2.2.3 Investment

Investment Overview

- Investment is expenditure on capital stock/goods (includes plant machinery and infrastructure)
- Official statistics call Investment gross fixed capital formation
- Gross investment is the total spending on new capital gods
- Net investment is the addition to capital stock after depreciation (fall in value of capital assets due to wear/tear and obselecence) has been taken into account

  $$net\ investment = gross\ investment - depreciat$$
- Net investment is a more useful measure as it signifies real improvements in the prospects for the economy

The Rate of Economic Growth as an Influence on Investment

- An increase in RGDP is an increase in demand for output
- As a result firms need more capital to meet demand
- As a result investment increases, causing RGDP to further rise

Business Expectations and Confidence as an Influence on Investment

- If firms have high confidence for the future they are much more likely to invest
- If firms expect to sell more units in the future they will also invest

Keynes and 'Animal Spirits' as an Influence on Investment

- Animal spirits is a term created by John Maynard Keynes that refers to the state of confidence in an economy held by consumers and businesses. It also refers to the ways that human emotion can drive financial decision making in uncertain times and environments
- Animal spirits informs a lot of investment decisions

Demand for Exports as an Influence on Investment

- An increase in demands for UK exports is likely to lead to an increase in british investment (as companies spend money on captial stock to produce more)

- Some firms may be hesitant to export due to regulations and other difficulties surrounding international trade

Interest Rates as an Influence on Investment

- An increase in interest rates leads to a decrease in investment as borrowing money becomes more expensive
- The extent to which increased interest rates prohibit investment depend on whether the investors think it is still profitable or are using retained profits to invest (which would still lead to investment)

Access to Credit as an Influence on Investment

- Low interest rates do not automatically mean loans are easily accessible

- Banks may not be willing to risk lending money to firms. This was especially prevelent in the aftermath following the 2008 financial crisis

Government as an Influence on Investment

- Government policy can affect tax rates which can affect investment
- If government cuts corparation tax (which is a tax on profits), firms are likely to increase investment as business is more profitable and there is more money to spend. Tax rates affect AD (level of investment) and AS (amount firms are willing to supply at any price)

Government Regulations as an Influence on Investment

- Deregulation tends to correlate positively with increased investment

- If government relaxes planning restrictions, firms will more often invest in building projects as they become cheaper and more achievable