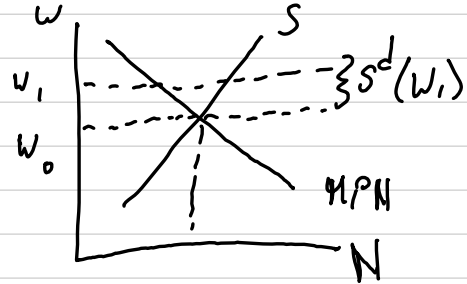


Dylan Black

Chapter 4 Consumption, Savings, and Investment

$$S^d = Y - C^d - G$$

\uparrow desired savings \uparrow desired consumption

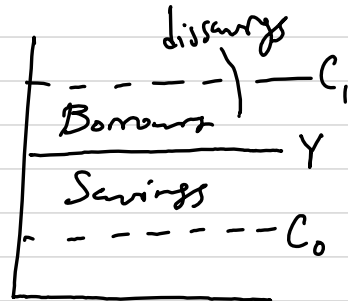


Savings can be positive (Consumption < Income) or negative (Consumption > income)

Trade off between current + future consumption

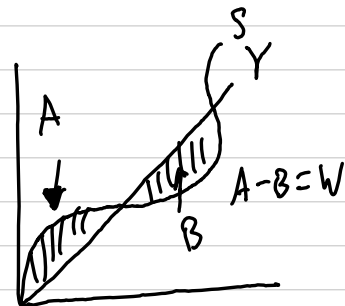
↳ price of 1 unit of current consumption is $1+r$ unit of future consumption ($r = \text{real i.r.}$)

↳ Consumption - smoothing
- want to have smooth spending



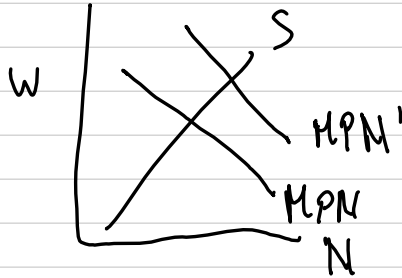
Consumption + wealth effect

ΔC due to change in relative prices of present + future goods as measured by real i.r.



Wealth effect: ΔC due to change in purchasing power

Sub Effect



Wealth effect



Wealth effect ex.

Effect of changes in current income

income $\uparrow \Rightarrow C \uparrow, S \uparrow$

Higher expected future income leads to more consumption today

Consumption + Interest rates

Sub effect - (+) effect on savings since rate of return is higher
 $i \uparrow \Rightarrow \text{saving} \uparrow$

Wealth effect

For a saver - negative effect - (less) saving to obtain

For a borrower - (+) effect

Taxes

$$r = (1 - t)i - p^e$$

higher taxes bring down real interest rates

Yield Curve



Fiscal policy

Fiscal policy @ full equilibrium
- directly affects national saving

Gov't purchases (temp. increase)

↳ Higher G by higher taxes lowers desired consumption

C^d declines less than G rises, so S^d declines

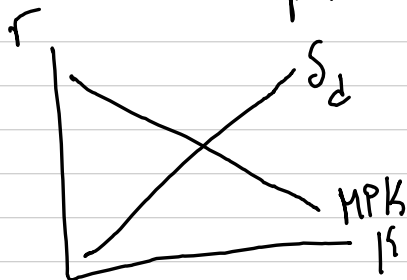
Ricardian equivalence proposition

↳ No fiscal policy could ever impact behavior
↳ future income loss = current income loss

Investment fluctuates sharply over the business cycle

Investment adds to the capital stock

- desired capital stock is the amount of capital that maximizes profit



MPK falls as K rises
b/c of diminishing marginal productivity

$$I_t = k_{t+1} - k_t + d k_t$$

Tobin's Q

q = capital's market value over replacement

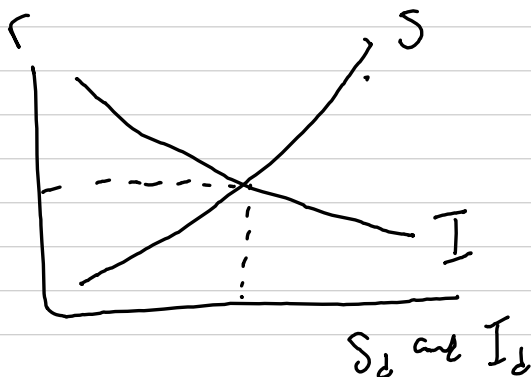
$$q = \frac{V}{P_k k_t}$$

$V \leftarrow$ stock market value
 $P_k k_t \leftarrow$ price of capital

Stock market boom $\rightarrow q \uparrow \rightarrow$ investment \uparrow

$q > 1$ = invest more
 $q < 1$ = invest less

Good market equilibrium Savings = investment



Scarp curve shift w/ desired songs