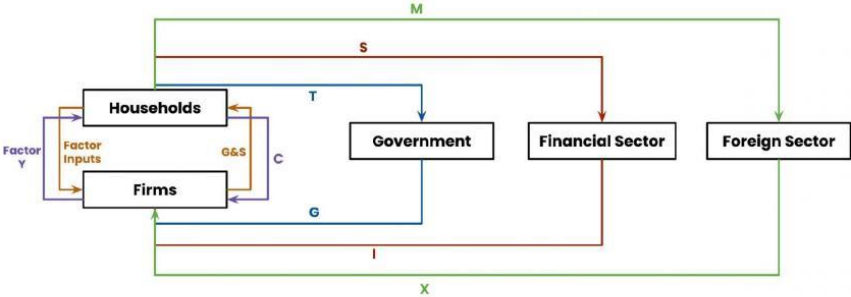


MACROECONOMICS

1. The Circular Flow of Income

Introducing the Model	<ul style="list-style-type: none"> The circular flow of income (Y) is a model of the macroeconomy that allows economists to explain and predict economic phenomena. The model assumes that all economic agents are categorised into four sectors — households, firms, the government and external sector. The model further assumes that households own all factors of production (FOPs) but do not engage in production and firms are the only economic agents to engage in production.  <p style="text-align: center;">Figure: The Circular Flow of Income</p>
Explaining Real & Nominal Flows	<ul style="list-style-type: none"> As such, households will provide factor inputs (land, labour, capital & entrepreneurship) to firms and, in exchange, will receive factor Y (rent, wages, interest & profits) for their services to the firms. With the Y earned, households will in turn use it to purchase G&S to satisfy wants and needs (C_d).
Explaining Withdrawals	<ul style="list-style-type: none"> In a four-sector economy, besides allocating their Y to C_d, households will save (S) to earn interest and fund future spending, pay taxes (T) which are compulsory payments to the government not for G&S; and purchase imports (M) which end up becoming the revenue of firms in other countries. Together S, T and M are called withdrawals (W) from the circular flow of the economy. The effect of W is to cause the circular flow of the economy to contract. <p>Withdrawals: Any part of households' Y that is not spent on domestically-produced goods and services (G&S) but are siphoned from the circular flow of income.</p>
Explaining Injections	<ul style="list-style-type: none"> Likewise, domestic firms do not produce only to sell to domestic consumers. They also sell to and earn revenues from the government (G), external sector (X), and also invest (I). Known as injections (J), these components (G, I & X) add on to the circular flow, creating additional spending and Y. The effect of J is to cause the circular flow of the economy to expand. <p>Injections: Any payment of income (Y) to domestic firms that do not arise from domestic households but are additional spending generated by the other sectors of the economy.</p>