TrendMacrolytics

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INTELLECTUAL AMMUNITION

"Savings" vs. Wealth

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Savings, in decline for two decades, is a sign of risk aversion. Wealth, at all time highs, is a sign of growth.

Amid the increasingly irrefutable evidence that this **economy** is performing in stellar fashion, one of the few openings left to the naysayers and their media mouthpieces is the low **"personal savings" rate**. Upon release of the latest savings data, it was widely proclaimed that the -0.5% savings rate was the lowest "since the Great Depression," as if that depiction provided some insight into current economic conditions. The profligacy supposedly reflected in a negative savings rate, of course, is also deeply implicated in one of the other purported vulnerabilities of the **US** economy represented by the **current account deficit**.

One would be hard pressed when perusing this coverage, however, to find any acknowledgement of the fact that the reported savings rate has been in a **secular decline** for the past two decades, a period of rarely interrupted **economic expansion** and unmatched **wealth creation**. Indeed, the conventionally defined savings rate, which is simply the residual appearing in the **national income accounts** after **consumption expenditures** are subtracted from **disposable income**, has had particularly perverse results as an attempt to calculate the deferral of **current production** to establish claims on **future income**. According to this indicator, for example, the savings rate recorded its recent historical high above 10% during the **stagflation** of the early 1980s, which can hardly be considered a period of robust wealth creation. As a measure of abstinence from current consumption, the so-called **NIPA personal savings rate** has more often than not functioned as a gauge of **risk aversion**, rising during periods of **economic uncertainty**, while falling when times are good.

While garnering much less attention than the personal savings rate, far more economically relevant is the data on **household net worth**, which are capturing an ongoing **boom** in wealth creation. According to the **Fed's Flow of Funds** release, household net worth stood at a record of more than $51 trillion in last year's third quarter -- the latest for which data are available -- up some $5 trillion from a year earlier. While **real estate** accounted for about 40% of that increase, it's worth noting that the gain of some $3.3 trillion in **financial assets** alone exceeded by some $1 trillion the average four-quarter growth of total net worth over the past 10 years.

The trajectory of these wealth gains took a striking turn higher following the second quarter of 2003, when **President Bush's tax cuts on dividends and capital gains** were enacted. By reducing the tax burden on expected future income streams, the tax cuts directly raised the **after-tax capitalized value** of those income streams and also set off a self-sustaining dynamic wherein the rising **expected returns** encouraged a greater willingness to put capital at risk. This process lies at the heart of the current expansion's vigorous pace of **capital formation**.

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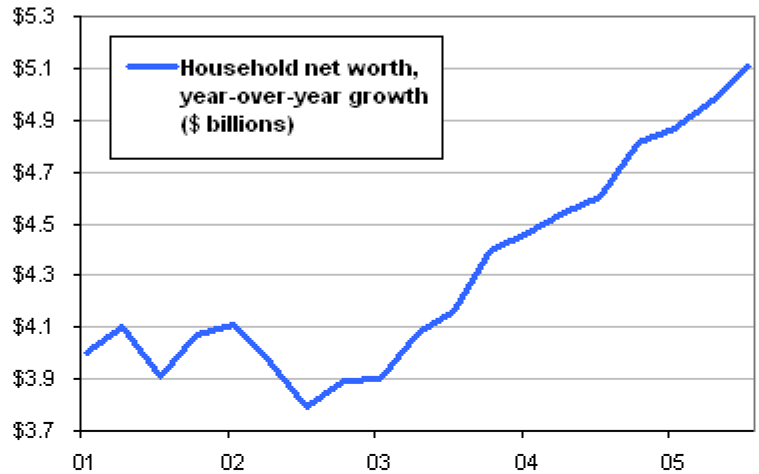

As opposed to the static current **cash-flow measure** presented by the NIPA savings rate, more insight into the forces actually at work can be gleaned from a gauge of current income versus the capitalized value of expected future income, *i.e.* wealth. By this standard, economically relevant "savings" now stand at better than 560% of disposable income, up from less than 500% in early 2003 before the tax cuts were enacted. As noted by the new annual report of the **President's Council of Economic Advisors**, this growth in wealth relative to current income is itself playing an important role in depressing the NIPA savings rate by encouraging a faster pace of consumption. "Studies find that an additional dollar of wealth tends to lead to a permanent rise in the level of household consumption of about 2 to 5 cents," the CEA says. This **"consumption-wealth effect,"** CEA says, has "proved to be one of the more enduring relationships in macroeconomics." The Council finds that "under the assumption that an additional dollar of wealth leads to a $.35 permanent rise in the level of consumption…the personal savings rate would have declined about half as much since 1980 if household wealth had grown at the same pace as disposable income." That would have seen the ratio of net worth to disposable income remaining stable at about 450%.

Growth in consumption and the decline in the NIPA-defined savings rate, then, can be seen as part and parcel of a US economic environment which continues to be characterized by a vitality that is the envy of the rest of the industrialized world. Nevertheless, the myth of the US **"savings shortfall"** continues to hold sway, particularly in the salons of the global economic elite. The **World Economic Forum** in **Davos, Switzerland**, last month was an occasion for repeated expressions of high dudgeon about the **"global imbalances"** precipitated mainly by too much consumption and not enough saving in the US. The contributions of **Western Europe** and **Japan** with their chronically sclerotic economies hardly rated mention in the rarified air of Davos. It was left to **Treasury undersecretary Tim Adams** to note that the US could easily resolve this imbalance by instituting policies that would contract domestic consumption. The savings rate would surely rise, and in the process US **GDP** would collapse and precipitate a **global depression**.