September 14, 2022

MACRO STRATEGY

Excess Savings and the Consumer

Key Takeaways

- Household income exceeded spending by a total of $5.5 trillion during the pandemic, or 72% above what it might have been in normal times.
- Consumers have been spending, and they likely have sufficient savings to stave off a recession into 2023 despite Fed actions toward reducing demand.

How Much Excess Savings Do Consumers Have, Anyway?

Consumers still have a lot of savings. A simple back-of-the-envelope calculation estimates the excess savings in the trillions. From March 2020 to June 2022, the Bureau of Economic Analysis reports that personal income has exceeded personal spending by a cumulative $5.5 trillion. At the pre-pandemic savings rate of 7.3%, consumers would have saved about $3.2 trillion, but, in fact, they have an additional hoard of around $2.3 trillion.

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It was not just stimulus savings that led to the hoarding of savings—pandemic inactivity contributed as well. In the same report, consumers saved some 8.2% of disposable personal income, even excluding extraordinary transfers—$357 billion above the pre-pandemic savings rate.

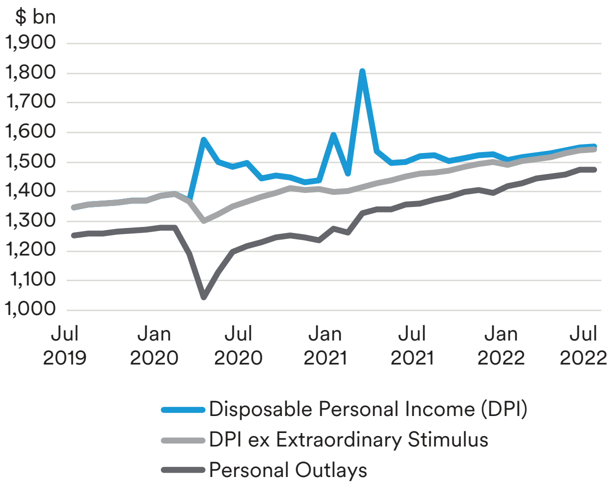
Consumers finally began to reduce their excess savings in 2022, albeit slowly. In July, according to the BEA's most recent month's personal income and outlays report, they spent $36 billion above usual outlays. At that rate, it would take more than five years for consumers to spend down their accumulated pandemic savings.

This doesn't mean that we expect consumer strength for the next five years—the calculations are too simplistic. There are several factors working against this outcome, including inflation and the possibility of higher long-run savings rates. A slightly more detailed approach of forecasting personal income and spending could shed better light on expected consumer behavior.

Another View: Forecasting Personal Income and Outlays

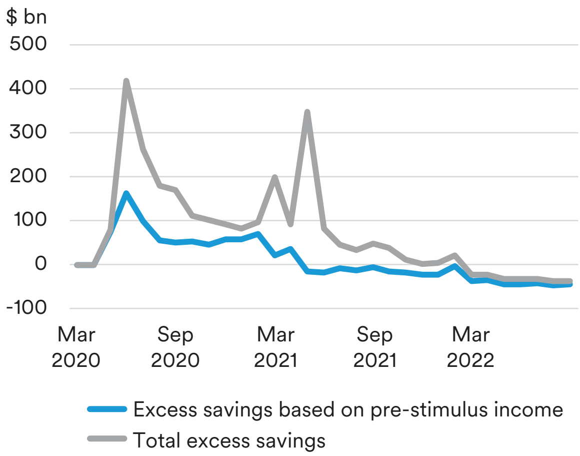
The above calculations make the simplifying assumption that savings will increase by a level amount. In fact, both personal income and outlays tend to grow by compounding over time. Historically, both personal income and outlays have grown by an average of 0.4% per month. Since March 2021, growth rates have diverged, likely due to price inflation of necessary goods (food, energy, shelter), with personal income growing by 0.6% monthly and personal spending growing by 0.9%. With spending growing so much more rapidly than income, excess savings may be spent down quite quickly. Looking at the chart below, projecting these growth rates going forward yields a relatively rapid drawdown in excess savings, with excess savings running out by the end of 2023.

Personal Income & Outlays



Source: BEA, Haver, MIM

Excess Monthly Savings



Source: BEA, Haver, MIM

This is still a notional exercise rather than a formal forecast and may still be somewhat optimistic in terms of recession timing.

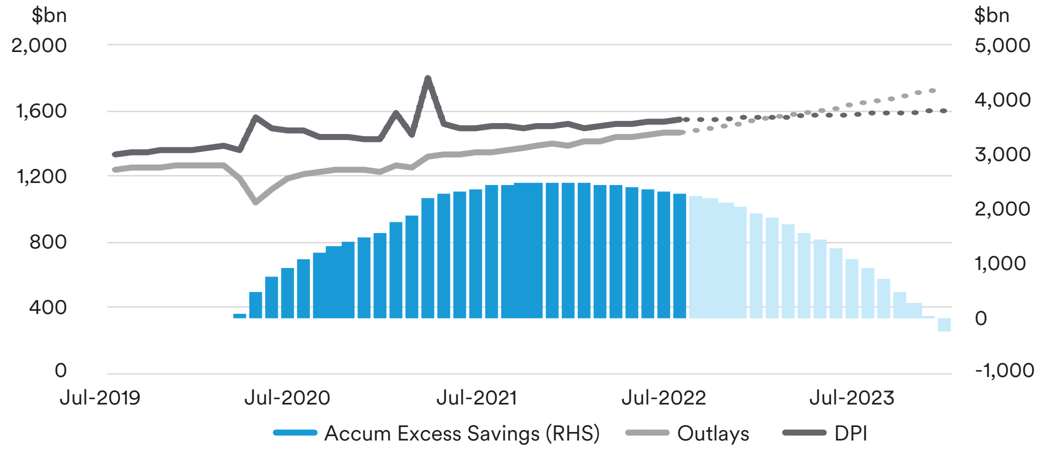
First, outlays have historically never exceeded disposable income; we would expect outlays to decelerate as it approached personal income.

Second, the current gap between income and spending would likely narrow as the Fed gains control over inflation, reducing the rate of nominal spending.

Third, consumers could be inclined toward higher savings rates going forward. Savings as a share of disposable personal income tends to rise following run-of-the-mill recessions, perhaps as households are (temporarily) scared into fiscal prudence. Following the 2008 financial crisis, savings rates rose substantially from a pre-crisis low of 2.1% to rates generally above 6%.[1] If consumers look to retain higher savings balances, spending could fall off sooner.

These points indicate that a consumption slowdown is likely before 2024, despite the large savings stash.

Personal Income & Outlays *dotted lines: projections*



Source: BEA, Haver, MIM

Distributional Effects Cut Both Ways

Finally, there are distributional concerns. If most of these excess savings are concentrated among the wealthy, spending would likely decelerate more rapidly as the lower- and middle-income households run out of excess savings sooner than the aggregate numbers would indicate.

However, we believe that these excess savings are spread relatively broadly. The broad middle-income population—which I define as people with bank accounts who have moderate- to no-liquidity concerns and tight-to-mild budget concerns—includes everyone who has some emergency funds available to those just below the wealthy.

Although this is a heterogenous group, we have two pieces of evidence that this group remains somewhat flush. First, aggregate household checking and currency holdings have skyrocketed since the pandemic, from $3.4 trillion pre-pandemic to $7.8 trillion by the end of Q1 2022.[2] This is unlikely to be driven solely by a small cohort of wealthy individuals; instead, it is more likely to be driven by a large number of households who now have a bit more liquidity in their bank accounts.[3] Second, a recent study has shown that individuals with an average of $500 in their bank accounts now have an average of $4,500 in the bank, and those with $3,500 in the bank now have an average of $13,000 in the bank.[4]

The lack of hard data on the distributional features of the excess savings means that we cannot come to strong conclusions about how rapidly households will spend down their savings going forward. We can, however, suggest that some share of the savings is owned by middle-income households rather than mostly wealthier households and is therefore likely to be spent down over time.

Conclusion

Excess savings of U.S. consumers is so far defying the Fed's efforts to constrain consumer growth via rate hikes. With their massive stash of savings, we expect them to continue to defy the Fed for some time to come. Equally, there are a number of forces that are likely to impede continued spending past the end of 2023. As a result, we continue to expect a recession in 2023 rather than earlier—or later.

Endnotes

[1] Bureau of Economic Analysis

[2] Financial Accounts of the United States, Federal Reserve Board

[3] It is very possible, however, that the lowest income group, those that are more severely liquidity constrained, may already have run out of savings. Aside from anecdotal evidence of economic hardship caused by inflation, there is evidence in the more rapid growth of credit card debt.

[4] "U.S. consumer: A macro and micro perspective," Erika Najarian, UBS Global Research, Aug 1, 2022.

Author

TANI FUKUI

Director, Global Economic & Market Strategy

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