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

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Graphing the Consumption Function

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

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

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

Saving is "0" at 1000 DI because there is NO distance between the C line and the 45 degree line.
Graphing the Consumption Function

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

Autonomous vs. Induced

• **Autonomous** means Self Governing

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 falls, induced income falls

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

\[ C = \text{Autonomous C} + \text{Induced C} \]

So
\[ \text{Induced C} = C - \text{Autonomous C} \]
This is your Autonomous Consumption

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!