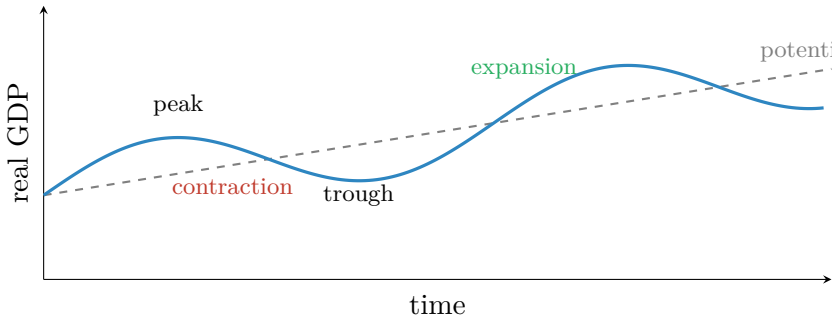
The Business Cycle

AP Macroeconomics | Unit 2 | phases, indicators, output gaps



1. The four phases

Peak → **contraction** (real GDP falls; a long one is a *recession*, often two quarters in a row of falling real GDP) → **trough** → **expansion** (recovery) → the next peak. The cycle swings around the long-run growth trend.

2. What the indicators do

Phase	Real GDP	Unemployment	Inflation
Expansion	rises	falls	rises, especially near the peak
Contraction	falls	rises (cyclical)	slows down

3. Output gaps

Output gap = actual real GDP − potential real GDP

Potential output: what the economy produces at full employment (unemployment at the natural rate).
Positive (inflationary) gap: above potential; unemployment below the natural rate.
Negative (recessionary) gap: below potential; unemployment above the natural rate.

Where students lose points

1. Saying unemployment rises in an expansion.
2. Treating the trend line as the peak: it is potential output.
3. Calling a positive gap recessionary.
4. Putting unemployment below the natural rate at the trough.
5. Using nominal GDP to spot a recession.

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