

Research Department Federal Reserve Bank of San Francisco

September 7, 1973

Saving Less

While the economy floundered in the doldrums several years ago, economists tried to reassure their readers that consumers sooner or later would give the economy a much-needed boost by spending more and saving less of their after-tax income. In the words of one such observer (Gardner Ackley), "Departures of the saving rate in one direction from the average are ultimately redressed by a regression toward the mean". These predictions have now come true with a vengeance, since the saving rate has dropped all the way from 8.1 percent in the 1970-71 period to only 5.9 percent in the first half of 1973.

There may be disagreements about the level of the "average" saving rate, but the rates recorded around the turn of the decade obviously were quite high—in fact, the highest of the past quarter-century. In contrast, the recent 5.9-percent rate fell about midway between the relatively low average rate of the 1960-64-period and the relatively high rate of the 1965-69 period.

The buy-now, pay-later atmosphere of early 1973 helped pull down the rate. So too did a crucial long-run factor—the growing importance in the population of large numbers of young families who normally are heavy spenders and poor savers. On the other hand, some factors worked to make at least some consumers save more—in particular, the recent fall in the level of consumer confidence, as well as the sharp increase this spring in income-tax refunds.

Take with caution

All estimates of personal saving, it must be added, should be treated with considerable caution. For example, the initially reported rate of 6.7 percent for the first quarter of this year has now been revised sharply downward to 5.9 percent, and some weighty discussions published this spring of why consumers were saving so much now appear somewhat irrelevant. The problem lies with the nature of the estimating process.

The Commerce Department calculates personal saving as a residual between disposable (after-tax) income and consumer outlays for goods and services. (Incidentally, the saving figure includes not only personal saving, but also the saving of noncorporate businesses, both farm and nonfarm.) Being a residual, the saving series is dependent on the accuracy of the estimates of the two underlying determinants. Since these series are constantly being revised, significant differences can develop between the initial saving estimate that Commerce makes just after the end of any given time period and the later estimate based on more complete and up-to-date information.

Buying for life

The present relatively low level of saving, as indicated by the latest revised figures, may be related to certain demographic changes which are best explained by the life-cycle theory. According to this view, households in their formative years keep up their consumption stan-

(continued on page 2)

Research Department Federal Reserve Bank of San Francisco

Opinions expressed in this newsletter do not necessarily reflect the views of the management of the Federal Reserve Bank of San Francisco, nor of the Board of Governors of the Federal Reserve System.

dards and maintain relatively low levels of saving. In other words, they devote a large share of their income to assets high in consumption services, such as housing and durable goods, and devote a correspondingly smaller share to assets high in saving services, such as time deposits, stocks and bonds. During middle-age, households take advantage of their higher income to build up their stock of saving assets for retirement. During retirement, the final stage of the life cycle, households keep a large percentage of their wealth in liquid form to meet current expenditures not covered by their sharply reduced income, and they also dissave by selling or consuming (through asset depreciation) certain assets such as housing and durable goods.

Consequently, the demographic shifts in recent years would contribute to a lower saving rate, because the sharp increase in the number of young people in the working population would tend to boost consumption rather than saving. Moreover, the importance of this factor should increase sharply throughout the present decade. The number of individuals in the 25-34 age bracket should rise by 9.1 million in the 1970's—a 57-percent gain, or three times the increase of the past decade.

This has meant a boom in household formations; in 1972, there were 2.3 million marriages, as against only 1.5 million in 1960. Moreover, these young families have been spending heavily—for

everything except baby clothes. (The birth rate has dropped consistently in recent decades, so that the number of babies born in 1972 reached the lowest level of the postwar period.) Also, the long-term decline in the number of persons per household has meant a duplication of purchases for housing and durable goods, especially in view of the large increase in the number of young single (or double) households. All of these factors have tended to induce higher consumption and thereby reduce saving.

Caution and inflation

In the immediate future, however, there may be a tendency toward a higher saving rate, especially in view of the "precipitous decline" in consumer confidence reported by the University of Michigan's spring consumer survey. Consumers indicated in this survey their intention to reduce purchases of both new cars and housing, partly because of increased caution, and partly because of the reaction to recent "borrowing" of sales from future time-periods. One recent study suggests that about one-fourth of this year's purchases represented hedge buying against future price increases.

The inflation factor is hard to measure, because some observers claim that inflation tends to make consumers buy in advance of future price increases, whereas others claim that it tends to reduce their buying because of an anticipated reduction in real income. The explanation may lie with the differ-

ence between *anticipated* and *un-anticipated* price inflation.

Some studies suggest that in periods of uncertainty—including uncertainty about rising prices—consumers become more cautious about spending and try instead to increase their saving. According to this view, rising prices force consumers to reassess their capability for servicing fixed commitments. In particular, when caught unaware by inflation, consumers tend to respond by increasing their saving and sharply reducing most types of consumption spending.

This year, however, the inflation apparently has been *anticipated* because of the wide publicity given, first, to the easing of price controls under the Phase III program, and secondly, to the price upsurge in the agricultural sector. In other words, consumers have hurried to buy in the anticipation that prices would only go up in the future. Accordingly, their saving has fallen off as they have increased their consumption to ever-higher levels, including a whopping 18-percent annual rate of gain in durable-goods spending in the first half of this year.

This factor should be less important as time goes on, assuming that consumers actually are becoming more uncertain about the future course of the economy. In addition, an increase in saving would automatically develop because of the speed-up in debt repayments resulting from the past upsurge in consumer-credit extensions, since

such repayments statistically are defined as saving.

Overwithholding

Finally, there may be less impact from the tax-overwithholding phenomenon, which has heavily influenced the saving-consumption picture during the 1972-73 period. This factor during 1972 caused disposable income (and presumably saving) to be smaller than it otherwise would have been—smaller than it would have been if taxpayers had acted to tailor their withholding taxes to match their liabilities. (Partly for that reason, the saving rate dropped from 8.1 to 6.2 percent between 1971 and 1972.) In 1973, overwithholding apparently has been continued on current paychecks, but it has been offset (at least in the spring period) by a larger-than-otherwise final settlement between the Treasury and taxpayers on their 1972 taxes.

It had been expected that the saving rate would rise in spring 1973 as consumers received their Treasury refund checks. This factor undoubtedly was present, but was offset by several other factors. (For that matter, measuring this phenomenon is difficult because of problems in seasonally adjusting the underlying data.) Disposable income and saving were reduced by the sharp increase (over 20 percent annually) in the social-security tax bite—and by the tendency of consumers to use their tax refunds as downpayments on big-ticket items, which in combination with heavy borrowing helped support the buying splurge.

William Burke

Research Department
Federal Reserve
Bank of
San Francisco
 Alaska • Arizona • California • Hawaii
 Idaho • Nevada • Oregon • Utah • Washington

FIRST CLASS MAIL
 U.S. POSTAGE
 PAID
 PERMIT NO. 752
 San Francisco, Calif.

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
 (Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 8 / 22 / 73	Change from 8 / 15 / 73	Change from year ago	
			Dollar	Percent
Loans adjusted and investments *	74,241	- 1,320	+ 9,892	+ 15.37
Loans adjusted—total*	57,489	- 1,175	+ 10,104	+ 21.32
Securities loans	1,130	- 1,158	- 923	- 44.96
Commercial and industrial	20,383	+ 26	+ 3,698	+ 21.16
Real estate	17,039	+ 72	+ 2,905	+ 20.55
Consumer instalment	8,556	+ 29	+ 1,335	+ 18.49
U.S. Treasury securities	5,026	- 127	- 912	- 15.36
Other securities	11,726	- 18	+ 700	+ 6.35
Deposits (less cash items)—total*	71,917	- 51	+ 9,338	+ 14.92
Demand deposits adjusted	20,918	- 498	+ 1,365	+ 6.78
U.S. Government deposits	461	- 4	+ 1	+ 0.22
Time deposits—total*	49,400	+ 508	+ 7,921	+ 19.10
Savings	17,566	- 33	- 651	- 3.57
Other time I.P.C.	23,081	+ 507	+ 6,894	+ 42.59
State and political subdivisions (Large negotiable CD's)	5,975 12,097	+ 56 + 386	+ 782 + 6,357	+ 15.06 + 110.75
Weekly Averages of Daily Figures	Week ended 8 / 22 / 73	Week ended 8 / 15 / 73	Comparable year-ago period	
Member Bank Reserve Position				
Excess reserves	11	50		34
Borrowings	126	226		2
Net free (+) / Net borrowed (-)	- 115	- 176		+ 32
Federal Funds—Seven Large Banks				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (-)	0	+ 463		- 933
Transactions: U.S. securities dealers				
Net loans (+) / Net borrowings (-)	+ 142	+ 651		+ 144

*Includes items not shown separately.