

Box 6

HOUSEHOLD SAVING BEHAVIOUR IN THE EURO AREA

According to the euro area integrated accounts, household saving has risen sharply over the past year.¹ This box looks at the possible factors shaping recent saving behaviour in the euro area and discusses the likely evolution of saving in the future.

Theoretical drivers of household saving behaviour

Theory suggests a variety of motives for household consumption and saving decisions and disentangling the various drivers of behaviour is difficult. A key principle is that people base their consumption on the real income they expect to receive over their entire lifetime. In this respect, household saving is a means of smoothing expenditure in the face of variations in income, over long horizons – for example, by saving for retirement – and over shorter periods, in case of temporary or unexpected income fluctuations.

However, income fluctuations may not be the only determinant of a change in saving. For some households, saving levels are affected by developments in their financial and non-financial wealth, as increases in the value of their net asset holdings represent an important additional source of current and future purchasing power. Other households have few financial assets and may find it difficult to access credit. Those households may be constrained to consume out of their current resources irrespective of the likely path of future income. Saving may

¹ See the box entitled “Integrated euro area accounts for the second quarter of 2009” in the November 2009 issue of the Monthly Bulletin. The latest release for the integrated accounts covered data up to the second quarter of 2009.

also be affected by the degree of uncertainty surrounding future income – for example, in relation to employment prospects – as it may lead households to hold higher cash reserves against unexpected future income reductions, which is known as “precautionary saving”.²

In addition, household saving decisions are likely to be affected by the decisions and actions of other economic agents. For example, changes in government finances can be an important factor: an increase in government debt may cause households to adjust their own savings, at least partially, in anticipation of future tax liabilities – so-called Ricardian behaviour.

Recent developments in euro area household saving

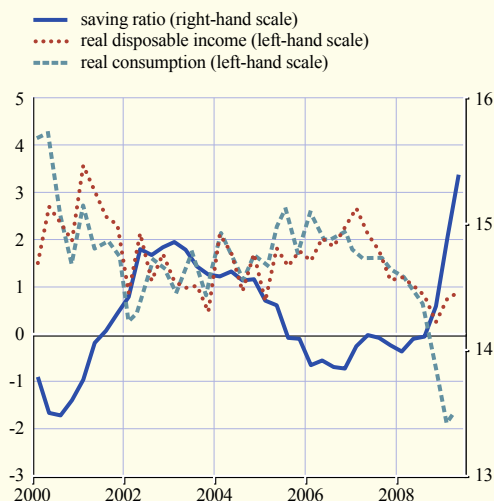
Household saving in the euro area has risen sharply in the past year. The household saving ratio rose to 15.4% in the second quarter of 2009 (on a four-quarter moving sum basis), 1.3 percentage points higher than a year before (see Chart A). The rise in the saving ratio contributed to a fall in consumption. Indeed, in the second quarter of 2009 nominal consumer spending was almost 2% lower than a year earlier.

The rise in the saving rate is at odds with the notion of consumption smoothing in the face of lower income. One key factor which may have influenced household saving decisions in 2009 is uncertainty about future prospects. The recent financial crisis has been characterised by a sharp increase in uncertainty about the economic outlook in the euro area during 2009.³ A particular concern for households has been job security. Employment has declined markedly over the past year, while by mid-2009 unemployment in the euro area was over 2 percentage points higher than at the beginning of 2008. Despite a modest improvement in confidence in the past six months, the European Commission’s consumer confidence survey highlights continued concerns among households about unemployment developments in the euro area.

It is also possible that households have increased their saving because expectations regarding future income have been revised downwards. Indeed, deterioration in expectations about future income streams may already be affecting household wealth holdings. Notably, households may expect permanently weaker housing wealth in the light of the correction in housing markets in many euro area countries. In addition, with declines in equity markets during

Chart A Household income, consumption and saving

(annual percentage changes; percentages of disposable income)



Sources: Eurostat and ECB.

² The impact of unemployment on household saving can be ambiguous. Higher unemployment lowers household disposable income, which may reduce households’ ability to save. However, increasing unemployment also entails heightened uncertainty, which may encourage households to raise their precautionary savings, at least temporarily.

³ See the box entitled “Uncertainty and the economic prospects for the euro area” in the August 2009 issue of the Monthly Bulletin; and the box entitled “Results of the ECB Survey of Professional Forecasters for the fourth quarter of 2009” in the November 2009 issue of the Monthly Bulletin.

2008 and early 2009, households' financial wealth has fallen markedly, although the recent rally in financial markets suggests some improvement (see Chart B).

As well as affecting household wealth holdings, the financial crisis may also have limited consumption by restricting households' ability to borrow. According to the Eurosystem bank lending survey for the euro area, credit standards on lending to households have tightened considerably since the onset of the financial turmoil. That may have prompted consumers to increase saving and reduce levels of debt, particularly if the changed financial environment has raised concerns among households about the state of balance sheets.

A further source of uncertainty is the impact of the large increases in government deficits since the financial crisis began. According to the integrated euro area accounts, government net borrowing increased to 3.9% of GDP in the second quarter of 2009 (on a four-quarter moving sum basis), a rise of close to 3 percentage points in the space of a year. Government deficits are projected to increase further in the near term and remain high for a sustained period. Future fiscal consolidation, either through increased taxes or through reduced government expenditure, is likely to affect household income in the years ahead. This prospect may have encouraged households to build up their savings in advance.

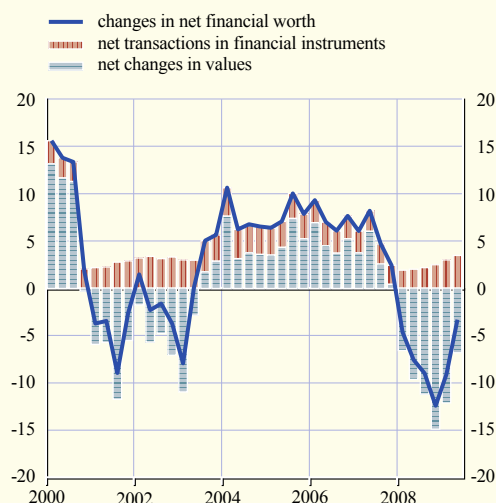
Differences across euro area countries

While most of the factors shaping aggregate euro area saving have also played a role in individual countries, their relative importance appears to have varied and consequently recent developments in household savings have differed significantly across euro area countries.⁴ At one extreme, saving has increased very sharply in Spain and Ireland. Sharp deteriorations in labour market conditions, with pronounced increases in unemployment, combined with marked falls in house prices have prompted households to adjust saving levels significantly.⁵ Relatively high household indebtedness may also have increased concerns about the need for balance sheet adjustment in these countries. In addition, both countries have seen a sharp worsening in their fiscal positions.

At the other extreme, some countries have seen hardly any change in the saving ratio in the past two years. For example, in Germany the saving ratio has remained largely unchanged during the turmoil. A key factor in this case may have been the relatively muted labour market reaction to the current downturn. Subsidised reductions in hours worked, work-time accounts

Chart B Household financial net worth

(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

4 As official data on saving ratios in 2008 and the first half of 2009 have not yet been published for all euro area countries, the analysis is based on estimates.

5 For a discussion of the wider implications of government labour market measures, see the box entitled "Links between output and unemployment in the euro area" in the October 2009 edition of the Monthly Bulletin; and the box entitled "Labour markets during the current contraction of economic activity" in the June 2009 edition of the Monthly Bulletin.

and overtime appear to have cushioned the impact of the downturn in activity on unemployment. In the short term, that may have helped to support incomes, reduce uncertainty and job insecurity and sustain consumption. In addition, as in a number of other countries, the government in Germany has introduced a vehicle scrapping scheme, which provides incentives for car purchase. This has also supported consumption and potentially dampened saving in recent quarters.⁶

The outlook for household saving

The euro area household saving ratio is expected to have increased further in the second half of 2009. With continued high uncertainty about the strength and sustainability of the economic recovery, and further adjustment anticipated in the labour market – unemployment is expected to increase further in the coming year – households are likely to continue to increase precautionary savings as a buffer against the possibility that income growth will be lower in the future.

Uncertainty about the course of household saving remains very high. As the recovery takes hold and incomes recover, households may be expected to reduce their savings somewhat. But household saving is likely to remain persistently higher than before the downturn if, for example, the crisis has caused households to worry more than before about income prospects or if it has prompted them to seek to rebuild balance sheets and reduce debt levels. In addition, following the bursting of bubbles in some asset markets, households may now have a more realistic assessment of their current wealth. Finally, saving may remain high if households are concerned about the implications of the rising levels of government debt and high deficits for their future tax burden. Such concerns highlight how important it is that euro area governments provide credible fiscal exit and consolidation strategies to correct the rising fiscal imbalances.

⁶ See the box entitled “The effects of vehicle scrapping schemes across euro area countries” in the October 2009 issue of the Monthly Bulletin.