N11114 Macroeconomics for Business
Seminar 1

Week 5 (w/c 23rd October 2017)

Please prepare written answers before attending the seminar.

1. Consider the circular flow of income model. The following figures refer to elements in the national income accounts of an economy currently in equilibrium.

	£ billions
Consumption (total)	60
Investment	5
Government expenditure	8
Imports	10
Exports	7

(a) What is the current equilibrium level of national income?
(b) What is the level of injections?
(c) What is the level of withdrawals?
(d) Assuming that tax revenues are £7 billion, how much is the level of saving?
(e) If national income now rose to £80 billion and, as a result, the consumption of domestically produced goods rose to £58 billion, what is the mpc_d? Assume all investment, government and export expenditure are on domestic products.
(f) What is the value of the multiplier?
(g) Given an initial level of national income of £80 billion, now assume that spending on exports rises by £4 billion, spending on investment rises by £1 billion, whilst government expenditure falls by £2 billion. By how much will national income change?

2. Credit creation. Assume that the banking system receives additional deposits of £100 million and that all the banks wish to retain their current liquidity ratio of 20 per cent.

(a) How much will banks choose to lend out initially? Explain why banks retain part of the additional deposits.
(b) What will happen to banks' liabilities when the money that is lent out is spent and the recipients of it deposit it in their bank accounts?
(c) How much of these latest deposits will be lent out by the banks?
(d) What is the size of the bank deposits multiplier?
(e) By how much will total deposits (liabilities) eventually have risen, assuming that none of

the additional liquidity is held outside the banking sector?

(f) How much of these are matched by (i) liquid assets; (ii) illiquid assets?

(g) Assume now that the banking sector receives additional deposits of £60 million only (instead of £100 million). By how much less will deposits have risen compared with (e) above?