BAJAJ MUTUAL FUND

ECONOMIC CYCLE AND BUSINESS CYCLE

Understanding the four phases through everyday life

THE EQUITY COMPASS EDITION 25

The economy has periods when business activity grows and periods when it declines. These broad movements are called the **economic cycle or business cycle.** They affect orders, jobs, income and spending.

The basic pattern: Expansion → Peak → Contraction → Trough → Expansion again. Peak and trough are turning points; the cycle has no fixed timetable.

1. EXPANSION — A BAKERY GETS BUSIER



MORE BREAKFAST ORDERS AND A NEW HELPER

Ramesh runs a small bakery. A new office opens nearby, and workers begin stopping for breakfast. Soon, his regular morning batch is no longer enough.

- **More demand means more work.** Ramesh bakes another batch, buys more flour and hires a helper to pack orders. His flour supplier receives more business too.
- **The new job supports spending elsewhere.** The helper now earns a regular income and can spend more at the neighbourhood grocer. One business's growth can support activity in other businesses.
- **Across the economy:** When demand improves across many businesses, production and hiring may rise. Higher income can support further spending. This is expansion; a particularly strong expansion is often called a boom.
- **One useful distinction:** Selling more does not automatically mean earning more profit. Ramesh also pays for ingredients, wages and electricity. Costs matter alongside sales.

Examples are hypothetical illustrations. One business's experience does not identify the economy's phase.

2. PEAK — THE HIGH POINT BEFORE A DECLINE



A RESTAURANT IS BUSY — BUT WHAT HAPPENS NEXT?

Arjun's restaurant is popular with nearby office workers. Tables are busy at lunchtime, takeaway orders are strong and he has added staff to serve customers.

- **At that moment, business looks healthy.** But busy tables alone cannot tell Arjun that demand is about to turn. Sales might keep growing, remain steady or decline.

  Over the following months, some nearby offices reduce team lunches and employees eat out less often. The change persists. Bookings fall and more tables remain empty.

- **Looking back:** The high point just before that sustained decline was the peak in this restaurant's activity. A peak is a turning point—not simply a day when every table is occupied.

HOW THIS RELATES TO THE ECONOMY

An economic peak marks the high point before a broad decline in activity. It does not mean every company has record sales, every factory is full or every person has a job.

When demand is strong, businesses may also face rising wages or input costs. These can put pressure on profits, but **higher costs alone do not prove that the economy has peaked.**

AN EASY WAY TO REMEMBER

Think of reaching the top of a hill. The peak is the point before the path turns down. In the economy, we usually recognise that turn only after enough evidence becomes available.

- **The sales-conversation takeaway:** "Business can still look strong near a peak. The key is whether activity subsequently turns down across the economy."

Examples are hypothetical illustrations. One business's experience does not identify the economy's phase.

3. CONTRACTION — BUSINESS ACTIVITY DECLINES



THE NEW SOFA CAN WAIT

The Patil family plans to replace its old sofa. Then one family member's variable pay is reduced. The family decides: "The sofa still works. Let us wait until our income is more certain."

- **The decision affects the furniture shop.** If many families postpone similar purchases, the shop receives fewer orders. It asks its supplier for fewer sofas.
- **The slowdown reaches the workshop.** With less work, the manufacturer cuts production and overtime. Workers with lower take-home pay may reduce their own optional purchases, affecting other shops too.
- **Across the economy:** When activity declines broadly, production and spending weaken and hiring may slow. A significant, widespread decline lasting for a period of time is generally called a recession. One weak shop or month is not enough.

DOES ALL SPENDING STOP?

No. The family may delay the sofa or a holiday but still needs basic groceries and necessary medicines. It might switch to cheaper brands or smaller packs, but many everyday needs remain.

That is why different businesses can feel the slowdown differently. **Steadier demand does not guarantee stable profits or rising share prices.**

- **Slowdown versus contraction:** If a shop sells 100, then 110, then 115 items in comparable periods, sales still grow—just more slowly. A fall from 100 to 90 means sales have declined. The same distinction matters when discussing economic output.

Examples are hypothetical illustrations. One business's experience does not identify the economy's phase.

4. TROUGH — THE LOW POINT BEFORE RECOVERY



THE SEWING MACHINES START RUNNING LONGER

After a prolonged weak period, Sanjay's tailoring shop stops losing orders. Customers gradually return for alterations and new clothes. Improvement continues over several months, beyond a short festive rush.

- **He starts with the team he already has.** Sanjay restores working hours before hiring another helper. More orders do not immediately mean more jobs.
- **Across the economy:** The low point before sustained improvement is the trough. Recovery is the early part of the next expansion. Activity can improve while remaining below its earlier high, and employment may take longer to recover.

WHAT THIS MEANS FOR MUTUAL FUNDS

- **Different needs support different businesses.** Families may postpone cars or holidays more easily than basic food and necessary medicines. Fund managers assess how changing spending affects company sales and earnings.
- **A business-cycle approach responds to changing prospects.** Within the scheme's mandate, a manager may adjust sector and stock exposure as conditions evolve. Company quality, debt and costs still matter, as does the price paid relative to the company's earnings and growth prospects.
- **Markets can move before the recovery is obvious.** Share prices may rise when investors expect better business conditions, even while current earnings remain weak. Expectations and cycle assessments can be wrong; returns are not assured.
- **Remember:** The cycle connects demand, production, jobs, income and spending. Understanding the phase is useful; it is not a guaranteed investment signal.

Policy effects and detailed sector performance will be covered in separate editions. All stories and illustrations are hypothetical; an economy-wide phase requires broad evidence.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.