

# National Economic Trends

## What's Behind the Falling U.S. Private Savings Rate?

The U.S. gross private savings (GPS) rate—the ratio of GPS to gross domestic product (GDP)—trended upward until the mid-1980s and has declined since then.<sup>1</sup> As the chart shows, the private savings rate was at its post-1950 average level of 17.6 percent as recently as 1993, but it dropped rapidly to 13.1 percent during the first quarter of 2000, its lowest level in nearly 50 years.

Why has the U.S. private savings rate declined recently? The results of a recent study by economists at the Central Bank of Chile and the World Bank might help shed some light on this question.<sup>2</sup> The research applied sophisticated econometric techniques to a carefully constructed uniform set of macroeconomic, financial, and demographic variables for a panel of about 70 countries over the period 1965-1994. The goal of the research was to identify patterns among these variables and private savings rates. Surprisingly, the level of real interest rates available to savers did not exert consistent effects on private savings rates across countries in the study. Furthermore, two features of the U.S. economy during the late 1990s that are generally *not* consistent with falling private savings rates are the surprisingly high rates of economic growth and the rising foreign exchange value of the U.S. dollar. Private savings rates usually increase under both of these circumstances. Intuitively, households and businesses tend to save some of the bounty of good times for a rainy day. While these incentives to increase saving might be operating in the United States, there must be countervailing factors that are even stronger to create a downward shift in private savings rates.

Indeed, several factors that reliably predict lower private savings rates around the world have been present in the United States in recent years. The

international evidence suggests that low inflation rates appear to signal a greater degree of macroeconomic stability, so the low inflation experienced in the United States in recent years might have induced a reduction in precautionary saving by households and businesses. Other statistically significant variables in the study that were associated with reduced private savings rates include increased domestic credit flows to the private sector, increased public saving (i.e., government budget surpluses), and ready access to foreign borrowing (a current-account deficit)—all of which have been observed recently in the United States.

Taken together, these findings from a large panel of countries may provide some insight into the marked decline in the U.S. private savings rate during recent years. Low inflation and supportive financial conditions—including easy access to domestic and foreign sources of credit, government budget surpluses, and a booming stock market—may have convinced U.S. businesses and households that it was appropriate to reduce their own saving.

—William R. Emmons

<sup>1</sup>Gross private saving is composed of personal saving plus the retained earnings and depreciation expenses of the business sector. Thus, increases in the book value of firms through retained earnings are captured in GPS, while increases in the market value of firms in excess of book value are excluded.

<sup>2</sup>Norman Loayza, Klaus Schmidt-Hebbel, and Luis Servén, "What Drives Private Saving Across the World?" *The Review of Economics and Statistics* 82 (2000), May, No. 2, pp. 165-81.

