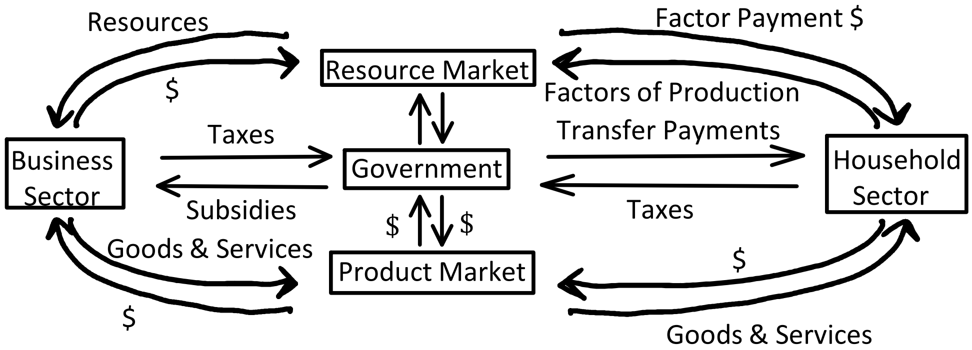
E101 - 1.1 - Macro Economics GDP & Growth

Circular Flow of Income



Financial Intermediaries

Savings (S)
Imports (IM)
Taxes (T)
Investment (I)
Exports (E)
Government Spending (G)
Consumption (C)

1) Households sell factor services to the business sector and earn income.
2) With this income, they pay for the goods and services received from the business sector.

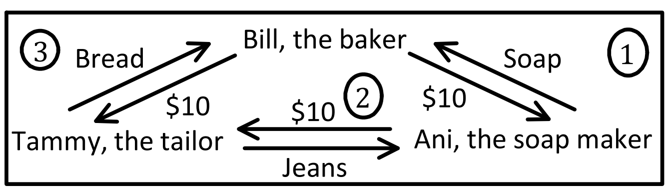
Consumption - Expenditure by households on goods and services.
Product Market - Market for goods and services.
Factor Market - Market for factors of production.
Income - Earnings of factors of production expressed as an amount per period of time.
Money - Anything widely accepted as a medium of exchange used to buy goods or settle debts.

$$\boxed{Velocity\ of\ Money = \frac{total\ income}{money\ supply}}$$

Velocity of money - Number of times per year that a unit of currency is used buying final goods and services

Stock of Money $= \$10$

Value of Total Spending $= \$30$



Value of Total Production $= \$10$

Value of Total Income $= \$30$

Savings - Portion of income that is not spent on consumption.
Leakage - Income received within the circular flow that does not flow directly back.
Financial Intermediaries - Financial institutions, i.e. banks, that act as agents between borrowers and lenders.
Injection - Any spending flow that does not depend on current level of income.
Investment - Spending on new capital goods

The reasons individual save (for retirement, future purchases and so on) differ from the reasons businesses invest. Savings (a leakage) and investment (an injection) are quite distinct actions.

Imports - Goods and services bought from another country and are a leakage from circular flow of income.
Exports - Goods and services sold to other countries and create an injection into circular flow of income.
Government spending - Purchases of goods and services by government.
Transfer payments - One way transactions in which payment is made by the government but no good or service flows back in return.
Net Tax Revenue - Total tax revenue minus government transfer payments.