UK: excess household saving, a key risk to outlook

Household savings ratio is likely to surge – but how long will it remain elevated?

- **Consumption matters:** The pace at which household spending recovers will determine the shape and speed of the UK economic recovery from the COVID-19 recession. Household spending makes up around 70% of GDP in the UK. A critical component of household behaviour is saving. A key risk is that household saving remains high even after the harsh lockdowns are lifted and the recession has ended. This would drag on the recovery.

- **Involuntary rise in saving:** The rate of household saving normally rises during a downturn – see chart. Households prefer to hold more cash as a precaution. The current recession is different, though. The lockdowns to contain the virus have triggered an involuntary rise in saving. Not much can be done about that. If the shops are closed, we cannot spend. It suggests, however, that the ongoing surge in saving will be much higher than during past recessions – the involuntary component will add to the likely rise in precautionary saving.

- **How high will the rate saving rate remain?** With luck, the inability to spend now will lead to an excess build-up of cash above that which households would actually prefer to hold. If households spend some of this extra cash in order to bring down their liquid balances – to still elevated levels reflecting the precautionary component – it would help to speed up the economic recovery. But whether that happens or not depends on future developments in household confidence. With two key major risks on the horizon, the rebound in spending may disappoint.

  1) **Lockdown uncertainty:** Learning to live with the virus will involve disruptions to daily life well into next year. People will have a continued sense of anxiety. Even when some restrictions are lifted, people could remain reluctant to go out and spend. The risk that lockdowns could be re-imposed if a second wave of the virus emerges will hang over the economic outlook. Anecdotal evidence from China and Germany shows that consumption has remained soft despite the easing of the lockdowns. This will probably be the case in the UK too.

  2) **Brexit risks:** While persisting virus anxiety will be a problem for all of the hard-hit countries, the UK faces an additional risk. UK-EU talks on the future relationship are not going well, to put it mildly. An extension to the talks seems unlikely. The UK is adamant that it will leave the single market and customs union at the end of 2020. While a disorderly exit from the single market and customs union is not our base case, it is the big risk facing the UK. Noisy talks and the threat of a disorderly Brexit could encourage households to keep their savings rate high.

- **Fiscal policy for the long-haul:** If everyone decides to save for a rainy day, that rainy day will surely come. This is the paradox of thrift. Too much precautionary saving risks depressing economic activity, employment and incomes even further. The recovery depends on a rise in demand. This is where policy makers come in. If private saving remains high even after the lockdowns are eased, even more deficit spending will be necessary to promote an economic recovery. Policy markers should be prepared to offset excess private sector saving with public sector dissaving, ie deficit spending. Lowering deficits will only be safe once private demand is on a sustained rebound.
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