluctuates around the trend line. The wave movement is caused by **BUSINESS CYCLE SHOCKS**.

These are sudden events in the economy and sometimes in broader society that can be **EXOGENOUS** or **ENDOGENOUS**.

Exogenous means “outside the economy.” The Covid pandemic is an example.

Endogenous means “within the economy.” A VAT reduction is an example.

The shocks can be **POSITIVE** or **NEGATIVE**.

A positive shock gives the economy a boost; in this example, this is the VAT reduction.

A negative shock pushes the economy into a downturn; in this example, this is the Covid pandemic.

Finally, we can also speak of **DEMAND SHOCKS**, **SUPPLY SHOCKS**, and **PRICE SHOCKS**.

An economy experiencing a boost can be recognised by the business cycle line rising above the trend line: the economy experiences a period of **ECONOMIC BOOM** (from point 1 to point 3).

An economy experiencing a downturn can be recognised by the business cycle line falling below the trend line: the economy experiences a period of **ECONOMIC DOWNTURN** (from point 3 to point 5).

When the business cycle line and the trend line coincide, the economy is in equilibrium (points 1, 3 and 5).

Let us take a closer look at the fluctuation of the business cycle line: there are four **BUSINESS CYCLE PHASES** in a **BUSINESS CYCLE**.

The first phase is **EXPANSION** (from point 1 to point 2).

Due to a positive business cycle shock, the business cycle line rises above the trend line. The economy receives a boost and enters a boom period. This reduces unemployment but increases inflation.

Rising inflation is not good for the economy. The economy can overheat, and therefore political authorities (governments) and monetary authorities (central banks) will try to counter economic overheating.

Governments can increase taxes, and central banks can raise interest rates.

When the business cycle line starts to decline again, we speak of a **RECESSION** (from point 2 to point 3).

The economy is still in a boom period, but the growth rate decreases. Consequently, inflation and job growth also decrease.

The closer the business cycle line is to the trend line, the better. The economy then grows in a stable way.

Suppose the business cycle line continues to decline and falls below the trend line, then we enter a **DEPRESSION** (from point 3 to point 4).

The economy collapses and enters a downturn. This increases unemployment but lowers inflation.

Falling inflation is not good for the economy. The economy may end up in deflation, and therefore political authorities (governments) and monetary authorities (central banks) will try to combat this economic cooling.

Governments can lower taxes, and central banks can lower interest rates.

When the business cycle line starts rising again, we speak of a **RECOVERY** (from point 4 to point 5).

The economy is still in a downturn, but the growth rate increases. Consequently, inflation and job growth also increase.

The closer the business cycle line is to the trend line, the better. The economy then grows in a stable way.

The above-mentioned business cycle phases will continue to repeat themselves over time.

That is why we speak of a “cycle.”

Note 1: point 2 is called a “peak” and point 4 a “trough” or “dip.”

Note 2: sometimes two dips can occur consecutively:



This is then called a “double dip.”