Cobweb cycle

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- This refers to a phenomenon where the prices of certain goods witness fluctuations that are cyclical in nature.
- Producers’ expectations about prices are assumed to be based on observations of previous prices.
- It happens due to faulty producer expectations.
- The producers of agricultural goods, for instance, might decide to increase their output one year because their product commanded a very high price the previous year.
- This, however, might lead to overproduction and cause prices to slump that year, thus leading to losses.
- Such cyclical price fluctuations are more severe in markets where speculators are banned from hoarding goods to sell them later at a higher price.
- Suppose for example that as a result of unexpectedly bad weather, farmers go to market with an unusually small crop of onion → results in high prices. If farmers expect these high price conditions to continue, then in the following year, they will raise their production of onion relative to other crops. Therefore when they go to market the supply will be high, resulting in low prices.
- The idea was proposed by Hungarian economist Nicholas Caldor.