Savings Rates Reflect Income Squeeze

You Cannot Save What You Do Not Have

Americans have a love-hate relationship with saving. We preach the virtues of squirreling it away, we give insufficient and ersatz tax breaks and deferrals to pensions, IRAs and other vehicles, we recognize someone saving somewhere is an absolute necessity to finance our various debt habits and then we go out on a spending bender whenever we get a chance to do so. Individuals have credit card debt, mortgage debt, student loans, etc, and while these have been declining as a percentage of GDP in recent quarters, they have been offset and then some by Uncle Sam and his nieces and nephews in state and local governments.

Corporate cash reserves, while actually well within the historic range as a percentage of corporate assets, are viewed as prima facie evidence of some wrongdoing by those who belief those funds should be used to hire people. Corporations are piling up cash out of concern over future economic and financial conditions; I suggested in February's Why Shareholders Should Ask For Their Money Back that these funds should be returned to shareholders ere management do something foolish therewith.

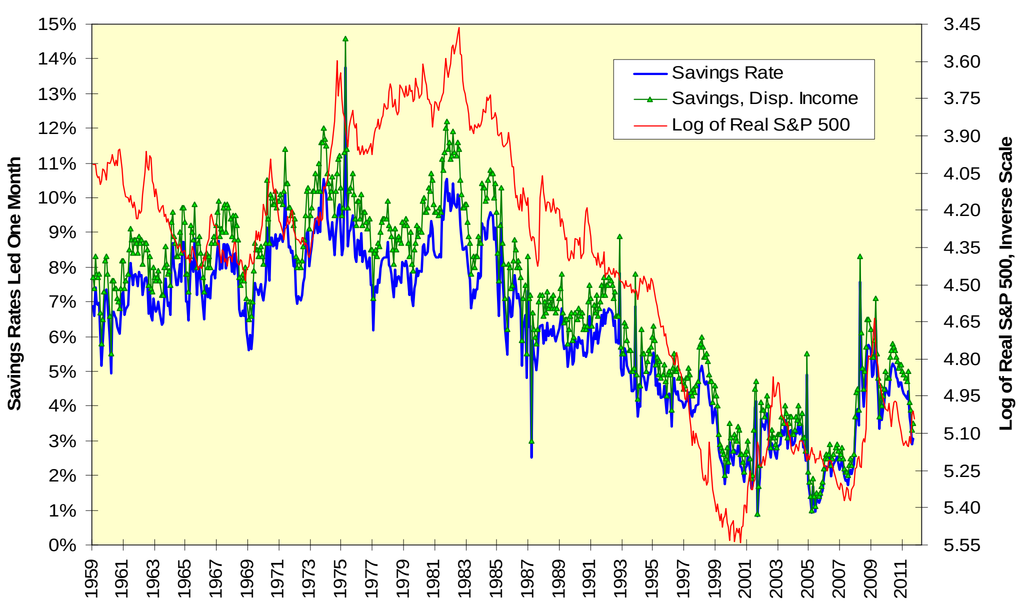
Regardless, two verities have existed on savings rates. The first is people treat investment gains as a form of saving, a sort of free gift from above relieving them of the need to deny themselves immediate gratification. The second is savings rates tend to rise during times of economic anxiety. Neither appears to apply in the present environment.

Stock Market Response

The U.S. stock market has been treading water on the other side of unchanged for most of 2011; this is quite the accomplishment relative to the rest of the world. American investors who fled for greener pastures in 2009 and 2010 should have asked what was making the grass so green. The economic news has not been an exercise in confidence-building, has it? We lurch between our government's ability to function to the Eurozone's ability to exist, and if you have not found this exhausting, I have.

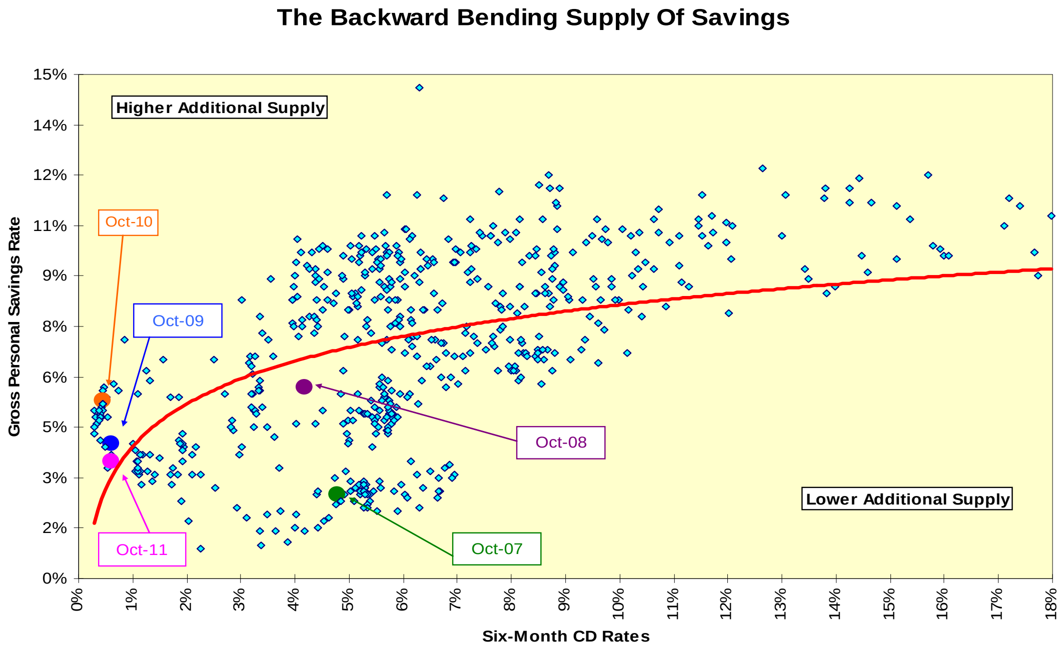
Yet the long-term relationship between savings rates, whether measured by the residuum between personal income and outlays or as a percentage of disposable income have declined since June 2010. Americans savers are acting as if they have been receiving a free kick from somewhere; a cynic might answer this kick has not come in the form of an effortless substitute for actual saving.

Saving Response To Equity Prices



We can see this behavior in the response of the gross personal savings rate to six-month certificate of deposit rates. Classical theory would hold savings rates should increase as returns fall as savers need to put away more money to make up for lower returns. However, we are at a "why bother?" moment: I have highlighted each of the past

October data points in the chart below. Please note how current savings rates are lower relative to both 2009 and 2010 even though six-month CD rates have not declined.



Alternative explanations abound, such as ravenous governments are claiming both domestic and global savings and Americans have decided to spend more; both of these are deficient as the year-over-year change in personal income has been declining since March and the rate of change in outlays has been flat. Moreover, if Uncle Sam needs money there are three price-insensitive lenders, the Federal Reserve, Japan and China, willing to lend it at rates once thought inconceivable.

No, the best explanation is the simplest. Americans are getting squeezed. You cannot save what you do not have, and that you can take to the bank.