RESERVE BANK OF AUSTRALIA

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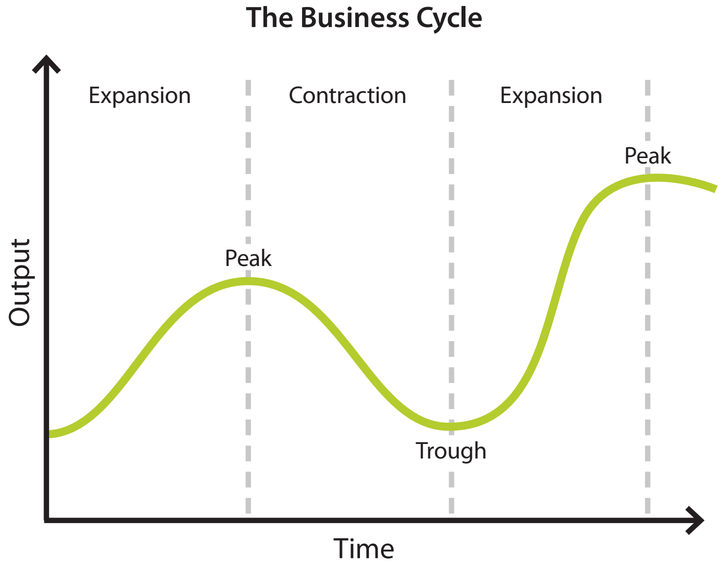
Illustrator
The Business Cycle

When the economy EXPANDS…

- ↑ **Production increases** – businesses produce more goods and services (output)
- ↓ **Unemployment decreases** – fewer people are out of work, as businesses need more workers to produce more output
- ↑ **Wages increase** – because businesses are doing well, they need to attract and keep workers by offering higher wages
- ↑ **Consumer spending increases** – people spend more because they are earning higher wages
- ↑ **Prices increase** – prices increase as consumers spend more. This is known as inflation.

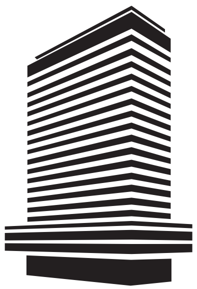


When the economy CONTRACTS…

- ↓ **Production decreases** – businesses produce fewer goods and services (output)
- ↑ **Unemployment increases** – more people are out of work, as businesses need fewer workers
- ↓ **Wages decrease** – because businesses are doing less well, they can attract enough workers at lower wages
- ↓ **Consumer spending decreases** – people spend less because they are earning lower wages
- ↓ **Prices decrease** – prices decrease as consumers spend less. This is known as deflation.

If the economy is expanding too quickly, and at risk of overheating, the Reserve Bank may **increase interest rates** to slow down the economy by encouraging people and businesses to spend less. Higher interest rates on deposits and loans provide an incentive for people to save their money, rather than spend it or borrow more.

↑ %



Reserve Bank of Australia

% ↓

If the economy is contracting the Reserve Bank may **reduce interest rates** to speed up the economy by encouraging people and businesses to spend more. Lower interest rates on deposits and loans provide an incentive for people to spend or borrow money, rather than save it.