week 7

savings and investment

Contents

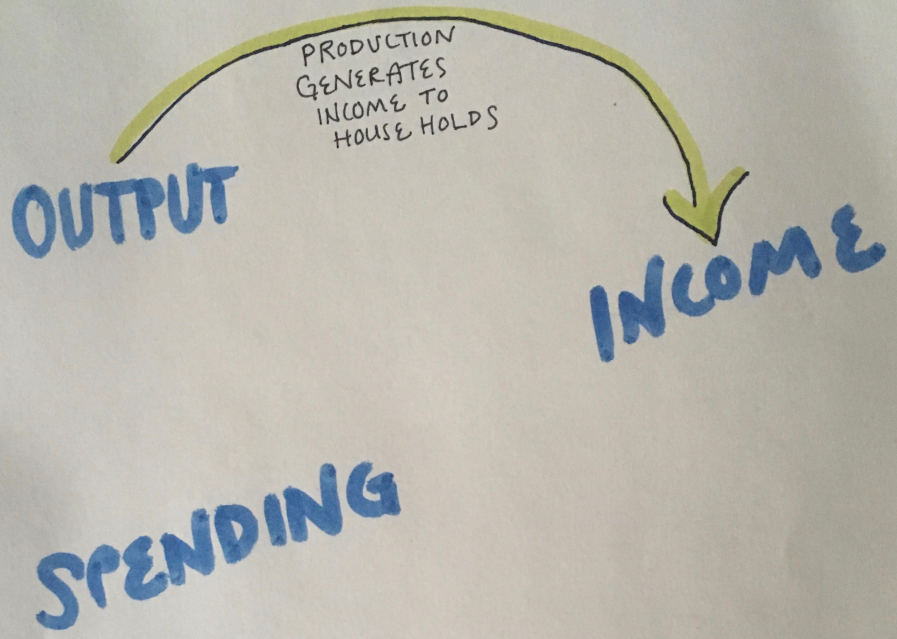
MACROECONOMIC MODELS

OUTPUT

INCOME

SPENDING

MACROECONOMIC MODELS



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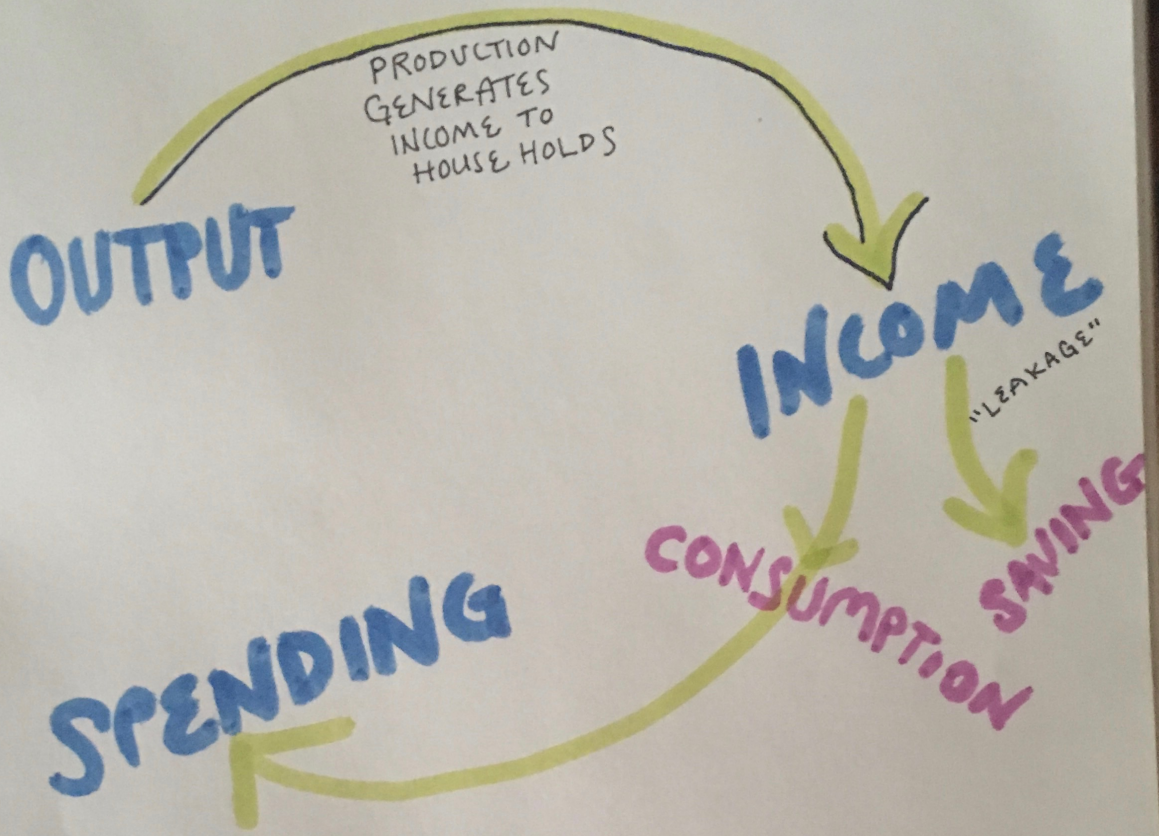

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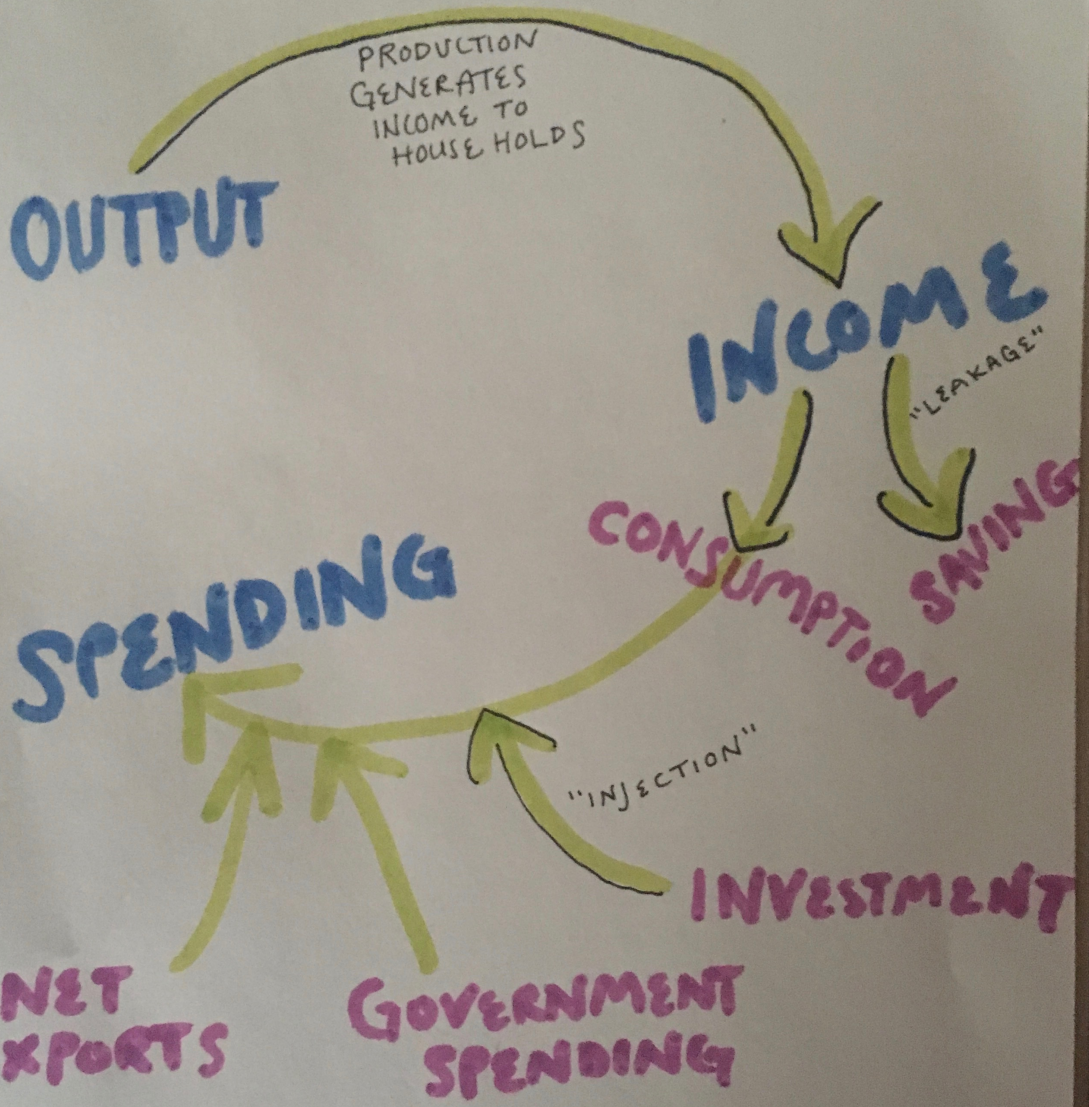

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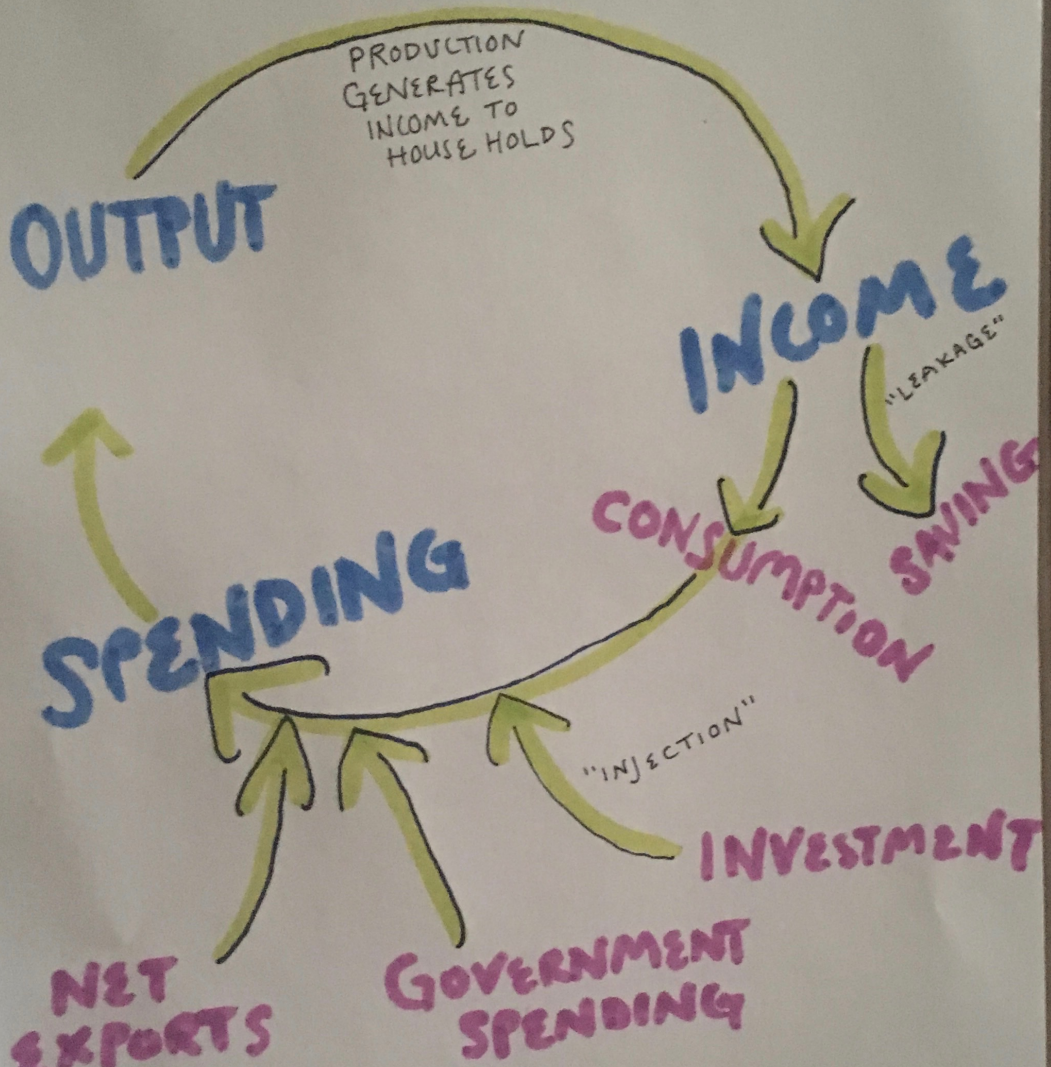
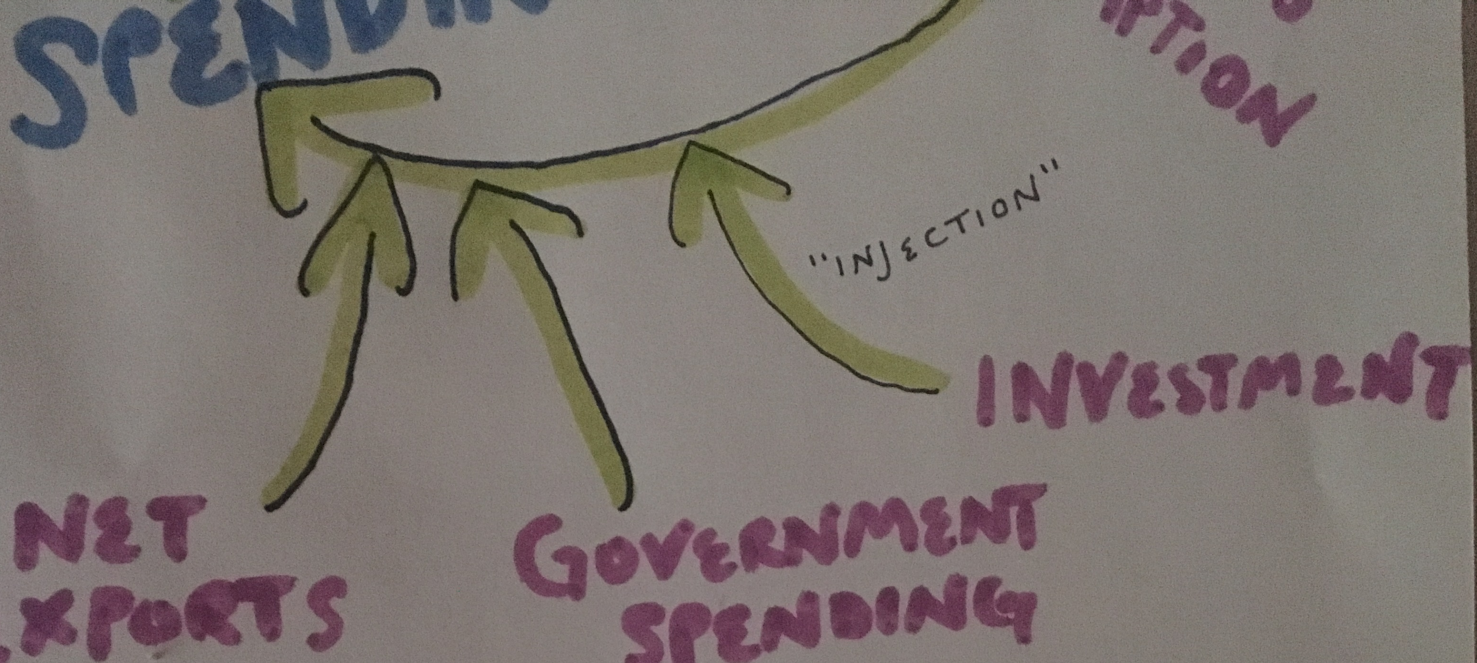




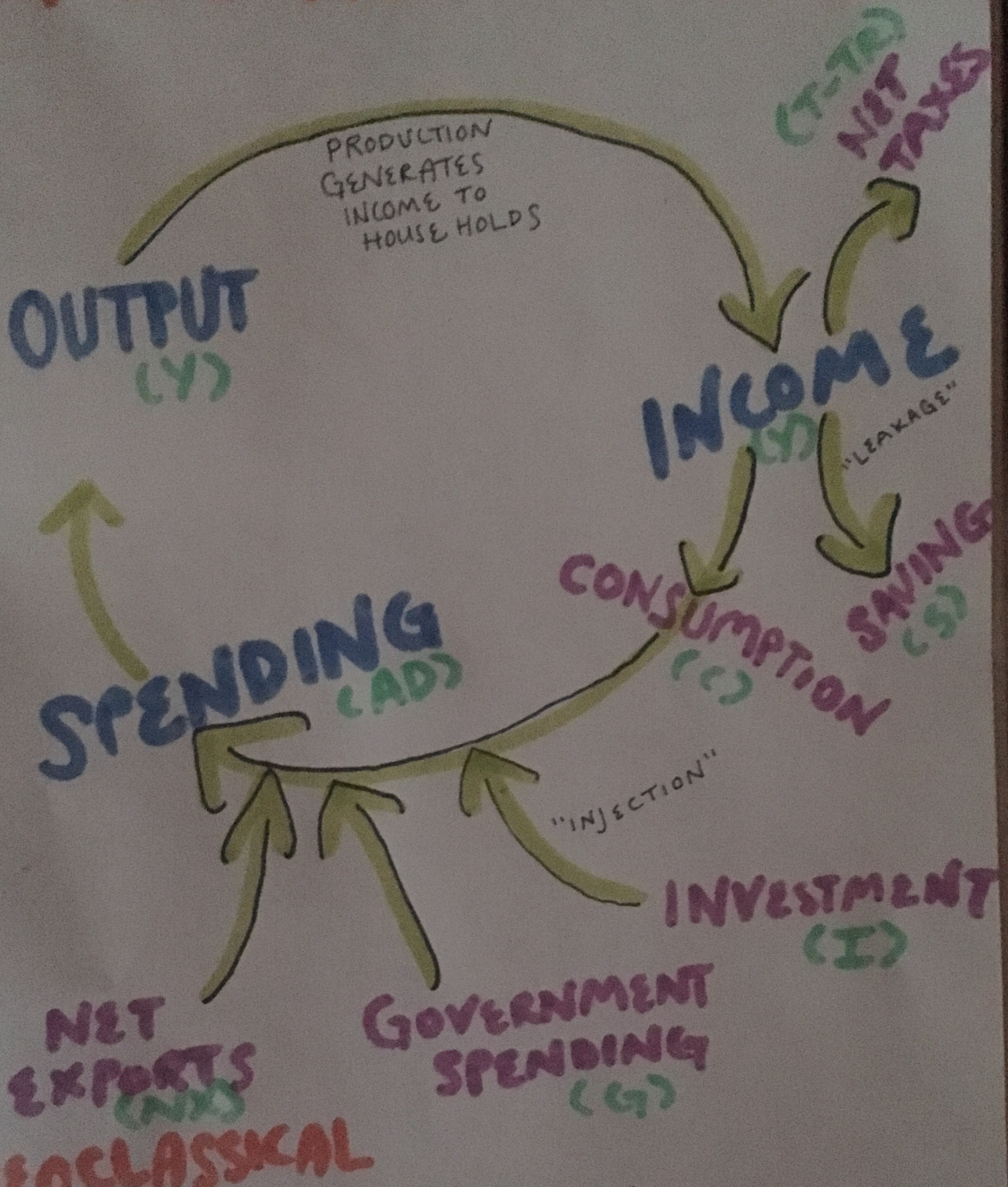
NEOCLASSICAL

- MARKET FOR LOANABLE FUNDS → SAVINGS = INVESTMENTS

KEYNESIAN

- SAVINGS + INVESTMENT DETERMINED SEPERATELY
- if SAVINGS > INVESTMENT, SPENDING < OUTPUT
- if SAVINGS < INVESTMENT, SPENDING > OUTPUT

MACROECONOMIC MODELS



WHY DO PEOPLE SAVE?

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KEYNESIAN

NEOCLASSICAL
— MAINSTREAM

WHY DO PEOPLE SAVE?

KEYNESIAN

- DEPENDS ON MARGINAL PROPENSITY TO CONSUME (MPC)

NEOCLASSICAL — MAINSTREAM

- DEPENDS ON INTEREST RATE

WHY DO PEOPLE SAVE?

KEYNESIAN

- DEPENDS ON MARGINAL PROPENSITY TO CONSUME (MPC)

MPC IS DETERMINED BY

- WEALTH
- CONSUMER CONFIDENCE
- ATTITUDES TOWARD SAVINGS
- GOVERNMENT POLICIES RELATED TO CONSUMPTION
- DISTRIBUTION OF INCOME

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- DISTRIBUTION OF INCOME

Δ = the change in
C = consumption
Y = income

$$MPC = \frac{\text{how much we consume now} - \text{how much we consumed then}}{\text{how much income we receive now} - \text{how much income we received then}} = \frac{\Delta C}{\Delta Y}$$

NEOCLASSICAL — MAINSTREAM

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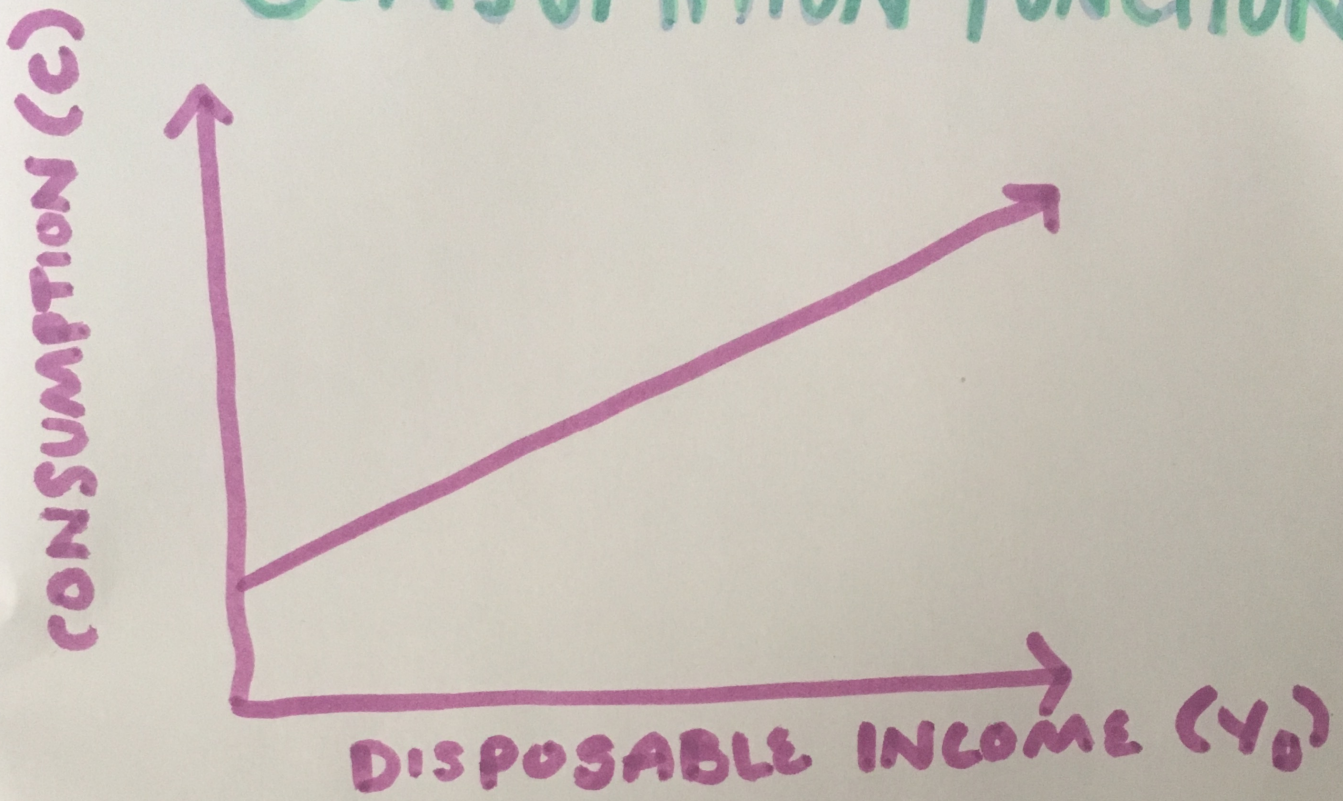
NEOCLASSICAL — MAINSTREAM

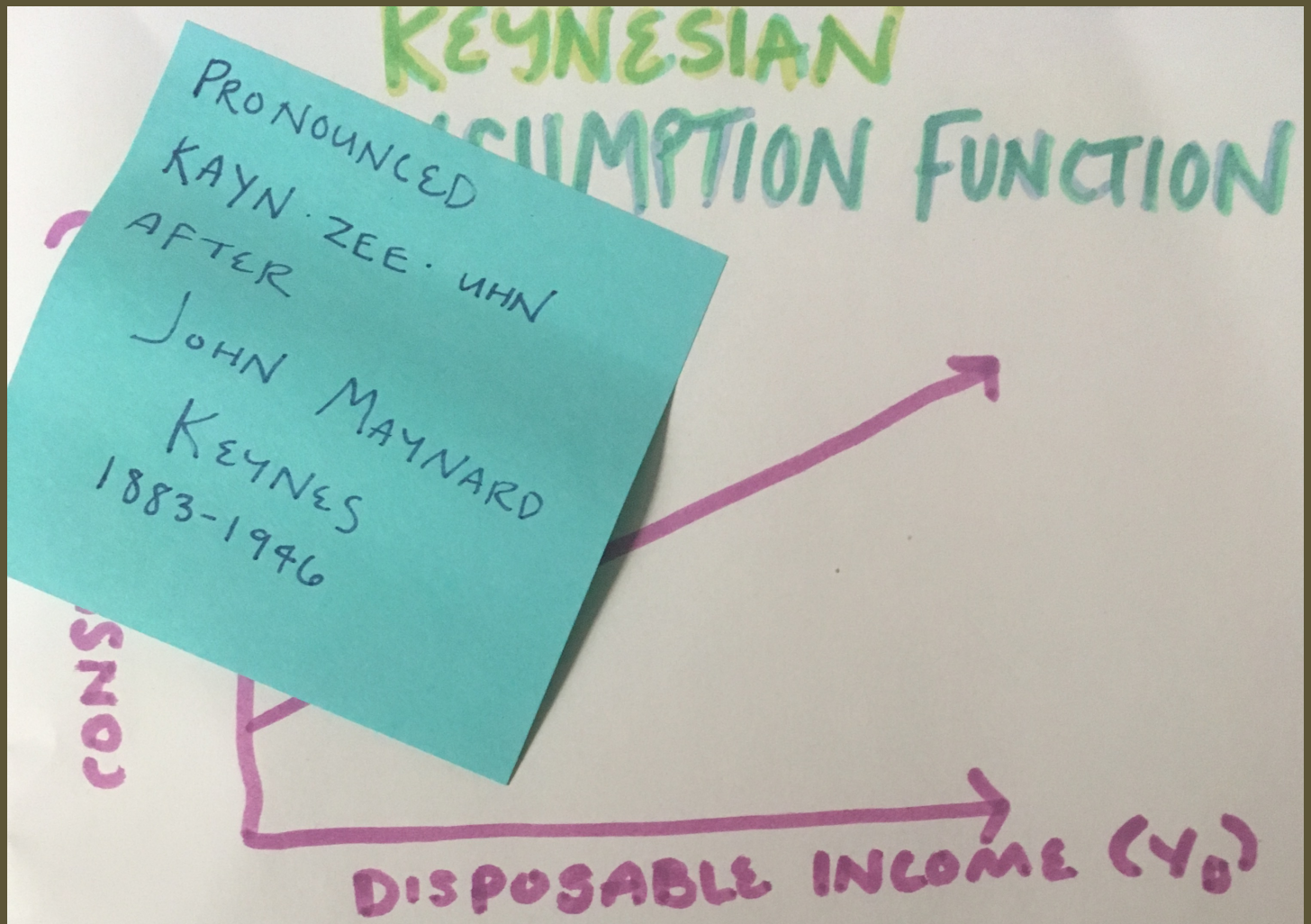
- DEPENDS ON INTEREST RATE

INTEREST RATE IS DETERMINED BY

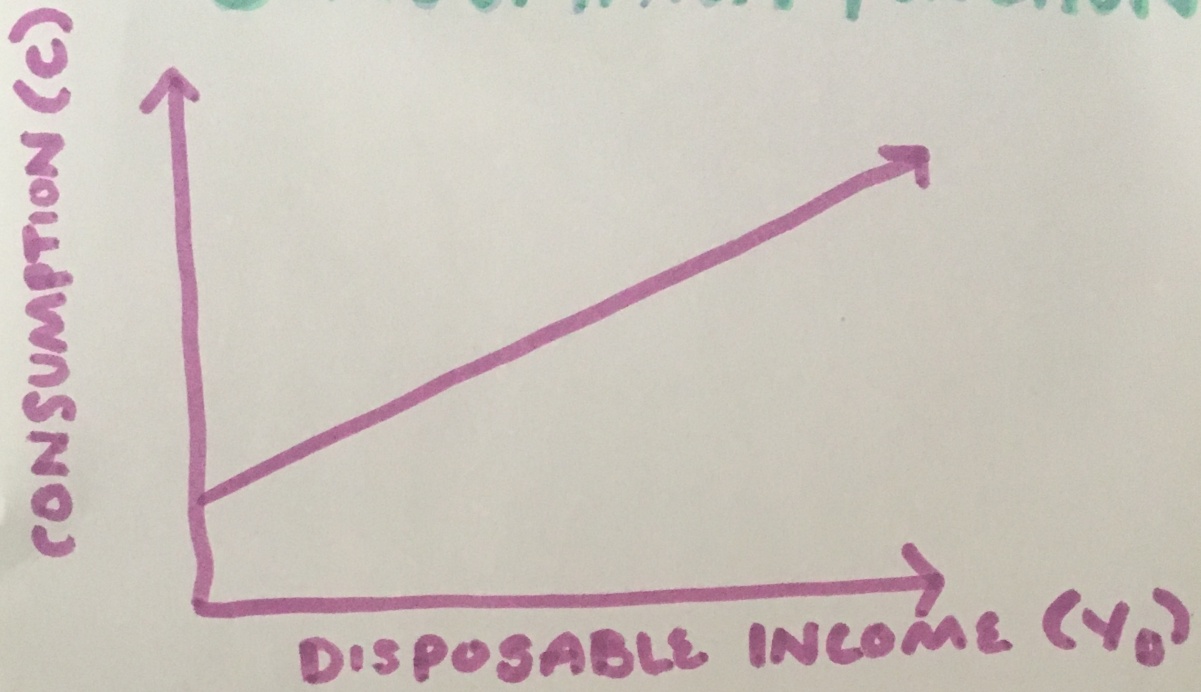
- INFLATION (LONG RUN)
- MONETARY POLICY (CENTRAL BANK)
- FISCAL POLICY (GOVERNMENT)

CONSUMPTION FUNCTION




KEYNESIAN
SUMPTION FUNCTION
PRONOUNCED
KAYN · ZEE · UHN
AFTER
JOHN MAYNARD
KEYNES
1883-1946
CONS
DISPOSABLE INCOME (YD)

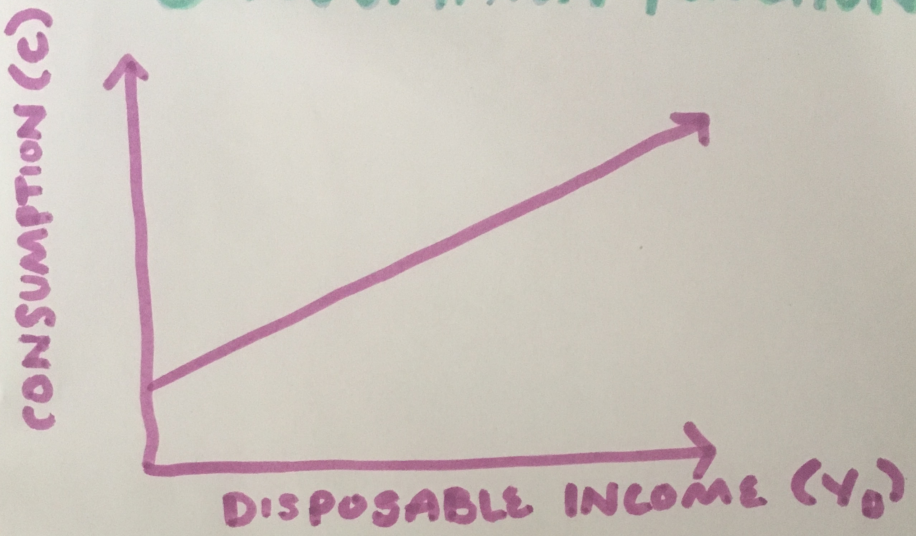
KEYNESIAN CONSUMPTION FUNCTION



$$C = \bar{C} + mpc(Y_D)$$

$C = 500 + 0.6(\text{disposable income})$

KEYNESIAN CONSUMPTION FUNCTION



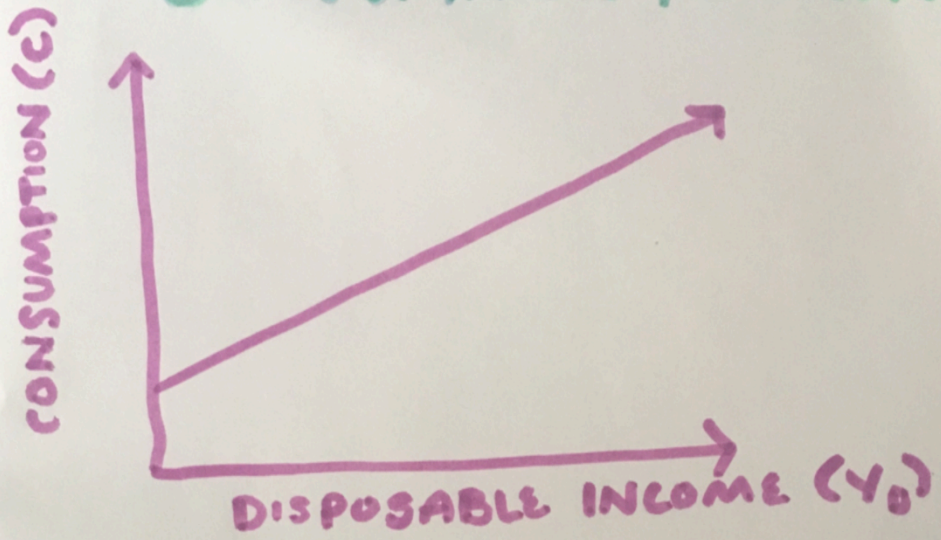
$$C = \bar{C} + mpc(Y_D)$$

$C = 500 + 0.6$ (disposable income)

key

- C ≡ CONSUMPTION
- $\bar{C}$ ≡ AUTONOMOUS CONSUMPTION ("C-bar")
- mpc ≡ MARGINAL PROPENSITY TO CONSUME
- Y_D ≡ DISPOSABLE INCOME

KEYNESIAN CONSUMPTION FUNCTION



$$C = \bar{C} + mpc(Y_D)$$

$C = 500 + 0.6$(disposable income)
what is Y_D?

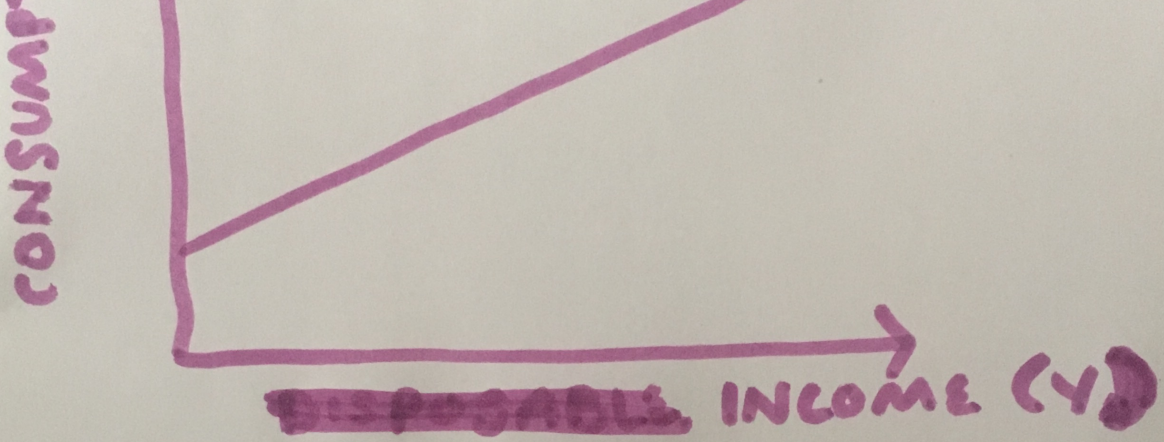
key

C = CONSUMPTION

$\bar{C}$ = AUTONOMOUS CONSUMPTION : "C-bar"

mpc = MARGINAL PROPENSITY TO CONSUME

Y_D = DISPOSABLE INCOME



$$C = \bar{C} + mpc(Y_D)$$

$$C = \bar{C} + mpc(Y - T)$$

$C = 500 + 0.6$ (disposable income)

what is Y_D?

Y_D = income − taxes

$Y_D = Y - T$

Key

$C \equiv$ CONSUMPTION

$\bar{C} \equiv$ AUTONOMOUS CONSUMPTION : C-bar

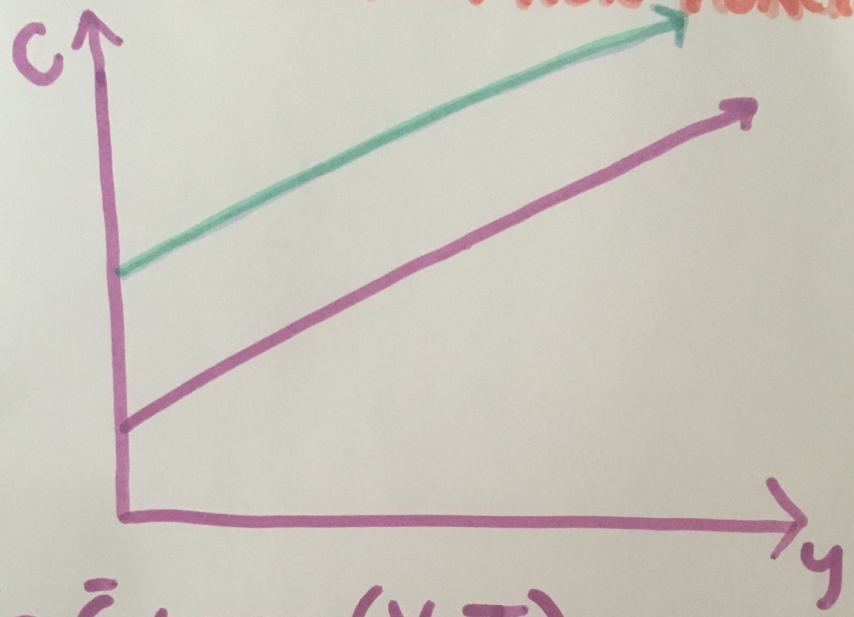
$mpc \equiv$ MARGINAL PROPENSITY TO CONSUME

$Y_D \equiv$ DISPOSABLE INCOME

$Y \equiv$ INCOME

$T \equiv$ TAXES

KEYNESIAN AD CONSUMPTION FUNCTION



$$C = \bar{C} + MPC(Y - T)$$

$$AD = C + I + G + NX$$

where...

C: CONSUMPTION

$\bar{C}$: AUTONOMOUS CONSUMPTION

MPC: MARGINAL PROPENSITY TO CONSUME

Y: income

T: taxes

AD: AGGREGATE DEMAND

I: INVESTMENT

G: GOVERNMENT

NX: NET EXPORTS (exports less imports)

MARKET FOR LOANABLE FUNDS

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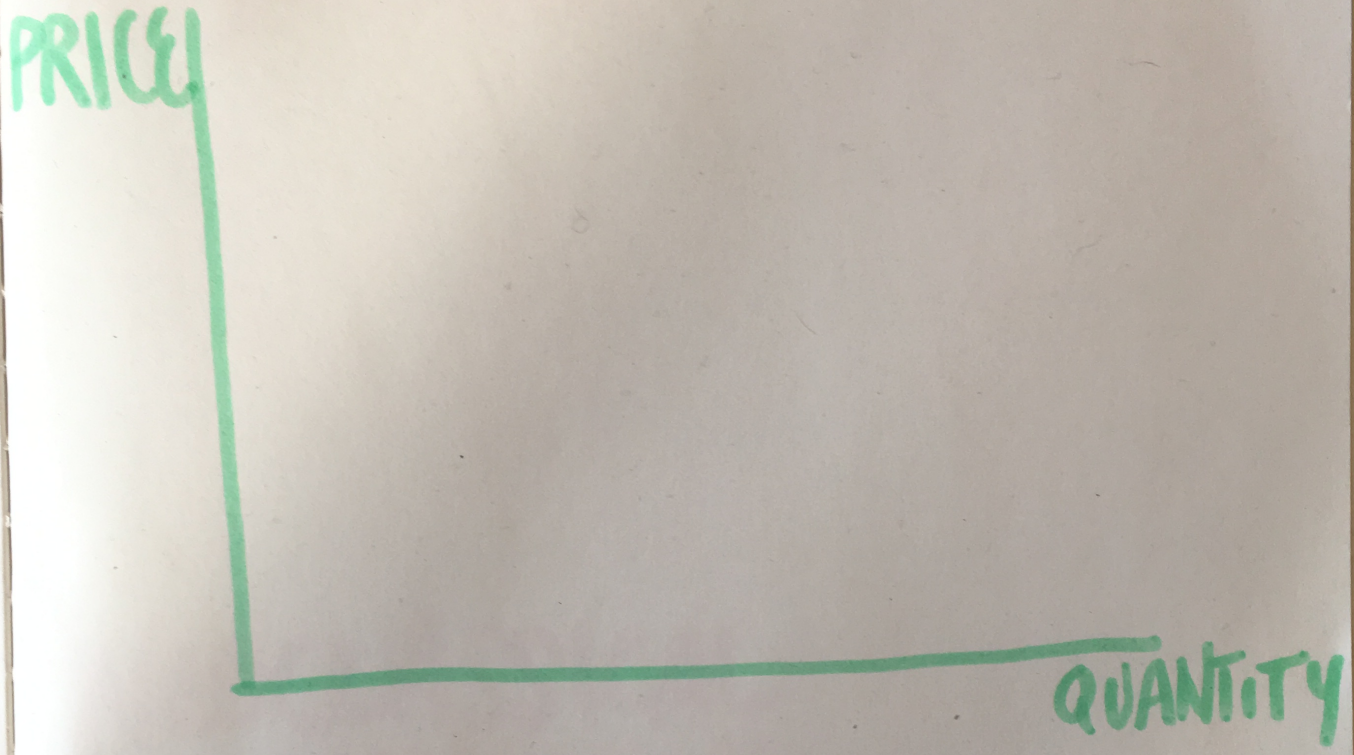

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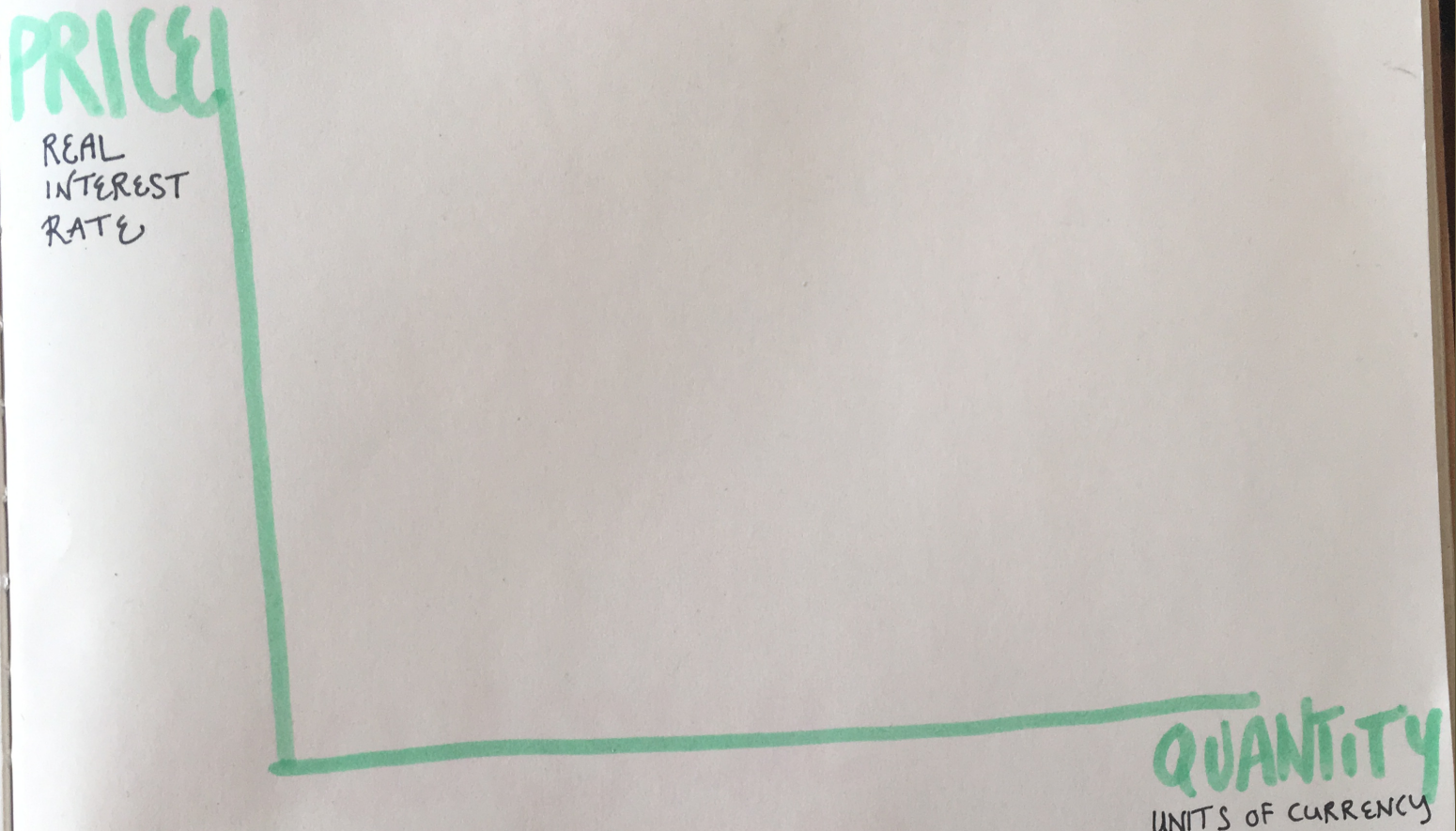

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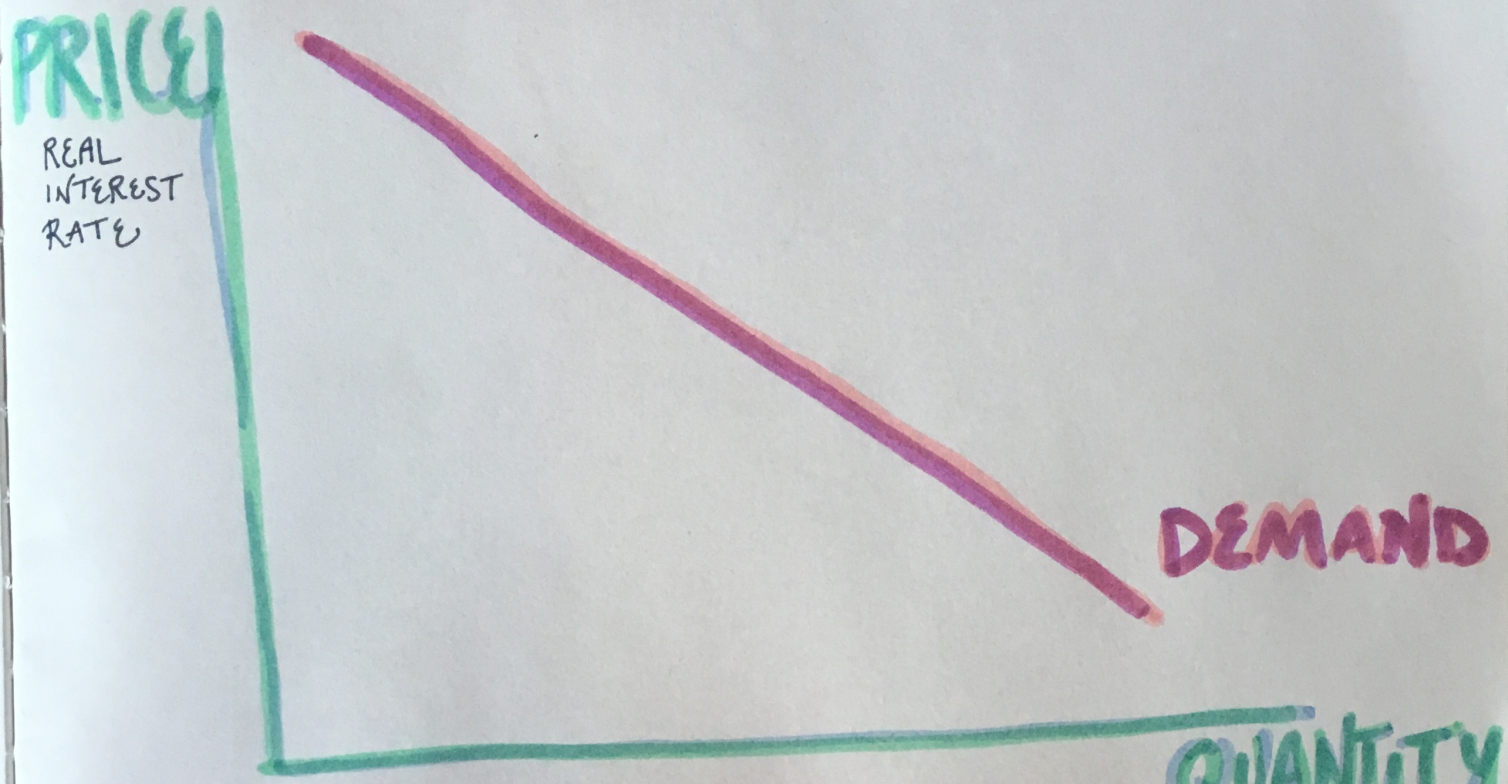

WHY REAL INTEREST RATE?

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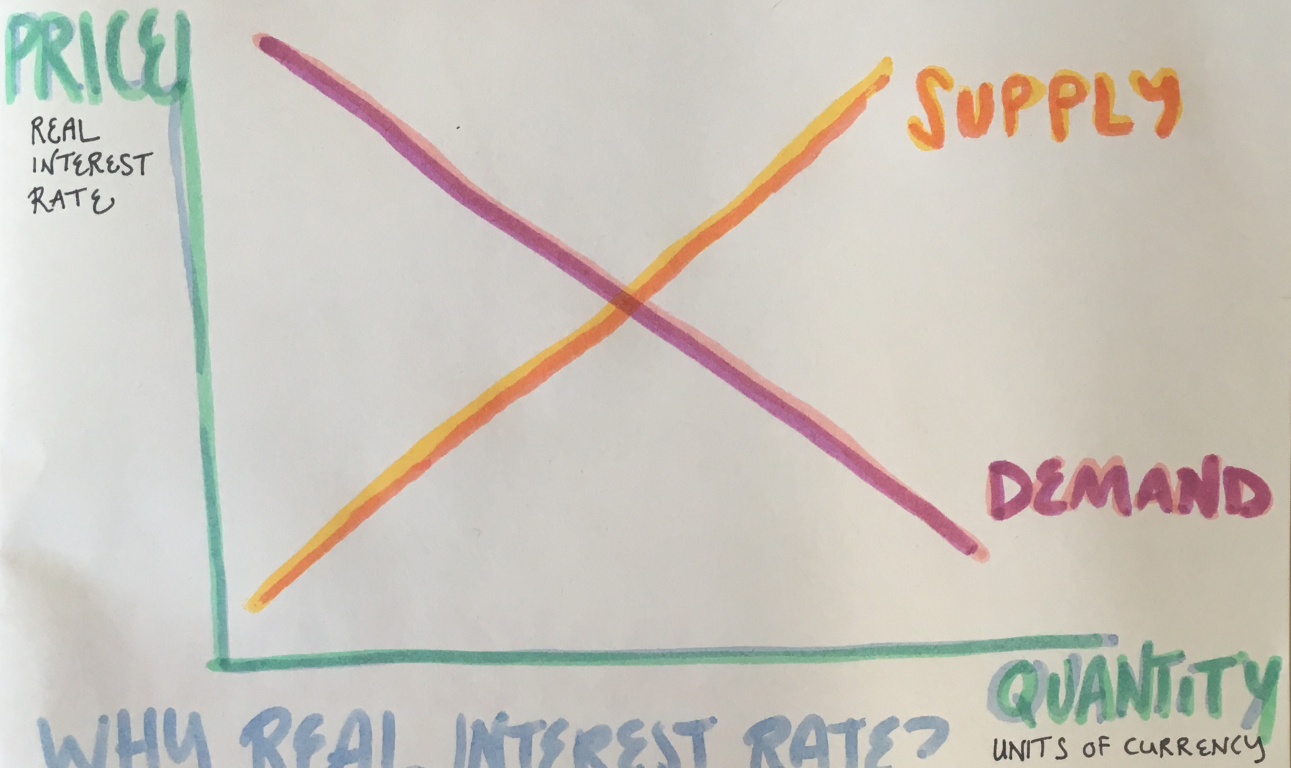
- LOANS ARE LESS LIQUID THAN MONEY → LONG RUN
- IF INFLATION IS HIGH, MORE PEOPLE WILL WANT TO TAKE MORE LOANS EVEN AS THE NOMINAL INTEREST RATE STAYS THE SAME BECAUSE WHAT THEY HAVE TO PAY BACK WONT BE WORTH AS MUCH (IN TERMS OF PURCHASING POWER)

→ → REAL INTEREST RATE = NOMINAL INTEREST RATE − INFLATION RATE

MARKET FOR LOANABLE FUNDS



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