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News release

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The Changing Pattern of Savings - Speech by Andrew Sentance

Delivering the twelfth RBS Scottish Economics Society Annual Lecture in Edinburgh today, Andrew Sentance, a member of the Bank's Monetary Policy Committee, discusses the implications for growth and inflation of the changing pattern of savings. A common theme he draws out is the potential to rebalance the sources of demand growth, both at home and abroad.

He explains that since the mid-1990s UK households have been both purchasing more financial assets and taking on greater amounts of debt. But new borrowing has grown more rapidly, pushing down the personal saving ratio and boosting consumer spending. The inflationary stimulus from rapid consumption growth over the past decade was offset by slack in the labour market in the late 1990s and then by relatively weak growth of investment and exports. But recently some of these factors had become ".less helpful in containing demand and price pressures.".

As in other major economies, UK companies' savings have exceeded their investment in recent years. There are many potential explanations for this and at least part may reflect temporary factors. In response to high saving and healthy global demand, companies could increase their investment, which may bring inflationary risks. He says, "this reinforces the view that we may need to see more subdued growth of consumption (public or private) relative to the last decade, to allow a rebalancing of the economy".

Over the past two decades, China and other emerging Asian economies have significantly increased their contribution to global savings, broadly offset by a decline in the US share. Andrew Sentance argues that there are several competing explanations for these flows, which are associated with the emergence of significant current account imbalances. But, he says, "perhaps of more significance is whether an unwinding of these imbalances - if it occurs - is gradual and orderly or disorderly and associated with financial market turbulence". Although imbalances may have added to recent market volatility, "so far, there is optimism among the international institutions that an orderly unwinding can be achieved.".

Turning to the implications for monetary policy, he describes how recent interest rate rises and the downward impact of energy prices would help to bring CPI inflation back towards the target rate. But there are risks on both sides. Looking forward, he highlights the potential for some rebalancing of domestic expenditure, with slower growth in consumption than over the past ten years offset by higher growth in investment. He says, "the conditions which ensured that such strong consumption growth was compatible with low inflation may not be sustained into the future" and "a continued surge in capital investment would require some further restraint in other components of demand - notably consumer spending - if it is to be compatible with low inflation".

While global imbalances persist, there is an associated risk of disorderly unwinding. He believes ".while this risk exists, we may see periodic bouts of financial market nervousness". While financial market turbulence can affect demand prospects, he warns that ".the appropriate response of monetary policy depends on the prevailing demand conditions. There is also the risk of repeating the mistakes of 1987, when loosening of monetary policy in response to falling stock markets was overdone and provided a further boost to the late-1980s demand-led boom".

http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2007/speech304.pdf