RECOMMENDED READING

MPC MEMBERS

From: (SEAD)

KEY ISSUES FOLLOW UP: WHAT EXPLAINS A BIGGER FALL IN THE SAVING RATIO?

Question

- At Key Issues 1, Ben Broadbent asked why, in an accounting sense, the saving ratio falls by more than it did in August.

Main message

- **The steeper fall in the saving ratio in the November Draft forecast, relative to August, reflects lower income growth.**
- **There are a number of offsetting piece of news within the income data, but wages and salaries, employer pension contributions, government benefits and a residual element are all pulling down on income growth relative to August.**

1. The household saving ratio was projected to fall by 2.2 percentage points between 2015 Q2 and 2018 Q3 in the November Benchmark forecast compared to 1.5 percentage points over the same period in the August Inflation Report (Chart 1). And when combined with the fact that saving ratio is now estimated to have been 0.6 percentage points lower than expected in 2015 Q2, that means the saving ratio ended the forecast 1.3 percentage points lower than in August, although the gap was wider than that in late 2016/early 2017, peaking at 1.9 percentage points (Chart 2). Visually the extent of the fall in November was also affected by judgement added around dividend forestalling, which pushes up income and the saving ratio in the first few quarters of the forecast and subsequently leads to a sharper fall as it unwinds.

2. In the Draft forecast, the saving ratio has been revised up slightly, such that it now falls by 0.3 percentage points less than in the Benchmark (Chart 2). That upward revision to saving since Benchmark reflects lower consumption, there is little change in projected income growth. In the Draft forecast, the bigger fall in the saving ratio relative to August is now all accounted for by slower real income growth.[1]

Chart 1: Household saving ratio

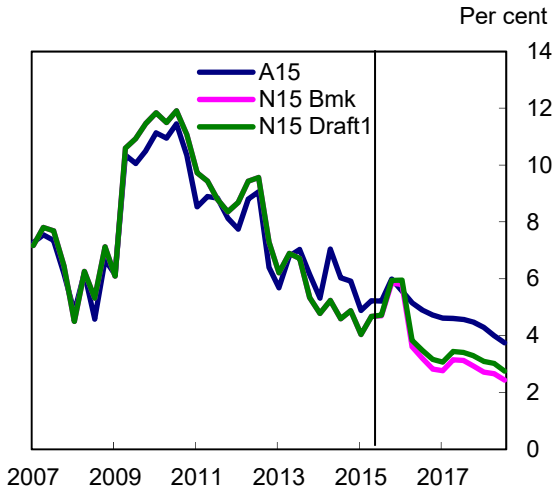
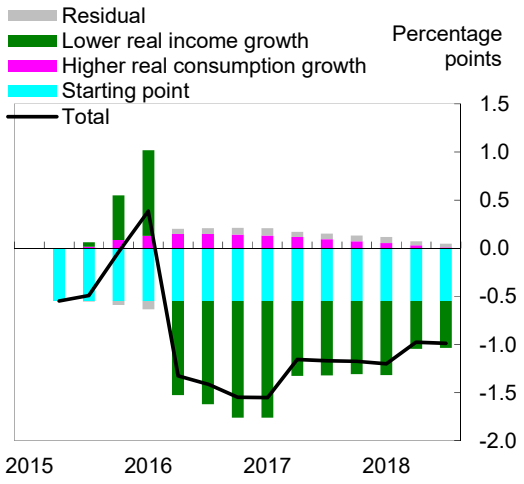


Chart 2: Contributions to change in level of saving ratio (August IR to November Benchmark)



[1] The saving ratio is actually calculated from nominal variables, although given the same deflator is used for both consumption and income it can also be derived from real variables. This note uses the real data because that is where our forecast discussions typically focus.

3. There are a number of offsetting pieces of news within the components of real household income over the forecast (Chart 3). Such changes are not unusual from round to round, but they do make it hard to identify any one component or story that can explain all of the news. The fact we are now using econometric model project some of the components of non-labour income could also result in more round on round changes, but over the past that model has outperformed the Inflation Report forecast, and so should represent an improvement.[2]

4. There are four components pulling down on income growth over the forecast, relative to August. The largest contribution is from slower growth in employer pension contributions. That largely reflects the fact that unusually weak recent data have been revised away, so less growth in this component of income is now needed to get back to the same level of employer pension contributions (Chart 4). The second element is lower wages and salaries growth. The third is lower government benefits, that mostly reflects a small downward revision to our nominal GDP growth forecast since August (we adjust the OBR forecast to allow for differences in our view on nominal GDP). The fourth and final factor pulling down income growth relative to August is that the real income residual is pulling down on income growth relative to August, as it now converges to a slightly lower level - this includes things like NPISH grants and some elements of net equity held in pension funds.

Chart 3: Contributions to news in level of real income beyond 2015 Q2

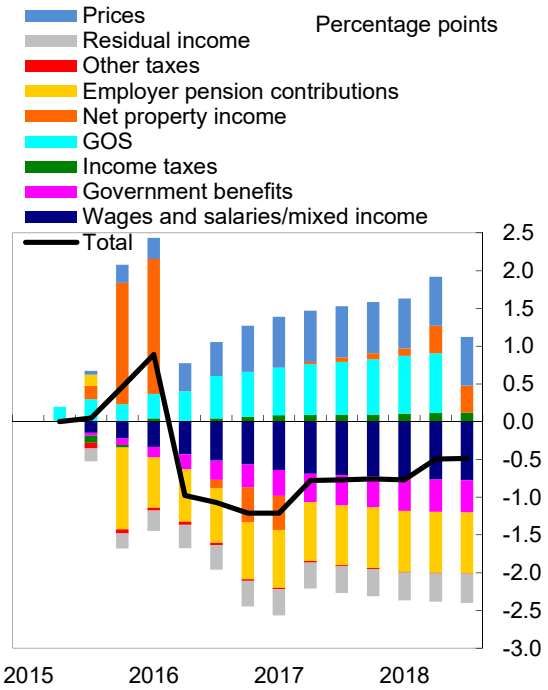
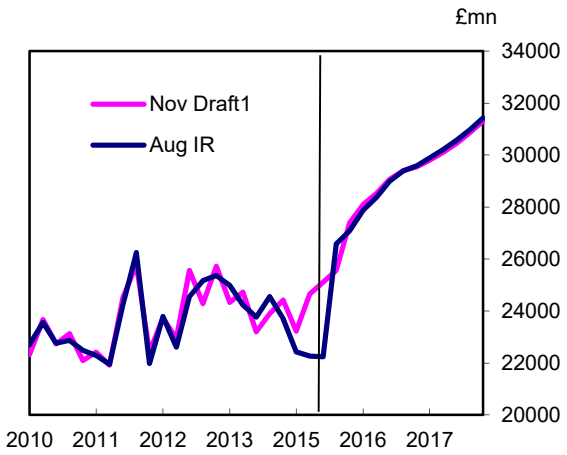


Chart 4: Employer pension contributions



[2] See for more details on this.