

Explain the main determinants of the level of consumption expenditure in an economy.

Consumption expenditure (C) is one of four elements, which denotes the total spending on goods and services produced in an economy. This is known as Aggregate Demand. The other three elements of Aggregate Demand are Investment expenditure (I), Government spending (G) and the Net expenditure on exports and imports (X-M). The equation for AD can be written as: -
 $AD = C + I + G + (X-M)$.

The main determinants of Consumption expenditure are: -

- **Changes in disposable income:** This is a key determinant of consumption expenditure. It is common sense to see that, if a person's income increases so does the total spending on goods and services by that person. This would lead to a *shift* to the *right* in the AD curve.
- **Interest rate changes:** Higher interest rates lead to a decrease in spending by consumers. People will be able to save more and will be able to pay back more money to mortgage repayments. This would lead to a *shift* to the *right* in the AD curve.
- **Changes in unemployment levels:** If unemployment levels fall, consumers are less afraid that they will lose their jobs, and therefore feel more confident to borrow money and purchase consumer durables. This would lead to an increase in consumer spending, hence an increase in AD, *shifting* the curve to the *right*.
- **Price expectations:** If prices are currently low, they will be expected to rise in the future, therefore it will be common sense to buy the goods now whilst they are cheap. This can also work the other way, where if prices are high and are likely to fall in the near future, customers will put off their purchases until prices have fallen. This would lead to a *movement* in the AD curve; depending on which situation, we are dealing with.