CHAPTER 28 : Consumption

Key terms

1. Average propensity to consume : the proportion of total income spent. It is calculated by C/Y
2. Average propensity to save : the proportion of a total income that is saved. It is calculated by S/Y
3. Consumption : total expenditure by households on goods and services over the period of time
4. Disposable income : household income over the period of time including state benefits, less direct taxes
5. Dis-saving : when individuals spend an amount of money that was greater than their disposable income. This is financed either by running down existing stocks of saving, or by borrowing
6. Durable goods : goods that are consumed over a long period of time, such as television or car.
7. Marginal propensity to consume : the proportion of a change in income that is spent. It is calculated by Change in C/ Change in Y
8. Marginal propensity to save : the proportion of a change in income that is saved. It is calculated by Change in S / Change in Y
9. Saving ratio : usually expressed for household saving as a percentage of total household disposable income.

1. <u>Defining consumption and saving</u>

- **<u>Consumption</u>** : is spending on consumer goods and services over a period of time. Consumers may spend on **durable goods** and **non-durable goods.**
- **<u>Saving</u>** : is not spent out of income

<u>2. Marginal propensity to consume (MPC) and Average propensity to consume (APC)</u>

- Marginal propensity to consume (MPC) : proportion of a change in income that is spent

MPC = Change in consumption / Change in income

- Average propensity to consume (APC) : measures the average amount spent on consumption out of total income.

APC = Consumption / Income

<u>3. Other influences on consumption</u>

3.1 Interest rate

: Lower interest, Lower cost of borrowing or lower return from saving

: Borrow and spend more

: Higher consumption

3.2 Consumer confidence

: Higher consumer confidence , consumers tend to maintain or increase their spending.

3.3 Wealth effect

: eg. Higher price of houses, consumers tend to spend more on goods and services

3.4 Inflation

: If consumers expect inflation to be higher in the future, consumers tend to consume more today

3.5 The availability of credit : If consumers can be easy to access source of finance, consumers tend to spend more.

4. The determinants of saving

- **The average propensity to save (APS)** : measures the average amount to save out of total income.

APS = Saving / Income

- **The marginal propensity to save (MPS)** : proportion of a change in income that is saved

MPS = Change in saving / Change in income

5. Saving ratio

5.1 Saving ratio : is the proportion of income that is saved.

: Higher saving ratio, lower consumption

5.2 Dis-saving : is when individuals in total were spending an amount of money that was greater than their disposable income.