2.2.2 Consumption (C)

a) *Disposable income and its influence on consumer spending*
b) *An understanding of the relationship between savings and consumption*
c) *Other influences on consumer spending:*
   - *Interest rates*
   - *Consumer confidence*
   - *Wealth effects*

- Consumption is spending by households (not firms) on goods and services, and is the main component of AD (about 65%)
- There is a directly proportional relationship between consumption and AD so changes in consumption have a big impact on AD
- When consumption is high, savings tend to be low and vice versa. Savings are made of consumption so income can be consumed or saved
- Factors affecting consumption:
   - Interest rates: Higher interest rates cause less consumer spending as it costs more to borrow when buying on credit and increases the opportunity cost of spending (i.e. spending). Consumers may have less money to spend if interest rates on existing loans and mortgages increase
   - Consumer confidence: when consumers are more confident with the economy and their financial situation, they spend more and save less therefore people's view of the economy has a big influence on what actually happens. Reluctance to spend is especially higher during and immediately after a recession
   - Wealth effect: an increase in share or house (asset) prices means households are willing and able to spend more; an increase in consumer confidence
   - Employment: when unemployment rises, consumers spend less and save more; people in employment will save more over fears of job security. A fall in employment means people have more money to spend
   - Income: As disposable income increases, consumption will rise. The rate at which consumption rises is usually lower than the rate at which income increases because households tend to save as well
   - Taxes: direct taxes lead to a fall in consumers' disposable income, so they spend less. Indirect taxes increase the cost of spending, so consumers tend to reduce their consumption. A reduction in direct taxes or indirect taxes leads to a rise in consumer spending
   - Availability of credit
   - Inflation: higher prices means consumers spend less if wages do not keep up
- Wealth effect: the effect on spending or incomes when asset prices change
- MPC (Marginal Propensity to Consume): how spending changes as a result of a change in income. Change in consumption/ change in income.
- APC (Average Propensity to Consume): average amount spent on consumption out of total income. Consumption/ income.