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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. The personal saving rate was disrupted by the COVID-19 pandemic, which resulted in a rapid increase and subsequent decrease in this metric, making future trends in personal saving uncertain.

Definition and Economic Considerations

Individuals receive a certain amount of after-tax income that they can spend or save. By definition, what is not spent is saved, so saving and spending are inversely related. The personal 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 less to be invested in capital projects that will boost future living standards. Conversely, a relatively high saving rate implies lower current but higher future consumption. This tradeoff has short-term and long-term economic implications.

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 them, which can result in accelerating inflation followed by a recession.

Long-Term Economic Impacts

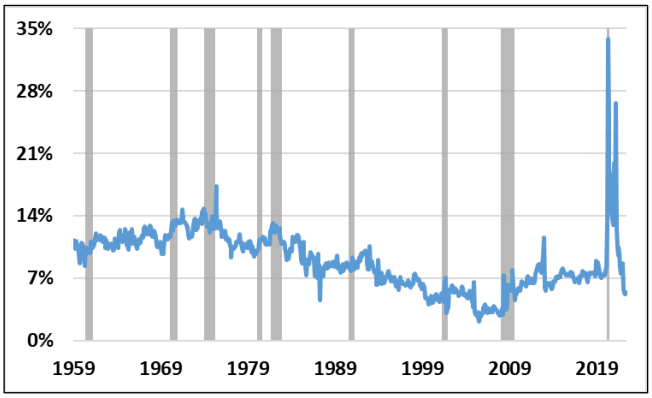
In the long term, a higher saving rate will generally lead to higher levels of economic output, up to a point. When individuals save a portion of their income, those savings are generally loaned to businesses to finance new investments. For example, an individual's 401(k) is a saving vehicle for their 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 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. U.S. Personal Saving Rate, 1959-2022



Source: Bureau of Economic Analysis.

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, 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 (%)
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.

Trends in Personal Saving

From the 1970s to the 2007-2009 financial crisis, the personal saving rate in the United States had generally trended downward from about 10%-13% to 3%-4%. After the crisis and before the pandemic, it rebounded partially but leveled off at about 7%, as shown by **Figure 1**. Economists have suggested the overall decline in saving across this time period could be due to increasing asset prices and access to consumer credit, both of which could increase consumption as a proportion of income. (Recall as personal consumption increases relative to income, personal saving as a percentage of disposable income decreases.)

Savings spiked at the onset of the COVID-19 pandemic, increasing rapidly to 33.7% by April 2020 as consumer spending plummeted. After traversing some relative peaks and valleys, the personal saving rate is now back down to pre-pandemic levels (5.4% as of May 2022). The extent to which the pandemic will continue to affect saving behavior is uncertain and depends on many factors, including the health of the economy and public health conditions moving forward.

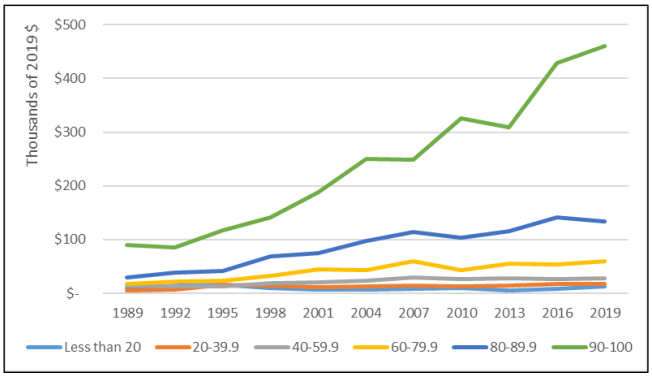
The personal saving rate increased rapidly during the pandemic for several reasons, including precautionary saving, the inability to spend money due to business closures, and increased personal income from various stimulus programs, notably three rounds of economic impact (stimulus) payments. The inability 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 have been due to high-income households, according to one real-time economic tracker based on private sector data. 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).

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. 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 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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