Section 5 External influences

Chapter 41 Economic influences

Key terms

1. Appreciated of a currency: a rise in the value of a currency.
2. Boom: the peak of the economic cycle where GDP is growing at its fastest.
3. Downturn: a period in the economic cycle where GDP grows, but more slowly.
4. Consumer price index(CPI): a common measure of price changes used in many countries.
5. Depreciated of a currency: a fall in the value of a currency.
6. Economic, trade or business cycle: regular fluctuations in the level of output in the economy.
7. Exchange rate: the price of one currency in terms of another.
8. Fiscal policy: using changes in taxation and government expenditure to manage the economy.
9. Government expenditure: the amount spent by the government in its provision of public services.
10. Gross domestic product(GDP): a common measure of national income, output, or employment.
11. Index linked: the linking of certain payments such as benefits to the rate of inflation.
12. Inflation: a general rise in price.
13. Monetary policy: using changes in interest rate and money supply to manage the economy.
14. Recession or upswing: a period where economic growth begins to increase again after a recession.
15. Slump or depression: the bottom of economic cycle where GDP starts to fall with significant increase in unemployment.
16. Taxation: charges made by government on the activities, earning and income of businesses and individuals.

1. External influences

1.) Inflation : Inflation is measured by consumer price index (CPI)

<u>⇒ The effects of inflation on business.</u>

1. Increased costs.
2. Uncertainty ; it is difficult to plan for investment.
3. Consumers may save more money to maintain purchasing power in the future.
4. Lower export revenue.

<u>⇒ How might business respond to inflation?</u>

1. search for cheaper supplier
2. control wage cost
3. Finding outsource or relocate production.

2.) Exchange rates

<u>⇒ The impact of an appreciation in exchange rate on imports and exports.</u>

↳ price of exports are more expensive.

↳ price of imports are cheaper.

<u>⇒ The impact of an depreciation in exchange rate on imports and exports.</u>

↳ price of exports are cheaper.

↳ price of imports are more expensive.

<u>⇒ How might businesses respond to a change in exchange rate?</u>

When currency is appreciated, price of exports is expensive in foreigners' view

1.) Exporters may lower price of their products to compensate for the increase in exchange rate.

2.) Importers benefit from appreciation as foreign goods are cheaper.

3.) Interest rate

Interest rate : cost of borrowing and returns on saving.

<u>⇒ Effects of interest rate on investment</u>

Rising in interest rate

⇒ People save more money rather than spend.

⇒ Firms' revenue falls.

⇒ Businesses face higher cost of borrowing, then they reduce investment.

<u>⇒ How might businesses respond to changes in the interest rate.</u>

when interest rate is high

⇒ Businesses face higher cost of borrowing, then they reduce investment.

when interest rate is low.

⇒ Businesses face lower cost of borrowing, then they increase investment.

4.) Taxation

<u>⇒ The effect on businesses of changes in taxation.</u>

1. Higher income tax ⇒ reducing consumers' income and spending.

2. Higher corporate tax ⇒ increasing cost of production.

<u>⇒ How might businesses respond to changes in taxation.</u>

1. Higher corporate Tax ⇒ increasing cost of production and investment

   ⇒ so firms reduce production and investment.

5.) Government expenditure.

<u>⇒ The effect of changes in government expenditure on businesses.</u>

Higher government spending ⇒ A spending level in an economy rises

⇒ Some firms maybe better off.

Higher government spending ⇒ it may cause inflation and higher interest rate.

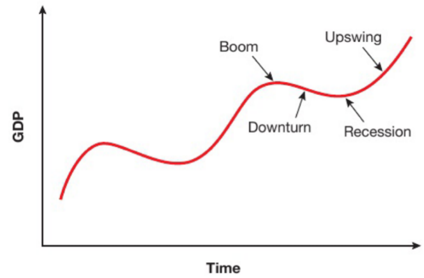
⇒ If higher government spending is funded by borrowing money from commercial banks.

<u>⇒ How might businesses respond to changes in government expenditure</u>

↳ Businesses are likely to benefit from government spending as demand in an economy tends to rise. It depends on how the government spends money as well.

The business cycle

- **Business cycle or economic cycle or trade cycle**: show fluctuations in the level of output in an economy.



▲ Figure 5 The economic, trade or business cycle

1. Boom : the peak of the cycle.

- During a boom GDP is growing fast because the economy is perform well.
- Demand rises
- Firms expand production.
- Employment rises , wage rises , price level rises

2. Downturn : The economy is growing at slower rate.

- Demand for goods and services begin to fall.
- Unemployment start to rise, wage increase will slow down, prices rise slowly.
- Some firms may leave market.

3. Recession or depression or slump: At the bottom of business cycle ODP may be flat.

- Demand for goods and services may fall.
- Unemployment rises sharply.
- Business confidence is low as bankruptcies rise and prices become flat or fall.

4. Recovery or upswing: when GDP starts to rise again there is a recovery or upswing.

- Businesses and consumers regain their confidence and economic activity increases.
- Demand starts to rise.
- Unemployment begins to fall and price start to rise again.

The impact of the business cycle on business

1. Output

- During boom ⇒ business increases production.
- During recession ⇒ business reduces production.

2. Profit

- During boom ⇒ business gain higher revenue and profit.
- During recession ⇒ business gain lower revenue and profit.

3. Business confidence and investment

- During boom ⇒ business confidence is high ⇒ higher investment
- During recession ⇒ business confidence is low ⇒ lower investment

4. Employment

- During boom ⇒ business may struggle in recruiting workers.
- During recession ⇒ business may lay off some workers.

5.Business startups and closures

- During boom ⇒ more businesses start up.
- During recession ⇒ more businesses go bankrupt.

How might businesses respond to the different phases in the business cycle?

1. **During boom** ⇒ business increases production.
2. **During slowdown** ⇒ business reduces production and investment.
3. **During recession or depression** ⇒ business may lay off some workers.
4. **During recovery** ⇒ business may start to invest.