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Economic Research Note

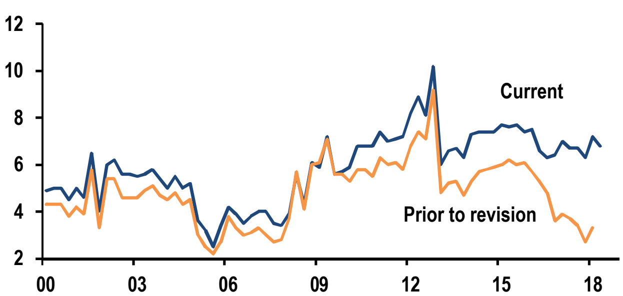
Meet the new, frugal US consumer

- **Upward revisions to income estimates lead to a much higher than previously thought personal saving rate**
- **This shouldn't come as a huge surprise—the saving rate has tended to get revised higher in the past**
- **While it makes us feel better about consumption, there's no strong evidence the saving rate predicts spending**
- **After the saving rate revision the wealth effect now looks non-existent during this expansion**

In the recent comprehensive revision to the national accounts data the personal saving rate in 1Q18 was revised to 7.2% from a previously-reported 3.3% (Figure 1). This huge upward revision was mostly due to a higher estimated path for personal income. Much of this new-found income was in the form of higher estimated income from assets (such as dividends and interest income) or from higher proprietors' income. While this upward revision was large, it shouldn't be too surprising. The saving rate has a tendency to be revised higher and usually for the same reason—an upward revision to personal income estimates.

Figure 1: Personal saving rate

%



Source: BEA, J.P. Morgan

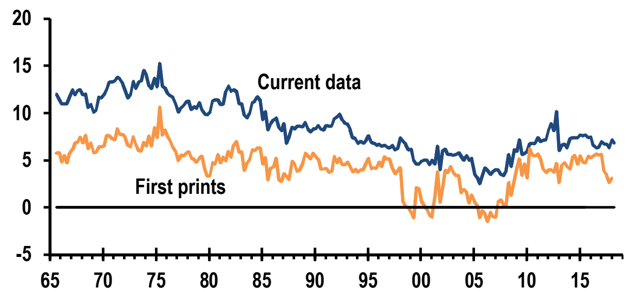
The higher saving rate makes us feel qualitatively better about the outlook for consumer spending, as it would mean consumers no longer look as stretched as they did before the revision. That said, the quantitative evidence that the saving rate predicts future consumption growth is mixed. As such, we didn't revise our outlook for consumer spending after the saving rate revision. Finally, before the revision standard wealth effect models would have predicted a lower saving rate than the one that actually was reported. After the revision this puzzle looks even greater. Put another way, after the revision it now looks like consumer behavior shifted materially after the Great Recession, and households appear to be much more cautious about increasing spending in response to rising wealth.

Look what's between the couch cushions

The recent upward revisions to the personal saving rate (Figure 1) have fit the historical pattern of the saving rate being revised higher over time. Using the Philadelphia Fed's real-time data set, we see that the saving rate for each quarter since 1965 currently stands at a higher level than the figure initially reported (Figure 2).

Figure 2: Personal saving rate

% of DPI, sa



Source: BEA, Philadelphia Fed, J.P. Morgan

The historical upward revisions to the saving rate have generally corresponded with upward revisions to income, and the recent annual revision was no different. The 1Q18 level of personal saving more than doubled in the BEA's recent benchmark revision, jumping from \$481bn to \$1094bn saar. Over three-fourths of this revision came from upward revisions to the income data, while downward revisions to spending and taxes accounted for the remaining 24% (Table 1).

Table 1: Personal income and spending, 1Q18

$bn, saar	Prior level	Updated level	Difference
Personal income	16850.7	17318.9	468.2
Employee compensation	10608.7	10709.6	100.9
Proprietors' income	1420.6	1549.9	129.3
Receipts on assets	2504.3	2719.5	215.2
Interest income	1523.9	1597.6	73.7
Dividend income	980.5	1121.9	141.4
All other	2317	2339.8	22.8
Personal current taxes	2077.6	2029.9	-47.7
Personal outlays	14292.4	14194.8	-97.6
Personal saving	**480.6**	**1094.1**	**613.5**

Source: BEA, J.P. Morgan

The upward revision to personal income was spread across many of the related subcategories, with an upward revision to receipts on assets (mainly dividend income) leading the way (Table 1). The revisions to the income data are based on the BEA's incorporation of more reliable source data that become available after earlier estimates have been released. Of particular note, the BEA indicated that recent upward revisions to dividend income were based on IRS Statistics of Income data and that upward revisions to the proprietors' income primarily reflected revisions to estimates of underreported income that were based on the IRS's tax gap data.

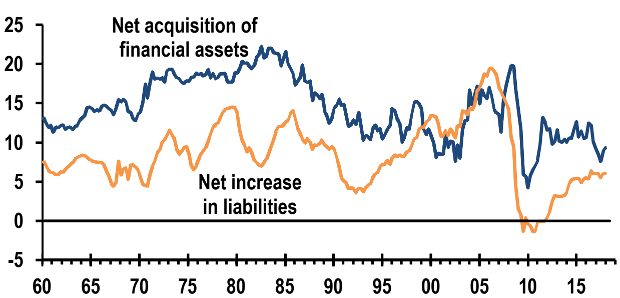
Great. So what does it mean?

It would make sense that a higher saving rate means a more upbeat outlook for consumer spending, as households aren't stretching as much to make ends meet. After all, the saving rate—measured either in first print or current data—reached historic lows in 2005-7, and we all know what happened after. Now it would appear we are in the opposite situation. Indeed, when we regress four-quarter real consumer spending growth on the saving rate lagged four quarters we find that a higher saving rate does portend faster consumer spending growth (and the results are significant using either first-print or current vintage data). However, this result is driven entirely by the Great Recession episode. When we drop that observation the saving rate loses all economic and statistical significance in projecting future consumption growth (again, with either first-print or current vintage data). Where does this leave us? We haven't revised our consumption forecast in light of the savings rate revision, but it does gives us comfort that consumers are nowhere near to being as overstretched as they were in the years heading into the Great Recession.

This message is similar to one that comes from looking at the composition of saving that prevailed in the data even prior to the revision. Saving can be defined as the difference between income and consumption—this is the definition in the national accounts data we have been discussing in this note—or as the difference between the acquisition of financial assets and the increase in liabilities (Figure 3).

Figure 3: Constituents of savings

% of disposable personal income



Source: J.P. Morgan

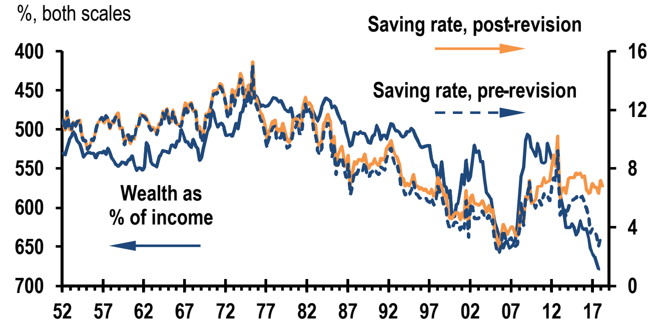
This latter measure is in the separately reported financial accounts data (and won't be directly affected by the national accounts revision). In that data the pre-recession years didn't feature exceptionally low asset acquisition, but rather exceptionally high liability accumulation. Just as we are comforted by the higher reported saving rate, we are also encouraged that leverage hasn't ramped up again.

Wealth effect RIP

The tendency of households to spend some fraction of an increase in net worth is known as the wealth effect. In the years prior to the great recession this was thought to be one of the more reliable regularities in macroeconomics: when household wealth increased by a dollar, consumer spending would increase by 3 to 4 cents and the saving rate would go down commensurately. When one overlaid the saving rate against the wealth-to-income ratio (Figure 4), there was a reasonably solid correlation. Beginning in 2014 we started noticing that the post-recession wealth effect was losing its power to explain saving behavior (see the link here). In spite of a roaring stock market, the saving rate barely budged in the early years of the recovery.

Figure 4: Wealth and saving

%, both scales



Source: J.P. Morgan, BEA, FRB

With the latest revision, the wealth effect looks even weaker. Had pre-recession wealth effects played out in the current expansion, the saving rate would be predicted to be 2.0%; the upward revision places the data even further away from that prediction. When we run those same models since the end of the recession they indicate that the wealth effect has disappeared completely. There are a number of explanations why the wealth effect has become attenuated in the current expansion, and our previously-referenced research discusses some of them. That debate hasn't been entirely settled, but there was probably some scarring effect of the Great Recession that altered behavior. That behavior may have led to a pokier pace of growth in this expansion—had the saving rate actually fallen to 2.0% the average pace of real consumption growth in this expansion would have been about 0.5%-pt per annum faster on average—but has probably also left the household sector more resilient to macroeconomic bumps in the road.

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