Global Strategy Weekly

Jan 2008 is here again! UK and US household debt excess comes full circle

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Very recent data confirms slumping household saving ratios in both the US and UK. This was last seen in 2007, just before the bursting debt bubble blew the global economy and financial system to smithereens. The Fed and BoE should surely hang their heads in shame having presided over yet another impending disaster. Why will politicians and the people tolerate this incompetence? Indeed they won't.

- I'm genuinely getting tired of bashing the major central banks, but every day more evidence mounts that almost exactly the same debt excesses that caused The Global Financial Crisis (GFC) in 2008, are present today. The UK Bank of England and US Federal Reserve deserve particular vilification for failing to remove the monetary punchbowl quickly enough – just like the 2003-2007 period, allowing grotesque debt excesses to build.

- The US has just this week seen substantial downward revisions to its household saving ratio (SR). Some 1½% has been lopped off recent estimates, taking the SR down from a respectable 5½% to just 3.8% - levels seen just before the last recession. The UK has also recently published some shockingly low household SR data, showing a slump in Q1 to only 1.9% (see chart). **Actually the UK's situation is worse than it looks relative to the US SR if you measure it on the same basis** (see chart below). The US measures household income and savings *net of depreciation* – mainly of the housing stock. If you add this back (as the UK does), the US household *gross* SR is some 3% higher!

- At 7%, the US *gross* SR looks positively Germanic for its high level compared to the UK! But it is still disturbingly low relative to US history. In addition, the sharp 2% decline over the last year has helped to sustain what has only been moderate consumer spending and GDP growth at a time when real wages have been squeezed.

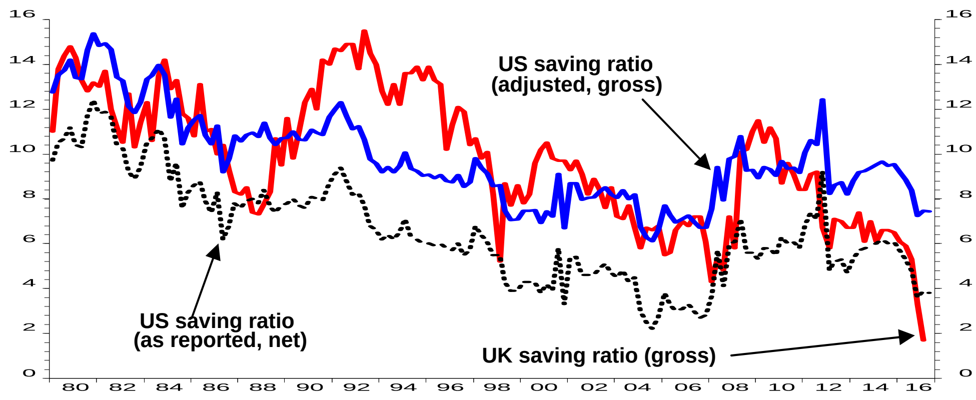
- The UK has also only sustained moderate GDP growth via a total collapse in the SR to unprecedented historical lows, but also relative to the levels of the credit crazy US. The BoE recently warned of "spiral of complacency" about mounting consumer debt. But, of course, there is no acknowledgement of its own pernicious role in this unfolding disaster.

Global asset allocation

%	Index	Index neutral	SG Weight
Equities	30-80	60	30
Bonds	20-50	35	50
Cash	0-30	5	20

Source: SG Cross Asset Research

Large declines in the SR are typically followed by large recession-inducing rises.



Source: Datastream

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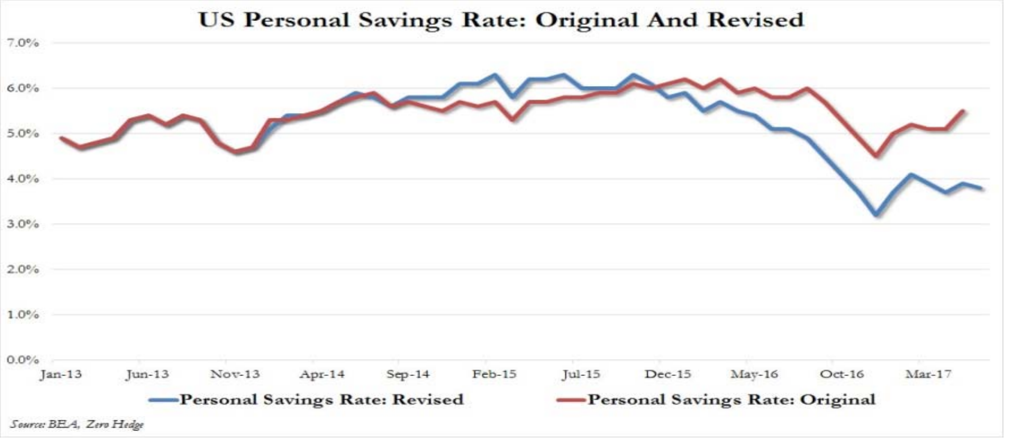
The US Bureau of Economic Analysis has this week undertaken some revisions of the US saving ratio (SR). Actually it has revised both income (downward) and expenditure (upward). And as the SR is the difference between these two very large numbers, it can be severely affected by small changes in income or spending. The new data shows the US SR actually declined from 6% to 4% through 2016 (see chart below) and undoubtedly stopped the US economy sliding into recession in the second half of last year as real household incomes suffered a severe squeeze due to rising headline CPI inflation.

Substantial downward revisions to the US SR over the last year

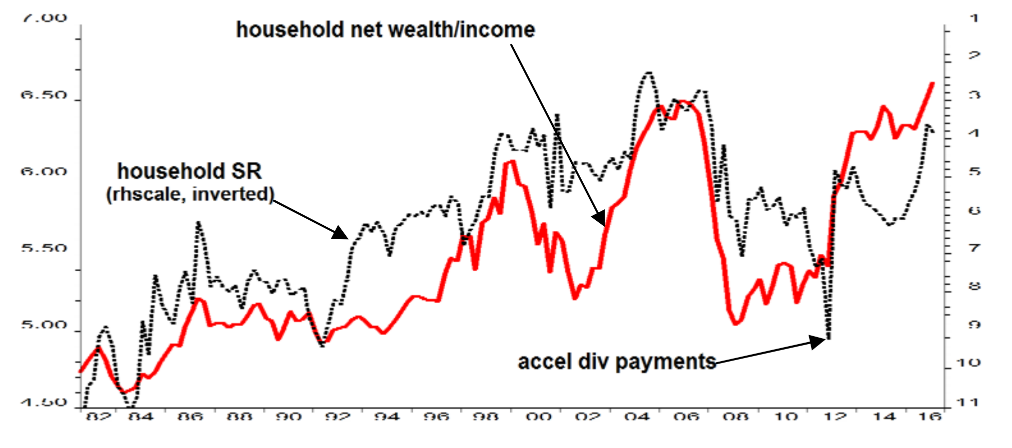


Source: Zero Hedge

We have previously highlighted on these pages that we believe it will be the US corporate sector borrowing binge that will take centre stage in the next credit crisis. Until this latest SR data we *had* been less concerned about the situation in the household sector. US household mortgage borrowing, comprising some two-thirds of total household debt, remained subdued in the wake of the 2003-2008 boom and bust. Indeed it is only in the last six months that the Fed Z1 Flow of Funds data shows mortgage borrowing growth has managed to crawl above 3%, compared to six years of double-digit growth in the run up to the 2008 bust. By contrast it has been consumer credit that has boomed at a 6-7% growth rate for the last five years, well in excess of that seen in the run-up to the 2008 bust, led by student and auto loans.

But the Fed has had its way. QE has not only inflated corporate debt to grotesque levels, but finally the US SR has responded to the surge in household paper wealth that QE has produced (see chart below). Typically the SR always declines (shown as a rise in the chart below) with rising wealth. Why do you need to bother saving if interest rates are close to zero and house and stock prices are rising? (Maybe some residual caution of the household sector is apparent as the SR has *not* fallen to a new low despite record high net wealth).

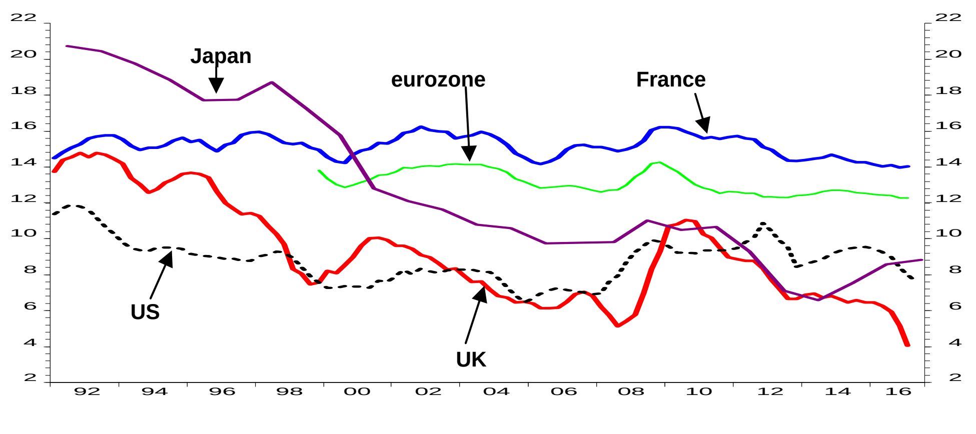
The rise in US net wealth is closely associated with swings in the SR



Source: Datastream

When I worked at the Bank of England Economics Department (between 1983-86), I was allocated the Household Sector to monitor. I could bore for Britain on the UK SR (and much else besides). But a quick look at the OECD annex tables will inform that only the UK, France and Portugal record their household saving ratio *gross* of depreciation. Eurostat usefully converts all European SRs to a gross basis but the county data is not timely – link. We show below just how extreme the current UK situation is relative to other SRs, all measured on a gross basis. Huge swings in the SR (representing credit booms and busts) are most apparent in the UK – especially relative to the stability of somewhere like France. But the recent decline in the UK SR is almost without historical precedent. It is a credit disaster waiting to happen.

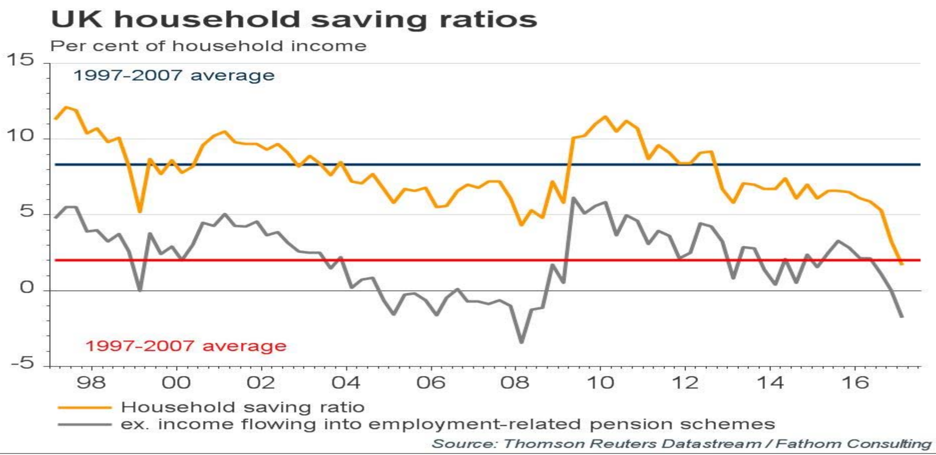
Gross household saving ratios (4 quarter moving average)



Source: Datastream

As a SR bore I am fully aware of the imperfections of the above UK SR measure and that there are alternatives (see chart below and link). But whatever way you look at it, the recent extreme decline in the UK SR is still intact. It is laughable that the BoE now warns of "a spiral of complacency" – link. The bank is in denial that ***it is itself*** the midwife of any impending credit bust. Instead of tinkering with qualitative controls it, like the Fed, should have unwound QE and normalised interest rates long ago. If credit growth has gone out of control it is 100% its own responsibility. Only in recent weeks has the market seen a glimmer of chance that the BoE might tighten, but with the composition of the voting committee shifting towards more doves, I will believe it when I see it. It is too late anyway. The seeds were sown long ago and have now grown into a field of barbed thistles.

Other measures of the UK SR show it yet to fall below 2008 lows, but still declining sharply



Source: Datastream, Fathom Consulting

For those readers who think I bang on about the same theme *ad nauseam*, I attach a 1992 article from the FT! It shows how the situation the UK is now in has been experienced again and again. Back then an extensive period of robust GDP growth during PM Margaret Thatcher's tenure proved to be yet another credit boom that turned to dust. At the height of what was dubbed the "Lawson Boom", after then Chancellor Nigel Lawson, the ensuing borrowing binge drove a decline in the saving ratio by a massive 6% to a low in 1997. After a credit boom comes the inevitable bust as the SR then rose sharply from these extreme lows – culminating in the UK's ignominious departure from the ERM in September 1992.

Nothing much has changed, and history suggests that **when UK SR (measured *gross*) declines to, or below, the US SR (measured *net*), as we saw in 1987 and as we see now (see front cover chart), we in the UK are sitting on a massive credit bubble that is primed to burst with recessionary consequences.** Alarm bells will be ringing all around the Bank of England – but it is too late. (Incidentally note the author of the 1992 FT article below is Ed Balls, who went on to become a significant figure in Tony Blair's Labour government as Gordon Brown's chief economic confidant. More recently he has starred in the UK Strictly Come Dancing (Dancing with the Stars to our US friends). By contrast I am still a sell-side Global Strategist and some 25 years later, still comparing the UK SR to the US! Hey ho.)

Kleinwort Benson Group

PRESS CUTTINGS

FINANCIAL TIMES

MONDAY NOVEMBER 16 1992

Unpicking the US and UK savings paradoxes

BOTH THE US and Britain, according to conventional economic wisdom, have savings problems. But is their shared problem too much or too little saving? The answer, confusingly, is that both statements are true.

The depth of the UK recession, and the failure of economic forecasters to predict its lingering nature, is largely explained by the uncharacteristic willingness of consumers to save rather than spend. Since 1988, the UK household savings ratio has doubled from a 1980s low of 5.1 per cent to 11 per cent in the first quarter of 1992. This occurred because consumer borrowing, which counts as negative saving, has dropped sharply.

The UK personal savings ratio is still lower than its main European competitors although it is now roughly comparable. The household savings ratio in 1991 was 13.7 per cent in Germany, 12.7 per cent in France and 15.6 per cent in Italy.

The US, according to the released data, has a much lower household savings ratio. According to the latest data, the US household savings ratio was a mere 4.5 per cent in the third quarter of this year, down from 5.3 per cent in the previous quarter but still well above its 1980s low of 3.1 per cent in 1987. The implication is that US consumers cannot increase their consumption as much as can UK consumers by reducing their rate of savings.

Yet this transatlantic comparison is misleading. The US household savings ratio refers to personal savings and income, net of depreciation charges, rather than to gross savings and income as is the normal practice in Europe. In 1990, the US authorities deducted $229m (£151.6m) to cover the depreciation of fixed household assets, equivalent to 6 per cent of total consumption. Half of this depreciation applies to the decline in the imputed value of housing wealth.

Mr Albert Edwards, an economist at Kleinwort Benson Securities, the investment bank, has calculated the gross US household savings ratio by restoring these depreciation charges. His adjusted US gross savings ratio is shown in the left-hand chart.

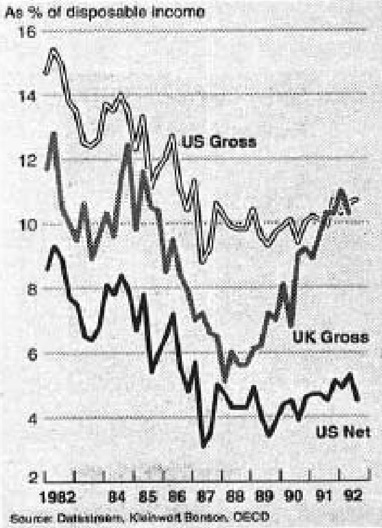
The UK gross household savings ratio has, in fact, been converging on US levels in recent years. UK gross household savings fell much further than US savings in the 1980s but have since caught up. The US gross ratio was 10.7 per cent in the third quarter of this year while the latest UK figure was 10.3 per cent in the second quarter. Both countries need a fall in household savings to fuel recovery.

Yet the medium-term economic performance of both countries has been hampered by too little national savings, not too much. National savings is the sum of private and public saving. The US government has been a net borrower throughout the 1980s while the UK government is expected next year to have twice as large a budget deficit, relative to the size of its economy, as the US.

In theory, there should be little relationship between rates of national savings and investment so long as low-saving countries are free to borrow internationally. In fact, the correlation between national savings and investment over the past 30 years is strong, as the right-hand chart shows. High saving countries have tended to invest a higher share of their national output, a relationship that has persisted throughout the 1980s. That is why the new US administration aims to raise the US national savings rate, and why that means tackling the budget deficit.

Edward Balls

UK & US household savings



Source: Datastream, Kleinwort Benson, OECD

National savings & investment