OUTLINE — October 24, 2018

- Consumption Spending & Its Determinants
  - Saving
  - Consumption Spending Depends upon . . .
- Multiplier
- Closing an Output Gap

PS 3 due 10/31-11/1 in section

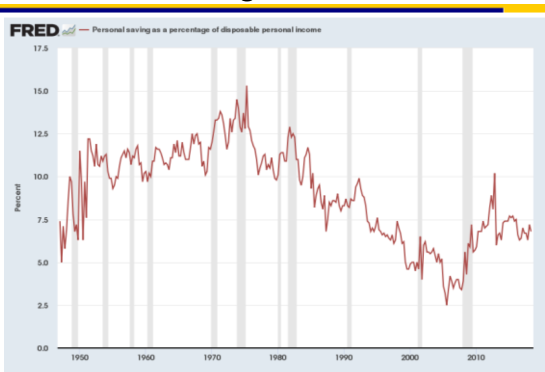
bCourses quiz due Tues 10/23 11:59 pm

Midterm 2 on Tues., Nov 6, 8-9:30 pm

Definitions: Consumption & Saving

- Consumption
  - Household (and nonprofit organizations) spending for final goods and services
- Saving
  - Any use of disposable income <u>other than</u> consumption
- Saving rate

Personal Saving Rate, 1950-2018



Consumption Spending

- C depends upon
  - YD
  - wealth
  - interest rates (i)
  - credit availability
  - expectations

Marginal Propensity to Consume

- mpc =
  - For the economy as a whole, mpc < 1
- ΔC =

Consumption Spending

- C = f (YD, wealth, i, credit availability, expectations)
- But can only graph in 2 dimensions . . .

Macro Equilibrium (Y=AD)

Changes in Equilibrium

What happens to equilibrium output (Y_E) if planned spending increases initially by 100?

Any initial Δspending results in a much larger ΔY_E because

1) Δspending → Δoutput
2) Δoutput → ΔY
3) ΔY → ΔYD → ΔC

Definition of size of multiplier:

Closing an Output Gap

- Suppose

  Y_{FE} = $15 trillion / year

  Y_E = $14 trillion / year

How big is the output gap?

- Closing an output gap requires an increase in AD

To close the gap, how big must the initial increase in AD be?

Step 2: Allocate your monthly C

	Category	Spending
1	Housing (rent or mortgage)	
2	Food (prepared/eaten at home)	
3	Eating out & travel	
4	Car / bus / Bart (including gas & insurance)	
5	Other durable goods (electronics, appliances)	
6	Shopping! (big box stores, department stores, etc)	
7	Health care (including health insurance premium)	
8	Education	
9	Bank fees, brokerage fees, lawyers, fees, etc	
	Total = $ for consumption spending on your B&G	

Which items are likely to be imports?

Put an asterisk next to or circle those amounts

Multiplier Process

- On your B&G sheet
  - Your occupation & industry
  - Monthly Disposable Income (Y+TR-TA) & Consumption

Step 1: Calculate your monthly Saving

Step 2: Allocate your monthly Consumption across spending categories

Step 3: Listen . . . Be ready to think about how your consumption changes

When someone is unemployed…

- Their income (Y) drops to 0
- They *may* receive unemployment benefits (part of TR)
  - Construction workers – probably not
  - Religious workers – almost surely not
  - Self-employed workers – definitely not
- Unemployment benefits replace < ½ of income
  - Max weekly benefit varies by state ($450 in CA, $240 in AZ, etc)
  - Number of weeks varies by state (26 in CA & AZ, 12 in FL)
- Therefore, to keep C constant requires dis-saving
  - Drawing down savings (how much were you saving per month?)
  - Going into debt (but remember . . . you have to pay that back)
- Alternative: cut C when lose your job

Unemployment Insurance (a TR)

- Replacement rate (benefits as % of usual wage)
  - U.S. average: 46% replacement rate
  - Most generous (52-57% replacement): HI, PA, ND, KS, NJ
  - California: right at national average
  - Least generous (31-42% replacement): AK, LA, IL, TN, MO
- Length:
  - Standard = 26 weeks
  - Some states fewer weeks
  - Federal extensions to 99 weeks post-2009 but that bill has expired
- Data: calendar year 2016
- Original source: https://ows.doleta.gov/unemploy/repl_ratio/repl_ratio_rpt.asp

Step 3: An event!

- Listen for the event
  - Does the event affect you?
    - What's your occupation & industry?
  - How will you react?
    - Is your income rising or falling?
    - Will you increase your C? Decrease C? Keep it the same?
  - Which components of spending will you change?
    - Be ready with your answer!