

Box A

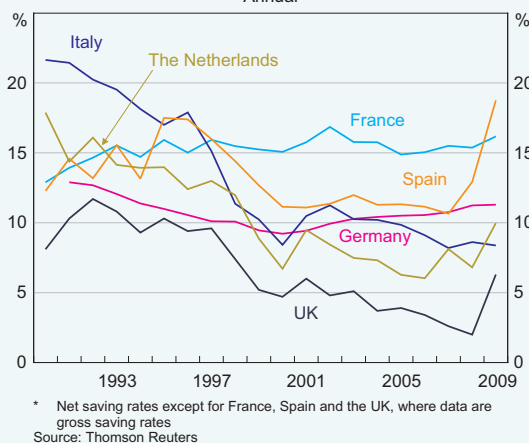
Household Saving Rates in Advanced Economies

A notable feature of the recent global downturn has been the sharp increase in household saving rates in many advanced economies. In Europe, household saving rates have generally picked up over the past few years, after having declined over recent decades in most countries (with France and Germany notable exceptions; Graph A1). In the United States, following a decline in household saving from around 10 per cent of disposable income in 1980 to around 2 per cent in 2007, the household saving rate has since risen by around 3½ percentage points. This increase in saving by US households stands in contrast to their behaviour through previous recessions over the past 30 years, where household saving typically changed little during and in the aftermath of downturns (Graph A2).

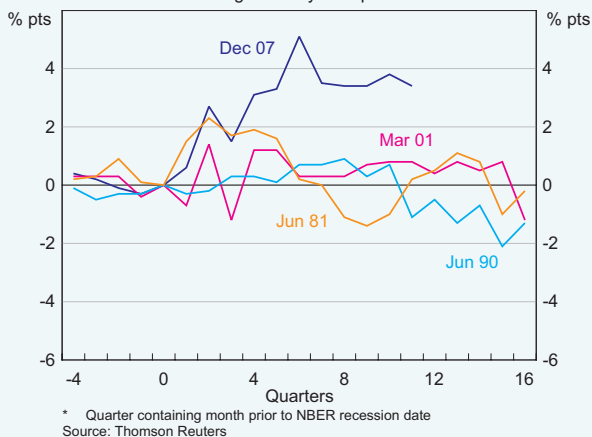
Understanding the factors driving the recent increases in household saving, and how persistent these are likely to be, is important for assessing the likely strength of domestic final demand growth in the various advanced economies over the next few years. Two factors often cited as influencing households' decisions about how much of their disposable income to save are a desire to smooth consumption (including over the lifecycle) and a desire to insure against negative shocks to income.¹ Both of these factors played a part in the long-run decline in household saving rates seen across most advanced economies prior to the recent global recession. For example, the marked decline in output volatility in almost all developed

¹ With households tending to save during their working lives and dissave during retirement, one important way in which lifecycle saving behaviour affects aggregate saving rates is through changes in demography. These tend to have fairly gradual effects at the aggregate level.

Graph A1
Europe – Household Saving Rates*
Annual

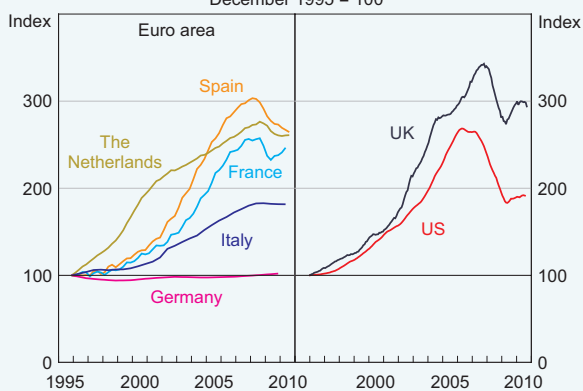


Graph A2
United States – Household Saving Rate
Change from cyclical peak*



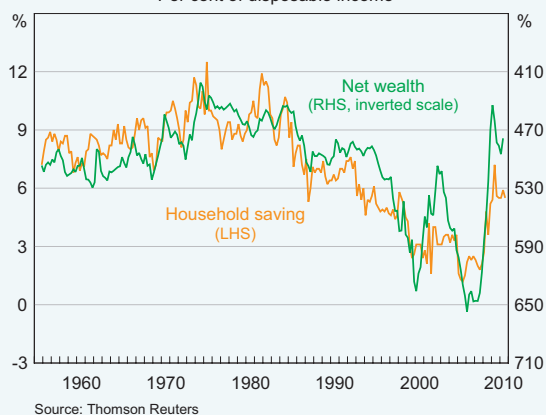
countries over the decades prior to the recent global downturn probably led to a reduction in perceived risk, and hence precautionary saving, on the part of households. The generally positive macroeconomic outcomes may also have reduced saving by boosting expectations about future income growth. The decline in saving was also the result of financial liberalisation that made it easier for households to access credit.

Graph A3
Nominal House Prices*
December 1995 = 100



* Euro area series are a combination of BIS and national sources; UK series is an average of the Halifax and Nationwide measures; US series is S&P/Case-Shiller 10 cities prior to 2000 and 20 cities thereafter
Sources: BIS; Standard & Poor's; Thomson Reuters

Graph A4
United States – Household Saving and Wealth
Per cent of disposable income



Source: Thomson Reuters

Developments in the financial sector are also likely to have contributed to the trend declines in household saving through their effect on asset prices. The house price booms that occurred in many developed economies over the past decade, combined with significant gains in the prices of other assets (notably shares), significantly boosted household wealth (Graph A3). In the United States, the ratio of net wealth to disposable income has been strongly correlated with the saving decisions of households for the past half century, presumably reflecting that individuals whose assets appear to have risen strongly in value feel less need to save out of current income to provide for their future retirement needs (Graph A4). Such a relationship has also been evident in some other developed economies.²

The severe economic turmoil of the past few years and substantial rises in unemployment rates are likely to have resulted in a substantial re-rating of perceived risk, and hence a desire to save more on insurance grounds. The recent increase in saving is also likely to reflect a reassessment of future income growth and, in some countries, the sharp decline in net wealth. This may have been amplified by uncertainty around the sustainability of government fiscal positions and a tightening of credit conditions. These explanations are consistent with the fact that the increases in household saving rates have been particularly large in those economies, such as the United States, the United Kingdom and Spain, where unemployment remains very high, consumer confidence is weak and government deficits are large. These countries also experienced some of the largest falls in asset prices, particularly house prices.

² In theory, increases in housing wealth may be better viewed as a transfer of wealth from future to current homeowners. However, in some countries, households in aggregate appear to have treated house price gains as a substitute for saving from current income.

It is noteworthy, however, that previous recessions in these countries have not typically been associated with sustained increases in household saving rates. An additional factor in the current instance appears to be the degree to which households had previously increased their borrowing and run down their savings, so that they entered this recession with much higher debt levels. Households in these countries appear to have concluded that, in the face of weak economic conditions and elevated risk, a sustained increase in saving is required so as to achieve significant balance sheet repair. By contrast, the household saving rate has risen less in some other countries – for example France – where, although the recent economic downturn has been severe, household balance sheets were in a stronger position entering the recession.

As households repair their balance sheets and maintain a higher degree of risk aversion than a few years ago, it seems plausible that saving rates in many advanced economies will remain at elevated levels relative to recent history. Combined with fiscal consolidation, this is likely to see demand growth in these economies remain subdued for some time. ❖