MACROECONOMIC ADVISERS
By IHS Markit

**Ben Herzon**
herzon@macroadvisers.com

**Joel Prakken**
prakken@macroadvisers.com

# Recently Asked Questions

Risk to PCE from Low Q4 Saving Rate

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***Does the rapid fall in the saving rate pose a downside risk to consumption growth?***

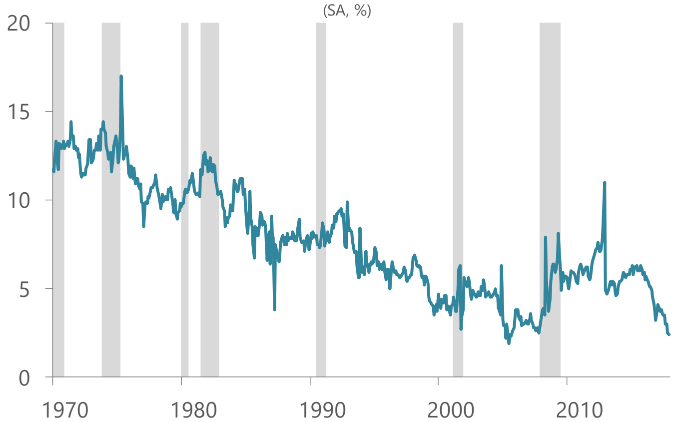
***PCE is likely to slow this year from rates of growth of 2.8% over the last two years, but not materially so. And the low Q4 level of the saving rate probably does not pose an independent material risk to the PCE forecast.***

The drop in the saving rate to 2.6% in the fourth quarter is, indeed, eye-catching. The extent to which the low level of the saving rate poses a downside risk to growth of PCE depends on what has caused the drop in the saving rate. Here are some thoughts on this.

First, state-and-local tax receipts were fairly strong in the fourth quarter of 2017, and this could reflect some pre-paying of state-and-local taxes prior to the new limits on deductions of S&L taxes from taxable income in the Tax Cuts and Jobs Act. This intertemporal shift in tax payments (from 2018 to late 2017) reduced disposable income and the saving rate in late 2017, but will raise disposable income in 2018. Therefore, the reduction in the saving rate from this source likely poses no risk to consumption going forward.

Personal Saving Rate

(SA, %)




Source: Bureau of Economic Analysis

Second, recent declines in the saving rate likely reflect, to some extent, the recent strength in household net worth stemming from robust increases in equity values and house prices. The boost to consumption (and drop in the saving rate) need not be reversed as long as household net worth continues along its solid trend.

Third, some of the drop in the saving rate reflects the boost to PCE from the late-year strength in vehicle sales, some of which was replacement spending from hurricane losses. The recent pace of vehicle sales is probably not sustainable and will come down. This would manifest as drag on PCE, but we already have that in our forecast, so that's not a risk from our perspective.

Fourth, the first reading on the 2017 Q4 saving rate reflects the first estimate of personal income, which is subject to revision once BEA folds in data from the Quarterly Census of Employment and Wages. We're not necessarily predicting an upward revision to Q4 personal income from this source, but the Q4 reading on the saving rate should be taken with a grain of salt, given that the primary source data for wage-and-salary income is not yet available.

Finally, we think it's important to keep in mind the potential role of forward-looking behavior. When it became apparent that taxes were going to be cut, this translated into an immediate increase in permanent (disposable) income. That is, it's certainly possible that PCE late last year was boosted by the expected increase in disposable personal income beginning in January. So PCE got out in front of income, temporarily lowering the saving rate. But once withholdings are adjusted (this month or next month), disposable personal income will rise, as will the saving rate. Indeed, our forthcoming updated base forecast will show a jump in the saving rate from 2.6% in the fourth quarter of last year to roughly 3½% in the fist quarter of this year, in line with the 3.6% saving rate averaged over the first three quarters of last year. That is, in our forecast, spending and disposable income come back in line, and the saving rate returns to the recent norm. This is a prospective increase in the saving rate that poses no risk to PCE.