

## AS Macro EW - Consumer Spending in the UK Economy

This EW focuses on changes in the level and pattern of consumer spending on goods and services. Consumption (C) is far and away the largest component of aggregate demand (AD) so understanding the factors affecting consumption is important in explaining changes in the economic cycle and also the impact of consumer spending on the rest of the economy.

Chart A: The components of aggregate demand

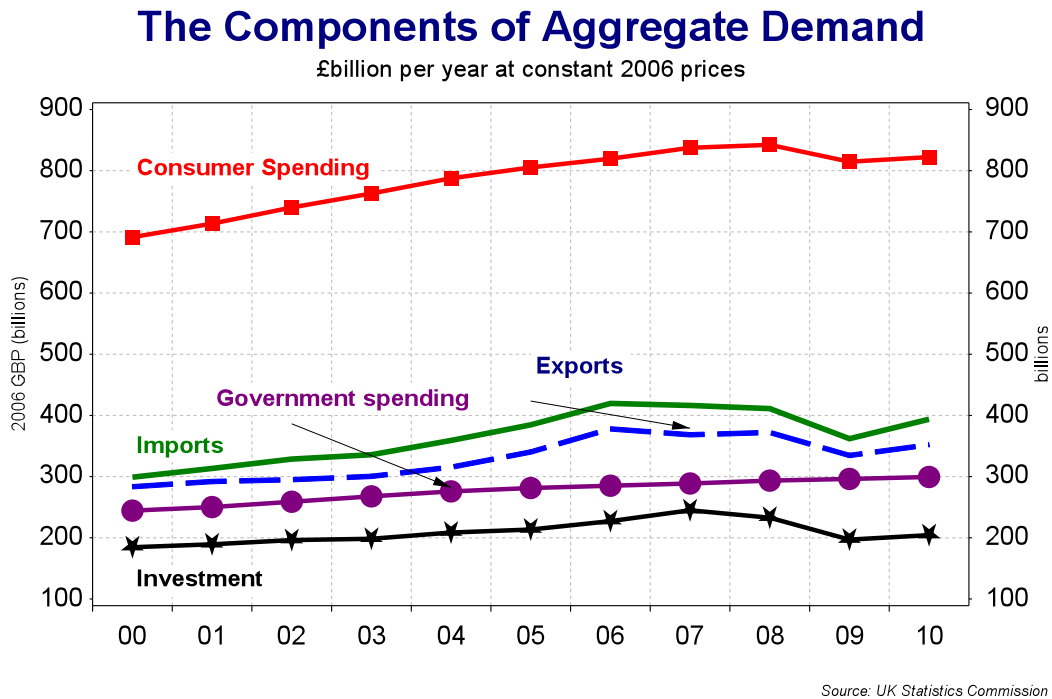
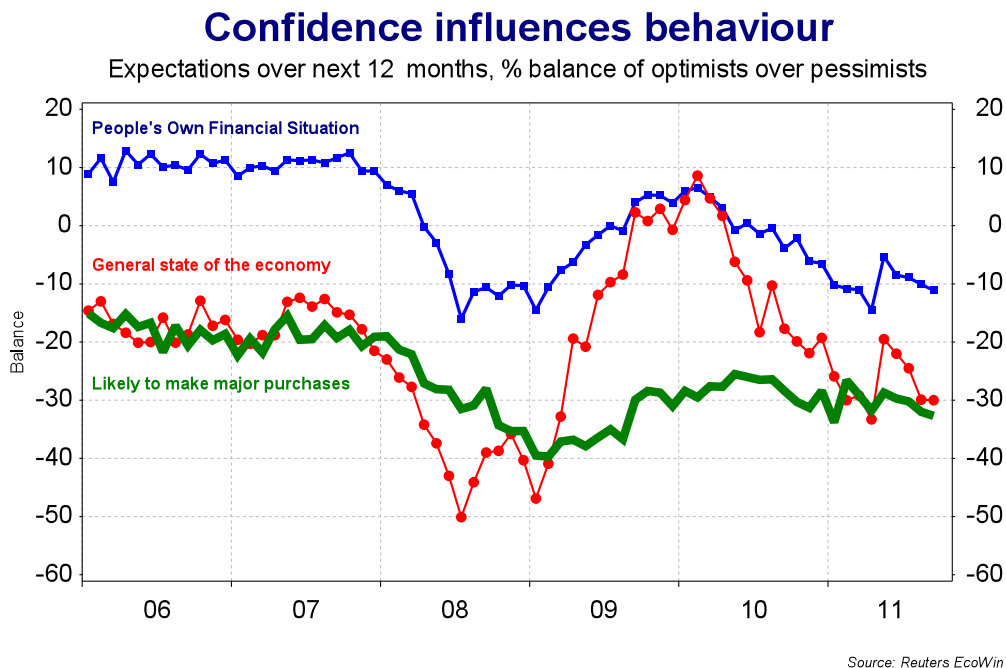


Chart B: Changes in UK consumer confidence

Consumer confidence is an economic indicator that measures the degree of optimism that consumers feel about the overall state of the economy.



### Extract 1: Families suffer sharp fall in their real disposable income

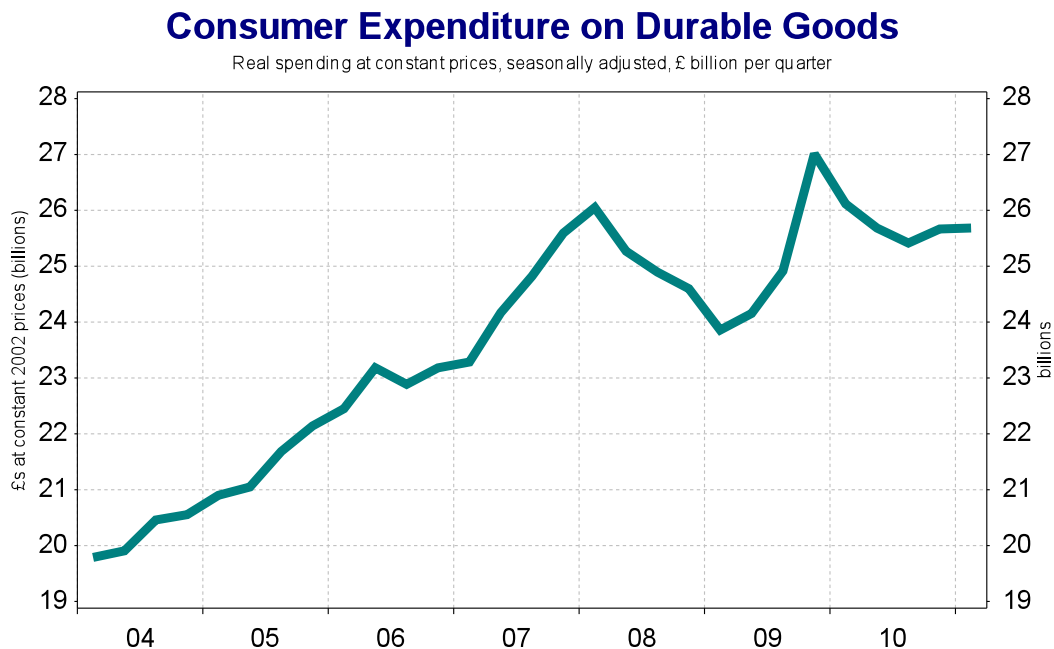
Families' disposable spending power in Britain has fallen by £730 over the last year due to the higher cost of living, according to supermarket Asda. Higher petrol, food and utility prices are behind the fall in spending power. Inflation is running at 4.5 per cent, almost double the amount by which incomes are growing. This means that household budgets are being squeezed.

Douglas Williams, an economist at the Centre for Economics and Business Research said: "The virtually unprecedented peacetime squeeze on real household incomes, combined with worsening forecasts for UK exports and investment growth means that GDP growth will be subdued for the next two or three years."

### Extract 2: 1.7million home owners face negative equity

Up to 1.7m home owners face the spectre of negative equity according to new data. Currently more than 800,000 home owners – 7.3 per cent of all households with a home loan – have a mortgage that is bigger than the market value of their property. This number could double if property prices dip a further 10 per cent. Since their peak before the onset of the credit crunch, house prices have fallen by nearly 18 per cent.

### Chart C: The real level of spending on consumer durables



Source: Reuters EcoWin

#### EW Questions:

1/ Define the following terms (3 marks each)

- Real disposable income
- Unsecured debt
- Real interest rate
- Durable goods
- Animal spirits

2/ What relationship would you expect (in normal times) between real disposable income and the level of household consumption? (5 marks)

3/ Identify and explain **two** non-income determinants of the level of consumer spending in the UK economy (10 marks)

4/ Identify and explain **two** macro-economic consequences of a sharp fall in consumer spending in the UK economy (10 marks)