PERSONAL INCOME AND CONSUMPTION

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Summary
The savings rate has rebounded from the lows of late-2007 / early-2008, but this has been due to falling taxes rather than falling spending.

I think there is an imbalance building: Spending is supported by low taxes (an explicit government policy to ameliorate the recession of 2008-2009). Eventually taxes will have to rise to fund the government deficit, and this will put pressure on spending. Either the savings rate will have to fall (building future imbalances) or spending will have to fall (recession).

Longer-term trends (over the past two decades) are:

- Savings rate (more accurately, what is left over from current spending) has fallen from roughly 6% of income to below 2% in 2007/2008, rebounding to about 4% now.
- Taxes rose during the late 1990s but fell dramatically post-2000, and again in 2008.
- Spending has risen from about 83% of income to about 86% of income, with the jump occurring post-2000.

Details on Recent Movements in Spending and the Savings Rate
Economists commonly consider the "savings rate," which is the difference between current income and spending – the excess of income left after spending and taxes are accounted for. The definition is:

Savings Rate = (Disposable Personal Income – Personal Outlays) / Disp Pers Inc .

(This "savings rate" is not exactly savings as one usually thinks of savings, but rather a definition of the excess of income over spending in the aggregate economy. One could equally well talk of the "spending rate" – Outlays / Income – which is just one minus the "savings rate".)

It is useful to decompose the rise in the savings rate in order to understand it a little more. To do so it is useful to consider savings as a percent of total personal income. Basically,

Disposable Personal Income = Personal Income – Personal Current Taxes
Savings = Disposable Personal Income – Personal Outlays

The standard definition of the savings rate is savings divided by Disposable Income:

Savings Rate (DPI) = (Disposable Personal Income – Personal Outlays) / Disp Pers Inc

= 1 – Personal Outlays / Disp Pers Inc

We can, however, define a savings rate divided by personal income that is only slightly different:

Savings Rate (PI) = (Personal Income – Personal Current Taxes – Personal Outlays) / Pers Inc

= 1 – Pers Curr Taxes / Pers Inc – Pers Out / Pers Inc

Since DPI and PI differ only by Pers Curr Taxes, which has monthly changes that are not large relative to the level of DPI and PI, the two measures will be very much the same. The advantage of the second is that we can decompose changes in that savings rate into changes due to taxes and that due to changes due to outlays (spending).

Table 1 shows both definitions of the savings rate, together with a decomposition for the personal income version. The savings rate has increased substantially since early-2008 but has been due largely to the fall in taxes. Spending as a percent of income actually increased. (Real personal income and real personal outlays have both fallen over this period, but spending as percent of nominal income has increased.) The Savings Rate (PI) jumped by 3.2 percentage points, of which 3.8 were due to falling taxes and –0.6 due to (increased) spending.

Table 1 – Savings Rate and Decomposition for 2008-2009

	I 08	II 08	III08	IV08	I09	II09	III09	IV09
Sav Rate DPI	1.2%	3.4%	2.2%	3.8%	3.7%	5.4%	4.5%	4.6%
Sav Rate PI	1.0%	3.0%	1.9%	3.3%	3.4%	4.9%	4.1%	4.2%
PersOut/PI	86.3%	86.2%	86.4%	84.9%	86.7%	86.1%	86.9%	87.0%
Tax/PI	12.6%	10.8%	11.7%	11.7%	9.9%	9.0%	9.0%	8.8%
Ch due to PersOut	-0.2%	0.2%	-0.2%	1.5%	-1.8%	0.6%	-0.8%	0.0%
Ch due to Tax	0.0%	1.8%	-0.9%	0.0%	1.8%	0.9%	0.0%	0.2%
%PI (simple rate)	0.3%	1.2%	-0.1%	-0.4%	-2.3%	0.8%	0.3%	1.0%
%PersOut (simple)	0.6%	1.0%	0.2%	-2.1%	-0.3%	0.1%	1.3%	1.0%

Figure 1 shows the longer trends in the savings rate and outlays – the savings rate has been trending lower for the past couple decades but with a sharp rebound starting in 2008. Spending has increased, with a particular jump about 2001. Figure 2 shows personal current taxes. This fell starting 2002 (the George W. Bush tax cuts), and then again starting in 2008 (in response to the recession). Taxes will no doubt rise at some point, in response to substantial government deficits.

Figure 1 – Savings Rate and Personal Outlays, as Percent of Personal Income

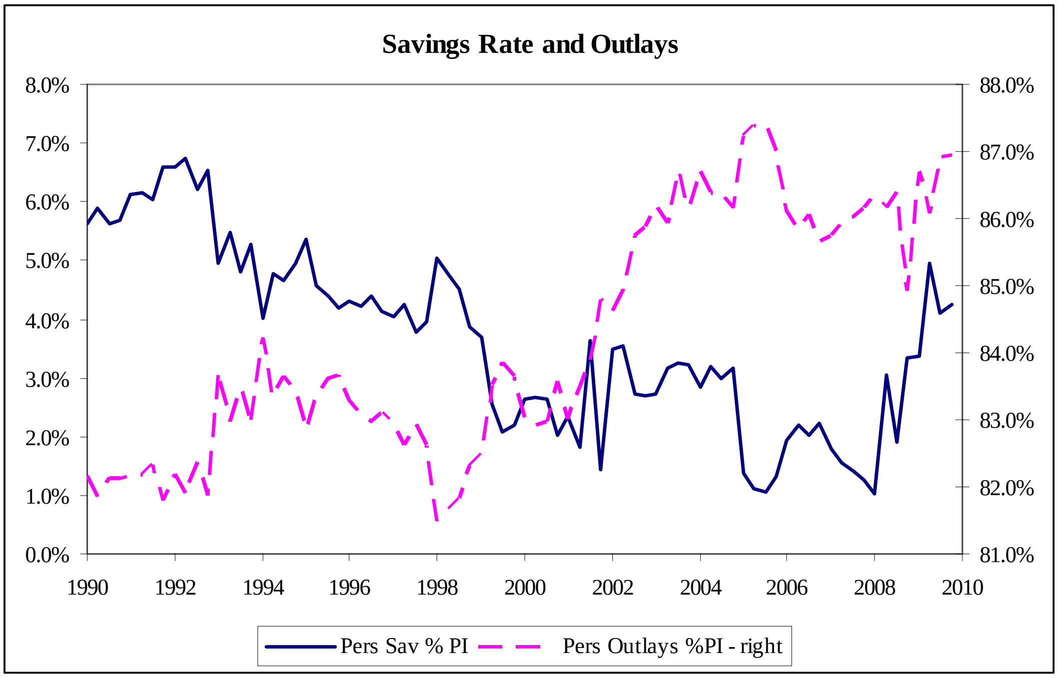

Figure 2 – Current Personal Taxes, as Percent of Personal Income