

Households

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What you need to know

This topic has one syllabus outcome: **the influences on how much households spend, save and borrow**. In plain words, you should be able to:

1. **Say what spending, saving and borrowing are**, and how they fit together: a household can spend its income, keep some of it back (save), or spend more than it earns by taking a loan (borrow).
2. **Explain the main influences** on all three, above all **income**, the **rate of interest** and **confidence** about the future, and use other influences where they fit, such as wealth, expected prices, how easy it is to get a loan and the household's stage of life.
3. **Compare different households**: why a rich household and a poor one spend, save and borrow in different amounts and on different things.
4. **Explain changes over time**: how a household's spending, saving and borrowing change as its members get older, and how households across a country change them when the economy grows or shrinks.

Understand it

Three things to do with income

A **household** is a person, or a group of people living together, who make spending decisions as one unit. What it can use is its **disposable income**: its income after income tax, plus any benefits from the government.

That income has only two destinations. Whatever isn't spent on goods and services is **saved**, whether it goes into a bank account, under a mattress or into shares. So

$$\text{saving} = \text{disposable income} - \text{spending}.$$

If a household spends *more* than its disposable income, saving is negative. This is called **dissaving**, and the gap has to come from somewhere: either from money saved earlier, or from **borrowing** (a loan, a credit card, a mortgage), which has to be paid back later with **interest** on top.

Keep **income** and **wealth** apart. Income is a flow, money coming in each month (wages, rent, interest, pensions). Wealth is a stock, what the household owns at one moment (a house, savings, shares) minus what it owes.

Every choice is "now or later"

Spending, saving and borrowing are really one decision seen from three sides: **when** to use money.

- Saving gives up something now to have more later.
- Borrowing brings forward something from later to now, at a price.
- Spending is using the money today.

So anything that changes what a household **has**, what it **costs to move money between now and later**, or how it **sees the future** will shift the choice. Every influence you need falls into one of these three groups.

Group 1: what the household has

- **Income.** More disposable income lets a household do more of everything: it usually spends more **and** saves more. Anything that changes disposable income works the same way: a pay rise, a cut in income tax, a rise in state pensions, or the opposite. A household with no job loses most of its income, so it spends less and may have to live off its savings.
- **Wealth.** A family whose house or shares have risen in value feels richer even though its monthly pay is unchanged, so it may spend more. Wealth also makes borrowing easier, because a lender can take the asset if the loan isn't repaid; an asset used this way is called **collateral**.

Group 2: the cost of moving money through time

The rate of interest is the price of time. It is the **reward** for saving and the **cost** of borrowing, and one change moves both:

When the interest rate...	Saving	Borrowing	Spending
rises	more attractive: each dollar saved earns more, so saving rises	dearer: each loan costs more to repay, so borrowing falls	usually falls
falls	less rewarding, so saving falls	cheaper, so borrowing rises	usually rises

A rise also hurts people who already owe money at a rate that changes with the market (many mortgages): their monthly repayments go up, leaving less to spend on anything else.

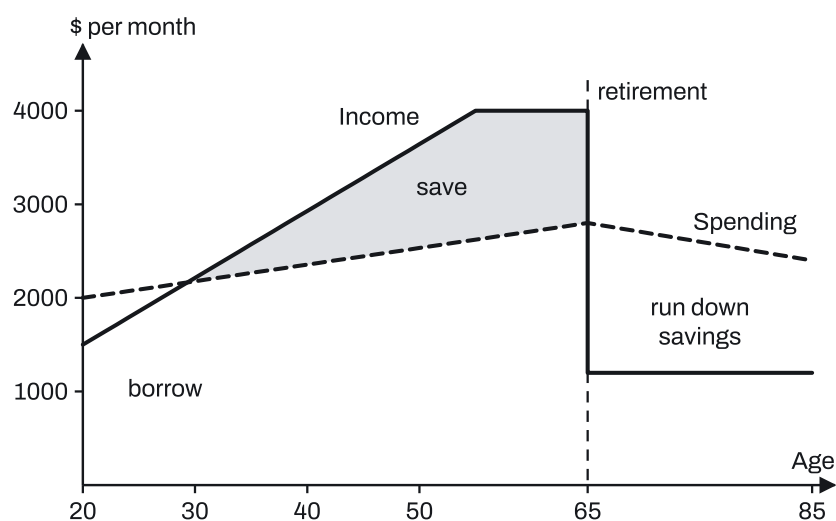
Two more influences work through the same "now or later" trade-off:

- **Expected prices.** If people think prices will be higher next year, buying now is a bargain, so they spend sooner and save less. If they expect prices to fall, waiting pays, so they hold back and save. Real income matters too: a 3% pay rise does not make a household better off if prices rise by 6%, because it can buy less than before.

- **Access to loans.** Borrowing needs a lender. Where banks are few, or lend only to people with a steady job or collateral, households borrow little however much they would like to. New ways of reaching banks, such as mobile-phone banking, make both saving and borrowing easier. Social attitudes matter too: in some countries being in debt is seen as shameful.

Group 3: how the household sees the future

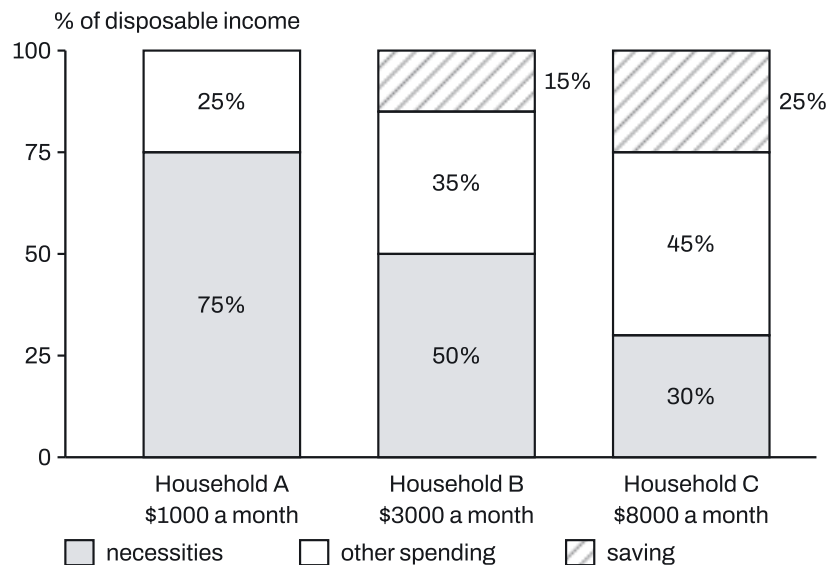
- **Confidence.** Picture a factory worker who hears that her firm may close. She shelves her plan to take out a loan for a motorbike, because she might not be able to keep up the repayments. She also puts off buying a new sofa and adds to her savings in case she loses her income: a **precautionary** motive. When the mood is good, with jobs secure and pay expected to rise, the same person feels safe to spend, save less and borrow for big items. Confidence can overpower other influences: when people are frightened, even very cheap loans may not tempt them.
- **Stage of life.** People plan across their whole lives, which leads to a typical pattern (the diagram below).



Young adults often earn little but have big costs (a first car, a home, furniture, a course), so they **borrow**, expecting higher pay later. In the middle years pay is highest and people **save** to pay off debts and prepare for old age. After retirement income drops, so people **draw on their savings** to keep up their living standards. An ageing country feels two opposite pulls at once: a growing number of retirees living off what they put aside earlier, and many people in their late fifties and early sixties putting extra aside while they still can.

Rich and poor households

Every household has to cover the basics first: food, shelter, fuel, transport to work. These **necessities** take a certain number of dollars whatever the income, so they eat up a large share of a small income and a small share of a large one.



The diagram shows what follows:

- **Spending pattern.** Household C spends more *dollars* on necessities than A (\$2400 against \$750, since it buys better food and a bigger home), but a much smaller *share* of its income. Once the basics are covered, extra income goes on things people can live without: eating out, holidays, travel, entertainment, luxury goods. So when you are shown what share of income households spend on different things, the one spending the **highest share on necessities** is almost certainly the **poorest**.
- **Saving.** After the basics, a poor household has little or nothing left, so it saves a small share of its income, or none. A rich one saves a larger share **and** a larger amount.
- **Borrowing.** Every loan is a deal with two sides: someone who wants to borrow and a lender willing to agree. Richer households tend to win on both. They are more likely to plan purchases worth many months of income (solar panels for the roof, a holiday flat, a home extension), and lenders are more ready to say yes to them because the repayments look safe. So they usually borrow **more**, not less. A poorer household may need a loan just as badly, say for a hospital bill, but a lender sees more risk and may turn it down or make the loan very expensive.

The same logic explains differences between countries. In a country with low income per head, food takes a large share of household budgets; in a rich one it takes a small share. The two-sides idea works for whole countries too: borrowing is high where many households have reasons and the nerve to take on debt, and where lenders are close at hand and cheap to use.

Changes across the whole economy

When a country's income (GDP) changes, households change two things:

- the **level** of spending: how much they spend in total;
- the **pattern** of spending: what they spend it on.

Picture one family's monthly budget as two piles. The first holds what they can't go without this month: rent, food, bus fares, electricity. The second holds what can wait or be done more cheaply: replacing the fridge, a trip to see relatives abroad, meals out, branded trainers. When the country's output shrinks, some families

lose pay or jobs and many more fear they might, and the cuts land on the second pile. That changes two things.

- **What they buy** (the pattern). The first pile now fills a bigger slice of the budget. Dearer brands give way to cheaper ones, and foreign-made goods, often the pricier choice, lose out.
- **How much they buy** (the level). The total drops. Families who still have work may keep a bigger cash reserve and steer clear of new debts, just in case. If shop prices are sliding, holding off on the fridge even saves money.

Families don't all react alike. One with a secure job and a healthy savings account may treat the slowdown as a bump in the road and carry on much as before.

In a period of **growth**, the reverse: rising pay and confidence raise spending, borrowing grows, and the pattern shifts over time towards services, leisure and travel.

Is more saving good for the economy?

It depends on where the saved money goes. Follow each dollar that isn't spent.

1. **It stays with the household for later.** Savings are a cushion for illness, job loss or a broken-down car; they pay for a child's university place or a retirement. A family with money put by can get through a bad patch without sliding into debt or poverty.
2. **It is not spent now.** Firms sell less, so they produce less. If the economy is already producing flat out and prices are rising because people want to buy more than can be made, this calms things down: less upward pressure on prices. If the economy is weak, the same fall in sales means firms cut output and jobs, and it can deepen a recession. Some of the money not spent would have gone on goods from abroad, so imports fall too, and the government collects less sales tax (and other taxes on spending).
3. **It sits in a bank.** Banks lend deposits on, so more saving can mean more money available for firms to borrow to build factories and buy machinery, which raises the economy's future output. But firms only borrow to expand if they expect customers, and weak spending is exactly what puts them off.

A judgement usually turns on **the state of the economy** (overheating or slack), on **whether banks and firms turn the savings into investment**, and on the **time scale** (short-run demand against long-run security and investment).

Key facts and formulas

This topic has no formula list in the exam. "Learn it" means you must remember it.

Formula or fact	Status
saving = disposable income – spending; negative saving is dissaving	Learn it
share of income saved (%) = $\frac{\text{saving}}{\text{disposable income}} \times 100$	Learn it

Formula or fact	Status
$\text{interest per year} = \text{amount} \times \frac{\text{interest rate (\%)}}{100}$	Learn it
Interest rate up : saving up, borrowing down, spending down. Interest rate down : saving down, borrowing up, spending up	Learn it
Higher income: spending and saving both rise; a smaller share goes on necessities and a larger share is saved	Learn it
High confidence: spend more, save less, borrow more. Low confidence: the reverse	Learn it
Expect prices to rise: buy now; expect prices to fall: wait and save	Learn it
Life stages: borrow when young, save in middle age, run down savings after retirement	Learn it

How to do it

We have tagged 31 questions on this topic (2021–2025): 21 multiple choice on Paper 1 and 10 structured questions on Paper 2. Counted by the parts about this topic, they came up this often. Two Paper 2 questions have two parts on it, so there are 33 parts.

Question type	Question parts
Multiple choice (concept)	20
Explain (4 marks)	5
Analyse (5 or 6 marks)	4
Discuss (6 or 8 marks)	3
Multiple choice (calculation)	1

1. Multiple choice (concept) (20 question parts)

1. **Find the influence** the question is about: income, interest, confidence, expected prices, wealth, or the household's income group.
2. **Put it in its group** (what the household has; the cost of moving money through time; how it sees the future) and follow the logic from "Understand it".
3. **Check each column of a grid separately.** Most options get one column right.

Variations you will meet:

- **Income groups** (7 parts): a table of spending shares, asking for the poorest household or an order from poorest to richest. Rank by the share on **necessities** (food, housing, clothing, basic transport): the highest share is the lowest income. Ignore the size of the luxury column when the necessities column already settles it. Statements about income groups: the rich save a **higher percentage** of income, and they still borrow (often more).
- **Interest-rate grids** (6 parts): a central bank raises or cuts the rate, sometimes with a story (fighting a recession, a crisis year). Ignore the story and apply the table in "Understand it". "Cost of borrowing" moves **with** the rate; the "amount saved" moves with the rate too; borrowing and spending move **against** it.
- **Which change makes households save or spend more or less** (6 parts): match each option to its group. Watch for distractors that sound financial but aren't about households' choice between now and later: a change in the exchange rate, or a tax rise that simply leaves less income. A higher income tax reduces disposable income, so it tends to cut **both** saving and spending; only a higher interest rate makes saving more rewarding. If income rose but saving didn't, look for something pulling the other way (prices rising faster than income, lower interest, more confidence). If both saving and spending rise together, the household must have more to use: higher income or more wealth.
- **Reading a spending table** (1 part): decide whether the question is about dollars or about **shares**. A share of total spending can rise even when dollar growth slows.

2. Explain (4 marks) (5 question parts)

A mark for **naming** an influence and a mark for **showing how it works** in this case. "Explain two reasons" needs two separate influences, each with its own "so". A part that asks about two things (such as spending **and** borrowing) usually caps each at 2 or 3 marks, so cover both.

Plan: influence (1) → what it changes for the household (income, reward, cost, worry) → so it spends, saves or borrows more or less (1).

Variations you will meet:

- **Why spending (or saving, or borrowing) changed in a country** (2 parts): read the stem for clues and pick influences from **different groups**, for example one about income or wealth and one about interest rates or confidence. If saving fell while income rose, the reason can't be income; find another influence pulling saving down. Write about the **causes** of the change, not what it will do to the economy afterwards.
- **The effect of one given influence** (2 parts), such as low confidence or an ageing population: stay with that influence and trace it separately through each thing the question names. For age, use the life-cycle diagram and take each age group in turn: people nearing the end of their working lives put more aside (saving up, spending down), while those already retired live off their savings (saving down, spending kept up by it).
- **Why one household borrows more than another** (1 part): treat the loan as a deal with two sides, as in "Understand it": does this household have a reason to borrow, and will a lender agree? Build each point from one side and end it with why that means more borrowing. "They have more money" or "they spend more" is not an explanation by itself; say why that leads to a loan.

3. Analyse (5 or 6 marks) (4 question parts)

A mark per link in a chain. Write **two or three developed chains**, each link a "so" or "because".

Variations you will meet:

- **Analyse the relationship in data** (2 parts, 5 marks, Section A): a table of income (GDP per head) against a kind of spending. Ask yourself five questions and answer each in a sentence:
 1. Which way does it go on the whole? Name it: **positive** (both rise together) or **inverse** (one rises as the other falls).
 2. Can I prove it? Compare two or three rows with their numbers **and** say what the comparison shows; copying figures earns nothing.
 3. Why would it happen? Use the income logic from "Understand it": richer households can afford more travel and luxuries, and spend a smaller share on necessities.
 4. Where does it break? Name the row or year that goes against the trend, with its figures.
 5. Why might it break there? Another influence: prices differ between countries, tastes differ, a crisis damaged confidence, a time lag.
- **How the level and pattern of spending change** when income or GDP changes (1 part, 6 marks): use the two-piles picture from "Understand it". Write one chain on what moves out of the basket (the pattern) and one on why the total shrinks (the level), each with its "so", then a sentence on why some households hardly change at all.
- **Why households in one country borrow more than in another** (1 part, 6 marks): use the two-sides idea again: pick two or three reasons from the borrowers' side or the lenders' side and develop each into a chain ending in more or less borrowing.

4. Discuss (6 or 8 marks) (3 question parts)

All three asked whether **more saving** is good: for a country, for an economy, or whether a government should encourage it. The 6-mark Section A part gives up to 4 marks a side; the 8-mark parts are levels-marked, and Level 3 (6–8) needs **both sides developed** and a judgement. Aim for **two developed chains each side**.

Plan:

1. **One-line definition:** saving is disposable income that is not spent.
2. **Follow the dollar** through the three routes in "Is more saving good for the economy?". Each route gives a chain for one side or both: route 1 is good for households' security; route 2 is good when prices are rising too fast and bad when the economy is weak; route 3 is good if firms borrow to invest.
3. **Other side:** the costs, or the reasons the gain may not happen.
4. **Judgement:** what it depends on (the state of the economy, whether savings reach firms, the time scale), and which side wins in the country in the question.

Don't flip a point to fill the other side: if one side says saving keeps prices steady, "but prices might still rise" adds nothing; the other side needs a new reason, such as jobs lost in shops. Keep the answer about saving. Don't turn it into an essay on interest rates or exchange rates, and don't exaggerate ("people who save don't

spend anything").

5. Multiple choice (calculation) (1 question part)

1. For each row, work out **saving = income – spending**.
2. Read the sign: negative is dissaving, zero means everything is spent, positive is saving.
3. Answer exactly what is asked: "first level of income at which saving is **positive**" means greater than zero, so a row where saving is exactly 0 doesn't count.

Worked examples

Example 1

A household's disposable income rises from \$2400 to \$3000 a month. Its spending rises from \$2250 to \$2640 a month.

- (a) Calculate the household's saving each month before and after the rise. [2]
- (b) Calculate the percentage of disposable income saved before and after the rise. [2]
- (c) Explain what these figures suggest about how a household's saving changes as its income rises. [2]

(a) Before: $2400 - 2250 = 150$, so \$150 a month (1). After: $3000 - 2640 = 360$, so \$360 a month (1).

(b) Before: $\frac{150}{2400} \times 100 = 6.25\%$ (1). After: $\frac{360}{3000} \times 100 = 12\%$ (1).

(c) As income rises, the household saves not just more dollars but a **larger share** of its income (1). Its necessities were already covered, so most of the extra \$600 was free to be saved or spent on non-essentials: it saved \$210 of it (35%) (1).

Example 2

Explain two reasons why a rise in house prices may lead homeowners to spend more. [4]

Homeowners' **wealth** increases, because the home they own is now worth more (1). They feel richer, so they are willing to spend more of their monthly income and save less of it, even though their pay has not changed (1).

A more valuable house is better **collateral** for a loan (1). Banks are more willing to lend to the homeowner, so the household can borrow to pay for a car or home improvements (1).

Two different influences (wealth, access to loans), each with how it leads to more spending.

Example 3

Analyse how a cut in income tax may affect household spending and saving. [6]

Income tax is taken from people's pay before they can use it, so a cut raises their **disposable income** (1). With more disposable income, households can afford more goods and services, so spending rises (1), especially on items beyond the basics such as eating out or new clothes (1).

Households are also able to save more, because some of the extra income is left over once spending has risen (1). The share saved is likely to rise most for high-income households, who have already covered their necessities (1).

The effect may be smaller than expected. If households think the tax cut will soon be reversed, or are worried about their jobs, they may save most of the extra income rather than spend it (1), so spending barely changes.

Example 4

Discuss whether or not a fall in the rate of interest will increase household spending. [8]

Why it might. A lower interest rate makes loans cheaper to repay, so households are more willing to borrow to buy expensive items such as cars, furniture and homes. The borrowed money is spent, so total household spending rises (developed point for).

Saving becomes less rewarding, because a bank deposit now earns less each year. Some households therefore decide to spend money now instead of keeping it in the bank, and many households with loans whose rate follows the market find their monthly repayments fall, leaving more of their income free to spend (second developed point for).

Why it might not. If households are worried about losing their jobs, they may not borrow even at a low rate, because they fear being unable to repay; they may keep saving as a cushion. Cheap loans do not create confidence (developed point against).

Some households live partly on the interest from their savings, especially retired people. A lower rate cuts their income, so they may spend **less**. Banks may also be unwilling to lend to households that already owe a lot, so the cheaper loans reach fewer people than expected (second developed point against).

Judgement. A fall in interest rates is most likely to raise spending when confidence is reasonable and households are not already heavily in debt, as in a mild slowdown. In a deep recession, when people fear for their jobs, the effect may be small, so the cut may need support from other measures. Both sides are developed and the conclusion says what the outcome depends on, so this meets the Level 3 descriptor (6–8 marks).

Common mistakes

- **Getting the interest-rate directions wrong.** A higher rate encourages saving and discourages borrowing and spending; a lower rate does the opposite. Examiners report answers that mix these up. Say the reason each time: reward for saving, cost of borrowing.

- **Writing about effects when the question asks for causes.** "Why has household spending increased?" wants influences such as income, confidence and interest rates, not what higher spending does to inflation or jobs.
- **Drifting away from the influence named.** If the question is about low confidence, every point must start from confidence; other influences on spending earn nothing.
- **Answering the opposite question.** "Why might households save **less** even though income rose" is not "why do households save more". Read the direction twice.
- **Treating "they have a higher income" as an explanation.** For why rich households borrow more, say why income leads to a loan: lenders trust them, they have collateral, they buy big items on credit.
- **Exaggerating.** Saving more does not mean spending nothing; say spending falls.
- **Only the level, not the pattern.** When asked how spending changes, say what happens to what is bought (necessities, luxuries, imports), not just the total.
- **Only one side of saving.** Strong answers look at households (security, school fees, retirement) **and** the whole economy (demand, jobs, investment).
- **Confusing retirement with unemployment.** Retired people have left the labour force; they are not unemployed.
- **Describing data instead of interpreting it.** "Norway spends 11% and Belgium 13%" is description; "the richer country spends a smaller share on food" is interpretation.

How to get the marks

- **Explain** (4 marks): name the influence (1) and say how it works for this household or country (1), twice. Use two different influences, not two versions of one.
- **Analyse** (5 or 6 marks): chains of reasoning. Each link must follow from the one before; a list of influences with no "so" earns little.
- **Analyse the relationship** (5 marks): trend named, evidence **interpreted**, reason, exception with figures, reason for the exception. Each of these is worth a mark or two.
- **Discuss** (6 or 8 marks): at least two developed points on each side and a judgement that says what the answer **depends on**. In the 6-mark source questions, up to 4 marks a side.
- **Use the source** in Section A: refer to the country and its figures, but don't just copy the text's words.
- **Calculations:** show the subtraction or the percentage working; a figure alone may still score, but working protects you if you slip.
- **Use the terms:** disposable income, saving, dissaving, borrowing, rate of interest, confidence, wealth, collateral, necessities, luxuries, pattern of spending.
- **Multiple choice:** 1 mark each, no penalty for guessing, so answer every one.

Quick check

1. Which is most likely to make households save a **smaller** share of their income?
 - **A** a rise in the interest rate paid on savings accounts

- **B** news that many firms are planning to cut jobs
 - **C** a rise in consumer confidence
 - **D** an expectation that prices will fall next year
2. A household has a disposable income of \$4500 a month and spends \$4800 a month. Calculate its saving and explain how it can spend more than its income.
3. Household X has a disposable income of \$2000 a month and spends \$1900. Household Y has \$6000 a month and spends \$5100. Calculate the percentage of income each saves, and say which saves the larger share.
4. Explain two reasons why a household may save more even though its income has not changed. **[4]**
5. A family has \$10000 in a savings account. The interest rate falls from 6% to 3% a year. Calculate the fall in the interest the family earns in a year, and state one likely effect on its saving.

Answers

1. **C.** More confidence means less need for a cushion against bad times, so households spend more and save a smaller share. A and D encourage saving; B makes people more cautious, so they save more. (1)
2. $\text{Saving} = 4500 - 4800 = -300$, so it dissaves \$300 a month. It must cover the gap by using money saved in the past or by borrowing.
3. X saves $2000 - 1900 = 100$, which is $\frac{100}{2000} \times 100 = 5\%$. Y saves $6000 - 5100 = 900$, which is $\frac{900}{6000} \times 100 = 15\%$. Y, the richer household, saves the larger share.
4. The rate of interest may rise (1), so each dollar saved earns more and saving becomes more rewarding than spending now (1). The household may lose confidence, for example fearing job losses (1), so it builds up savings as a cushion in case its income stops (1). (Other answers: approaching retirement, so saving for old age; expecting prices to fall, so waiting to buy.)
5. At 6%: $10000 \times \frac{6}{100} = 600$. At 3%: $10000 \times \frac{3}{100} = 300$. The family earns \$300 less a year. Saving is less rewarding, so it is likely to save less and spend more.

Past questions to try

- **0455/12/O/N/25 Q11**: spotting the lowest-income household from its spending shares.
- **0455/13/M/J/25 Q10**: the effect of a higher interest rate on saving and the cost of borrowing.
- **0455/22/F/M/22 Q3**: part (b), why a high-income household may borrow more.
- **0455/21/O/N/22 Q3**: part (b), how low confidence affects spending and borrowing.