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NationalEconomicTrends

Saving Up: Gross and Personal

Personal consumption significantly contributed to the impressive growth of the economy during the last several quarters. Concomitantly, personal saving—defined as the difference between personal disposable income and personal consumption expenditures—has been falling. It became negative during the fourth quarter of 1998 for the first time since the early 1930s. Some observers interpret the negative personal saving rate as portending lower future wealth accumulation.

Personal saving is a good measure of wealth accumulation only if businesses pay out all earnings, government budgets are balanced, and the current account is balanced. The current account and the collective budgets of local, state and federal governments are rarely balanced, and firms generally retain some profits. The gross saving rate includes business and government saving as well as personal saving, and is therefore a better measure of wealth accumulation.

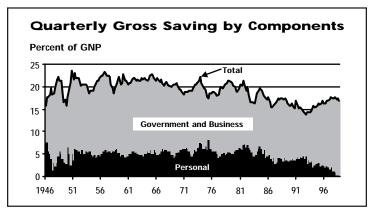
The chart below shows gross saving from first quarter 1946 to fourth quarter 1998. After World War II, gross saving averaged around 20 percent of Gross National Product (GNP). During the third quarter of 1982, gross saving dropped below 20 percent of GNP. Driven by negative government saving, gross saving reached a trough of 13.8 percent during the fourth quarter of 1992. Increasing government saving after 1992 kept gross saving rising despite a downward trend in the personal saving rate.

Economists argue that saving decisions are influenced by a desire to smooth lifetime consumption. This life-cycle hypothesis predicts that young individuals will spend more than their current income, borrowing against future earnings. Middle-aged individuals pay off debts and accumulate wealth for retirement years. During retirement they again spend more than their current income. The high current consumption may be driven, in part, by perceived increases in wealth, but it may also reflect demographic shifts in the labor force. An increase in younger individuals entering the workforce, and/or older individuals consuming their accrued wealth, lowers the aggregate saving rate. Baby-boomers should be net savers, and should have a disproportionate effect on the aggregate data; however, they may be accumulating wealth in ways other than through personal saving.

Personal saving as defined in the national income accounts is just one contribution to individual lifetime wealth accumulation. Investing in assets that appreciate in value (buying a home for example) also is wealth accumulation. When firms retain profits, this adds to the value of the firm. Since households own the firms, the increase in the value of the firm represents household wealth accumulation.

Retained profits of firms, a more fiscally conservative government, and international saving are helping to finance capital accumulation in the United States. Efforts to increase the personal saving rate, using incentives like the Roth IRA, may increase the domestic funds available for investment. In the end, individual saving decisions reflect incentives to defer consumption and invest in human and physical capital. The personal saving rate is only a partial measure of these decisions.

-Donald S. Allen



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