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Introduction to U.S. Economy: Personal Saving

Personal saving, which includes the saving of households but not of businesses or government, can have a significant impact at both the individual and economy-wide levels in the long and short terms. Recent trends in personal saving, specifically during the Coronavirus Disease 2019 (COVID-19) pandemic, have shown notable increases in the personal saving rate.

Economic Considerations

The saving rate, which is the ratio of total personal saving to disposable income, presents a tradeoff between current and future consumption. A relatively low saving rate implies higher current consumption but lower future consumption. Greater present consumption boosts individuals' living standards now; however, it leaves little to be invested in capital projects that will boost future living standards. Conversely, a relatively high saving rate implies lower current consumption but higher future consumption. This tradeoff has implications for both short-term and long-term economic growth.

Short-Term Economic Impacts

In the short term, a rising personal saving rate can temporarily slow economic activity, assuming no other changes to income. If on average individuals begin saving a larger portion of their paychecks, it means less money is being spent on consumer goods and services in the economy. Because consumer spending makes up about 70% of the U.S. economy, even a small decrease in consumer spending can reduce aggregate demand and economic activity. Alternatively, a falling saving rate may result in temporarily faster economic growth as individuals spend a larger portion of their pay on goods and services.

Whether changes in the saving rate are helpful or harmful in the short run depend on the state of the economy. A rise in the saving rate during an economic downturn can be problematic. In response to a recession, individuals may rationally respond to increased uncertainty about their future income by increasing their saving rate to provide a buffer against reduced income (caused by job loss, for example) in the near future. As a result, however, the economic downturn is further exacerbated due to the additional decrease in consumer spending resulting from the rising saving rate. By contrast, in the midst of a healthy and expanding economy, a rising saving rate may result in a more sustainable level of consumer spending, thus preventing the economy from overheating. An overheating economy occurs when demand for goods and services exceeds the economy's ability to produce those goods and services, which can result in accelerating inflation followed by a recession.

Long-Term Economic Impacts

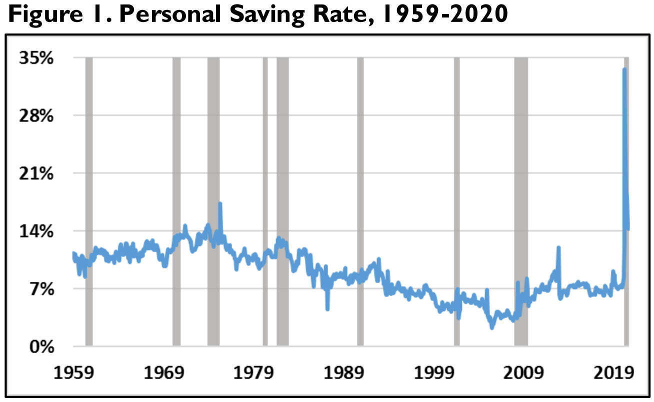
In the long term, a higher saving rate will generally lead to higher levels of economic output, up to a point. When individuals save a portion of their income, those savings are generally loaned to businesses to finance new investments. For example, an individual's 401(k) is a saving vehicle for their future consumption after retirement, but before retirement, those funds are generally invested in various companies through the purchase of stocks and bonds.

The overall level of investment is one of the main determinants of long-term economic growth. Business investments in physical capital (i.e., machinery, buildings, and factories) allow the economy to produce more goods and services with the same amount of labor or raw materials, increasing the productive capacity of the economy. As personal saving contributes to investment, all else equal, a higher saving rate will result in a higher level of physical capital over time, allowing the economy to produce more goods and services. For further information on business investment, refer to CRS In Focus IF11020, *Introduction to the U.S. Economy: Business Investment*.

How Is Personal Saving Measured?

The Bureau of Economic Analysis (BEA) measures the U.S. personal saving rate (see **Figure 1**) as the difference between aggregate income and consumption spending, which likely introduces some measurement error. The saving rate may understate the level of saving in the economy because certain spending is considered consumption, even though such spending is conventionally thought of as investment, such as spending on durable consumer goods (e.g., automobiles, appliances). Additionally, BEA does not include changes in asset prices or capital gains as income under the saving rate measure.

Figure 1. Personal Saving Rate, 1959-2020



Source: Bureau of Economic Analysis

Notes: Ratio of total personal saving to total disposable income in the United States. Gray bars represent recessions.

Alternative measures show that many households are struggling to save a portion of their income, particularly lower income households. According to the Federal Reserve, in 2019, about 58.6% of adults reported saving some portion of their income over the past 12 months. As shown in **Table 1**, among families with an income in the bottom 20th percentile of income, 36.5% saved some portion of their income, whereas among families with an income in the top 10th percentile, 85.5% saved some portion.

Table 1. Family Saving by Income Level, 2019

Percentile of Income	Median Income (Thousands)	Families That Save (Percent)
Less than 20	16.3	36.5
20–39.9	35.6	47.8
40–59.9	58.6	59.8
60–79.9	95.7	68.8
80–89.9	152.1	74.1
90–100	290.9	85.5

Source: Federal Reserve, Survey of Consumer Finances, 2019.
Notes: Income percentiles based on total family income.

COVID-19 and Personal Saving

Consumer spending and saving are inversely related. Individuals receive a certain amount of after-tax income that they can spend or save. By definition, what is not spent is saved. For this reason, it follows that when personal consumption expenditures decreased relative to income as the COVID-19 spread, personal saving as a percentage of disposable income would increase, as evidenced by **Figure 1**. As shown, the personal saving rate in the United States increased rapidly to 33.7% by April 2020 and has since fallen, although it still remains elevated from 8.3% in February, before the pandemic hit.

Although personal saving has been on the rise since the financial crisis of 2007-2009, the personal saving rate increased rapidly during the pandemic for several reasons, including precautionary saving, the inability to spend money due to business closures, and increased personal income from various stimulus programs, notably the economic impact payments of up to $1,200 for eligible adults and $500 for each qualifying child. A National Bureau of Economic Research working paper, in which the authors used a large-scale survey of consumers, found that 33% of individuals reported mostly saving the payment and 52% used it to pay down debt, which would qualify as saving in this context.

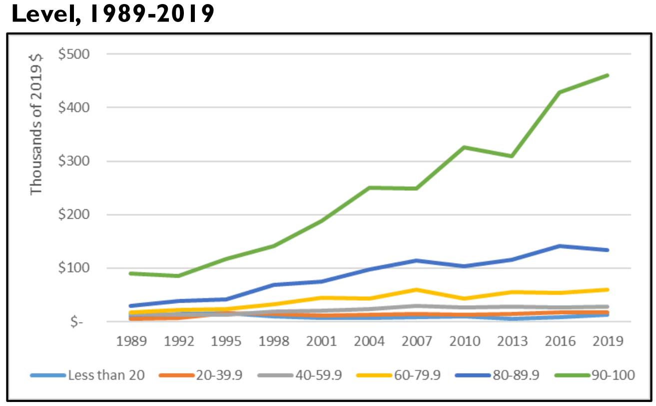
The inability to spend money due to business closures and social distancing may be a primary reason for the spike in the personal saving rate. Notably, most of the increase in saving appears to be due to high-income households. According to an economic tracker based on private sector data created by economists to record the effects of COVID-19 in real-time, as of June 10, high-income households reduced spending by 17% as compared with low-income households by 4%. Further, despite the overall increase in the personal saving rate, some individuals borrowed or used savings from retirement accounts to cover financial obligations, according to the Federal Reserve Survey of Household Economics and Decisionmaking (SHED). In July, 15% of adults who had been laid off or had work hours reduced reported borrowing from or cashing out retirement savings accounts in the past 12 months, as compared to 7% for adults who had not been laid off or had hours reduced.

Personal Saving and the Individual

Prior to the COVID-19 pandemic, the personal saving rate was below 10% for a majority of the previous two decades. In historical context, this was relatively low, with rates between 10% and 15% for much of the 1950s through 1980s (see **Figure 1**). While the personal saving rate has increased during the recession, there is, as of yet, little evidence to suggest that it will remain elevated indefinitely. Regardless of any future trends in the personal saving rate, the prolonged low rates have implications for individuals, such as the ability to save adequately for retirement or the ability to pay unexpected expenses. According to SHED, in 2018, 27% of adults would need to borrow or sell something to pay for an unexpected expense of $400, while 12% would not be able to cover the expense at all.

Since 1989, median retirement accounts have grown substantially for families in the top 10th percentile of income, but much less for all other families, as shown by **Figure 2**. Further, for those families in the bottom 60th percentile of income, the median retirement account holds at a maximum $28,000, likely not adequate for the decade plus average retirement length in the United States.

Figure 2. Median Retirement Account by Income Level, 1989-2019



Source: Federal Reserve, Survey of Consumer Finances, 2019.
Notes: Income percentiles based on total family income. Dates correspond to survey years.

(*Note*: This In Focus was originally authored by Jeffrey Stupak, former CRS Analyst in Macroeconomic Policy.)

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