

NZ Insight: Households understandably wary

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Contact

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Household retrenchment a drag on growth that monetary policy is looking to offset

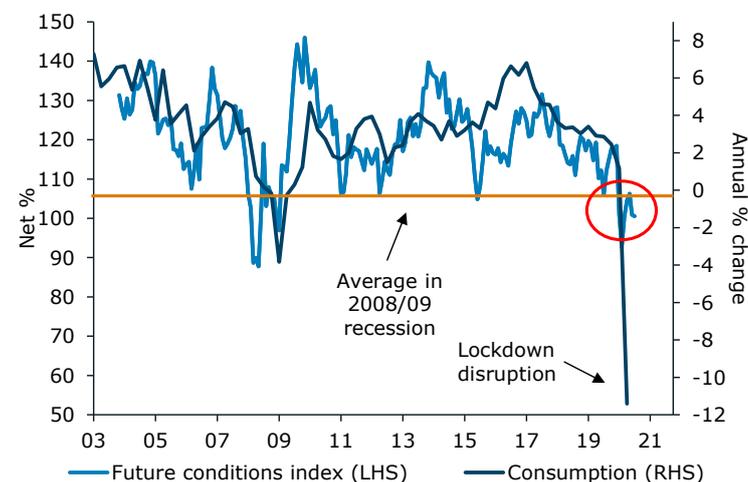
Summary

- Households are understandably feeling wary. The rate of household saving may therefore increase, though the extent of this is uncertain, depending on job prospects and housing market developments.
- A pull-back in spending is a perfectly sensible response when financial prospects are uncertain, but is bad for growth if widespread. We expect monetary policy to provide an offset, supporting cash flow, confidence, and spending. Low interest rates stimulate the economy through a range of channels; one of them is to make saving less attractive.
- Total deposit growth has risen, but that doesn't tell us anything about household saving behaviour. It is simply a consequence of the RBNZ's LSAP programme, which boosts the money supply and deposits. This dynamic can be expected to continue to some degree, regardless of what households do.
- To boost the economy further, the RBNZ is planning on implementing a Funding for Lending Programme (FLP), providing money cheaply to banks. This will weigh on deposit and lending rates, but ultimately the strength of credit demand will be a key determinant of the scheme's impact.
- Strong deposit growth, along with FLP funding, mean banks will have capacity to lend, but households (and firms) are likely to remain cautious about spending and taking on debt for some time yet. As such, we think the RBNZ will deem that more stimulus is required, with the OCR to go negative next year.

The view

Households are feeling wary about the future. And fair enough too, with job losses rising, *challenging months ahead*, and the outlook uncertain. Perceptions of future conditions are where they were in the GFC (figure 1), when consumers reduced their spending in order to preserve or build their financial buffers.

Figure 1. Households' perceptions of future conditions and consumption growth



Households are feeling wary, as in the GFC.

Source: Roy Morgan, Statistics NZ, ANZ Research

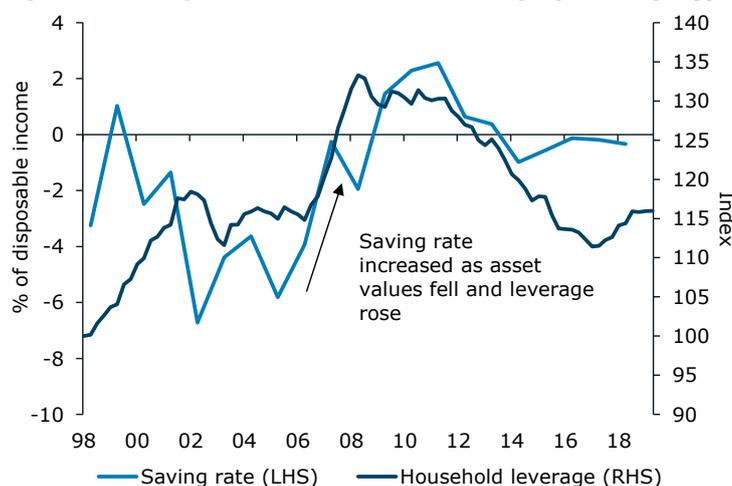
We expect to see households saving more and spending less.

That's bad for growth, but makes sense as expectations shift.

A smaller economy and slow recovery mean income growth will be under pressure, weighing on spending in and of itself. But in addition to this, we expect household caution to lead to a higher rate of saving, especially as unemployment rises, implying even less spending per person for a given level of income. Add to that the fact that population growth is very weak, and the outlook for consumption growth is modest at best.

A pull-back in spending on the part of households is bad for growth in the economy, but increasing one's rate of saving is an understandable and sensible response on the part of individuals. When income or wealth positions are eroded, it is natural to want to shore up financial positions. That's what we saw in the GFC. Household leverage rises when either debt levels increase or equity positions reduce. When asset values fell during the GFC, equity positions were eroded and leverage rose (figure 2). Households looked to consolidate their financial positions by saving more. Downward revisions to expectations of income growth also played a role.

Figure 2. Saving rate and household leverage (debt/equity)



Source: RBNZ, Statistics NZ, ANZ Research

The housing market is resilient.

One positive for household spending currently is that, so far, the housing market has been resilient, with housing credit growth supported by falling mortgage rates. The wage subsidy scheme has also provided a cash-flow boost to help households weather the lockdown-induced income shock. However, there is some evidence that households are nonetheless a bit more cautious about taking on debt. Mortgage lending has been supported, but consumer credit has contracted 11% since February; and borrowing by businesses (ultimately owned by households) has been gradually declining. We may see some [housing wobbles emerge](#) in coming months as fiscal income support wanes, though the extent that this might be counteracted by further declines in mortgage rates is unclear. Any downturn in the housing market would be expected to suppress spending further, deepening the downturn.

Monetary policy is supporting spending...

Monetary policy is providing an offset, supporting spending. This is occurring in part via the housing market, but also by cushioning confidence, cash flow, broader asset values and incomes. One way that lower interest rates support spending is by discouraging saving and encouraging movement into more risky assets. For some, lower interest income reduces spending power. And long-lasting low interest rates mean more saving is required to reach certain goals, whether that's a house deposit or saving for retirement. But by reducing the attractiveness of saving and encouraging spending through other channels, lower interest rates have a stimulatory effect overall.

...providing a partial offset to household retrenchment, and supporting growth.

Measuring the household saving rate is not a simple task.

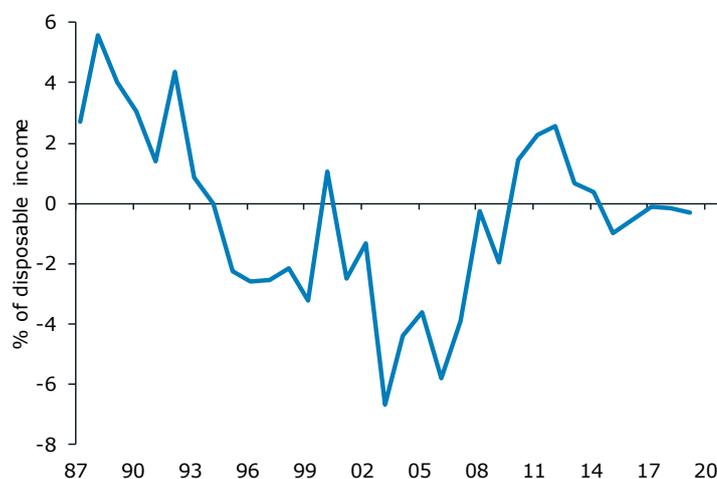
But we think the impetus to save has increased.

It's not simply a case of bringing forward spending from the future, either, or 'tricking' people into making poor financial decisions. The spending response generated through low interest rates boosts incomes, which supports further spending, and also leads to investment, which has a positive impact on long-term incomes. By boosting spending, monetary policy can create a virtuous cycle supportive of growth, speeding up the recovery and supporting job creation and inflation. It can also reduce debt-servicing burdens in real terms as incomes rise; expansionary monetary policy in times of trouble does not necessarily boost debt in the long run.¹

Of course, policy doesn't always work as intended, given how fickle economies are. But the point here is that outcomes for the overall economy are not as simple as adding together a set of independent decisions. Our choices all affect each other in complicated ways. By discouraging a self-reinforcing herd panic response, monetary policy can interrupt a downward spiral and make us in aggregate better off.

So what is happening to the saving rate? This actually isn't an easy question to answer. The household saving rate is difficult to measure; it is the residual between measured income and consumption, where data on underlying income sources can be noisy and incomplete. Over the period of the COVID-19 crisis, measuring saving will be fraught with even more difficulties and volatility, given that income and spending have both been disrupted by the impacts of COVID-19 and associated restrictions. Saving data is also very lagged; the last data point we have is for March 2019 (figure 3), and we won't know where it was in March 2020 until late this year. However, Stats NZ is currently working on producing this data quarterly and making it much timelier, which will eventually help improve our understanding.

Figure 3. Saving rate



Source: Statistics NZ, ANZ Research

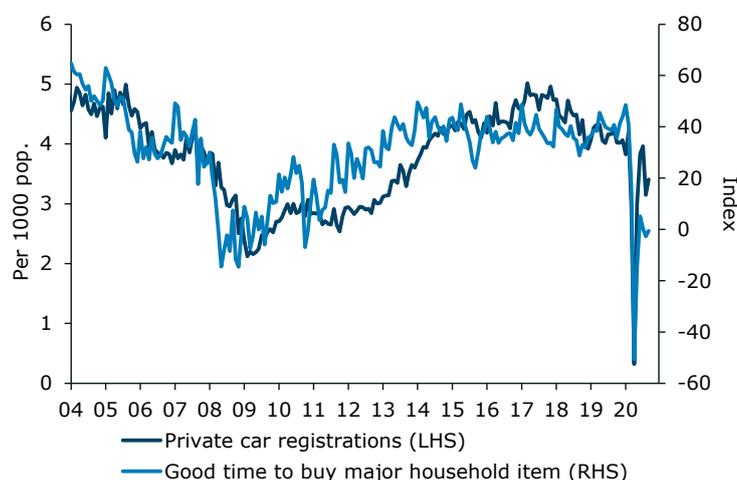
Where the saving rate goes from here will depend on income and housing developments, and the impact of interest rates. It is unclear how these forces will net out. But often in recessions, the impetus to save increases (as the chart above shows, with recessions occurring in 1990, 1998, and 2008). We expect that is happening now too, with dampening effects on growth.

One thing we do know is that households are more reluctant to spend, with fewer households saying it is a good time to buy a major household item. The data is consistent with levels seen during the GFC – and this is passing through into durables spending. There was a flurry of car purchases

¹ <https://larseosvensson.se/files/papers/leaning-against-wind-costs-benefits-effects-debt-dsge-models-framework-comparison-results.pdf>

post-lockdown, boosted by pent-up demand, a cash injection from the wage subsidy, and deferred travel spending. But sales have now settled at a more modest level and could come under further pressure as income strains mount (figure 4). But is this a higher saving rate or just the impact of lower incomes? Probably a mix of the two – we’ll have to wait to find out.

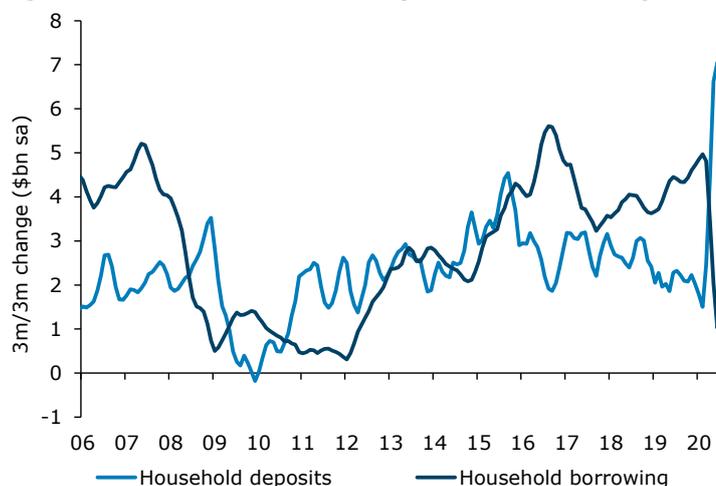
Figure 4. ANZ Consumer Confidence “good time to buy” and car registrations



Source: Roy Morgan, NZTA, ANZ Research

But look at all those bank deposits! It is tempting to look at household borrowing and deposit statistics (figure 5) for clues about household saving, but the latter in particular tells us very little, unfortunately.

Figure 5. Growth in household deposits and borrowing



Source: RBNZ, ANZ Research

Key drivers of banking system deposit growth include:

- liquidity injection by the RBNZ (like the bond-buying it is currently undertaking through its Large-Scale Asset Purchase (LSAP) programme (QE) (see our FAQs [here](#) and [here](#));
- transfers and payments from the Government (eg wage subsidies);
- domestic credit growth (itself spurred to some extent by deposit growth); and
- income/transfers generated from offshore.

Importantly, households’ saving and spending decisions do *not* affect the rate of deposit growth. If someone chooses to spend rather than save, this will reduce funds in that person’s bank account, but it increases someone else’s.

Higher bank deposits reflect decisions made by the Reserve Bank and Government, not households.

The strong increase in household deposits earlier this year evident in figure 5 has been primarily a result of the Reserve Bank's QE programme and the Government's wage subsidy. Slower growth more recently has been a matter of timing of various financial flows, but assuming that ongoing QE continues to boost liquidity, deposit growth can be expected to continue, regardless of households' saving decisions.

Likewise, if some households are borrowing more, that doesn't necessarily mean that in aggregate households are saving less. So the upshot is that the saving rate is almost certainly rising, as that is an intuitive response to income uncertainty. But we'll have to wait to see it confirmed in the data. And deposit and lending statistics are not the place to look.

With household caution likely, the RBNZ is likely to conclude more stimulus will be needed. The RBNZ is planning on implementing a [Funding for Lending Programme \(FLP\)](#) by the end of the year, providing money cheaply to the banks. This would provide stimulus in and of itself, but could also be used in conjunction with a negative OCR to make it more effective (see our [FAQ](#) for more). An FLP will reduce bank funding costs and thereby weigh on deposit and lending rates, but by how much is unclear. (Note that to the extent that banks take the funds, this will boost the money supply and deposits too.)

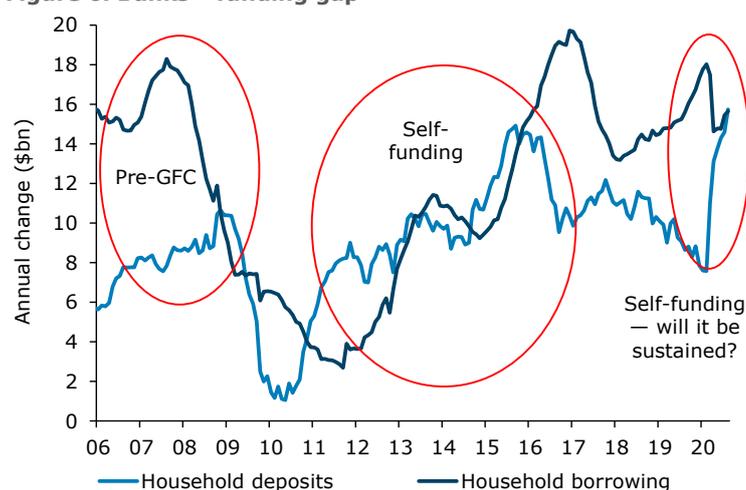
The overall impact of the FLP scheme will be greater if banks access the scheme at scale and use the funds to lend. But even if the banks do not use the funding, knowing the programme is there as a backstop should contribute to downward pressure on retail rates.

Take-up of the scheme will depend partly on the strength of deposit growth, and whether banks can "self-fund" through that (figure 6). Although deposit growth is expected to remain robust, we expect there will still be a reason for banks to take up funding via the FLP, because it will be cheaper. But how much funding is taken – and how stimulatory this will be – will depend crucially on the strength of credit demand.

The RBNZ is planning on implementing an FLP.

The impact will depend on take-up and on credit demand.

Figure 6. Banks' "funding gap"



Source: RBNZ, ANZ Research

Downward pressure on retail rates will provide an incentive for households to borrow and spend. However, although we expect the FLP will be stimulatory, households are likely to remain somewhat cautious towards debt and spending as the weak economic environment becomes clearer. As such, the RBNZ is likely to conclude that more stimulus is required beyond the FLP for it to meet its inflation and employment mandate. We expect that the OCR will be **taken negative** in April next year.

We expect the OCR to be taken negative next year.



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