

A PRIMER ON THE NATIONAL SAVINGS RATE

The Commerce Department recently announced that the nation's personal saving rate, calculated as a percentage of disposable (or after-tax) personal income, had fallen to a *negative* number for the first time since October 2001. The national savings rate fell to a negative 1.1 percent in July 2005, followed by a negative 0.7 percent in August

What's happening to savings in America? In the short-term (and prior to the impact of Katrina), the Commerce Department says consumers remained in a spending mood: personal consumption expenditures rose 0.7 percent in *real* (or inflation-adjusted) dollars from June to July, and by another 0.9 percent in July.

But in the long-term, the recent declines serve as a reminder of how long the savings rate has been declining. After peaking in 1944 at 26.1 percent and dropping during the early post-World War years to 4.3 percent in 1947, the annual rate fluctuated within a narrower range until reaching a post-war high of 11.2 percent in 1982. From there it trended down, ending the 1990s at 2.4 percent, dropping to 1.8 percent in 2001 and 2004 and never exceeding 2.4 percent again. In the first half of 2005, the seasonally adjusted annual rate fell below 1 percent.

To understand what these figures mean, it is important to know how the Commerce Department defines personal saving: what's left of employee compensation after personal taxes, self-employment income, rental income, personal interest and dividend income on assets, plus transfer payments (formerly classified as non-tax payments, these are payments by people to government including donations, fees, and fines), minus current personal taxes after subtracting personal outlays.

It *excludes* capital gains from sales of assets, which have been substantial in some years. According to the Commerce Department, "Saving from current income may be near zero or negative when outlays are financed by borrowing (including borrowing financed through credit cards or home equity loans), by selling investments or other assets or by using savings from previous periods."

By contrast, the Federal Reserve measures personal saving as the difference between households' net acquisitions of assets (excluding cars and other consumer durables) and the net increase in their liabilities. It excludes capital gains, too.

Whatever the differences, the long-term trend in Fed-basis personal saving as a percentage of disposable personal income has been the same: down. From the early postwar low of 7 percent in 1949, it rose to the low double-digits and remained there with few exceptions through 1990's 11.5 percent. It slipped in ensuing years, falling to a *negative* 0.7 percent in 2000 – when the Commerce-basis rate was a *positive* 2.3 percent – and has remained in the low single digits since.

Do lower rates of household saving matter in the face of higher household debt, as some suggest? Not to Fed Governor Susan Schmidt Bies, who, in two speeches this year, said that she takes a “considerably more sanguine” view than those who are concerned that households “have become overextended and will need to rein in their spending.”

Fed staff analyses, she explained, “indicate that households in the top income quintile can account for *nearly all of the decline* in the aggregate saving rate since 1989 (when estimates of saving by income quintiles were first disseminated). “Given that these higher-income households have more financial resources to weather shocks, the significant decline in savings is less troublesome than if it had occurred in the lower part of the income distribution.”

Governor Bies also noted that some analysts consider changes in net worth to be a more relevant measure of saving adequacy than the portion of current income set aside for saving. “In this regard, the picture of household saving looks more favorable than suggested by the saving rate,” she said.

At some point, the Governor said, consumers, who have passively relied on markets to raise the value of their assets, will need to set aside more of their earnings for investment in new assets for their future needs.

Addressing the personal saving rate's impact on the economy, Fed vice-chairman Roger W. Ferguson, Jr., recently said that a near-term return to the average rates prevailing through the 1980s may not be needed. “In the aggregate, an economy needs to generate savings for two basic purposes – to invest in new plant and equipment with the aim of raising future consumption growth and to expand the residential housing stock,” he said. “As the growth rate of the labor force slows with the retirement of the baby boom generation, less investment will be required to equip each worker with the same amount of capital.”

Other economists point to the imbalances in the global economy as being unsustainable, and are less comfortable relying on asset bubbles and low mortgage rates to drive economic expansion.

October 2005 – This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Marnie Aznar, MBA, CFP®, a local member of the FPA.