The Financial Crisis and Personal Saving

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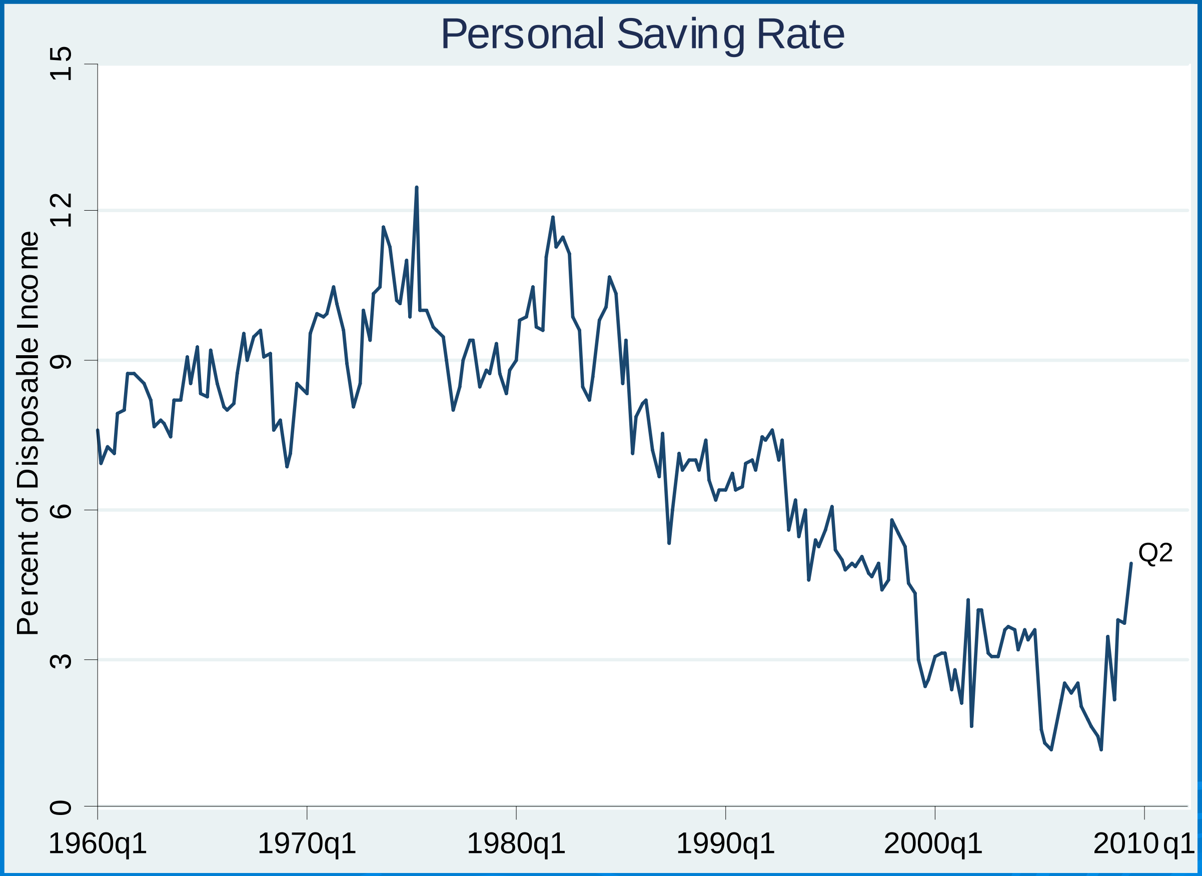
Overview

- Personal saving for the U.S. as a whole
- Personal saving among lower income households

Aggregate Personal Saving

The personal saving rate has risen over the past few quarters

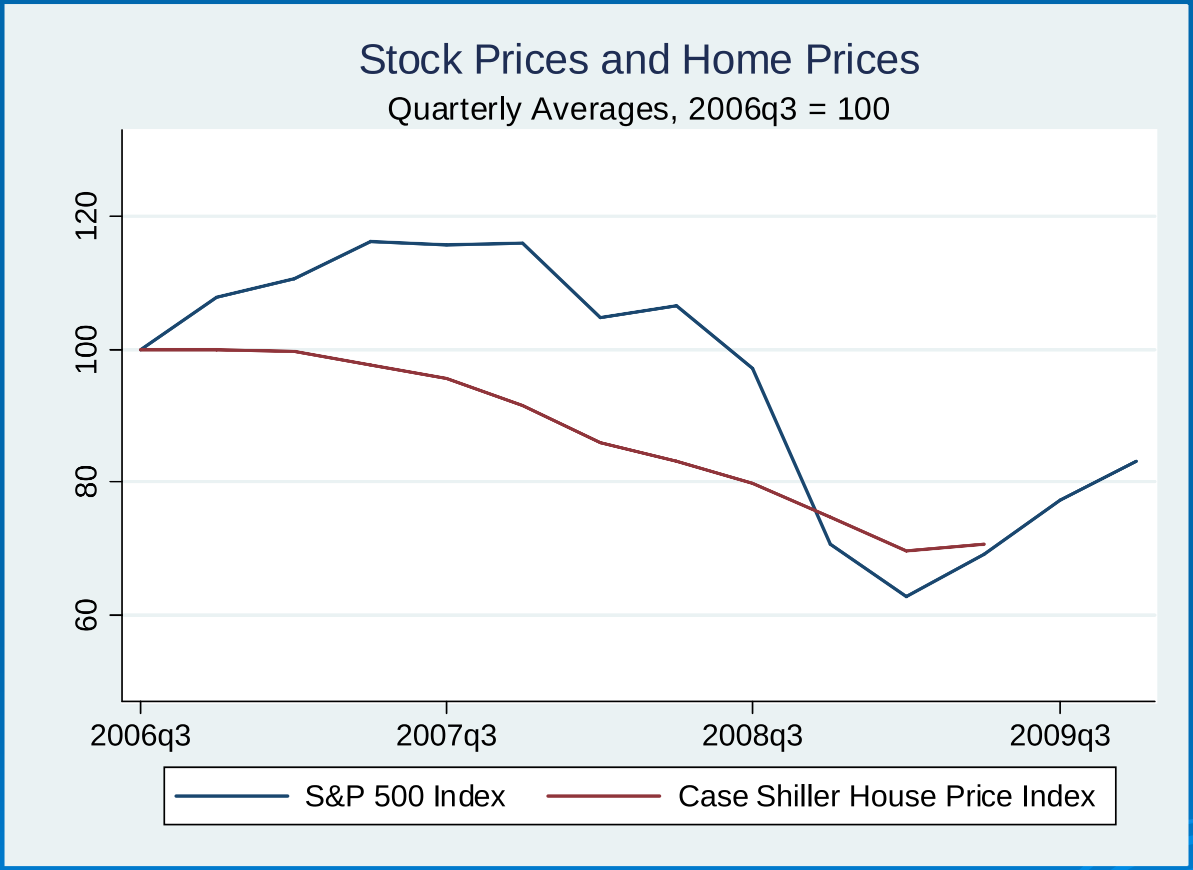


And it is likely to remain higher because of wealth effects

- Pre-crisis: Households did not need to save as much because home and stock prices were climbing rapidly.

- But things changed as the crisis unfolded …

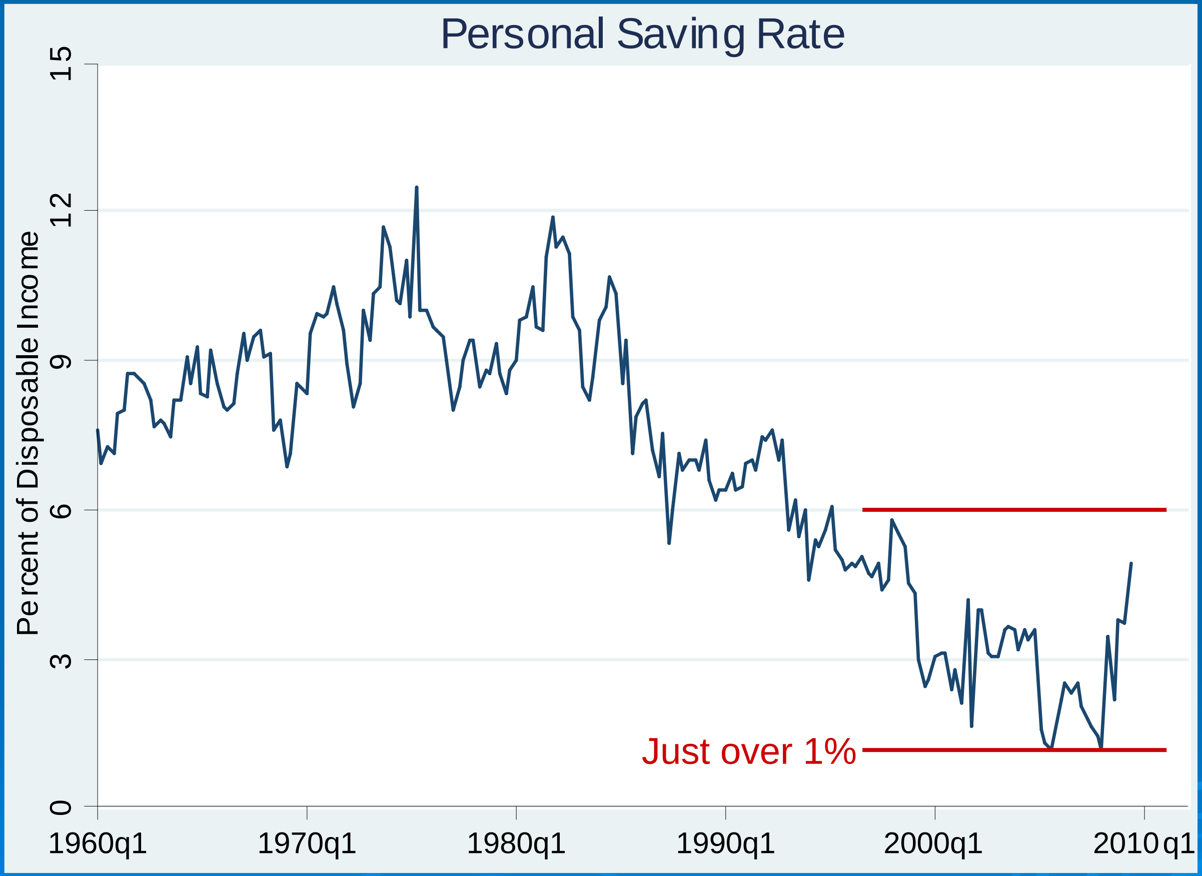
Household wealth has fallen sharply



Lower wealth implies higher saving

- Macro models imply that saving rises by 3 to 5 cents for every $1 of lost wealth.
- Adjustment occurs gradually, over a couple of years.
- Applying these results to the decline in wealth since 2007: **Saving rate should run close to 5 percentage points higher than in boom years.**

Thus, wealth effects alone => saving rate returns to early-90s level



And there are reasons to believe the saving rate may rise even further …

Different perceptions of the world:

- “My income isn’t going to grow as fast as I thought it would.”
  - Could raise retirement saving.

- “The world is a riskier place.”
  - Could raise precautionary savings.

And lenders probably also see the world as a riskier place

Credit is likely to be less readily available even over the long run => will raise aggregate saving by hindering dis-saving.

Percent of Banks Expecting Standards to Remain Tighter than Long-Run Averages "Over the Foreseeable Future"			
	Residential Real Estate Loans	Credit Card Loans	Other Consumer Loans
Prime customers	42	32	25
Nonprime customers	58	67	57

Source. Federal Reserve Board.

Tighter regulation is likely to damp the supply of credit as well

Examples so far:

- In 2008, the Federal Reserve amended Truth-in-Lending regulations to prohibit unfair, abusive, or deceptive home mortgage lending practices.
- In 2009, the Federal Reserve adopted new rules regarding lending to households through credit cards.

Summary: Aggregate Personal Saving

- Wealth effects imply a rise to the highest levels since the early 1990s.

- Other forces are likely to offer some boost as well, but we do not know how important they will be.

How has the crisis affected the saving of lower income households?

We don’t really know …

- Movements in the aggregate saving rate need not correspond to movements in the lower part of the distribution.
- And we have no direct data on how the saving of these households changed during the crisis.

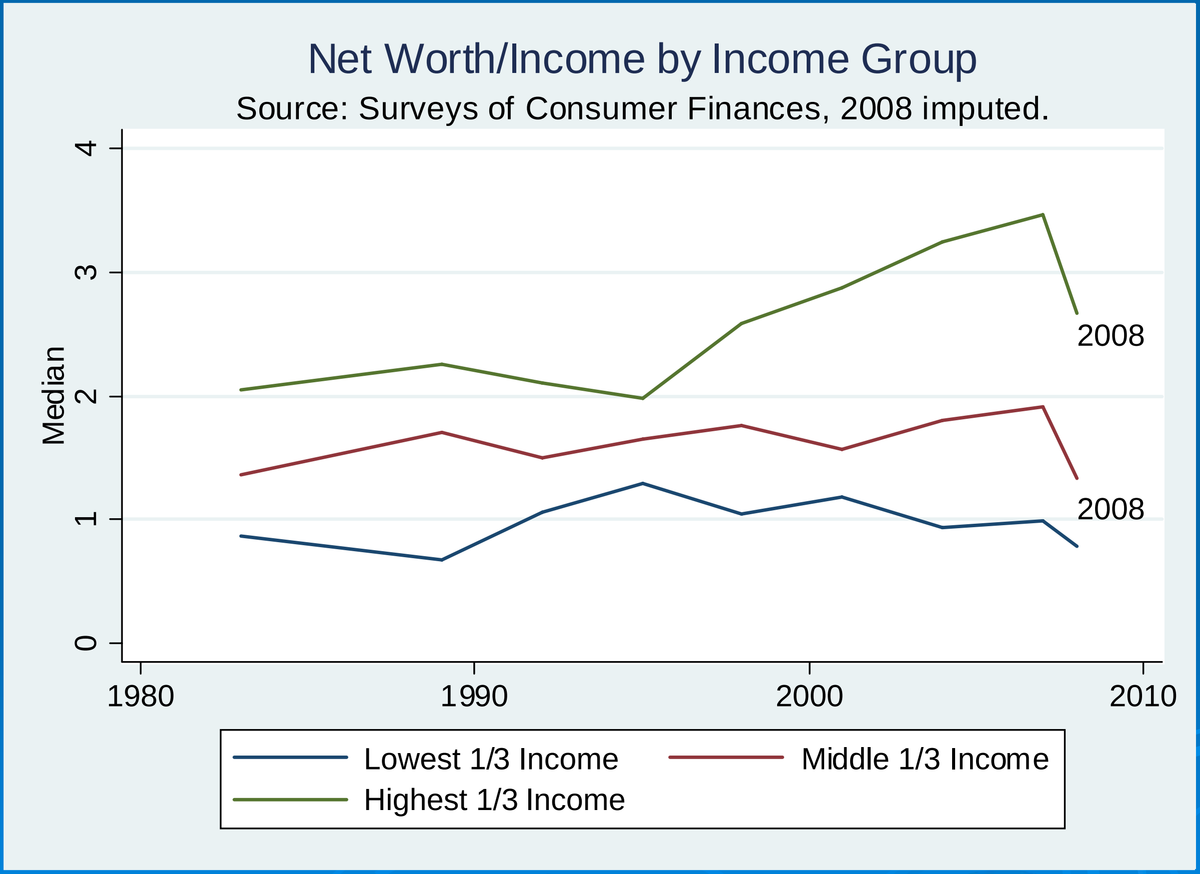
What We Do Know About Low Income HHs
They tend to save less out of income

Saving Rates by “Permanent” Income Quintile

Quintile 1	0.3%
Quintile 2	2.8%
Quintile 3	6.4%
Quintile 4	6.2%
Quintile 5	11.9%

Source. Dynan, Skinner, Zeldes, 2004.

What We Do Know About Low Income HHs
They tend to have less wealth and have been hard hit by the crisis



What We Do Know About Low Income HHs They have different challenges and needs

- Different saving challenges
  - Less access to mainstream financial services
  - Less access to other institutional savings vehicles
- Different saving needs
  - Less need to save for retirement saving because social security replaces more of their income
  - Long-run needs: for downpayments, education
  - Short-run needs: for emergencies

Some Speculation about the Saving of Lower Income HHs in the Wake of the Crisis

- The saving of some would-be borrowers will rise because of the more restrictive credit environment.

- Others will want to rebuild wealth because of capital losses and greater precautionary needs.

Some Speculation (cont'd)

- But, will lower income households be able to save more?
  - Short-run constraints: Job loss, depressed income
  - Long-run constraints: Impaired credit records

Conclusions (I)

- Aggregate personal saving should be markedly higher than before the crisis.

- Will slow the recovery but ultimately put the economy in a more solid and sustainable position.

Conclusions (II)

- Harder to say what the saving of lower income households will do.
  - Desire to save probably greater but obstacles greater.
  - Heightens the need for public and private programs to promote saving.