Analysis

Household savings historically low

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Saving by Finnish households has been at very low levels for an historically long time. Since autumn 2014, the savings ratio has actually been negative. Underlying contributory factors include the low level of interest rates and consumer confidence, which has strengthened in recent years. Both factors encourage households to increase consumption and reduce saving, which has also been reflected in strong private consumption growth. Households' continued accumulation of debt does, however, entail risks for the economy.



Household savings ratio exceptionally low

The savings ratio[1] of Finnish households has been negative since autumn 2014. It embarked on a downward trajectory as early as 2010 (Chart 1). If households consume as much as their disposable income, the savings ratio will be zero. Thus, a negative savings ratio means that

households consume more than the amount of their income, i.e. they either realise their financial assets or borrow to finance their consumption. Household indebtedness has, in fact, continued to grow at the same time (Chart 2).

Chart 1.

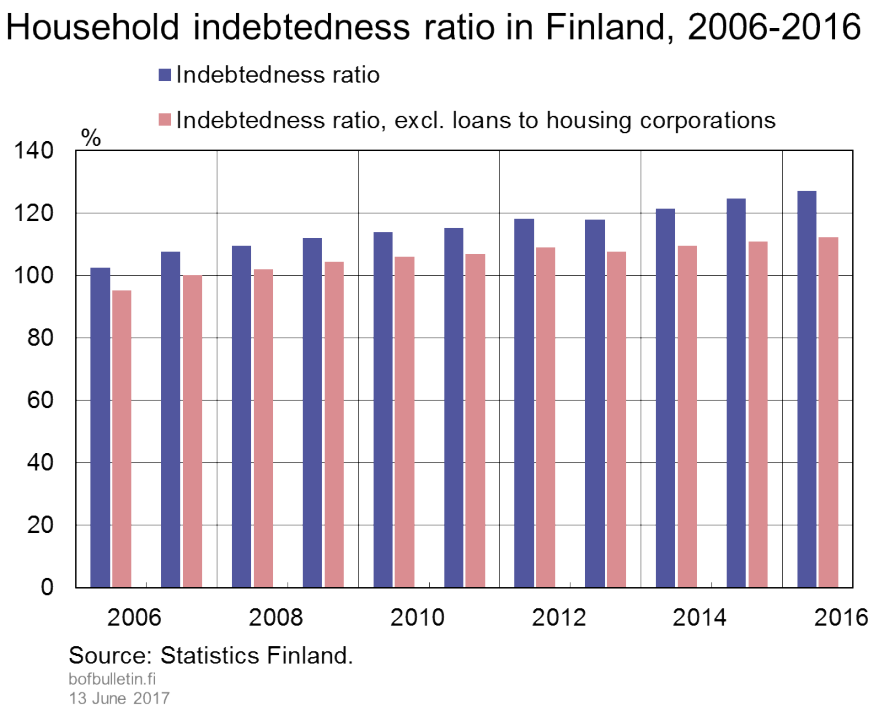
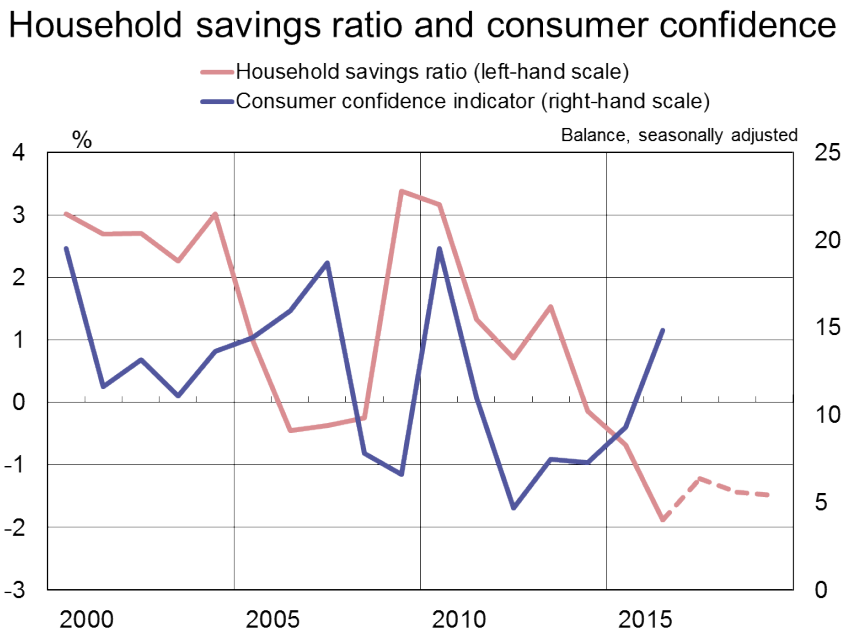


Chart 2.



The total household sector savings ratio remaining negative for such a long time is historically exceptional. In 2016 the savings ratio was –1.9%. Prior to the current period, Finland had last witnessed a negative savings ratio in 2006–2008, when it fluctuated between –0.25% and –0.5% (Chart 1). Based on the Bank of Finland forecast, the savings ratio is not expected to enter positive territory in the immediate years ahead. This phenomenon reflects, in particular, the low level of interest rates and households' strong confidence in the future performance of the economy.

Savings reduced by low interest rates and strong consumer confidence

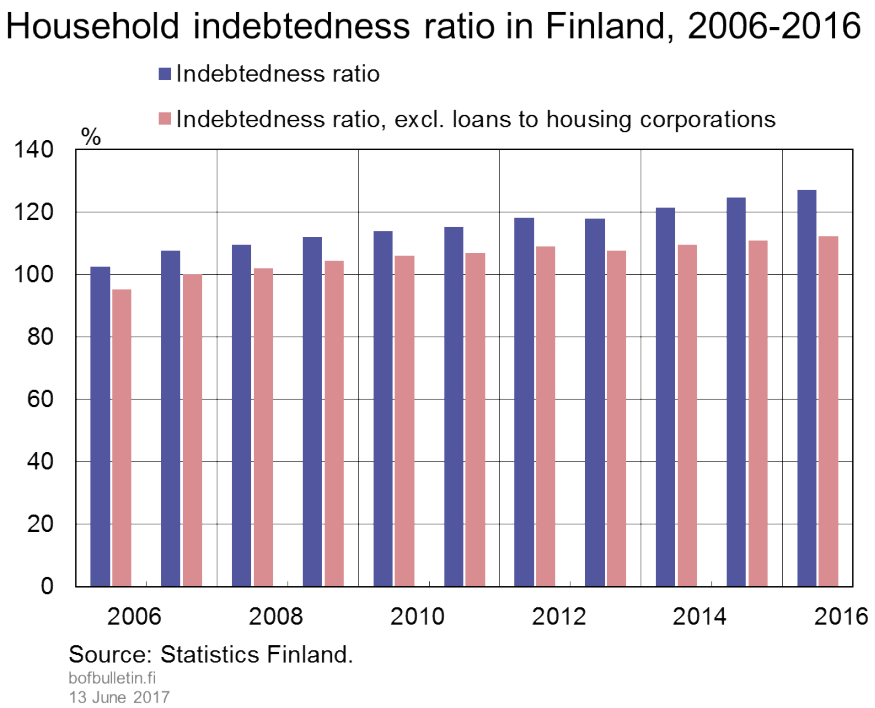
The three-month Euribor and other market interest rates turned strongly downwards in autumn 2008, as the financial crisis broke out and the European Central Bank began to ease its monetary policy (Chart 1). Low interest rates encourage households to consume and borrow rather than save. Supporting private consumption is, in fact, one of the purposes of an accommodative monetary policy.

In Finland, private consumption in the post-financial crisis years has grown much faster, on average, than disposable income. Income growth has been slowed by moderate wage developments, among other things. Household debt accumulation has increased notably via new

home loans and loans to housing corporations, but recourse to consumer credit has also become more widespread.

On the other hand, on the basis of the consumer confidence indicator in Statistics Finland's Consumer Survey, households' confidence in the development of the economy began to strengthen in 2015 and 2016 (Chart 3), and the indicator has risen to record highs in early 2017. The strengthening of the confidence indicator is accounted for most by consumers' optimistic views of the outlook for the Finnish economy at large, as the expectations of households that responded to the survey regarding their own finances have remained fairly stable. The exceptional strengthening of the consumer confidence indicator is thus likely to reflect the economic recovery that commenced in 2015, and particularly the many positive news reports on the economy in the early months of 2017.

Chart 3.



The link between consumer confidence and saving is not unambiguous. The confidence indicator does, however, correlate with the business cycle in the economy. Strong confidence can therefore correlate with households' risk appetite and manifest itself as indebtedness amid good economic prospects. Meanwhile, a low confidence indicator may be an indication of households' willingness to prepare for a rainy day by increasing savings and repaying their debts.

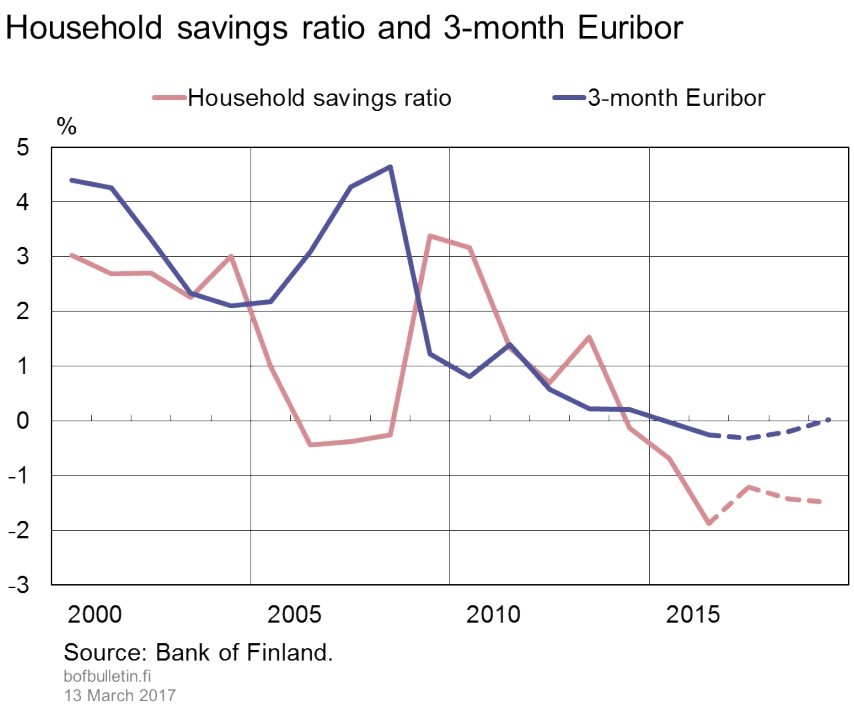
Accordingly, a low level of interest rates and strong consumer confidence both contribute

positively to private consumption and negatively to the savings ratio. The savings ratio cannot, however, remain sustainable and negative in the long term. Both a strengthening and a slowing of economic growth may before long lead to the savings ratio entering positive territory, but for different reasons.

Protracted household indebtedness a source of risks

If the business cycle were to remain favourable, a negative savings ratio would not necessarily pose immediate problems for the economy. Interest rates are currently expected to remain low for an extended period of time, and the ongoing strength of private consumption will bolster economic growth. In addition, despite showing a record high ratio of indebtedness, Finnish households are not among the most indebted households in international comparison (Chart 4). Nor can, for example, any overheating on the housing market be identified for the time being, as house prices relative to disposable household income have developed moderately.[2]

Chart 4.



Even so, with ongoing economic growth, interest rates are set to begin to rise before long, prompting households' debt-servicing expenditures to increase and financial leeway to diminish. This will act as a constraint on the position of the most indebted households, in particular. On one hand, higher interest rates will also encourage households to reduce borrowing and to save, which

will also cause the savings ratio to rise. On the other hand, at the end of 2016, about 11% of total household debt comprised housing corporation loans, which significantly raise the ratio of household indebtedness (Chart 2). The bulk of Finland's housing stock was built in 1960–1980. Given that there will be a considerable need for renovation in the coming decades irrespective of the business cycle, drawdowns of housing corporation loans are not likely to decline going forward.

Household debt accumulation would also be a risk if economic growth were to slow and disposable household income were to decline, for example, as a result of lay-offs or loss of jobs. In such a situation, households may even have to cut back their consumption strongly – especially if their debt burden is heavy relative to their income. The savings ratio could then begin to rise, as expenditures are reduced and savings relative to disposable income increase. But lower private consumption would further impair the economic situation. The household sector's broad-based indebtedness could therefore in the worst case amplify the cyclical turn and lead to recession.

The amount of unsecured consumer credit, in particular, has grown rapidly in the early part of 2017. A significant proportion of households' bad credit records is generally due to non-performing consumer loans.[3] Strong growth in the stock of unsecured consumer credit may pose a significant risk for both households themselves and the financial institutions that have granted such financing, if the business cycle turns and households' debt-servicing ability weakens, as the financial sector incurs larger losses from non-performing unsecured credit than secured credit.

Consequently, a protracted period of household indebtedness will create risks in the economy irrespective of whether economic growth remains favourable or not. Debt repayment will be sluggish, and turning the trend in the indebtedness ratio will take time. It is therefore advisable to take a long-term approach to reining in household debt accumulation.[4]

Notes

1. The savings ratio is defined as the ratio of household sector savings to disposable net income. Savings represent the difference between disposable net income and consumption expenditure and can be positive or negative. ↑
2. See: 'Risks in long-term and large housing loans – Sweden's worry is also ours'. Bank of Finland Bulletin 2/2017. ↑
3. See 'The overall picture of debt accumulation gets blurred as provision of consumer credit becomes diversified'. Bank of Finland Bulletin 2/2017. ↑
4. Effective macroprudential tools for reining in household indebtedness are discussed in greater detail in the article 'Nordic interconnectedness and indebted households pose a risk to financial stability'. Bank of Finland Bulletin 2/2017. ↑

Keywords

consumer confidence, household indebtedness, indebtedness ratio, savings ratio