NICO Asset Managers

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INVESTOR'S GUIDE

A guide to the financial markets, investments and the economy

3 August 2018

Topic 276: EXPANSIONS

1. Introduction

For the past two weeks we have been looking at economic fluctuations and the recession stage. This week, we would like to finalize the topic by discussing expansions which are defined as the period of extensive growth in business activity and real GDP.

2. Impacts of an expansion

i. High employment rates in the country

Profits that are commonly made by firms during expansion periods may act as a motivation for others to establish their own businesses or to expand their already existing firms, thereby creating employment opportunities for many individuals.

ii. Increase in personal income

Personal income tends to display a rising trend during expansion periods and declines during recessions. Sources of personal income may include employee's salaries, wages, bonuses, shareholders dividends etc. Therefore when firms make profits during expansion periods most of the sources listed above may also increase resulting in an overall rise in personal income. In addition, increase in personal income will help in improving the living standards and reducing levels of poverty.

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iii. Increase in consumer and investment spending

As personal income increases for most individuals, households have more to spend on goods and services. Similarly, investors invest more as the benefits of doing so increase with the rise in the company profitability.

iv. Prices may be higher

During an expansion prices may increase however, it may not always be the case. As the money in the economy as well as demand for goods increase, producers may respond to this by slightly increasing prices to further increase profits.

v. Government budget

Government revenue increases during expansion periods as the number of people employed, firm's profits and expenditure rise thereby increasing the amount of tax that the government collects from the public. This results into a budget surplus and as a result of this, government increases it's spending in different sectors for example health, education, transport and any other government projects.

vi. High interest rates

Change in the interest rate is part of the monetary policy that is taken by the Central bank on behalf of the government. In most cases, expansion is followed by inflation, high employment, high investment expectation, and increased expenditure. Therefore interest rate is raised as a way of reducing money circulation and encouraging savings. This is done to control inflation levels in the country.