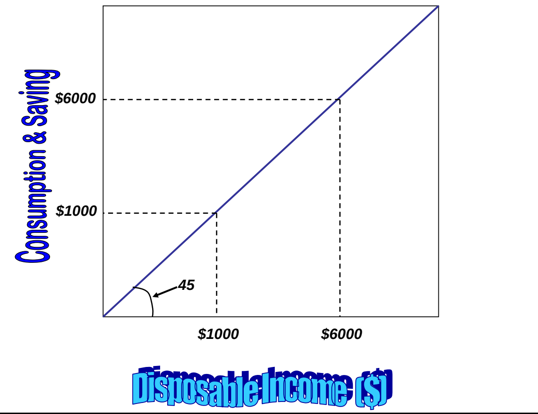
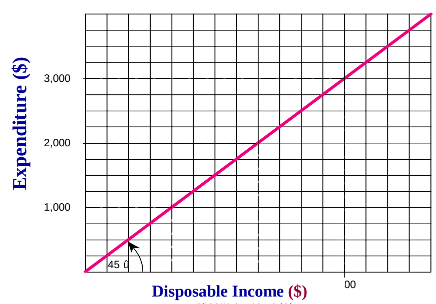
Graphing Consumption & Determinants of Consumption

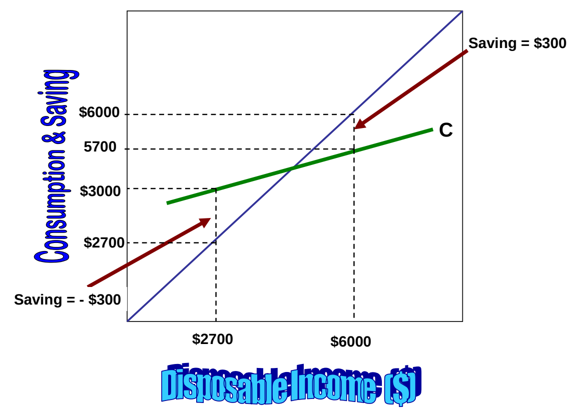
Consumption Part 2

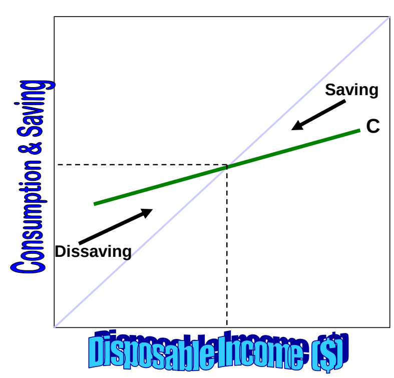


Graphing the Consumption Function

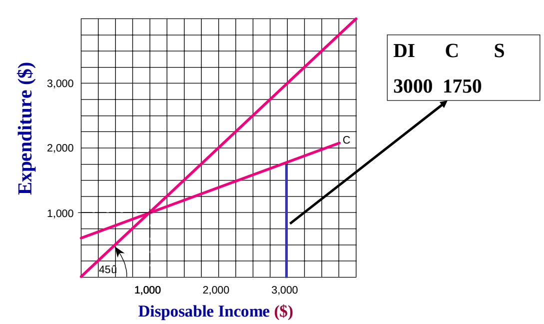


If Consumption rose at the same rate as Disposable Income . . . A graph of this function would be a 45 line





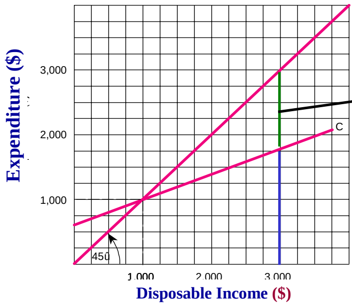
Graphing the Consumption Function



Consumption is the vertical distance between the bottom (horizontal) axis and the "C" line.

5-32

Graphing the Consumption Function

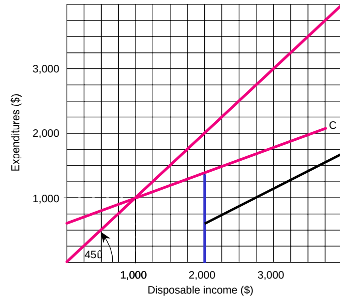


DI	C	S
3000	1750	1250

Saving is the vertical distance between the “C” line and the 45 degree line

5-33

Graphing the Consumption Function

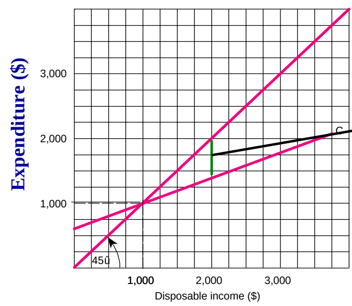


DI	C	S
3000	1750	1250
2000	1440	

Consumption is the vertical distance between the bottom (horizontal) axis and the “C” line.

5-34

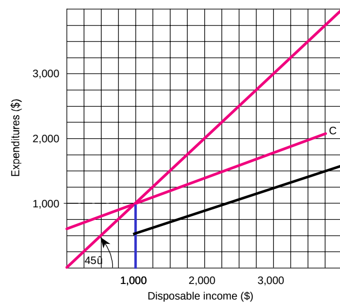
Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560

Saving is the vertical distance between the “C” line and the 45 degree line

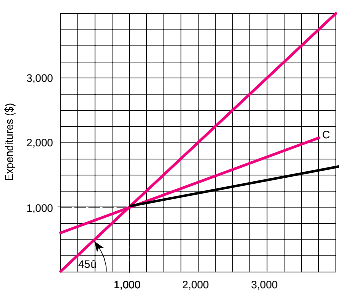
Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	

Consumption is the vertical distance between the bottom (horizontal) axis and the “C” line.

Graphing the Consumption Function

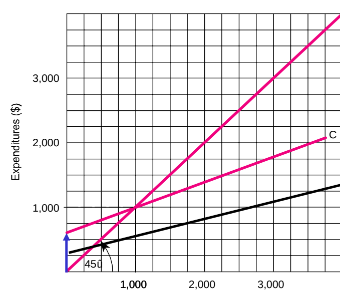


DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0

Saving is “0” at 1000 DI because there is NO distance between the C line and the 45 degree line.

5-37

Graphing the Consumption Function

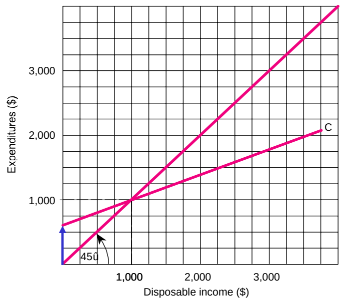


DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	

Consumption is the vertical distance between the bottom (horizontal) axis and the “C” line.

5-38

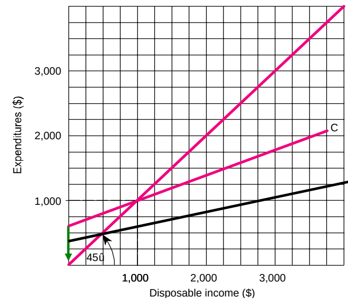
Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	

When DI is "0" the level of Consumption is called *Autonomous Consumption* (AC)

Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	-625

Saving is the vertical distance between the "C" line and the 45 degree line. Saving is negative to the left of where the C line crosses the 45 degree line

Autonomous vs. Induced

- Autonomous means Self Governing

Autonomous Consumption versus Induced Consumption

- *Autonomous consumption* (AC) is the level of consumption when disposable income is "0"
  - It is called autonomous because it is independent of change in disposable income

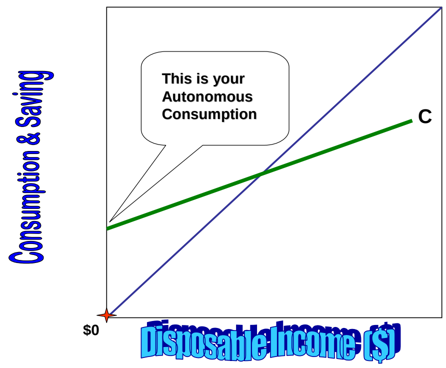
Induced Consumption

- *Induce consumption* (IC) is that part of consumption which varies with the level of disposable income
  - As disposable income rises, induced income rises
  - As disposable income fall, induced income falls

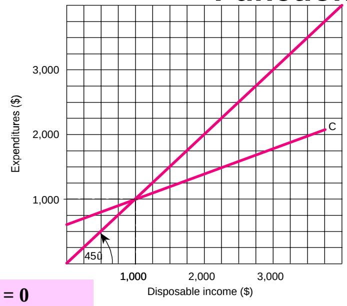
C = Autonomous C + Induced C

So

Induced C = C – Autonomous C



Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	-625

IC = C - AC

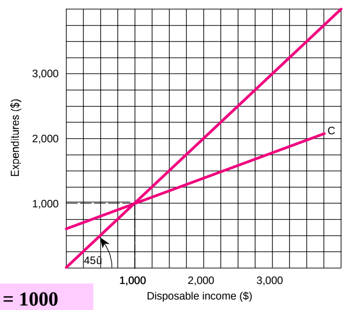
IC = 625 - 625

IC = 0

DI = 0

What is IC?

Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	-625

IC = C - AC

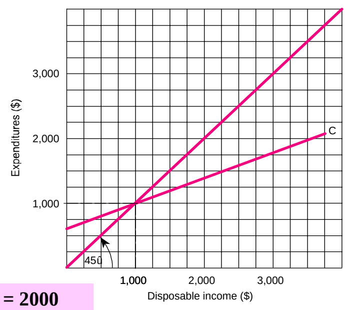
IC = 1000 - 625

IC = 375

DI = 1000

What is IC?

Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	-625

IC = C - AC

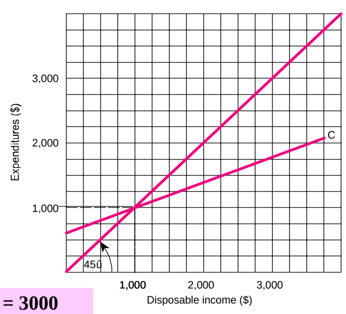
IC = 1440 - 625

IC = 815

DI = 2000

What is IC?

Graphing the Consumption Function



DI	C	S
3000	1750	1250
2000	1440	560
1000	1000	0
0	625	-625

IC = C - AC

IC = 1750 - 625

IC = 1125

DI = 3000

What is IC?

Determinants of Consumption

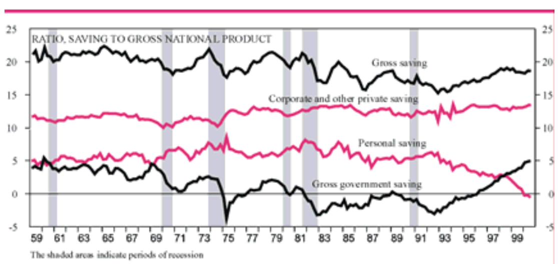
1. Disposable Income
   - The most important determinant of consumption
2. Credit Availability
3. Stock of Liquid Assets
   - in the hands of consumers
4. Stock of Durable Goods
   - in the hands of consumers
5. Keeping up with the Jones's
6. Consumer Expectations

Permanent Income Hypothesis
(Milton Friedman)

- People gear their consumption to their expected lifetime average earnings more than to their current income
  - Apparently there are quite a few deviations from the behavior predicted by the permanent income hypothesis

The Determinants of Saving

- There is no single reason why people save
- Some spend virtually all of their disposable income
- Some spend more than they earn
- Americans now save less than 5% of disposable income
- Americans used to save 7-10% of disposable income



Why Do We Spend So Much and Save So Little?

- Americans have been on a spending binge the past 20 years
  - Mottos
    - Buy now, pay later.
    - Shop till you drop.
    - We want it all, and we want it all now!