

## MACROECONOMICS AT WORK EXERCISE

### DETERMINANTS OF INVESTMENT

**REFERENCE:** ‘Investment picture is looking brighter’ (by Alan Mitchell), *Australian Financial Review*, 3–4 August 2002, p. 55.

**CHAPTERS RELEVANT TO THIS EXERCISE:** Chapters 6, 7.

### OVERVIEW

Recent data have suggested that there is an increase in planned investment expenditure by business. Given that private investment expenditure is a significant element in Gross Domestic Product (roughly the same as government expenditure) the investment plans of businesses are an important determinant of GDP and economic activity generally.

A recent National Australia Bank survey, for example, has shown an increase in the number of respondents planning to undertake investment expenditure in the September quarter, while the Investment Monitor published by the private economic consultant Access Economics indicates that the value of investment projects currently under way or in the planning stages also rose by 1.7 per cent in the June quarter. The likelihood of an increase in investment was also indicated by the increase in business credit, and thus of the demand for funds by business to undertake investment expenditure.

Total investment expenditure is, of course, the aggregate of expenditure in *different sectors* of the economy. Of the increase in investment predicted in a survey by the Australian Bureau of Statistics, two-thirds was in the *service* sector of the economy (where construction activity, related particularly to retail development, was significant) and planned investment in the *resources* sector – that is mining and related manufacturing (i.e. minerals processing) – was also significant. By contrast the survey indicated only a low level of planned investment in the *manufacturing* sector.

Investment plans are, however, ‘lumpy’ (i.e. investment is usually made in large, multi-million-dollar ‘projects’) and notoriously volatile. Planned (or projected) investment is thus usually placed in different categories, which vary in the degree of certainty that plans will actually come to fruition. The categories of ‘projects under construction’ (i.e. investment projects actually under way), ‘committed’, ‘under consideration’ and ‘possible’ are used by Access Economics (see the graph in the article), with those in the latter categories being increasingly subject to deferment or abandonment in the light of factors which influence investment decisions: for example the state of the global economy; the demand for the products of the industry in question; the investment plans of competitors; the value of the Australian dollar; and interest rates. By contrast, investment projects already under way, or to which firms have made a firm commitment, are more certain to proceed.

## QUESTIONS

1. What is investment expenditure and why is it undertaken?
2. What evidence was there, at the time of writing, that there would be an increase in investment expenditure by businesses? How reliable is this evidence?
3. What sectors are contributing most to the projected increase in investment plans?
4. Explain what is meant by investment being 'lumpy'.
5. What factors may influence investment decisions, especially those towards the 'under consideration' or 'possible' end of the spectrum?
6. Explain how investment in sectors where a large proportion of production is exported may be particularly affected by the value of the Australian dollar. Give an example of such a sector.