# The Household Saving Ratio

After falling for more than two decades, the aggregate household saving ratio in Australia increased sharply in the latter half of the 2000s (Graph B1). While it has since remained close to 10 per cent – which implies that, collectively, households have been saving about 10 per cent of their incomes – the saving ratio has declined modestly over the past three years or so. Understanding developments in the saving ratio is important because changes in household saving behaviour can have implications for the outlook for aggregate consumption.

Graph B1
Household Saving*
Per cent of household disposable income
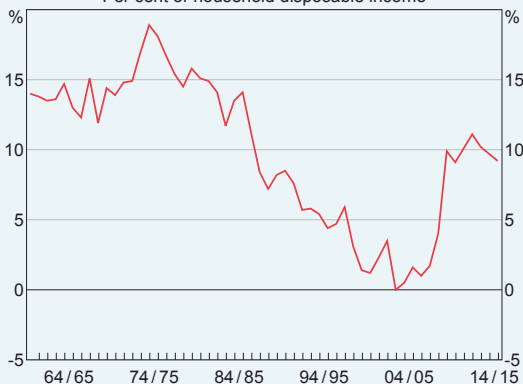
* Household sector includes unincorporated enterprises; net of depreciation
Source: ABS

Households save for a number of purposes: to fund their retirement; to make sizeable purchases (such as buying a house); or to insure against an unexpected loss of income. Central to these purposes is the notion that households typically prefer to smooth consumption over their lifetime. This means that households tend to save more when their income is high relative to the average income they expect over their lifetime. For example, households tend to save more during their working years than in retirement. They also tend to save more of any increase in income if they believe it to be temporary – for instance, due to bonus payments or extra hours of work. However, households with restricted access to credit or on especially low incomes may find it difficult to smooth their consumption.

Trends in the household saving ratio in Australia over recent years are likely to reflect a range of factors, including the effect of the boom in commodity prices and mining investment on household incomes, behavioural changes stemming from the global financial crisis, and the current low level of interest rates. Longer-term factors such as financial deregulation and population ageing have also played a role.

The boost to household incomes associated with the resources boom is one factor that might have contributed to the rise in the saving ratio over the 2000s.[1] The substantial rise in commodity prices and the expansion of resource production capacity was accompanied by very strong growth of household incomes, particularly wage and salary income for households in the resource-rich states of Western Australia and Queensland (Graph B2). The rise in the saving ratio over this period was also most pronounced in these states. This suggests that households could have perceived some of the boost to their incomes to be temporary and responded by raising their rate of saving. As commodity prices have fallen and

1 The channels through which commodity price changes have affected household incomes are described in Gorajek A and D Rees (2015), 'Lower Bulk Commodity Prices and Their Effect on Economic Activity', RBA *Bulletin*, September, pp 31–38.

the mining investment boom has transitioned to the production phase (which requires relatively less labour), household saving ratios in Western Australia and Queensland have declined, allowing households to maintain higher consumption than otherwise.

Graph B2
Household Saving and Income*
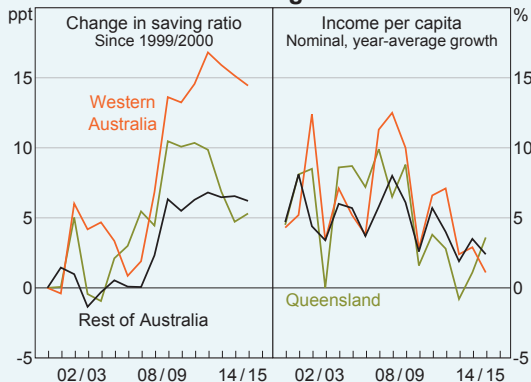
*   Household saving and disposable income are measured gross of
      depreciation, owing to data limitations at the state level
Sources: ABS; RBA

The global financial crisis may have contributed to the increase in the saving ratio in the latter half of the 2000s partly because it resulted in a sharp fall in the prices of equities and other assets. Since households typically rely on their accumulated stock of wealth to fund consumption in retirement, they may have increased their saving ratio during and after the financial crisis to rebuild their wealth. This motivation would have been especially relevant for retired and soon-to-retire households, which usually have more assets and fewer remaining years of labour income with which to rebuild lost wealth. The financial crisis may also have reminded households about risks associated with a low saving ratio and rising indebtedness that had characterised the period up to the mid 2000s.

Households' expectations about future income growth and asset valuations, and the uncertainty around those expectations, are also relevant to their saving decisions. Many households accumulate precautionary savings to insure against an unanticipated loss of future income or unexpected expenditure (such as on a medical procedure). At the macroeconomic level, precautionary saving is likely to be particularly important if households are very risk averse or constrained in their ability to borrow to fund consumption when their incomes are temporarily low. For example, the financial crisis is likely to have made households more uncertain about their future employment or income growth and/or led them to reassess their tolerance for risk, which would have encouraged them to increase their rate of saving. Surveys at that time showed an increase in the share of households nominating bank deposits or paying down debt as the 'wisest place for saving', although this may have also reflected lower expected rates of return on other financial assets following the financial crisis.

The level of interest rates can also influence the saving ratio. On the one hand, the current low level of interest rates reduces both the return to saving and the cost of borrowing, which encourages households to bring forward consumption; this might explain some of the recent decline in the aggregate household saving ratio. Low interest rates also support the value of household assets, which increases the amount of collateral households can borrow against, and potentially reduces the incentives for households to save. On the other hand, the household sector in aggregate holds more debt than interest-earning assets, so cyclically low interest rates provide a temporary boost to disposable income through a reduction in net interest payments, some of which may be saved. Households also need to save more to achieve a given target level of savings when interest rates are low.

Structural changes to the Australian financial system have been important longer-term drivers of changes in household saving behaviour. Financial deregulation in the 1980s and a structural shift to low inflation and low interest rates in the 1990s allowed households that were previously credit constrained to accumulate higher levels of debt for a given level of income. This rise in indebtedness was accompanied by strong growth in housing prices and a reduction in the household saving ratio to unusually low levels. In this way households were able to support consumption via the withdrawal of housing equity.[2] Innovation in financial products – such as credit cards and home-equity loans – also gave households much better access to finance. The adjustment to these structural changes in the financial system appears to have largely run its course by the mid 2000s.[3]

The ageing of the population is another longer-term influence on the saving ratio. If shares of younger and older households in the population were constant over time, the different saving behaviours of these households would not affect the aggregate saving ratio. However, Australia's baby-boomer generation is a larger share of the population now and has been entering the retirement phase since around 2010 (Graph B3).[4] Because households save less in their later years, this is expected to have a gradual but long-lasting downward influence on the aggregate household saving ratio. However, a potentially offsetting influence is rising longevity, which may lead households to save more during their working years to finance a longer period of retirement.

Graph B3
Population Shares by Age
Per cent of total population

Source: ABS
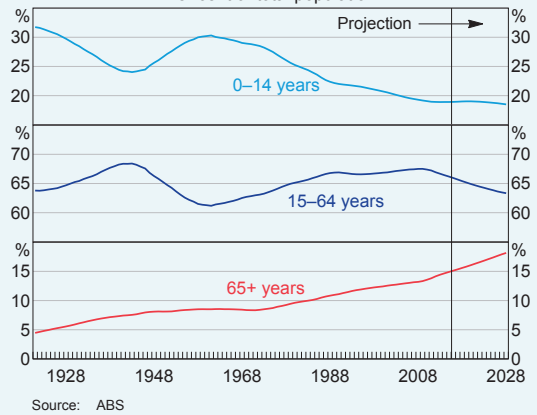
The amount that each of these drivers have contributed to recent trends in the aggregate household saving ratio is unclear. It is also uncertain how they will evolve over the next few years, although the Bank's central forecast embodies a further modest decline in the saving ratio, that reflects, in part, the unwinding of the impact on saving from the earlier boom in commodity prices and mining investment.

---

2   See Schwartz C, T Hampton, C Lewis and D Norman (2006), 'A Survey of Housing Equity Withdrawal and Injection in Australia', RBA Research Discussion Paper No 2006-08.
3   See Ellis L (2013), 'Housing and Mortgage Markets: The Long Run, the Short Run and the Uncertainty in Between', Address to the Citibank Property Conference, Sydney, 23 April.
4   See Kent C (2014), 'Ageing and Australia's Economic Outlook', Address to the Leading Age Services Australia (LASA) National Congress, Adelaide, 20 October.