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The U.S. Personal Saving Rate

October 2007

This month's newsletter focuses on the low and declining U.S. personal saving rate. As measured by the Bureau of Economic Analysis (BEA), the U.S. personal saving rate fell into negative territory during the third quarter of 2005 and has remained close to zero since then. The July 12, 2007, issue of the *Wall Street Journal Online* includes a sample of this debate, in "Is the Negative Savings Rate a Negative for the Economy?"

"The most important factors behind the rise in debt and the associated decline in saving out of current income have probably been the combination of increasing house prices and financial innovation."
Donald L. Kohn and Karen E. Dynan, *Board of Governors of the Federal Reserve System*

The BEA calculates personal saving by subtracting personal outlays (spending including non-mortgage interest payments) from disposable personal income (take-home pay). The personal saving *rate* (PSR), then, is the percentage of disposable personal income that isn't spent. Simply put, a negative PSR implies that U.S. households are spending more income than they have to spend. Why? Households may expect that their incomes will increase in the long-run. They also have access to financial innovations—such as credit cards, home equity loans, and subprime mortgages—that allow expected future wealth to be transformed into current purchasing power. Other possible reasons for the recent "consumption boom" include low inflation, low long-term interest rates, and the perception that programs such as Social Security will provide financial support in later years.

The Board of Governors of the Federal Reserve System releases an alternative estimate of the PSR: the change in U.S. households' net worth divided by their disposable income. These two measures are conceptually similar and highly correlated. Both experienced a steep decline in recent years, but both are subject to substantial measurement error. For example, both measures omit payments of benefits from pension funds, despite the fact that they include contributions paid into pension funds. Although many economists have investigated such discrepancies in an attempt to explain the recently negative levels of the PSR, measurement error does not seem to fully account for the low and declining rate of personal saving in recent years. It is likely that our low saving rate is a real economic phenomenon.

Low personal saving affects the national economy as well. Personal saving, when combined with business saving, yields total private saving. Businesses ultimately use these funds to finance domestic investments, such as purchases of new buildings and equipment. If total U.S. private saving can't meet our investment needs, then the money must come from either government surpluses or foreign investment. Currently, foreign credit is flowing into the United States to compensate for our shortfall in private saving; foreign governments, for example, purchase U.S. Treasury bills. Economists generally consider that such dependence on foreign credit is undesirable in the long run and that the U.S. eventually will become less dependent on foreign investment. At that time, private U.S. saving will need to finance a larger portion of private gross investment. In a recent speech, Federal Reserve Bank of St. Louis President William Poole noted that this reversal need not be "difficult or disorderly, but it will require that U.S. consumption outlays expand more slowly than U.S. GDP for a time." In short, U.S. consumers will have to save more, or face a lower standard of living, in the future.

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The views expressed are those of the author and do not necessarily reflect the official positions of the Federal Reserve Bank of St. Louis, the Federal Reserve System, or the Board of Governors.

Recent Articles and Further Reading on the U.S. Personal Saving Rate

How Worrisome is a Negative Saving Rate? By Charles Steindel, Federal Reserve Bank of New York *Current Issues in Economics and Finance,* May 2007, *13*(4), pp. 1-7.
Steindel takes a closer look at saving trends and suggests that the risks to household well-being may be overstated.

"Should the Decline in the Personal Saving Rate Be a Cause for Concern?" by Alan C. Garner, Federal Reserve Bank of Kansas City *Economic Review*, Second Quarter 2006, pp. 5-28.
Garner examines several measurement issues, possible explanations, and common concerns regarding the negative U.S. personal saving rate.

"Alternative Measures of Personal Saving," by Marshall B. Reinsdorf, Bureau of Economic Analysis *Survey of Current Business*, February 2007, *87*(2), pp. 7-13.
Reinsdorf presents several alternative measures of personal saving and finds that none of these change the conclusion that personal saving has fallen dramatically in recent years.

How Is It Possible for the Personal Saving Rate To Be Negative? Bureau of Economic Analysis.
A brief explanation of how the personal saving rate can become negative is presented here.

Free Data Sources

Data: Personal Saving Rate and Personal Saving
Description: Monthly data from 1959 to the present; downloadable in tables, graphs, or files
Published by: Bureau of Economic Analysis (BEA)
Location: http://research.stlouisfed.org/fred2/series/PSAVERT and http://research.stlouisfed.org/fred2/series/PMSAVE

Data: Personal Saving in the Flow of Funds Accounts (FFAs)
Description: Quarterly data from 1952 to the present; downloadable in tables, graphs, or .csv file
Published by: Bureau of Economic Analysis (NIPA) and Board of Governors of the Federal Reserve System (FFA)
Location: http://www.bea.gov/bea/dn/nipaweb/Nipa-Frb.asp

Data: Gross Domestic Product
Description: Quarterly data from 1947 to the present; downloadable in tables, graphs, or files
Published by: Bureau of Economic Analysis (BEA)
Location: http://research.stlouisfed.org/fred2/series/GDP

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