PERSONAL INCOME AND CONSUMPTION

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T. S. Coleman PhD
Close Mountain Advisors
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Summary
Figures on US personal income and outlays show warning signs of a continuing consumption bubble. During the recession of 2008-2009 the US savings rate rebounded from the lows of late-2007 / early-2008. On the face of it this was good news because it seemed that US consumers were re-balancing away from the high consumption and debt that fueled the bubble, but in fact consumption is growing, the savings rate is falling again, and any rise in savings has been due to tax cuts.

- Personal outlays (consumption) as a percent of personal income is at an all-time high: 88.2% of income for March 2010.
- The savings rate is falling again – from 4% and higher in 2009 to 2.7% for the most recent month (March 2010).
- Most importantly, what small increases in the personal savings rate have occurred are all due to falling taxes. In other words the increase in personal savings has been funded by government dis-saving. Falling household debt has been offset by rising government debt, so that there has not really been any net de-leveraging.

This is storing up trouble for the future – I don't think the imbalances that led to the financial crisis of 2007-2009 are being redressed (at least for the US). 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 fall further (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, rebounded to about 4% in 2009 but is now trending back down – the most recent monthly figure is 2.7%.
- Taxes rose during the late 1990s but fell dramatically post-2000, and again in 2008.
- Spending has risen from about 83% of income to over 88% of income, with the jump occurring post-2000 and continuing apace.

Household debt (measured in the Federal Reserve's quarterly flow of funds reports) has fallen since early 2008, from 96.4% of GDP in QI 2008 to 93.6% in QIV 2009. This is good news and shows households have started de-leveraging. Unfortunately the increase in government debt has been far larger. According to the OECD, central government debt for the US grew by $2.5tn from 2007 to 2009, or from 35.6% of GDP to 53.1%. Future tax liabilities, which are a future liability and thus function as a sort of implicit household debt, have probably offset any decrease in directly-owned household debt. The net result is that household leverage has probably not decreased much, if at all, over the past three years.

Details on Recent Movements in Spending and the Savings Rate

Table 1 shows the savings rate for the definitions discussed below, together with a decomposition of savings as a percent of personal income. The savings rate has increased since early-2008 but it has been due largely to the fall in taxes – personal taxes as a percent of personal income fell from 12.6% in QI

2008 to 9.4% in QI 2010. Spending as a percent of income actually increased, from 86.3% to 87.9%.[1] The Savings Rate (PI) rose by 1.7 percentage points since QI 2008, of which 3.3 points were due to falling taxes and –1.5 due to (increased) spending.[2]

Table 1 – Savings Rate and Decomposition for 2008-2009

	I 08	II 08	III08	IV08	I09	II09	III09	IV09	I 10
Sav Rate DPI	1.2%	3.4%	2.2%	3.8%	3.7%	5.4%	3.9%	3.9%	3.1%
Sav Rate PI	1.0%	3.0%	1.9%	3.3%	3.4%	4.9%	3.6%	3.5%	2.8%
PersOut/PI	86.3%	86.2%	86.4%	84.9%	86.7%	86.1%	87.5%	87.6%	87.9%
Tax/PI	12.6%	10.8%	11.7%	11.7%	9.9%	9.0%	8.9%	8.8%	9.4%
Ch due to PersOut	-0.2%	0.2%	-0.2%	1.5%	-1.8%	0.6%	-1.4%	-0.1%	-0.2%
Ch due to Tax	0.0%	1.8%	-0.9%	0.0%	1.8%	0.9%	0.1%	0.1%	-0.5%
%PI (simple rate)	0.3%	1.2%	-0.1%	-0.4%	-2.3%	0.8%	-0.4%	0.8%	1.0%
%PersOut (simple)	0.6%	1.0%	0.2%	-2.1%	-0.3%	0.1%	1.3%	0.9%	1.2%

Source: Bureau of Economic Analysis and Calculations

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

[1] Real personal income and real personal outlays have both fallen over this period, but spending as percent of nominal income has increased.

[2] These are quarterly figures. The most recent monthly figures (March 2010) show the same trend of lower savings and higher spending: Savings/DPI = 2.7%, Savings/PI = 2.5%, Personal Outlays / PI = 88.2%, Tax / PI = 9.4%.

we can decompose changes in that savings rate into changes due to taxes and that due to changes due to outlays (spending).

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

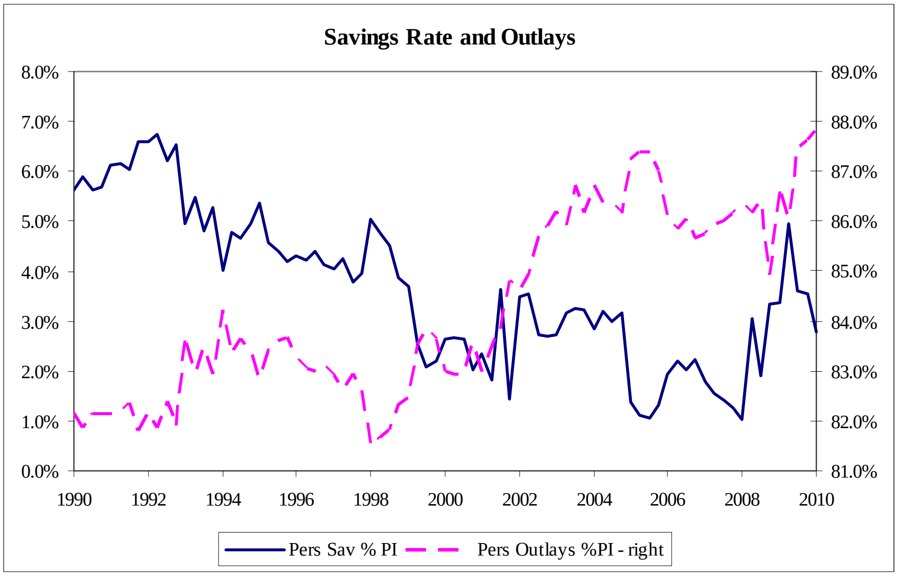

Figure 2 – Current Personal Taxes, as Percent of Personal Income