SATPREP

Consumer spending and income

Factors through which people earn –

1. Salary / Wages
2. Interest on savings
3. Rent earned from leasing property
4. Dividends
5. Profits earned from running a business

Disposable Income:

1. Amount of income a person has available to spend on goods and services.
2. Higher disposable income usually leads higher spending.
3. Direct taxation reduces the amount of income a person receives.

Positive Wealth Effect:

This causes people to spend more and, in some cases, causes owners of assets to borrow against the value of their assets such as residential or commercial property.

Determinants of consumer spending:

Inflation	Interest Rates	Confidence levels	Age	The size of households
The general level of prices in the economy influences consumer spending because an increase in inflation reduces the purchasing power of individuals.	The interest rate refers to the cost of borrowing or lending money. An increase in interest rates may lead to decreased consumer spending, less borrowing and more saving because – 1. **Borrowing** has become more expensive therefore demand for loans falls so less consumer spending. 2. **Saving** has become more attractive due to higher return, so individuals more and spends less. 3. If an individual has a loan or mortgage, the increase in interest repayments may lead to decrease in demand for other goods and services, so spending falls.	During recession people prefer to save than spend as they lack confidence in future of economy like fear of losing job. Contrarily, during economic boom people feel confident about economic future and purchase more goods and services. Sale of luxury items increases. More jobs will be created as firms will invest in new equipment and technology.	Young single person may earn relatively low income and may spend most of it on goods and services to support their lifestyle. With more age, earnings will rise so does their saving. They save to buy a property or in anticipation of marriage and children. In family stage, they spend more on their children and save for their retirement or children's future education. After retirement people **dissave.**	Average size of households changed overtime. Marriages are late; birth rates are declining which influences spending pattern of families.

Consumption Trends or Propensity to consume in countries is the result of the following factors.

Real Income have risen	People work for fewer hours now	Social Attitudes have changed	Couples marry later and have fewer children	People are more health conscious	Technology is changing rapidly	Concern for environment is growing
So people increase spending	So they have more leisure time and more holidays	More women are working today so there is greater demand for time saving things.	Average age expectancy has risen, birth rates have fallen, household size has fallen, and single people have increased. All this has led to different consumption and saving patterns.	So there is more spending on healthier food and sporting goods.	So more spending on newer technologies	So more purchasing of products emitting less pollutant.

Savings: Reasons to save –

1. A person sacrifice current spending to save for a holiday or for retirement.
2. A person may choose to save a portion in bank or other financial institution in order to earn interest.
3. A person may save for emergencies like accidents, job loss or unforeseen event.

Factors affecting level of savings:

Age	**Attitude to saving**	**Consumer and business confidence**	**Interest rates**
People start saving around age of 25. They will likely to have secured employment and paid off student loans. Amount saved depend on facilities given by government for old-age pensions and health-care provisions.	Different persons have different attitude of saving. Eg. In USA and UK credit cards are more used for purchasing, while Asian countries tend to save more for unforeseen emergencies.	If people and firms have confidence in the performance of the economy, the level of savings will usually fall as people will be more willing to spend money. Savings tend to rise during recessions when consumers are feeling less optimistic about the future.	A rise in interest rates means that people with existing debts have higher repayments to make to the lender. This will reduce their spending. On the other hand, when interest rates are low people have a disincentive to save and may choose to spend their money or find an alternative to increase value of their savings – purchasing shares etc.

Desire and ability to save depends – on culture, age, income and family circumstances.

Borrowing: Reasons to borrow –

1. To fund expensive items like car, overseas holiday
2. To purchase property or land such as factory, offices or home
3. To start up a new business
4. To fund a large projects such as business expansion in foreign countries
5. To fund private and tertiary education
6. To fund current expenditure in the event of job losses or economic decline.

Factors that affect level of borrowing:

Availability of funds	Credit Cards	Store cards	Wealth
Banks and other financial institutions lend money to individuals and firms in the form of loans. The central bank of a country controls the amount of funds which are available for borrowing by setting a cash reserve ratio. A decrease in cash reserve ratio means that more funds are available for lending and an increase in the money supply can therefore lead to an increase in borrowing.	Credit allows people to purchase goods and services with deferred payments. People or firms take ownership of the goods and services immediately and must repay the amount to the credit card company several weeks later. They buy now and pay later. Interest rates charged on credit card borrowing are extremely high.	These are issued to regular customers of large retail stores in many countries to encourage spending. They act as credit cards that can be used only in individual retail outlet. Firms offer gifts or discounts as loyalty points on the card, which can be used in the future to purchase goods and services in the store. Store cards can give people to overspend and can raise their level of debt. If debts are cleared when payment is requested then no interest will be charged.	The wealth of a person may affect their level of borrowing, as a bank will be more willing to lend money to wealthier individuals or highly profitable firms because they are less likely to default and will have collateral against loan. .