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The Bottom Line

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Who's Doing All of the Saving?

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Are households rebuilding their savings in the wake of the economic and financial collapse or is the rise in savings, measured as a residual in the national income accounts, merely a statistical illusion? The fact is that while consumers have certainly cut their budgets and become far more value conscious, all but the wealthy are likely seeing their pre-tax nominal incomes fall more than their spending habits.

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Most average households in both Canada and the U.S. have experienced some level of financial constraint. To be sure, it has been more dramatic in the U.S., because the losses in both financial investments and housing equity have been more pronounced. In Canada, though the housing market slowed, its recent rebound has been stellar and house price declines are muted in comparison to those stateside.

We are just beginning an economic recovery. Weakness is now prevalent in the commercial real estate market, which typically happens in the ninth inning of a recession, after people have been laid off. Offices empty and people stop spending money, they stop going to the mall, business activity slows, and hotels suddenly become ghost towns. Financial markets have improved and the global economy is stabilizing, but for the majority of households, especially in the U.S., the savings rate is negative—meaning people are still spending more than they earn. It may well be less negative with the restrictions in consumer credit availability and crackdown on unsecured credit lines, auto loans and home equity loans, but average households are having trouble making ends meet and have certainly not rebuilt their nest eggs to desired levels. The restructuring of the household balance sheet has a long way to go and deleveraging will take considerably more time, slowing the potential growth rate of the economy for years.

An analysis of Internal Revenue Service data on annual income inequality in the U.S. shows that, for the most recent data available (2007), the top 15,000 households—roughly 0.1% of the U.S. population—received just over 6% of income, the highest figure for any year since the data became available in 1913, reflecting the surge in income inequality. The top 1% of households received 23.5% of income (the second highest on record, after 1928), while the top 10% received nearly 50% of income (the highest on record).

Income inequality in Canada is not nearly as dramatic owing to a more progressive tax system and a broader social safety net accompanied by a much flatter pre-tax income distribution. CEOs in Canada are not paid the astronomical multiple of rank-and-file workers as in the U.S. The problem in the U.S. is exacerbated by the recession, as the

underemployment rate there has risen to a shocking 16.8%, well above the level in Canada. Having said this, however, Canadian income distribution is nowhere near as flat as in some countries, such as Denmark and France. The top 1% of Canadian households received 11.2% (vs. 23.5% in the U.S.) of income and the top 5% accounted for 24.1% (in 2004).

The top 15,000 households in the U.S. earned an average annual income of just over \$35 million in 2007, with an after-tax average income of just under \$23 million. What this tells us is that a small number of households have the ability to save about half of the actual dollars saved by the whole country. In other words, the mega-rich have the ability to dramatically skew the data.

Including the top 1% of U.S. households, average annual income per household in 2007 was \$1.4 million before tax (compared to C\$684,000 in Canada in 2004). Their after-tax income averaged just over \$900,000 per household. If their after-tax savings rate were 25%, we would come up with more than 100% of the personal savings of the entire U.S. population according to Bureau of Economic Analysis (BEA) data. If all of this makes sense, it implies that 99% of the U.S. population could still have a negative savings rate of about 1%-to-1.5%. Including all of the households in the top 10% of household income, the remaining 90% could have even larger dissaving and the numbers would still show the rise in U.S. savings rates we have seen this year, to as high as 6.2% in May and 4.2% in July.

Bottom Line: Aggregate data can be very misleading, particularly when it comes to measuring savings and savings rates. The BEA calculates the U.S. savings rate as a residual from actual income and expenditure data, which showed a savings rate of 1.7% in 2007. That rate has risen considerably since then, but that could well be consistent with continued dissaving by the bulk of the population. To be sure, things have improved a bit from the crisis period a year ago, which lasted at least until March '09, but there is still a long way to go before most U.S. households will be on a sound footing, particularly as the boomers—age 44 to 64—head towards what they had hoped would be retirement.

The general theme applies to Canadian households, but to nowhere near the extent as in the U.S. for a number of reasons. Canadians, on average, were never as over-extended as Americans. There was no housing crash (because there was no real housing bubble and subprime mortgage lending was relatively rare). Canadians do not have the U.S. tax incentive to buy a house they cannot afford, and the banks here would be less likely to lend that much money anyway. Mortgage loans are recourse loans in Canada so foreclosure implies the unsavory prospect of losing everything, not just your home. Delinquency rates on Canadian consumer loans and revolving credit are rising, but remain well below levels in the U.S. With less income inequality in Canada, the aggregate data are more suggestive of the average household behaviour than in the States.

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