

UK SAVINGS RATIO PLACE MAT

1 Outline the advantages and disadvantages to an economy of an increase in consumer spending

2 Explain the term 'paradox of thrift'

3 Carry out some research to find out why the savings ratio fell to such a low level in the 1960s

4 Using an AD/AS diagram, show how a fall in savings leads to positive overall growth (ceteris paribus)

10 Explain the difference between public debt and private debt

CASE STUDY



UK Savings

In March 2017, the Office for National Statistics (ONS) confirmed the UK economy grew by 0.7% in the final three months of 2016. Economists said it was driven by a rise in consumer spending, partly funded by households dipping deeper into savings and running up debt. As a result, the UK savings ratio fell to its lowest since the early 1960s, the ONS said.

The savings ratio measures the (average) percentage of household income that is saved. Whilst it has fallen significantly at the end of 2016, it is very much part of a wider trend which has seen the ratio fall since 2011. Although the effect on overall growth is positive there is a worrying fact that household borrowing is slowly rising to fund this spending. In Q4 2016, households borrowed over £11bn, the highest quarterly level in nearly 30 years!

source: <http://www.bbc.co.uk/news/business-39453844UK>

5 Explain why household borrowing worries Economists

9 Explain the difference between the Marginal Propensity to Consume and the Average Propensity to Consume

6 State and explain two policies that a Government could use to increase the Savings ratio

8 Using 1 Jan 2012 as the base, calculate the Savings Ratio index on 1 Jan 2010 and 1 Jan 2014



7 Describe the data and identify two factors that may have caused the trends shown in:
1 2008-2010
2 2010-2017

UK SAVINGS RATIO PLACE MAT SUGGESTED ANSWERS

1 Outline the advantages and disadvantages to an economy of an increase in consumer spending

Advantages: Leads to economic growth and less unemployment, which in turn may lead to less government spending (on welfare) as well as increased government revenue from sales taxes, profit taxes and taxes on incomes from those now working. Investment should also increase through the accelerator effect.

Disadvantages: (demand-pull) inflation is likely to rise, private debt is likely to increase (if consumption is based on credit) which may lead to solvency issues in the economy and the trade balance may deteriorate if the spending includes many imports. There may be environmental damage from increased spending on consumer goods (which may be disposable or luxuries rather than necessities).

2 Explain the term 'paradox of thrift'

The Paradox of Thrift was popularized by John Maynard Keynes. It states that individuals try to save more during an economic recession in order to protect themselves against the risk of losing their jobs and therefore income, which in turn leads to a fall in aggregate demand and hence a fall in economic growth, which thereby increases the risk of them becoming unemployed.

3 Carry out some research to find out why the savings ratio fell to such a low level in the 1960s

Research task.

- Many banks had undergone a 'rebranding' exercise and looked inviting and trendy places to be – this incentivised borrowing
- Banks were competing to provide loans in order to fuel demand for goods/services that had been unavailable for years due to rationing/post war rationing
- Economic boom
- A greater proportion of people buying rather than renting homes (in 1918 77% of UK households rented rather than owned their home whereas by 1970 it was roughly 50:50)

4 Using an AD/AS diagram, show how a fall in savings leads to positive overall growth (ceteris paribus)

Diagram to show AD increasing (i.e. shifting right) – due to rising consumer spending and a subsequent multiplier effect - and therefore causing real GDP to increase.

5 Explain why household borrowing worries Economists

Private debt is a long-term problem. It restricts future spending (because people are repaying their loans) and could lead to insolvency issues (people defaulting on their debt) which, if done in high numbers, could also lead to lenders getting into financial difficulty as they will be unable to repay people who have deposited money (savings) with them.

6 State and explain two policies that a Government could use to increase the Savings ratio

Policies could include:

- Increasing interest rates. The reward for savings increases, but also the cost of borrowing increase (so people are less inclined to spend and borrow).
- Providing a greater level of financial education might also help people understand reasons why they need to save.
- Reduce / remove taxes on interest earned from savings accounts (as happens in an ISA)
- Legislate so that banks are encouraged to talk to customers about savings every time they enter a bank to make a transaction

7 Describe the data and identify two factor that may have caused the trends shown in:

1 2008-2010

2 2010-2017

(i) 2008-2010 there is an upwards trend in the savings ratio although there are significant dips along the way. During this time, the UK was in recession and therefore savings were likely to have increased. In addition, unemployment rates were high so many people would have been concerned by job security (thus, increasing their savings rate)

(ii) 2010-2017 there is a downwards trend, which declines rapidly halfway through 2016. During this time, interest rates were extremely low (thus, savings are less incentivized) and confidence has returned to the economy after the recession (thus, people are more willing to spend and borrow, and less inclined to save).

8 Using 1 Jan 2012 as the base, calculate the Savings Ratio index on 1 Jan 2010 and 1 Jan 2014

2010 = 136 (using 2010 = 11.2 and 2012 = 8.2 as figures)
and 2014 = 83 (using 2012 = 8.2 and 2014 = 6.8 as figures).

9 Explain the difference between the Marginal Propensity to Consume and the Average propensity to consume

APC is the percentage of income spent on goods and services (rather than saved), whereas MPC is the percentage of additional income spent on goods and services when income increases.

10 Explain the difference between public debt and private debt

Public debt is debt built up by the government as a result of its fiscal policies. Private debt is debt built up by households for spending done on credit (i.e. loans, credit cards etc).