Investment (I)

# Starter: Discussion Question

Instructions:

* Individually consider the below questions
* Discuss your thoughts with a partner
* Share your ideas with the class

*What do firms ‘invest’ in?*

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| Note Space: |

# Presentation 1 – Intro to Investment

Complete the activities below so as to have a complete set of notes:

**Definition:** *Investment*

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This includes spending on working capital such as stocks of finished and semi-finished goods.

*Stat:*Investment made up 17% of UK GDP in 2018.

*A broader definition***:** Investment also includes spending on improving the human capital of the workforce through training and education.

**Key Question:** What is the distinction between Capital Investment and Financial ‘Investment’?

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# Article task: UK Business Investment

**Instructions:**

* Read, highlight and annotate the article, making notes to answer the key discussion question
* Discuss as a class

**Article:**

*Sharp drop in UK business investment*

Business investment in the UK has fallen for the second quarter in a row, recording the biggest fall since 2009. Spending by business fell by 1.4% in the fourth quarter from the previous three-month period.

The Office for National Statistics (ONS) which collects the data said falling oil prices may be to blame. The oil price has fallen by over a half since June last year, and oil companies have pulled back on investment in the UK and around the world.

Oil impact

"Given the recent steep fall in oil prices, it might be expected that investment by the oil extraction industry might also fall, as oil production becomes less profitable," the ONS said.

Earlier this week the industry body Oil and Gas UK said that after reaching £14.8bn last year investment was forecast to fall to between £9.5bn and £11.3bn in 2015.

Economists have said overall business investment in Britain might also be affected by uncertainty over the outcome of Britain's national elections in May.

On an annual basis, investment still increased by 2.1% on the same period a year ago.

But it marks a sharp slow down from the middle of last year when business investment was growing at an annual rate of 11%.

The ONS also confirmed last month's estimates that the economy grew 0.5% in the last quarter of 2014. It follows a 0.7% rise in the third quarter.

**Discussion Question:**

*What may have caused this change in the level of investment by firms?*

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# Presentation 2 – Determinants of Investment

Complete the activities below so as to have a complete set of notes:

**Elaborate:** Elaborate on the below key determinants of investment

*Interest rates:*Investment is financed either out of current savings (retained profits) or by borrowing. High interest rates act to reduce the level of investment.

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*Business Confidence:*Investment in new capital is expensive and can be a very risky commitment.

*Animal spirits:* refers to the level of confidence or pessimism of consumers and firms.

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*Availability of finance:*For investment to be funded by borrowing, banks must be willing to lend to businesses.

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*Profitability:*If firms have more profits, they have greater funds with which to purchase new capital, expand existing factories, etc.

*Productivity of capital:*Long-term changes in technology can influence the attractiveness of investment.

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*Government Policies:*Some government regulations can make investment more difficult.

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*However:* it can also affect the quality of investment as there is less incentive to make sure the investment has a strong rate of return.

*Economic Growth:*Firms invest to meet future demand.

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*The Accelerator Effect:* When an increase in GDP results in a proportionately larger rise in capital investment spending.

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# MCQs

1. In economics, investment is best defined as
2. the flow of money into the stock of savings
3. spending on capital goods in an economy
4. the profit kept back by firms to finance future expenditure on new machinery and equipment
5. the stock of economic resources such as factories and machinery

Explain you answer:

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1. Which of the following statements concerning UK investment is correct?
2. Increased investment leads to a reduction in saving
3. Investment is the largest component of aggregate demand
4. Investment is a withdrawal from the circular flow of income
5. Investment can increase the capital stock of the economy

Explain you answer:

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# Assignment

**Section B (Data Response)**

**Extract 1 - Components of Aggregate Demand (Report from the Office of Budgetary Responsibility)**

The real disposable income of UK households is forecast to have fallen by 2.3% in 2011, a post-war record. Earnings growth is not expected to overtake inflation again until 2013 and not by a significant margin until 2014. As a result, we expect consumer spending to remain broadly constant in real terms in 2012 before picking up as real household disposable income starts growing again. We expect private sector employment to rise by around 1.7 million between the start of 2011 and the start of 2017, but this will be partly offset by a fall of around 710,000 in general government employment. The government still aims to reduce the budget deficit rapidly in order to achieve its fiscal target. Business investment has shown virtually no growth in 2011. The CBI’s latest Quarterly Industrial Trends Survey suggests that the investment that has taken place has largely replaced worn out assets, rather than added to the capital stock. Businesses have used some of their profits to pay back bank loans and they may also have started to build up cash reserves against further shocks as uncertainty over the outlook has risen. This might lead to a reduction in business investment in 2012. We also continue to predict a small current account deficit in the medium term.

(Source: © Crown Copyright Office of Budgetary Responsibility Autumn Report, November 2011)

**Question:**

Identify and assess two factors that could influence the level of business investment (Extract 1, line 10). [10]

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[10]

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| **Planning Grid: Aim = 4 paragraphs - 2 KAA points (6); 2 Eval points (4) with a conclusion** | |
| **KAA Point 1 = signpost key point** |  |
| Application |  |
| Main concept & diagram |  |
| **Eval Point 1 = relate to your earlier point & re-read the title** |  |
| Context / evidence |  |
| **KAA Point 2 = signpost key point** |  |
| Application |  |
| Main concept & diagram |  |
| **Eval Point 2 = relate to your earlier point & re-read the title** |  |
| Context / evidence |  |