

CONCEPT: DETERMINANTS OF CONSUMPTION AND SAVINGS

- The consumption function _____ up or down when factors other than _____ change:
 - *Sudden Changes in Wealth*
 - > Example: An unexpected increase in stock prices leads to _____ in consumption
 - > Example: The crash of the real estate market in 2009 caused _____ in consumption
 - *Borrowing leads to _____ in current consumption at the cost of future consumption*
 - > The interest cost of borrowing leads to a decrease in future “wealth”
 - *Expectations about future prices and income*
 - > If prices are expected to increase in the future, current consumption would _____
 - > If household income is expected to increase in the future, current consumption would _____
 - Likewise, expectations of an upcoming recession would lead current consumption to _____
 - *Real Interest Rates*
 - > A low real interest rate leads to _____ in current borrowing and consumption
 - Buy more goods that are purchased with credit (i.e. a new car)
 - Less incentive to save, so consume instead

PRACTICE: The country of Consumptia has had a booming economy for nearly a decade. However, prices have been rising faster than income, leading analysts to believe that a recession is on the horizon. If the citizens of Consumptia expect a recession in the coming years, then:

- a) Current consumption will increase
- b) Current consumption will decrease
- c) Current savings will decrease
- d) Recessions are not related to the consumption/savings functions.