The personal sector 1966–1975

An article on 'Personal saving and financial investment: 1951–65' in the September 1966 issue of the *Bulletin* noted that the marked rise in the saving ratio and the consequent increase in the personal sector surplus during that period were linked with economic growth. The present article surveys developments during the subsequent decade: after changing little on balance for several years, the saving ratio and the surplus began to rise sharply again in the early 1970s, even though the economy grew more slowly than in the earlier period.

'Personal sector' is defined in this article as in the flow of funds accounts. It includes not only individuals but also unincorporated businesses and private non-profit-making bodies.

The article discusses in turn: saving by the sector; its capital expenditure; the surplus resulting from the excess of saving over capital expenditure; the interaction of the surplus with the deficits of other sectors; borrowing by the sector; and the use of the surplus and borrowed funds to acquire financial assets.

Saving

Table A shows income, expenditure and saving by the personal sector over the period, expressed in nominal money terms, together with the corresponding saving ratios.

It can be seen that saving increased both absolutely and in proportion to incomes from 1972 onwards. After remaining around 8%–9% in the preceding six years, the saving ratio then rose in each of the following three years to about 14% in 1974 and in 1975.

In interpreting the statistics, one problem arises from the inclusion within the personal sector of unincorporated businesses. Although income from these businesses has generally been less than 10% of total personal income, their share of total personal saving has been greater. A proportion of such saving is the counterpart of stock appreciation which, unlike the rest of savings, is not available to buy additional physical or financial assets. So by deducting stock appreciation and provisions for capital depreciation from total personal saving, a broad estimate of saving by individuals or 'households' can be obtained. This is shown in Table B as a percentage of personal disposable income.

The table shows that this particular saving ratio followed broadly the same pattern as the overall saving ratio, changing little until 1972 and then rising markedly.

Part of household saving is contractual, either to finance future expenditure (e.g. contributions to life assurance and pension funds)[1] or to repay debts already incurred (such as mortgage debt and hire-purchase obligations). Chart A shows that, as a proportion of personal disposable incomes, the main forms of contractual saving have remained fairly stable while the overall saving ratio has risen sharply. The largest changes have thus occurred in non-contractual saving.

However, the rise in saving has not led to faster growth in the personal sector's real financial wealth. Indeed, since 1971 inflation has eroded the real value of wealth, whereas in the earlier years under review the real stock of wealth had been broadly unchanged.[2] Recent research (see, for example, the March 1976 *Bulletin*, page 53) has suggested that the sharp increase in the personal saving ratio has been partly in reaction to this decline: in particular, people may have

Table A

£ millions

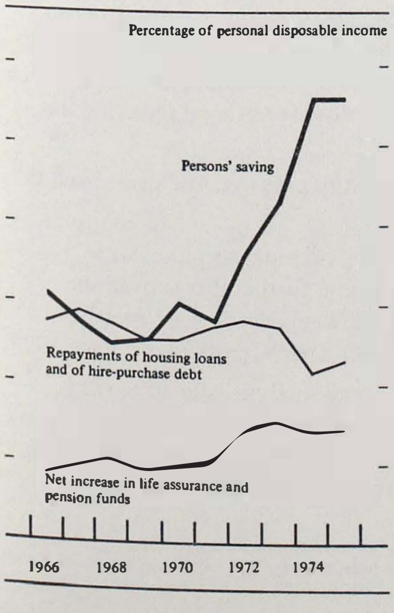
	Total personal disposable income	Consumers' expenditure	Personal saving (1)–(2)	Personal saving as a percentage of total personal disposable income
	(1)	(2)	(3)	(4)
1966	26,655	24,211	2,444	*9·2*
1967	27,798	25,428	2,370	*8·5*
1968	29,701	27,338	2,363	*8·0*
1969	31,663	29,102	2,561	*8·1*
1970	34,766	31,644	3,122	*9·0*
1971	38,454	35,165	3,289	*8·6*
1972	44,229	39,716	4,513	*10·2*
1973	50,954	45,044	5,910	*11·6*
1974	60,305	51,832	8,473	*14·1*
1975	73,751	63,373	10,378	*14·1*

Table B
Saving ratio: 'households'[a]

	Percentages
1966	8·1
1967	7·5
1968	6·7
1969	6·8
1970	7·6
1971	7·1
1972	8·8
1973	9·7
1974	11·7
1975	12·0

[a] Personal saving as a proportion of personal disposable incomes, after allowing for stock appreciation and depreciation of capital stock (other than houses).

Chart A



[1] Personal savings in the national income accounts include the increase in these funds stemming from the excess of contributions (including those by employers), premiums and income from other investments and property over pensions, other benefits and administrative costs.

[2] Balance sheets for the estimated value of assets held by the personal sector at the end of 1971, 1972 and 1973 can be found in Table 27 of Report No. 1 of the *Royal Commission on the Distribution of Income and Wealth*. Further work is being done for the Royal Commission on the compilation of balance sheets for the personal sector.

increased their savings in order to maintain the value of the liquid assets which they hold available against possible expenditure. Alternatively, or additionally, people may have spent a smaller proportion of their incomes on consumption because they were more conscious of higher prices than of their own higher incomes.

The growth in saving during the period should not in any case be interpreted in isolation from other transactions recorded in the financial accounts. For example, in 1973 both capital expenditure and borrowing for house purchase not surprisingly rose together. For a given surplus, the larger the borrowing, the more financial assets that can be acquired; for a given amount of saving, the more capital expenditure that is undertaken, the more the sector will have to borrow if it is to acquire a certain amount of financial assets.

Capital expenditure

Because of the heterogeneous nature of the personal sector, its capital expenditure should also be divided between households and the rest of the sector (i.e. unincorporated businesses and private non-profit-making bodies).

Within the total, there was a large increase in spending on houses – not surprisingly in view of the rise in house prices during the period, the spread of owner-occupation, and the imposition of capital gains tax on other assets after 1965. Spending rose particularly fast in 1971, 1972 and 1973, when house prices increased on average by 15%, 30% and 35% respectively (compared with an average rise of about 13% per annum for the whole period 1966–75). The remainder of the sector's capital spending is mainly by unincorporated businesses, e.g. farmers and shops – and consists of the acquisition of productive equipment, and increases in the value of stocks and work in progress. The stock appreciation element of capital expenditure rose rapidly after the turn of the decade.

The personal sector surplus

Table C gives annual figures for the personal sector surpluses resulting from the excess of saving over capital expenditure and net capital transfers by the sector.

Thus, the surplus of the personal sector – like its total saving – rose steeply in the last three years, and the sector became a more important supplier of funds to the rest of the economy.

Interaction of the personal sector with other sectors

Flow of funds analysis emphasises the interdependence within the financial system of its various sectors – public, personal, overseas and corporate (both industrial and financial). A sector in surplus must in principle be balanced by another (or others) in deficit, because the receipts of one sector are the payments of others, and no one sector can spend less than it receives without another (or others) receiving less than it spends.[1]

Table D shows the personal sector surpluses over the period and their counterparts in the other sectors.

In contrast to 1951–65, when rising personal surpluses were matched by a decline in corporate saving, further increases in the personal sector surplus during the following decade were mostly matched by an expanding public sector deficit, particularly since 1972.

The essential purpose of flow of funds analysis is to trace the channels along which funds flow to finance the sectoral surpluses and deficits. However, the quality of the statistics is far from perfect: the sectoral surpluses and deficits derived from the national income

[1] A full description is given in the handbook *An introduction to flow of funds accounting: 1952–70* (Bank of England, 1972); this includes (on page 4) a section on the interaction of the personal sector with other sectors.

Table C

£ millions

	Personal saving	Capital expenditure plus net capital transfers by the personal sector	Personal sector surplus
	(1)	(2)	(1)–(2)
1966	2,444	1,296	1,148
1967	2,370	1,437	933
1968	2,363	1,715	648
1969	2,561	1,776	785
1970	3,122	1,855	1,267
1971	3,289	2,489	800
1972	4,513	3,167	1,346
1973	5,910	3,420	2,490
1974	8,473	3,265	5,208
1975	10,378	4,078	6,300

Table D
The personal sector surplus and its counterparts[a]

£ millions

Surplus +/deficit –

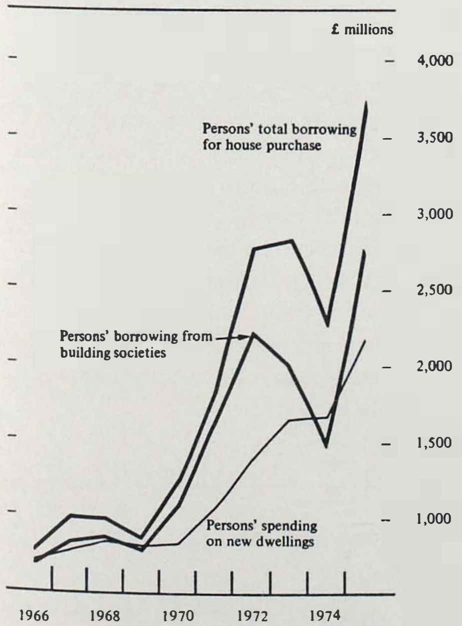
	Personal sector	Public sector	Industrial and commercial companies	Financial companies	Overseas sector
1966	1,148	– 968	– 141	– 74	– 101
1967	933	–1,645	169	– 97	298
1968	648	–1,138	228	–224	272
1969	785	335	– 77	–468	– 460
1970	1,267	708	– 759	–392	– 733
1971	800	– 311	499	–285	–1,084
1972	1,346	–1,718	1,136	–229	– 154
1973	2,490	–2,904	469	–523	752
1974	5,208	–5,265	–2,500	–700	3,365
1975	6,300	–8,257	370	–959	1,616

[a] Financial surpluses or deficits for all sectors combined do not in practice sum to zero, although in principle they should do so. The discrepancy arises because the respective estimates of gross domestic product derived from income sources and from expenditure sources do not match. The net total of the 'unidentified' entries for all sectors is the counterpart of this discrepancy (the residual error).

statistics cannot be matched at all closely with the net change in financial assets and liabilities derived from financial accounts. This is especially true of the personal sector, for which an erratic – but generally large and almost invariably negative – unidentified item has to be recorded each year in the flow of funds accounts to complete the reconciliation of the figures; otherwise, recorded net acquisitions of financial assets would exceed the sector's surplus. In some years (e.g. 1969), unidentified transactions have been larger than the sector's surplus (see Table F on page 33).

This difference cannot yet be satisfactorily explained. The unidentified item is, by convention, recorded in the financial accounts, but it reflects errors and omissions both in these accounts and in the national income statistics. Among financial transactions, one such omission is unrecorded trade credit: assuming that persons are net takers of trade credit from companies, this would constitute a liability of the personal sector and hence give rise to a negative sign under their unidentified transactions; there will be a corresponding positive unidentified item in the accounts of industrial and commercial companies. The financial accounts also fail to identify several other items, e.g. unrecorded loans granted by employers. However, omissions and inaccuracies are equally likely to occur in the national income statistics. A negative unidentified figure could result from underestimating saving or overestimating capital expenditure, as well as from overestimating financial assets acquired or underestimating financial liabilities incurred.

Chart B



Borrowing by the personal sector

Persons acquire assets with borrowed funds, as well as by running a financial surplus. The largest lenders to the personal sector during the period under review were building societies, banks, finance houses and shops.

Borrowing from building societies and other sources to finance house purchase rose every year apart from 1968, 1969 and 1974 (see Chart B). The large increase in such borrowing in the early seventies was associated with rapidly rising house prices; indeed, the unusually sharp rise in prices in 1972 may even in part have resulted from heavy lending by the building societies during that year.

The personal sector's borrowing from banks rose steeply in the early seventies, after remaining fairly subdued in the second half of the sixties. In the period of restraint following the devaluation of sterling in 1967, bank lending to persons was not only restricted by the quantitative ceilings on total bank lending, but also received low priority within the directional guidance given to banks. However, in 1971 a new approach was adopted by the authorities, under which credit was to be rationed mainly by cost rather than by administrative control; aggregate ceilings on bank lending were accordingly suspended, though the authorities retained the option of giving directional guidance.

In 1972 bank lending to the personal sector increased by more than £2 billion, and the amount outstanding had reached over £7 billion by the end of 1973. Part of this increase was a once-for-all adjustment following the suspension of ceilings on lending: banks were quick to develop business forgone under the earlier controls. They were greatly assisted in this by the restoration (in April 1972) of income tax relief for interest paid on loans besides those for house purchase or improvement. In September 1973, however, the authorities reinforced qualitative guidance to the banks, requesting them to give priority to lending for manufacturing and export industries, and to restrain the provision of credit to persons; and in December 1973 the supplementary special deposits scheme was introduced. In the following year, tax relief was again withdrawn from interest on loans other than for house purchase.

In 1974 and 1975 persons' bank borrowing fell steeply in real terms – and declined even in nominal terms in 1975. Such a sharp turn-round, after the rise in earlier years, cannot adequately be explained by the reimposition of restrictions on borrowing, especially as inflation was accelerating during this period. The withdrawal in 1974 of tax relief from interest on loans was probably an important influence, especially on those in high tax brackets; and persons may also have sought to restore their net liquidity to some desired relationship with incomes and expenditure (see the March 1976 *Bulletin,* page 53).

Consumer credit extended by deposit-taking finance houses was also subject to quantitative control in the second half of the sixties and, more particularly, to hire-purchase controls. The latter were widely used as an economic regulator before 1970, to restrain consumer spending.

Under the new approach mentioned above, ceiling controls on finance house lending were abolished in 1971, and terms controls were also suspended; the amount of debt outstanding with retailers and, finance houses rose sharply (by 80%) between 1970 and 1973. Hire-purchase controls were then reintroduced in December 1973 as part of a general tightening of fiscal and credit policy – similar restrictions were applied to bank loans for the purchase of consumer durables – but were eased again two years later.

Lending to the public sector

As has been mentioned, the main counterpart of the growth in the personal sector surplus during the period was a rise in the deficit of the public sector – central government, public corporations and local authorities. In order to fund the public sector deficit in a non-inflationary way, the authorities have sought to obtain as much finance as possible from outside the banking system; and, to ease their continuous refinancing problems, they have also sought to borrow through long-term instruments as well as through short-dated ones (e.g. Treasury bills). Such borrowing from persons was both indirect and direct.

The growth in the funds of life assurance and pension schemes is treated in the statistics as personal savings, matched by the acquisition of claims by the personal sector on financial intermediaries; the employment of these funds by investment managers is recorded within 'other financial institutions'. Thus, to the extent that these institutions (and others, such as building societies, which receive almost all of their funds from the personal sector) invest in public sector debt, persons are financing the public sector borrowing requirement in an indirect way. Net transactions in British government stocks – the main vehicle for such investment – are shown in Table E.

Table E

£ millions: cash values

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Net transactions by:										
Insurance companies' life funds, including pension funds run by such companies	28	219	127	120	84	417	255	296	116	1,149
Building societies	62	124	– 48	81	215	372	– 38	62	61	641
Pension funds and property unit trusts	38	62	15	– 3	– 21	296	15	189	87	929
All financial institutions other than banks	126	502	38	285	321	1,415	422	703	309	3,358

Direct financing during 1966–75 was provided largely by purchases of gilt-edged, national savings, and local authority bonds and deposits.

Persons' transactions in gilt-edged are derived as a residual after net transactions by other sectors have been identified as far as possible. The pattern changed between the two halves of the decade under review (see Table F on page 33): net sales of £600 million between 1966 and 1970 were followed by purchases of £2,700 million in the later period, when both the personal saving ratio and the public sector borrowing requirement rose sharply. One reason for this change was the exemption from capital gains tax in April 1969 of gilt-edged stocks held for over a year. Moreover, in the years since 1973 the yield on gilt-edged improved in relation to that on other assets; demand was especially strong in periods when inflationary expectations were probably revised downwards and when the implied fall in nominal interest rates offered the prospect of capital gains.

The net inflow from the personal sector into national savings media also varied considerably from year to year. For example, from 1966 to 1970 there were actually net withdrawals from national savings. These fluctuations partly reflected variations in the competitiveness of yields on national savings compared with those on other investments, e.g. short-dated gilt-edged. Because the return on national savings instruments has been adjusted only slowly, purchases by the public have been light when market rates have risen, and increased when rates have fallen, notably in 1971 and 1972. Also, purchases of national savings certificates were largest in years when new issues were introduced, with yields usually more attractive than those on existing certificates.

After the committee to review national savings (the Page Committee) reported in 1973, rates offered on national savings became rather more competitive (relative to other outlets for personal savings). This, together with the rise in the saving ratio and the issue of new types of national savings instruments – index-linked Save-As-You-Earn and index-linked retirement certificates – all contributed to the larger average inflow into national savings during the 1970s.

Lending to the corporate sector

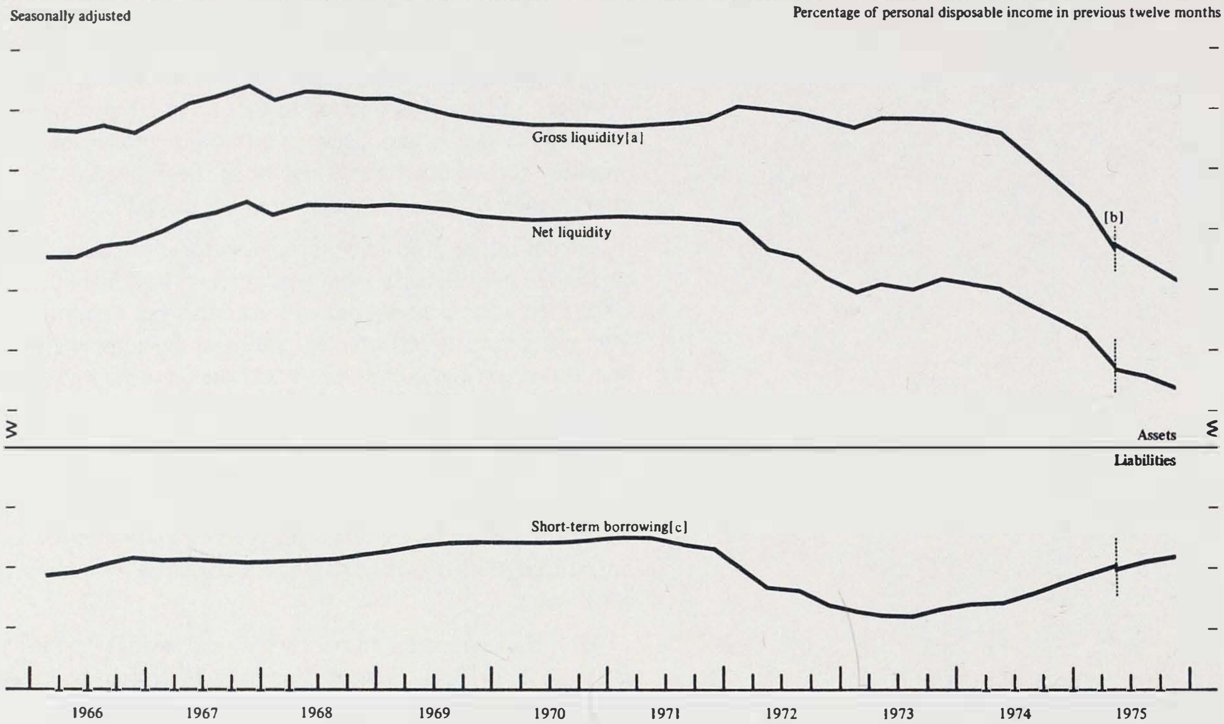
As Table D suggests, companies have not needed to borrow as heavily from the personal sector as the public sector has. Where persons have provided finance, it has not generally taken the form of direct acquisition of equities and debentures (the latter were a relatively minor source of finance for companies in most of the period under review). Instead, funds have been channelled through financial institutions, in particular, life assurance funds, pension funds, and unit trusts. These institutions have taken up most of the new issues made by companies as well as buying existing securities from persons.

The personal sector has been a continual net seller of UK company securities since the early sixties. In one year – 1973 – sales of such securities amounted to no less than £2 billion. There are several reasons for this persistent selling. Individuals may have sold shares to meet estate duties, or because of tax changes (e.g. the introduction of capital gains tax in 1965 and the surcharge imposed on unearned income in 1974), or because of the periodic imposition of dividend controls. In the seventies, selling may have reflected disillusionment with equities as a hedge against inflation. The relative advantages (tax or otherwise) of alternative investments such as annuities, life assurance, government securities, and house purchase have also probably played a part. Finally, for small savers, unit trusts continued to provide an alternative to direct holdings of equities, allowing individuals to diversify risks while investing relatively small amounts.

Acquisitions of liquid financial assets by the personal sector

In each year between 1966–75 persons added substantially to the nominal value of their stock of liquid assets (see Table F on page 33). Nevertheless, their liquidity (both net and gross) fell sharply as a proportion of personal disposable incomes in 1974 and 1975 (see Chart C). In the same period, the real value of the sector's liquid assets also declined, in spite of the large sums invested in new acquisitions (over £5 billion in each of the two years). As noted earlier, the tendency to

Chart C



[a] Comprises M_3 plus building society and finance house deposits, national savings and holdings of tax reserve certificates and local authority temporary debt.

[b] The break in the series in the second quarter of 1975 reflects the introduction of new reporting forms by banks (see the December 1975 *Bulletin*, page 344). Other breaks in the series have been smoothed.

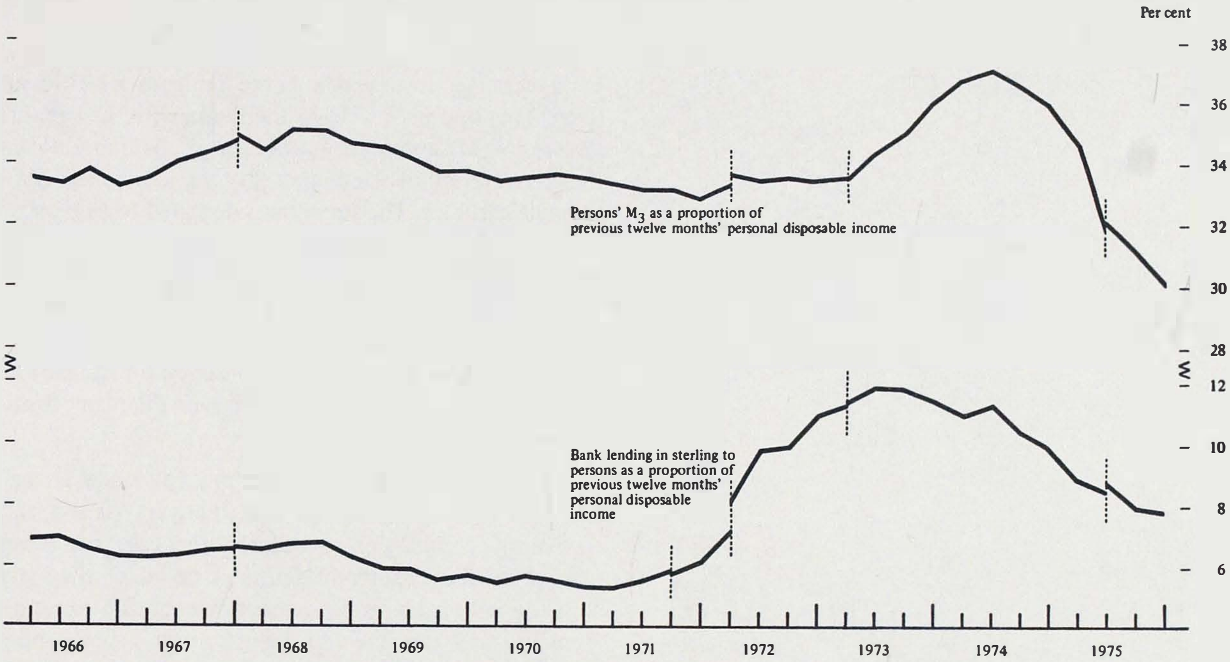
[c] Comprises bank advances and hire-purchase debt. Excludes borrowing for house purchase.

invest more in liquid (rather than illiquid) assets during the seventies may have been a reaction to the fall in the real value of the stock of liquid assets or, towards the end of the period, a precautionary response to uncertainty about future earnings during a recession.

Inflows from the personal sector into building society shares and deposits can fluctuate widely. Because of administrative difficulties in changing interest rates frequently in response to changes in money-market rates, and because the public is sensitive to increases in mortgage repayments, building societies' deposit rates are not generally very flexible. In practice, the societies' rates have usually followed a rise in competing rates (though not always immediately or in full), while remaining unchanged for long periods when other rates have fallen. Thus, between 1970 and 1972 other rates fell markedly, but building society rates only slightly, so that inflows became much larger, demand for houses strengthened partly because the societies were able to lend more, and house prices rose rapidly. During 1973–74, when rates on competing assets again rose, inflows failed to increase further and at times fell back quite sharply. With the prospect of lower interest rates, the societies were able to meet strong demand for mortgages without needing to raise their rates too steeply, with the help of a short-term subsidy on the mortgage rate for three months from April 1973 and, later, of government loans between May and October 1974.

Persons' sight and time deposits with UK banks, plus their estimated holdings of notes and coin, showed quite a stable relationship with income (measured as personal disposable income over the previous twelve months) until the first quarter of 1973 (see Chart D). They then grew very rapidly as a proportion of income until the latter part of 1974. Subsequently they fell back, partly because of uncompetitive rates offered by commercial banks for time deposits – demand for loans had been weak since 1974, and banks had no need to bid actively for deposits. Another influence may have been agreement by the banks to impose a limit of 9½% on the rate payable on deposits of under £10,000 between September 1973 and February 1975.

Chart D [a]



[a] The breaks in the series indicate a lack of continuity in the coverage of the statistics.

Conclusion

There was a marked change of pattern in the personal sector's accounts within the period under review: during the seventies, the saving ratio (and also the sector's financial surplus) became much larger, after remaining broadly unchanged during the sixties. Consequently, more funds were spent on financial assets, in particular to finance the public sector. These developments occurred as the economy was moving into a period of faster inflation, subsequently combined with high unemployment.

At the time of the earlier article on the personal sector, it was generally accepted that persons' saving was determined largely by 'real' factors, and that most financial decisions were made separately. But developments since then have drawn attention to the way in which real transactions (the saving ratio) may in turn be influenced by financial factors, in particular the erosion by inflation of the real value of the sector's financial assets.

Table F
Flow of funds – personal sector

£ millions

	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Saving	+2,444	+2,370	+2,363	+2,561	+3,122	+3,289	+4,513	+5,910	+8,473	+10,378
Capital transfers (net)	– 156	– 170	– 233	– 397	– 358	– 324	– 371	– 321	– 313	– 371
Capital expenditure	–1,140	–1,267	–1,482	–1,379	–1,497	–2,165	–2,796	–3,099	–2,952	– 3,707
Financial surplus +/deficit –	+1,148	+ 933	+ 648	+ 785	+1,267	+ 800	+1,346	+2,490	+5,208	+ 6,300
Borrowing (–)										
For house purchase	– 768	– 982	– 980	– 858	–1,246	–1,835	–2,779	–2,831	–2,278	– 3,704
Bank borrowing [a]	+ 60	– 138	– 38	+ 77	– 59	– 576	–1,927	–1,027	– 24	+ 446
Hire-purchase debt	+ 112	+ 17	– 23	+ 31	– 43	– 191	– 253	– 183	+ 66	– 57
Other [b]	– 40	– 16	– 79	– 130	– 91	– 32	– 33	– 272	– 247	– 56
	– 636	–1,119	–1,120	– 880	–1,439	–2,634	–4,992	–4,313	–2,483	– 3,371
Acquisition of financial assets (+)										
Life assurance and pension funds	+1,241	+1,372	+1,508	+1,507	+1,735	+1,930	+2,603	+3,093	+3,490	+ 4,331
Government stocks	– 19	– 217	– 245	+ 77	– 201	+ 451	– 15	+ 732	+ 588	+ 959
Company and overseas securities	– 464	– 590	– 697	– 528	– 881	–1,338	–1,469	–2,232	–1,217	– 1,364
Unit trust units	+ 105	+ 84	+ 258	+ 186	+ 89	+ 46	+ 203	+ 162	+ 25	+ 113
Bank deposits, notes and coin	+ 393	+ 803	+ 592	+ 378	+ 935	+1,060	+2,007	+3,616	+3,327	+ 329
Building society shares and deposits	+ 726	+1,090	+ 762	+ 890	+1,484	+1,961	+2,139	+2,188	+2,017	+ 4,165
National savings	– 202	– 43	– 91	– 224	– 51	+ 371	+ 459	+ 102	– 17	+ 423
Local authority debt	+ 236	+ 159	+ 157	+ 237	– 93	– 215	– 92	+ 355	+ 772	– 180
Other	+ 202	+ 175	+ 229	+ 103	+ 184	+ 279	+ 326	+ 87	– 15	+ 200
	+2,218	+2.833	+2,473	+2,626	+3,201	+4,545	+6,161	+8,103	+8,970	+ 8,976
Identified financial transactions	+1,582	+1,714	+1,353	+1,746	+1,762	+1,911	+1,169	+3,790	+6,487	+ 5,605
Unidentified	*– 434*	*– 781*	*– 705*	*– 961*	*– 495*	*–1,111*	*+ 177*	*–1,300*	*–1,279*	*+ 695*

[a] Other than for house purchase.
[b] Including accruals adjustments and trade credit received from public corporations.