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# Running on Empty?

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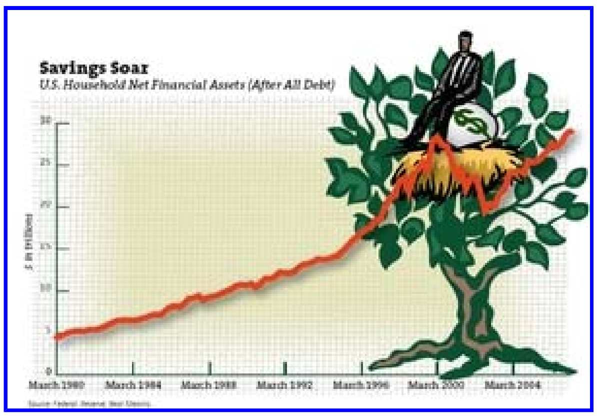
**Worries about the U.S. savings rate are overblown, argues DAVID MALPASS. American households have more net financial assets than the rest of the world combined, and our savings are setting new records.**




One of the enduring but incorrect concerns about the U.S. economy in recent years is that household savings are low and the consumer is weak because of it. The anxiety has been that consumer spending would hit the wall—Americans would run out of money, having depleted their savings. Instead, the economy has been solid since 2002, helped by steady growth in consumption. Despite housing and auto weakness, GDP rose 2.6 percent in 2006, and in 2007 it has re-accelerated from the first quarter's housing-related weakness. Consumption growth in the fourth quarter of 2006 and the first quarter of 2007—supposedly weakened by housing, gasoline prices, the decline in mortgage equity withdrawals, and poor consumer finances—was actually the strongest for any two consecutive quarters since 2004.

The truth is that the U.S. isn't running on empty. The household sector has the world's biggest stock of financial savings, more than the rest of the world combined. How could such a huge sum accumulate if the savings rate is low?

The answer is simple: The published savings rate excludes the economy's gains. Instead, it is calculated by subtracting personal spending from a narrow definition of personal income after taxes. But savings can grow even when you spend more than you earn in a particular month. For example, if you own $100,000 worth of stock and your portfolio rises by 10 percent (the annual average for the broad U.S. market), your savings rise by $10,000—a fact ignored in the official savings rate.

More and more Americans are working to accumulate assets: by funding a 401(k) plan that appreciates, buying a house and fixing it up, holding a job that pays a pension from long-term investments, or patenting an invention that will make them rich. Over the decades, this activity has added tremendously to America's net worth (think Google or Warren Buffett), yet it gets excluded in the calculation of the savings rate.

Rather than looking at the savings rate, I prefer to look at a clearer, simpler, and more meaningful number: actual savings. Every three months, the Federal Reserve publishes America's household balance sheet, which shows assets (for example, houses, cars, stocks, pensions, life insurance) and liabilities (mortgages, credit card debt, auto loans). Through March, household financial savings reached a record $29.1 trillion. This is a very conservative figure since it includes only financial assets (not houses, for example), but it also includes *all* liabilities (such as mortgage debt).

The International Monetary Fund tracks financial savings measures for other countries. At the end of 2006, Japan had $9.8 trillion, the UK $4.8 trillion, and France $2.6 trillion; Germany, at the end of 2005, had $3.2 trillion. In other words, the U.S. had about 40 percent more in financial savings than all these countries combined. If houses and automobiles are counted, too, the broader measure of savings would show an even larger gap between the United States and other large savers. The U.S. advantage makes sense because, more than any other nation, we have focused on the kind of innovation that brings capital gains, which increase the value of underlying assets.

> Yes, the debt-to-income ratio has risen sharply. But for U.S. households, assets are increasing much faster than debt.

Since the reported personal savings rate is lower now than it was in the past, the monthly reports give the impression that the U.S. savings rate has worsened. However, the official personal savings rate is being pushed down by the gains taking place in the economy. As more of the economy is oriented toward producing longer-term gains rather than current output, the personal savings rate can become negative even though actual savings increase.

But are savings being displaced by debt? Shouldn't we worry that the debt burden is increasing? It is true that the ratio of household debt to disposable personal income has doubled over the last 25 years, rising from 65 percent in the early 1980s to 136 percent in the first quarter of this year. This rise, in large part, reflects the increase in home ownership, in the value of homes, and in the volume of associated mortgages.

Since both assets and debt have risen faster than income, both the debt-to-income ratio and the asset-to-income ratio have increased. The good news is that assets have been growing substantially faster than debt; thus, the big rise in savings. For example, while total household liabilities rose $1 trillion from the second quarter of 2006 through the first quarter of 2007 (the most recent data), households increased their assets by $3.7 trillion (financial assets by $2.5 trillion and housing assets by $1.2 trillion).

While we hear a great deal about its debts, the fact is that the U.S. household sector is the world's largest net *creditor*, with a maturity structure well-positioned for rate hikes (most liabilities are fixed-rate, while many assets are short-term and earn more if rates go up.)

Shouldn't people save more? Of course. Many people need more liquid savings to prepare for retirement, economic downturns, and asset price declines. There's a strong argument for lighter taxation of savings, particularly interest income—one of the safest forms of investment. But as long as the United States is a confident society investing for future growth, the "personal savings rate," as currently presented by the Commerce Department, will probably remain low even as actual savings grow to new records.

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Image credit: Chart illustration by Alex Reardon.