The Savings Glut:
The Good and the Bad

The concept of savings gluts, while prominently highlighted in the early to mid-2000s by then Chair of the Federal Reserve (Fed) Ben Bernanke, goes back much further in the history of economic thought. Such eminent economists as Karl Marx and John Maynard Keynes wrote of savings gluts and their economic implications. It is generally assumed that savings gluts occur due to an excess of savings relative to investment opportunities. In essence, in a glut the private sector is unable to sufficiently translate savings into investment, thereby leaving an excess of savings. Economies that are trending toward equilibrium are usually the healthiest, and the existence of a savings glut is an excess that causes disequilibrium.

The nature of both saving and investment should be clearly understood. Investment basically means expenditure towards capital goods, the production of goods that will be used to produce other goods. This type of investment has nothing to do with the popular definition of investment in stocks or bonds. Rather, it means expenditures for “hard assets” or capital goods such as factories, warehouses, distribution facilities, computers, and software. It can also include “softer” monetary commitments in human capital, such as research and development.

Savings, the other side of the savings/investment equation, can include savings accounts at banks, stocks, bonds, and corporate buyback of shares. Savings are the source of funds for capital investment, and depending on the level of either, there may be an excess or shortage of savings. For many years, savings have considerably exceeded the demand for investment, both globally and domestically. Here we will focus on the savings glut in our domestic economy.

Why have savings been increasing rapidly over recent decades? It would appear that there have been structural changes in the propensity to save and invest. Larry Summers, prominent for his espousal of “secular stagnation,” argues that factors operating to increase private savings include longer retirement periods, increased income and wealth inequality, and rising uncertainty regarding future economic outcomes. At the same time, there are factors at work to discourage private investment. These include slowing labor force growth, greater efficiency in the use of capital, and reductions in the relative cost of capital goods. Increases in corporate market power and pressure to reward shareholders may also contribute to lower capital investment.

The issues surrounding savings and investment and resulting saving gluts are complicated and multifaceted. In this brief paper, we examine only a few of the economic implications, focusing on the bad and the good.

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THE BAD. In and of itself, a savings glut implies lower economic growth than would otherwise be attained if savings were appropriated into capital investment. We believe there is a clear parallel in the longer-term decline from 3% average Gross Domestic Product (GDP) growth to 2%, and the declining level of capital-investment spending. Even the Trump corporate tax cuts that were designed to stimulate capital spending failed to reverse this trend.

Consider the example of spending on hamburgers and semiconductor plants. A dollar spent on a hamburger improves GDP by a small amount, but once the hamburger is eaten, the effect is over. Funds spent on a semiconductor plant, by contrast, will create jobs during its construction thereby adding to GDP, and it will continue to add to GDP in succeeding years as workers are employed and computer chips are sold each year. This is how investment leads to economic growth. Without it, economic growth would halt. Again, a shortage of investment implies slower overall economic growth, a less than desirable outcome.

A savings glut can also contribute to income and wealth inequality, one of the more pernicious trends in our economy today. There are many aspects of inequality that are undesirable, but from an economic standpoint, concentrated income and wealth means more savings and less consumption. Consumption, the largest component of GDP at some 70%, is critical for economic growth. But overall demand is limited when spendable dollars are concentrated among a relatively few individuals whose propensity to save is so much greater. It seems that higher wealth people just cannot spend all of their income, and the result is that they tend to save large portions of their disposable income. Studies show that the top 10% of earners save some 20% of disposable income, while the top 1% can save up to 40%. These savings, principally invested in financial assets, continue to accumulate as long as the return on financial assets is attractive. The wealthy get wealthier, and the concentration of wealth becomes even greater.

THE GOOD. Most economists would agree that the implications of a savings glut tend to be more negative than positive. However, for some there are tangible benefits that flow from a savings glut. Here, we refer primarily to individuals or corporations that have accumulated capital and who benefit from committing their savings to stocks and bonds.

Savings gluts tend to force interest rates lower. This effect is pure supply and demand. If there are more buyers than sellers of fixed income securities, interest rates will be prone to decline. Also, lower growth in the overall economy will be motivation for monetary stimulus, which always takes the form of lower interest rates. Everything being equal, lower interest rates are desirable for individuals, households, and corporations - the principal savers.

If savings cannot be absorbed into hard assets through capital investment, then they have to go somewhere. Inevitably, with interest rates so low, they will migrate toward higher return instruments such as stocks, and for corporations that cannot find attractive investment opportunities, stock buybacks and dividends.

For stock investors, lower interest rates can have a powerful effect on valuations. The discounting of future earnings and dividends enhances valuations when interest rates are low. These future earnings and dividends are worth more when discounted back to present value by a lower interest rate. If the savings glut persists, which we believe it will, and therefore keeps us in a low interest rate environment, it argues for the continuation of higher price-to-earnings ratios and other valuation measures. This is a decidedly favorable outcome of the savings glut.

CONCLUSION. For the economy as a whole, savings gluts are negative, for they imply slower overall economic growth. Lower growth in the economy further implies slower advances in standards of living. But, for the financial sector and those investing primarily in stocks, the results can be favorable. Because the underlying conditions responsible for the current savings glut appear to be secular in nature, excess savings would appear to be a somewhat permanent feature of our economy. This leads us to a constructive outlook for financial assets over the longer term, especially high-quality stocks.