Savings rate issues and consumption

The marginal propensity to consume is equal to the change in consumption divided by the change in disposable income. For example, a consumer who gets a raise at work will have a choice as to whether to spend or save. So, assume that a person earns an additional $100 per week. The marginal propensity to consume would be equal to the new consumption habits of the individual divided by the $100 increase in pay. As such, if the individual decides that 5% of their net income should be saved, the marginal propensity to consume is $5 / $100, equaling . 05.

The spending multiplier is calculated as follows: 1 / MPS + MPI, in which the denominator equation is the marginal propensity to spend and the marginal propensity to import. When the savings rate increases, consumption begins to rise. As such, the multiplier will continue to decrease as consumption increases.

Finally, there will be significant changes in consumption due to a savings rate decrease, represented by lesser consumption when savings amounts increase. At the same time, equilibrium GDP is affected and will increase in direct proportion with a decrease in savings and an increase in consumption at the same time.

Mr. Mallon, I believe that the only real concern involving a diminished savings rate will be the long-term impact on the regional economy. From an individual consumer perspective, these changes would be barely noticeable, and the only thing affected would be either an increase in consumption or decrease, based on how much the consumer saves. However, over the broader landscape, when savings drop all across the nation and consumption increases, equilibrium GDP will be affected.