

2.2.2 Consumption

Consumption Overview

- Consumption is household spending on consumer goods and services
- It is determined by disposable income (income after direct taxes)
- The relationship between disposable income and consumer expenditure is explained by the marginal propensity to consume

Relationship between Savings and Consumption

- In simple models of an economy (circular flow diagram) and money that is not spent is saved
- Average propensity to consume is the proportion of disposable income that is

spent on goods and services

- $APC = \frac{\textit{consumption}}{\textit{disposable income}} * 100$
- Average propensity to save is the proportion of disposable income that is saved
- $APS = \frac{\textit{savings}}{\textit{disposable income}} * 100$

Interest Rates as an Influence on Consumption

- The interest rates determine the cost of credit/borrowing and the reward for saving
- If interest rates rise, borrowing money becomes more expensive and the opportunity cost of spending becomes higher
- Higher interest rates therefore lead to increased saving and reduced spending

Consumer Confidence as an Influence on Consumption

- If consumers have perceived job security and faith in future prospects they are more likely to have an increased level of consumption (especially on expensive goods such as cars)
- Consumer speculation can also affect consumption

Wealth Effect as an Influence on Consumption

- Increases in house prices and share prices (assets commonly held) lead to increased household wealth
- Increased household wealth leads to an increase in consumer expenditure
- Bank manager may lend person more money when their house is worth more as the house could act as a collateral asset (security for a loan)

Other Influences on Consumption

- Level of employment
 - Higher employment means more people have incomes
 - Leading to increased spending
- Welfare benefits
 - Generous benefits lead to higher disposable incomes
 - Leading to increased spending
- Pensions
 - Better pensions mean that retired people have more money to spend