Mankiw discusses three models of consumption and saving in Ch. 19: the Fisher model, the lifecycle model, and the permanent income hypothesis. Since the lifecycle model embodies the intuition for all three, we will focus on that one.

Key assumptions:

1. Rational planning: At each point in time, households make plans for consumption and saving over their remaining lifetimes given their current assets (debts) and expectations for future income.

2. Consumption smoothing: At any point in time, consumers prefer that their future consumption paths be smooth, rather than fluctuating. An extreme version of this would be that they desire to have a constant future path of consumption.

Simplifying assumptions for starters (these can be relaxed):

1. future incomes are known with certainty.

2. the (nominal and real) interest rate at which consumers can borrow and lend is zero.

3. there are no credit constraints (consumers can borrow against their future income).

4. consumers plan to leave no bequests (i.e., to have no remaining assets or debt when they die).

5. there are no forced pension or social security plans.

Implications include:

1. Demographics matter for aggregate saving. Note that over a lifetime, individual consumers do zero net saving (i.e., any saving done by an individual consumer at one time in her life is offset by dissaving at other times).

2. There is no single MPC – MPCs are context specific. The MPC on a change in income that was anticipated in the past will be small (zero under the assumptions above). The MPC on unanticipated changes in income that are expected to persist in the future will be larger than on changes in income are expected to be temporary (e.g., a raise vs. a one time bonus that you don't expect to get again).

3. Unexpected changes in wealth should affect consumption.

4. Ricardian equivalence (see Ch. 17)