Is negative personal saving a serious problem?

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In most of 2005, personal saving was negative, attracting widespread attention and concern. Many analysts suggest that negative personal saving means that the typical U.S. consumer is living well beyond their means. Since this would be unsustainable, the fear is that an end of a consumer spending binge could lead to a recession. Such fears have taken on many incarnations over the past five years, focusing first on wealth declines due to the stock price crash in 2001, concern over foreigners' appetite for U.S. assets and fear of its disappearance and, lately, a feared bursting of a suspected housing bubble that would lead to a surge in saving and decline in consumer spending.

Personal saving is the difference between disposable personal income and consumer outlays. From the second quarter of 2005 to the end of the year, personal saving was negative \$21.5 billion, negative \$151.9 billion and negative\$33.3 billion. Personal saving can be pushed down by a rise in consumer spending or by a fall in disposable personal income. To see what has been happening recently, one can compare the third quarter of 2005, the latest quarter for which there is comprehensive saving data, to two years earlier, the third quarter of 2005 when personal saving was \$205.1 billion, its last peak. The table below provides more detail on selected components of income, both in billions of dollars and as a percent of GDP, that help explain why personal saving became negative.

The decline in personal saving was associated with a fall in disposable personal income relative to GDP, not with an increase in consumer spending. Personal consumption expenditures actually declined slightly, falling from 70.2 percent of GDP to 70.1 percent of GDP over the period, so the personal saving decline did not occur because consumption spending or outlays outstripped the growth of the nation's income or GDP. Consumer spending matched the 6.6 percent annual rate of increase of growth of GDP, a broad measure of the nation's income. Instead, disposable personal income grew at only a 4.4 percent rate over the same two years, so that the share of disposable personal income in GDP fell 3.1 percent of GDP. This decline shaved about 391 billion from disposable income and personal saving during the third quarter of 2005.

The shortfall in disposable income and personal saving is largely due to increases in "saving" elsewhere in the economy. As the table suggests, corporate profits boomed up over the period and were, in part, paid out as higher corporate taxes or held by companies as undistributed corporate profits. In addition, increased individual incomes pushed up personal current taxes. As percents of GDP, undistributed profits rose by 1.5 percent, corporate taxes rose 0.5 percent and personal taxes rose 1.2 percent. These three items account for slightly more than all of the shortfall of disposable income relative to GDP and the decline in personal saving to negative territory.

The significance of this result is that undistributed corporate profits are part of business and private saving, so that part of shortfall of personal saving was offset by a rise in business saving. Similarly, higher tax payments reduce the government deficit, or raise "government saving," so that, again, part of the shortfall in personal saving is offset by a rise in another component of overall saving. Thus the decline in personal saving is not reflected in a decline in overall U.S. saving. A measure of overall saving, gross saving, which includes funding for government capital spending, rose from 13.3 percent of GDP in the third quarter of 2003 to 13.5 percent of GDP in the third quarter of 206, despite the large fall in the personal saving. Removing the component of government capital spending does not alter the result that overall saving rose in the U.S. between the two periods.

Note that personal saving was not a large share of private sector or of total saving even in the third quarter of 2003. This component of U.S. saving has always been a small share of the total. There are other reasons for discounting the importance of personal saving, including the likelihood of revisions that will eliminate negative saving, at least if the past is a guide, and other imperfections with its measurement. Even taken at face value, however, the appearance of negative personal saving should not be a new source of concern for the U.S. economy.

Personal saving and disposable income have been held down by factors boosting saving elsewhere

	III/2003 (billions)	Percent of GDP	III/2005 (billions)	Percent of GDP
Personal saving	$205.1	1.9%	-$158.9	-1.3%
Disposable personal income	8274.6	74.6	9015.1	71.5
Personal tax	940.8	8.5	1215.9	9.7
Corporate tax	246.9	2.3	346.2	2.8
Undistributed corporate profits	289.2	2.6	512.2	4.1

Source: Bureau of Economic Analysis