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Delivery Notes
The Nature of the Economy

The Reserve Bank of Australia's public education program is committed to supporting students and teachers of economics and economics-related subjects. We have developed a suite of resources aimed to support a number of commerce and economics curriculum objectives for Years 7–10.

Students will be introduced to the Australian economy and its participants, learn about the five-sector circular flow model of the economy, and explore how the business cycle affects the economy.

Resources

The following resources have been designed to be used flexibly, according to the time you have available and the learning needs of your students. You can use all or select the ones most relevant to the objectives you wish to cover.

Learning themes

- The role of consumers, business, government, financial institutions and the overseas sector within an economy (through the five-sector circular flow model)
- The interdependence between different sectors of the economy
- The business cycle and its impact on the economy, including the role of the Reserve Bank
- Characteristics of economic expansion and contraction

Key words

boom, business cycle, circular flow model, consumer price index, consumers, consumption, demand, economic growth, economy, expenditure, exports, government expenditure, imports, income, inflation, injection, interest rates, investment, labour, leakage, outputs, production, recession, Reserve Bank of Australia, resources, revenue, savings, supply, taxation

Resource	Summary
Delivery Notes: The Nature of the Economy	A summary of available resources and how they could be used within a classroom setting, as well as background information
Presentation: What is the Economy?	Slides containing key information introducing students to the economy and its participants; the five-sector circular flow model; and the interdependence of the sectors
Presentation: The Business Cycle	Slides containing key information introducing students to the business cycle; inflation; interest rates; and the role of the Reserve Bank of Australia
Illustrator: Circular Flow Model	A diagram showing the circular flow model and descriptions of its component parts
Illustrator: The Business Cycle	A diagram showing the business cycle and a summary of the key features of economic expansion and contraction
Activity: Sectors in the Economy	An overview of the five sectors in the circular flow model
Activity: Injections and Leakages	Examples of injections and leakages within the circular flow model
Activity: Complete the Circular Flow Model	A blank version of the circular flow model, which students can be asked to label and annotate
Activity: Business Cycle Case Studies	Case studies showing how different people might be affected by the business cycle
Digital Interactive: Inflation Explorer	A digital tool that lets students explore how prices of individual goods and services, and overall inflation, have changed over time

What is the Economy?

Example learning journey

The following is an example of how the resources could be used in a sequence of learning activities to explore this topic. You can decide which activities would work best with your class and the time period over which the learning takes place.

Baseline assessment of students' existing knowledge

Slide 2 of the **Presentation: What is the Economy?** contains key words to do with the economy. You may wish to show these to students at the start of the first lesson. They could work in groups or individually to consider any of the words they are familiar with or create a basic mind map showing any connections between the words.

Introducing the economy

Slides 3 to 6 introduce students to the concept of the economy, also indicating its relevance to their own lives.

The circular flow model

Slides 7 to 12 provide an overview of the five sectors of the economy (as portrayed in the circular flow model).

Activity idea (Slide 13): Students could be organised into pairs or groups and given **Activity: Sectors in the Economy**, which contains information about the sectors. They could cut the sectors out and stick them to a large sheet of paper, then discuss and draw in notes and arrows to create a diagram showing some of the relationships between them (e.g. arrow between Households and Government to represent taxation; arrow between Households and Firms to represent consumption). You may wish to show the words on **Slide 2** again as prompts. After their group work, they could share ideas with the class.

> ***Background information:***
> The circular flow model provides one way to show the connections between different sectors of the economy. It shows the flows of goods and services, money, factors of production and income that occur between the different sectors, and how they interrelate.

Slide 14 contains the circular flow model including arrows. The diagram is also shown in **Illustrator: Circular Flow Model**, with more detailed description. Students can compare the completed model with the diagrams they have drawn themselves. Were there any relationships that they missed?

Injections and leakages

Slides 15 and 16 explain that money is injected in and leaks out of the economy, using a bathtub as an analogy to help students understand the concept. When there are injections and leakages, not all income will flow between Households and Firms.

- Injections are the introduction of income into the flow, such as additions to investment, government expenditure and exports.
- Leakages are the withdrawal of income from the flow, such as savings, taxation and imports.

Activity idea (Slide 17): Students could work individually or in pairs to read through **Activity: Injections and Leakages**, determining whether each example would be an injection or leakage and linking it to an area of the circular flow model.

(See the answers on page 6.)

Slide 18 shows where the injections and leakages sit within the circular flow model.

Background information:

- **Savings** are considered a leakage because they reduce the flow of income; money could be 'spent' to generate further output, but if it sits in the bank and is not lent out (to support investment), it creates no further output.
- **Taxation**, in a similar way to savings, is collected by the Government and, if not spent, will generate no new output.
- **Imports** are considered a leakage because, as Firms and Households purchase imports of goods and services, the money used to pay for that import goes to foreign businesses, therefore, leaving the Australian economy.
- **Investment** is an injection. As the Financial sector 'injects' money into businesses, this creates opportunities for those businesses to purchase new plant and equipment to expand output.
- **Government expenditure** is the building of infrastructure and other such projects that create demand for the goods and services that businesses produce which, in turn, creates employment. This increase in employment generates more income and will lead to greater levels of consumption and, therefore, output.
- **Exports** bring foreign (new) money into Australia that businesses can invest and utilise to generate output.

Economic growth

Slide 19 introduces the idea of economic growth, providing its basic calculation.

Background information:

For an explanation of economic growth, see the Explainer: Economic Growth.

When injections into the economy are greater than the leakages, the economy is expanding i.e. *(investment + government spending + exports) > (savings + taxes + imports)*

Interdependence between sectors of the economy

Activity idea (Slide 20): Students could work in small groups to discuss one or more of the questions on the slide, considering the relationships between the sectors of the economy and how each change might affect other sectors. For example, if the Government decided to raise taxes on Households:

- Households will have less disposable income and may choose to cut down on their spending and the amount of money that they save.
- Firms are likely to receive less revenue, as a result of reduced consumer spending. They may choose to decrease production or even reduce the number of workers.
- The Government will receive more tax revenue and, if they increase their spending, this would increase demand for the goods and services that firms produce. This, in turn, is likely to increase employment. (This would offset to some extent the reduction in Household spending from the initial increase in tax.)
- If Households reduce their savings, the Financial sector will have less funds to lend out to support investment.

Slide 21 provides an example, showing how the Financial sector can facilitate business investment. As a homework or assessment task, students could be asked to label the diagram in **Activity: Complete the Circular Flow Model (Slide 22).**

Background information:

The Financial sector directs the flow of savings into the economy which, in turn, helps to facilitate the accumulation of capital (money or assets owned by individuals or businesses) and the production of goods and services.

Funds are channelled from savers to borrowers to facilitate investment by Firms and Households.

Businesses rely on banks lending them money so they can use those funds to invest in things like new equipment to increase production. In addition, businesses can deposit some money in the bank and earn interest on it, again generating more income for future investment. If the banking system is healthy, this is a supportive environment for depositors and lenders.

Households rely on banks lending them money so they can use those funds to invest in assets (like property) or increase their consumption today.

If there is instability in the financial sector:

- banks are less inclined to lend money as they worry that Firms and Households will not be able to pay them back, making it harder for firms and households to access credit (money) and reducing the amount of investment
- Firms and Households are less likely to deposit their money into, or borrow from, banks, so there is less investment.

The Business Cycle

Example learning journey

The following is an example of how the resources could be used in a sequence of learning activities to explore this topic. You can decide which activities would work best with your class and the time period over which the learning takes place.

Introducing the business cycle

If you have completed previous work on the economy, students could be asked to recall the sectors within the economy and some of the relationships between them. **Slide 2** of the **Presentation: The Business Cycle** and the diagram in **Illustrator: The Business Cycle** can be used to introduce students to the business cycle.

Characteristics of economic expansion

Slides 3 to 7 take students through the characteristics of economic expansion.

Characteristics of economic contraction

Slides 8 to 12 take students through the characteristics of economic contraction.

Boom, recession and depression

Slide 13 provides a description of a boom, recession and depression.

Explaining inflation

Slide 14 to 17 introduce students to the concept of inflation, how it's measured, how it is affected by the business cycle and why it is important. You may wish for students to further explore how inflation is calculated by using the **Digital Interactive: Inflation Explorer**.

Background information:

Further explanations of inflation and its measurement and Australia's inflation target can be found in the following resources:

- Explainer: Inflation and its Measurement
- Explainer: Australia's Inflation Target
- In a Nutshell: The Inflation Target

The role of the Reserve Bank in smoothing the business cycle

Slides 18 and 19 introduce students to the Reserve Bank's role in monitoring and targeting inflation.

Slides 20 and 21 explain interest rates and how they are influenced by the Reserve Bank's cash rate which, in turn, affects inflation.

Slides 22 and 23 show how the Reserve Bank acts to smooth the business cycle. An easy way for students to remember is the 'up and up' and 'down and down' mnemonic. When the economy is going up, towards a peak, the RBA is more inclined to increase the cash rate. When the economy is going down, towards a trough, the RBA is more inclined to decrease the cash rate.

Activity idea (Slide 24): Students can refer again to the characteristics of expansion and contraction in **Illustrator: The Business Cycle**. In pairs or small groups, students can go through the examples on **Activity: Business Cycle Case Studies**, discussing where during the business cycle they are likely to be occurring. You may wish to ask some students to complete the extension or to come up with their own case study examples.

(See the answers on page 6.)

Background information:

For simplicity, the business cycle is described in terms of **levels** of output, wages, prices etc. In practice, the Reserve Bank considers the **growth** of output (GDP growth), prices (inflation) and wages (wage growth). The rate of economic growth is considered relative to the economy's 'potential' growth rate, which reflects the economy's capacity. Further explanation of the Reserve Bank's role in relation to the business cycle can be found in the following resources:

- Explainer: What is Monetary Policy?
- Explainer: The Transmission of Monetary Policy
- In a Nutshell: Monetary Policy in Australia
- Video: What does the Reserve Bank do?

Assessing students' learning

Students can again be shown the key words on **Slide 2** of the **Presentation: What is the Economy?** and asked to create, or amend their, mind maps to reflect their progressed knowledge about the concepts.

Extension or homework ideas

Students could:

- seek out and identify news reports that concern one or more sectors of the economy, discussing how the sector may be affected
- read the latest statements concerning the Reserve Bank's cash rate decision: <https://www.rba.gov.au/statistics/cash-rate/>
- further explore the Reserve Bank's Chart Pack to build up a picture of current economic conditions within Australia: <https://www.rba.gov.au/chart-pack/>
- search current interest rates offered on savings and loans, and calculate the annual interest paid or charged
- create their own glossary around the key words
- discuss the ways that their decisions, as consumers, can affect the economy.

Answers for Activity: Injections and Leakages:

- An individual decides to reduce their spending and save more of their income – Leakage (Savings).
- The state government has received tax revenue but has not yet decided what to spend the money on – Leakage (Taxation).
- A business decides to borrow money from a bank to invest in new equipment that will increase its output – Injection (Investment).
- An Australian mining company sells iron ore to a steel manufacturer in China – Injection (Exports).
- An Australian electrical retailer decides to buy products from an overseas business – Leakage (Imports).
- The local government decides to spend money to build a skate park – Injection (Government expenditure).
- Foreign students come to Australia to attend university, paying the university for their education – Injection (Exports).

Answers for Activity: Business Cycle Case Studies

A. Taylor – the rising prices indicate that there is an economic expansion.

B. Alex – the increase in job opportunities after a period of unemployment indicates that the economy is coming out of a trough and is starting to expand.

C. Bhakti – the falling sales and need for Bhakti to close a store indicate that there is an economic contraction.

D. Kyle – the increase in demand from customers and willingness of the boss to pay more to staff indicate that there is an economic expansion.

E. Kelly and Li Qiang – the recent decrease in interest rates indicates that there is an economic contraction.