Consumption, Saving and Borrowing

IGCSE

Consumption

What is consumption?

Consumption refers to consumers' expenditure on goods and services.

Consumption

Consumption is necessary for consumers' survival. Some of consumed goods and services are necessities and human survival is impossible without them like food, clothes, home etc. Other goods and services are considered as luxury but consumers spend income on these products since they provide some utility / satisfaction.

Income

Income refers to periodic inflow of money / earnings that someone receives over time. Income of an individual is either made up of his / her salary / wage or from the profit earned from any investment made.

Wealth

Wealth is the total amount of assets like bank balance, real estate and other assets owned by someone.

Wealth is basically accumulation of savings.

The amount of money that someone has saved overtime becomes his / her wealth.

Income Classification

Disposable Income = Gross Income − Income Tax

Gross Income: is total income earned / received by someone.

Income Tax: is the amount of income that government takes away in the form of taxes. Every country has some form of income taxes.

Disposable Income: is the income that is available to someone to undertake his / her consumption.

Savings

Any unspent income left after consumers' expenditure is known as savings.

Saving allow for higher future consumption however savings come at the expense of lower current consumption.

Saving allows individuals to smooth their consumption through different phases of their lives especially during hard times like loss of job or some emergency.

Borrowing

Certain individuals' expenditure is greater than their incomes and to make up for the shortfall people borrow from banks and other sources.

All individuals can be classified as savers or borrowers.

Individuals whose expenditure is less than their income are savers and those whose expenditure is greater than their income are borrowers.

Factors determining Consumption

Disposable Income / Gross Income:

Consumers with higher incomes are more likely to spend more. Greater affordability allows individuals to consume more.

Factors determining Consumption

Interest Rates: Interest is paid by borrowers to savers. People prefer to save more during times of high interest rates because they receive more return for their savings. Similarly borrowers are less likely to borrow during times of high interest rates since they have to pay more for the borrowed money. Since borrowing will be low, consumption is expected to be lower during times of high interest rates.

Factors determining Consumption

Expectations about future: If consumers are optimist about their future they are expected to consume more and save less and vice versa. It is human psyche to spend more during good times and save more during hard times.

Factors determining Saving

Consumption: if someone is spending more then they will be savings less.

Income: if someone earns less then obviously they will have less money left to save after consumption.

Interest Rate: higher the interest rates higher the savings

Some planned future expenditure: when people have something particular expense in mind they are likely to save. For instance to buy a car, house etc.

Factors determining Borrowing

Income: Individuals with higher income are less likely to borrow for they can afford better living standards with their current income. But then such individuals might also have higher spending needs.

Interest Rates: Since interest is cost of borrowing hence consumers are expected to borrow less during times of high interest rates.

Factors determining Borrowing

Expectations about future: Consumers are more likely to borrow if they are optimist about their future. Expectations of higher future income encourage consumers to borrow more and vice versa.

Consumers' Age: individuals are expected to borrow more during their early years for they have lesser assets like car, house etc. In later years of life most individuals have saved enough to comfortably spend their retirement years.