



ROYAL LONDON POLICY PAPER 15

Has Britain really stopped saving?

DIP IN SAVINGS Money Brits save each month crashes to an all-time low fuelling fears of living standards crisis

Household income falling at fastest rate since 1976 as UK savings rates crash

We should be worried about the UK's lack of savings

Britons saving less than at any time in 50 years

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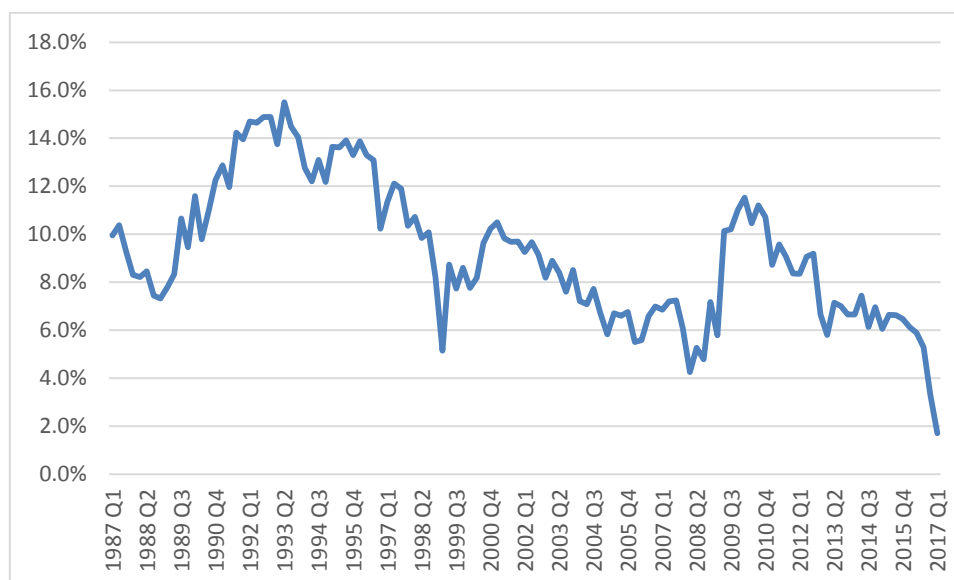
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HAS BRITAIN REALLY STOPPED SAVING?

Executive Summary

In June 2017, the Office for National Statistics published its estimate of the UK savings ratio for the first quarter of 2017. It showed that a savings ratio which had hovered in the 6-8% range for most of the last five years had fallen for the sixth successive quarter and had slumped to a record low of just 1.7%. Figure 1 shows the quarterly savings ratio for the last thirty years and highlights the dramatic changes in recent quarters.

Figure 1. Quarterly savings ratio 1987 Q1 to 2017 Q1



Not surprisingly, the latest figures have sparked a big debate about why Britain has apparently ‘stopped saving’ and what we might do about this.

Closer examination of the data for 2017 Q1 suggests that large lump sum income tax payments due at this time of year may have contributed to the particularly sharp decline. We deal with this issue in the appendix to this paper.

But even ignoring the most recent quarter of data, the savings ratio halved between the start of 2014 and the end of 2016. We therefore focus on that recent period and look at the factors which contributed to the fall in the savings ratio.

We find that, far from being a story about consumers going on a credit-fuelled spending spree, the fall in the savings ratio over the period is almost entirely explained by changes in the rate at which individuals built up

pension entitlements. This is because the definition of 'savings' includes not just money put aside for a rainy day but also any change in a household's pension rights from one quarter to the next.

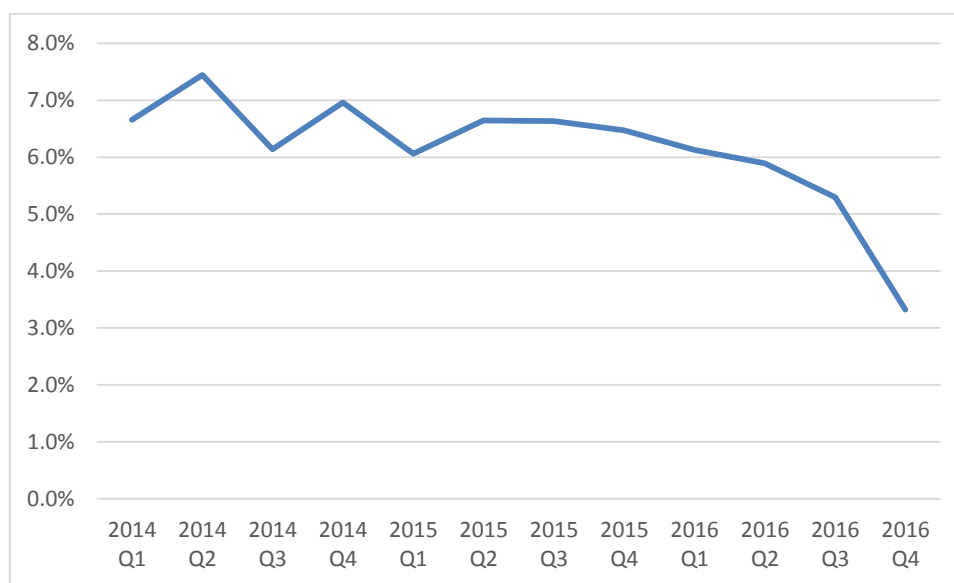
The big drivers of the change in pension rights seem to be to do with a fall in the rate at which companies sought to tackle historic pension deficits, a decline in the rates of return achieved by pension funds and a rise in the number of older savers moving their savings out of pensions. We also find that the definition of savings used excludes some categories of pension saving (that into unfunded public sector pensions) and that taking account of the rise in pension saving under this heading could potentially have wiped out the reported fall in the savings ratio altogether.

Clearly, the savings ratio does fluctuate over time and over the economic cycle in ways that are nothing to do with pensions. In addition, there may be legitimate reasons to be concerned about current data on consumer use of credit and levels of household indebtedness. But this case study of the movement of the savings ratio over a three-year period shows that there is a real risk of policy makers and commentators drawing the wrong conclusions if they fail to dig beneath the surface of the headline figures.

1. Introduction

It is now received wisdom that there has been a collapse in savings rates in the UK. Even ignoring the most recent quarterly data¹, the ‘savings ratio’ – the amount we save as a percentage of our total resources – halved over the last three years. Figure 2 shows the quarterly data from the start of 2014 to the end of 2016.

Figure 2. Quarterly savings ratio 2014 Q1 to 2016 Q4



At first sight, this chart would seem to confirm the view that something very dramatic has been going on amongst UK households. After hovering a little above 6% for several quarters, the savings ratio has fallen sharply and now stands at half its level at the start of the period.

There has already been considerable speculation as to what this data tells us – could it be a sign of consumer confidence post-Brexit? Is there a risk of a credit-fuelled consumer spending binge which will be followed by the bursting of this bubble?

In this paper we ‘lift the bonnet’ of the savings ratio to see if the headline figure tells us what we think it is telling us. In particular, we highlight the way that changes in pension entitlements can be a major factor in driving trends in the savings ratio and that these in turn may tell us little about consumer savings behaviour. Finally we point out a methodological quirk in the savings ratio which suggests that some of the decline in savings even on this measure may have been overstated.

¹ There is reason to think that the data for Q1 2017 may have been distorted by large lump-sum tax payments by households at the start of the year which may have overstated the underlying fall in savings rates – see Appendix.

2. How is the savings ratio calculated and what account is taken of pension savings?

For purposes of the National Accounts, the amount of savings is defined as the difference between the ‘Total Resources’ of households and the ‘Final Consumption Expenditure’ of households².

The amount of savings is thus the difference between two relatively large numbers. In 2016 Q4 for example, Total Resources were £332.3 billion, Final Consumption Expenditure was £321.2 billion and savings were thus £11.0 billion. The savings ratio is simply the amount of savings expressed as a percentage of Total Resources, in this case 3.3%.

‘Total Resources’ is made up of the ‘Gross Disposable Income’ of households plus ‘Change in Pension Entitlements’. In 2016 Q4, the change in pension entitlement was a positive number: + £10.9 billion. It will be immediately apparent that without the addition of the change in household pension entitlements, savings in 2016 Q4 would have been close to zero.

Given the importance of the ‘change in pension entitlements’ component of the savings ratio calculation, we investigate in the next section in more detail what has happened to the value of this variable in recent years.

3. The change in pension entitlements – recent trends and impact on the savings ratio

Table 1 shows the value of the ‘change in pension entitlements’ variable for each quarter from 2014 Q1 to 2016 Q4.

Table 1. Change in pension entitlements (quarterly, 2014 Q1 – 2016 Q4, £ million)

2014 Q1	19,595
2014 Q2	17,297
2014 Q3	18,016
2014 Q4	15,055
2015 Q1	14,584
2015 Q2	13,675
2015 Q3	11,299
2015 Q4	12,275
2016 Q1	13,487
2016 Q2	12,761
2016 Q3	14,154
2016 Q4	10,893

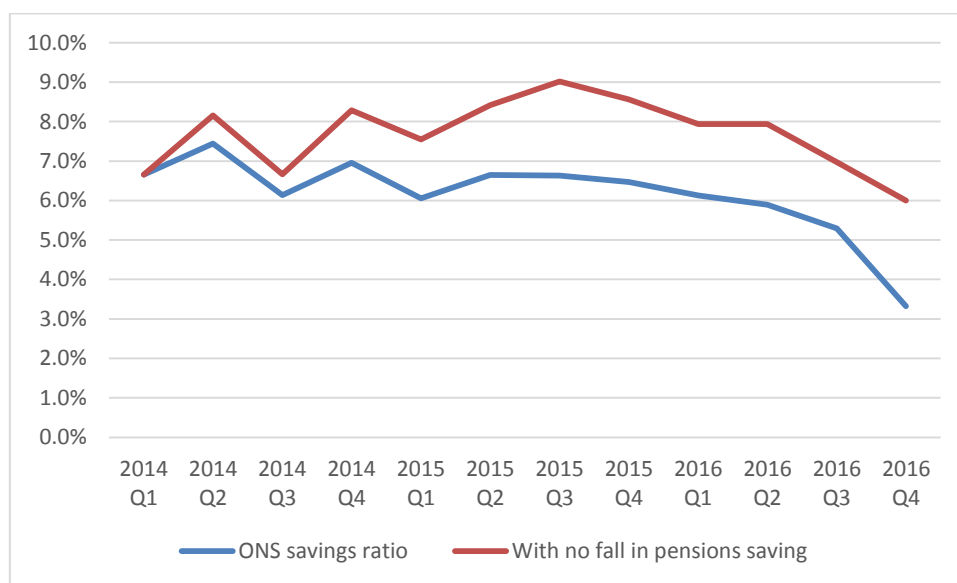
Source: ONS

² An adjustment is also made to reflect the role of ‘Non-profit institutions serving households’ (NPISH)

Given the amount of money being contributed by British industry to deal with deficits in final salary pension schemes and the growth in pension saving through automatic enrolment, it is perhaps surprising that the ‘change in pension entitlements’ figure should have fallen by over 40% in three years, even ignoring the effects of inflation.

To see how far changes in this variable are driving the fall in the savings ratio, we show in Figure 3 the reported savings ratio (as per Figure 2) and then recalculated on the ‘what if’ assumption that the change in pension entitlements had stayed constant in real terms from the start of 2014.

Figure 3. Savings ratio 2014 Q1 to 2016 Q4 – actual, and if no real fall in pension saving



Although Figure 2 shows that even on an adjusted measure the savings ratio has fallen since late 2015, the fall is much more modest and leaves the savings ratio very close to its level at the start of the period. This compares with a halving of the savings ratio in the published figures. Put another way, over three quarters of the fall in the savings ratio between the start of 2014 and the end of 2016 is down to the fall in pension saving. What is happening to the pension numbers is having a big impact on the savings ratio over this period and so we need to understand what is causing the fall in pensions saving.

The figures for actual amounts of saving and the contribution of the change in pension entitlements is shown in Table 2.

Table 2. Total household saving in 2014 Q1 and 2016 Q4 and contribution of change in pension entitlements

	2014 Q1	2016 Q4	Change
Household saving	£20.7 bn	£11.0 bn	-£9.7 bn
Of which:			
Change in pension entitlements	£19.6bn	£10.9 bn	-£8.7bn

As Table 2 shows, overall household saving fell by just under £10 billion over the period but nearly all of this was attributable to a fall in the rate at which households were building up pension entitlements.

In the next section we therefore look at what makes up the figure for ‘change in pension entitlements’ to see what is going on.

4. Components of the change in pension saving

To start to break down the data on the change in pension saving, Box 1 shows how the figure used in the savings ratio calculation is made up, together with actual monetary values for Q1 2014 and Q4 2016, the start and end of the period under examination.

Box 1. Derivation of ‘Change in Pension Entitlements’

(All figures in £ million)

Code	Money going into funded pensions comprises:	2014 Q1	2016 Q4
L8N8	employers' actual social contributions	15165	13245
M9X6	<i>plus</i> employers' imputed social contributions	3246	3522
L8PE	<i>plus</i> households' actual social contributions	4026	3525
L8Q2	<i>plus</i> households' social contribution supplements	20054	17149
L8LQ	<i>minus</i> social insurance scheme service charge	-4658	-5147
NSBO	Equals Net social contributions	37833	32294
	Money coming out of funded pensions is measured as:		
L8R4	other social insurance benefits	18238	21401
	Change in pension entitlements is simply		
NSBO	Net social contributions	37833	32294
L8R4	<i>minus</i> other social benefits	-18238	-21401
RPPT	D.8 (change in pension entitlements)	19595	10893

a) Definitions

Before looking at the change over the period, it is worth spending a moment understanding what each line of this table covers³.

³ Each line begins with a four character code which simply helps to identify which data series in the national accounts has been used.

The first four rows of data are meant to capture the extent to which people are building up rights in ‘funded’ pension schemes. They therefore exclude the rights that teachers, nurses, civil servants and others build up in ‘unfunded’ public sector schemes where there is simply a promise of future payment but no pension ‘pot’ set aside to meet those promises. We return to this issue later.

The definitions of these various lines are as follows:

- **“employers’ actual social contributions”** is simply the amount of money that employers are putting in to ‘funded’ pensions. This is mostly private sector employers putting money into a mixture of ‘Defined Benefit’ (or salary-related) pensions and ‘Defined Contribution’ pensions.
- **“employers’ imputed social contributions”** is an estimate to reflect the fact that in the case of Defined Benefit schemes, the amount employers contribute may not be enough to match the increased liabilities which the scheme has incurred over the year. In an era of rising DB pension scheme deficits, this variable seeks to capture the extra pension rights people have built up which may not be reflected in the actual contributions which they and their employer make. However, it should be noted that this figure is currently calculated in a very crude way, simply as a fixed percentage of the total wage bill. Work is underway at ONS to see if a more precise figure could be used in future.
- **“households’ actual social contributions”** covers the money which individuals contribute towards funded pension schemes. Following the closure of most private sector DB schemes to new members, this is largely contributions into DC arrangements.
- **“households’ social contribution supplements”** reflects the addition in pension rights arising from two sources: for DC schemes it reflects the investment growth achieved in the fund; for DB schemes it reflects the fact that for those who are building up pension rights the date at which they are payable is now a year sooner and the rights are therefore more valuable (this is known technically as the ‘unwinding of the discount rate’).
- **“social insurance scheme service charge”** is a negative item and reflects flows out of funded pensions to reflect the costs and charges levied by pension providers and schemes.

Adding together these various inflows into pensions and deducting costs and charges gives a figure for the net inflow into funded pensions.

However, whilst new money is going in to pensions, money is also flowing out to those who have retired. For a complete picture it is therefore necessary to deduct such payments.

- **“other social insurance benefits”** therefore measures the amount paid out in the period to members of funded pension schemes. If, as a nation, we are putting more into our pensions than we are drawing out then saving is increasing.

b) Trends between Q1 2014 and Q4 2016

The overall level of change in pension entitlements fell from + £19.6 billion at the start of our period to + £10.9 billion at the end, a fall of £8.7 billion. Table 3 shows how this change was broken down between the different elements in the box above.

Table 3 shows very clearly that there are three main factors driving the fall in inflows into pension entitlements:

- a) Fall in employer contributions (-£1.9 billion)
- b) Fall in investment returns etc (-£2.9 billion)
- c) Increase in outflows to retired households (-£3.2 billion)

Table 3. Disaggregation of fall in net pension inflows 2014 Q1 to 2016 Q4

	Change 2014 Q1 to 2016 Q4
employers' actual social contributions	- £1.9bn
<i>plus</i> employers' imputed social contributions	+ £0.3bn
<i>plus</i> households' actual social contributions	- £0.5bn
<i>plus</i> households' social contribution supplements	- £2.9bn
minus social insurance scheme service charge	- £0.5bn
equals D.61 (Net social contributions)	- £5.5bn
Money coming out of funded pensions is measured as:	
other social insurance benefits (D.622)	+£3.2bn
Change in pension entitlements is simply	
D.61 (net social contributions)	-£5.5bn
<i>minus</i> D.622 (other social benefits)	+£3.2bn
D.8 (change in pension entitlements)	-£8.7 bn

What is immediately striking is that none of these major swings which are driving the trend in the savings ratio of the period has much to do with changes in household savings behaviour as commonly understood. The three factors are:

- There is some evidence that employers were putting less into workplace pensions than before; a more detailed look at the data suggests that this is overwhelmingly because of a slowing in the rate at which firms were trying to ‘repair’ the deficits in their defined benefit pension schemes⁴;
- The return on money invested in DC pensions reduced, and falling interest rates mean the way new DB rights are valued also fell;
- Pension schemes were paying out more money at the end of the period than at the start; looking at the breakdown of these totals it appears that it is an increase in withdrawals from DC pensions which may have driven this change; a possible explanation is withdrawals from DC pensions under the new ‘pension freedoms’ changes which were implemented in April 2015; this would apply exclusively to those aged 55 and over; in addition, research⁵ into the use of funds released under ‘pension freedoms’ suggests that a relative small proportion was used for current consumption, with a large part invested in other ways or to reduce indebtedness;

c) What about unfunded pensions?

There are several reasons why a narrative about reduced saving into pensions over the period would seem surprising, and one of these is that more money has been going into the pensions of millions of public sector workers. In recent years workers across the public sector have seen substantial increases in the rate at which they are required to contribute into their pensions whilst public sector employers have also been asked to contribute more. However, with the exception of the Local Government Pension Scheme, all the main public sector pension schemes – such as those for teachers, NHS workers, civil servants, emergency services and the military – are all ‘unfunded’ and hence do not feature in the calculation shown above.

Whilst figures for contributions into unfunded pensions are not readily available on a consistent basis with those for funded pensions, if we look at the example of a single large unfunded scheme – the NHS pension scheme – we can get some sense of what the omission of unfunded pensions might be doing to the data.

From the annual reports of the NHS pension scheme for 2013/14, 2014/15 and 2015/16, we have the following data.

⁴ It has been pointed out that the quarter-by-quarter data for employer DB contributions can be very volatile, but this reinforces the case for not relying too heavily on one quarter’s headline savings ratio number.

⁵ See Figure 3, FCA ‘Retirement Outcomes Interim Study’: <https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review>

Table 4. NHS Pension Scheme 2013/14 to 2015/16 inclusive

	2013/14	2014/15	2015/16
Cost of benefits accruing in year (as % of payroll)	28.6%	32.7%	36.0%
<i>Of which:</i> average member contribution (%)	9.0%	9.5%	9.5%
Actual employer contribution (%)	14.0%	14.0%	14.3%
Cost of Benefits accruing	£11.7 bn	£13.5 bn	£15.2 bn
Cost of pensions in payment	£6.4 bn	£7.0 bn	£7.4 bn

Rows two and three of Table 4 show actual data on the average percentage contribution made into the NHS Pension Scheme by employees and employers respectively. In each case, the contribution rate has risen. If this were a funded pension scheme, this would show up in the ONS data as an increase in saving, but because it is an unfunded scheme it is ignored.

More interesting still is the first row which shows the true value of the benefits accruing to members of the scheme expressed as a proportion of the NHS payroll. It is clear that the value of additional pension rights accrued within the year exceeds the actual contributions made by employees and employers, and the gap is growing. The fourth row shows the cash value of these rights which rose by around £3.5 billion over the two year period. By contrast, as shown on the final row, pensions in payment to retired NHS staff rose by only £1 billion.

The clear message of this table, which is just for one of the unfunded public sector pension schemes, is that over the period of interest to us, there was significant net saving into the NHS pension scheme by NHS staff and their employers.

Whilst we do not yet have data for 2016/17, based on these trends, if the other major unfunded public sector pension schemes (such as those for teachers and civil servants) were included, **it seems quite possible that total saving between the start of 2014 and the end of 2016 would actually have gone up had account been taken of saving into unfunded pension schemes.**

Whilst the nature of an unfunded pension promise is different to a funded pension promise, from the perspective of the employee and employer, unfunded pension contributions involve foregoing current consumption in exchange for the right to higher consumption later. It is hard to see why the pension contributions of a local government worker and his/her employer should count towards the savings ratio

(because the LGPS is a funded scheme) but the contributions of a neighbour who works as a teacher or a nurse should not count towards the savings ratio.

5. Commentary – so has Britain stopped saving?

A central message of this paper has been the danger of over-interpreting a single figure – the quarterly savings ratio – and rushing to potentially misleading conclusions about the savings and consumption behaviour of UK households. But if the savings ratio is certainly not the whole story, what other indicators could we look at?

The savings figures in this paper are based on the difference between household incomes (adjusted for changes in pension wealth) and household expenditure. Looking just at the figures for household expenditure, it is clear that households are spending more than in the past – up around £30 billion between the start of 2014 and the end of 2016. But household incomes rose by £29 billion over the same period. It is true to say that at the start of this period household income (£292 billion) and household expenditure (£291 billion) were very close, suggesting little net non-pension saving was going on, but that is equally true at the end of the period. In other words, ignoring the most recent quarter where lump sum income tax payments seem to have played a key role, it is hard to see UK households going on a spending spree.

There is other data which might give cause for concern about the sustainability of UK consumers' spending and borrowing habits. Credit card lending is currently at record levels and concerns have been expressed at the growth in unsecured lending to fund purchases of second hand cars etc. Record low interest rates mean that all forms of credit are generally more affordable than ever before.

However, it is interesting to note that the latest inflation report by the Bank of England makes the following observation:

“Households looked through Brexit-related uncertainties initially. But more recently, as the consequences of sterling’s fall have shown up in the shops and squeezed their real incomes, they have cut back on spending, slowing the economy”

(Source: Bank of England Inflation Report, August 2017);

Speaking at the press conference which launched the report, the Governor of the Bank of England said:

“The consumer, his or herself, is relying on what they’re getting paid, not what they can borrow. Next point, again, to put it into context, is that this country and the UK households have gone through a decade of very painful deleveraging. It’s only really in the last year that growth of debt has started to exceed income, so there has been some borrowing. Consumer credit is the minority in that and mortgages are still much more important. There are some issues that the FPC has raised around the nature of some of the credit that’s on

offer and the potential channels for financial stability because of some developments in the consumer credit side”.

(Source: www.bankofengland.co.uk/publications/documents/inflationreport/2017/conf030817.pdf)

In other words, until recently individuals have been running down debt and whilst there has been more borrowing in the last year this has been more driven by mortgage lending than consumer credit. This is not to say that there are not issues around certain forms of lending, but the Bank of England’s narrative suggests that a story about Britain ‘giving up on saving’ based solely on the headline savings ratio data would be well wide of the mark.

6. Conclusion

Almost any commentary on the current state of the UK economy which talks about high levels of consumer spending or worries about excessive credit now cites the collapse in the savings ratio as evidence that, as a nation, we have given up on saving.

What this paper has sought to show is that the movement in the headline savings ratio tells us remarkably little about consumer spending behaviour.

By focusing on the period from the start of 2014 to the end of 2016 – a period during which the headline savings ratio halved – we have shown that almost none of this could be attributed to a spending spree by consumers as a whole.

We have found that changes in pension entitlements explain almost all of the drop in household saving over the period – and indeed more than explain the drop if unfunded pensions were to be included in the measure.

Within this total, the three drivers of the “fall in saving” seem to be:

- A period during which employers eased back on the contributions that they had been making to their final salary pension schemes, particularly those to ‘repair’ deficits;
- A fall in interest rates which lowered returns to DC savings and lowered the rate at which measured DB pension rights accrued;
- A rise in the outflow from pensions; the underlying data suggests this was mainly from DC pensions and could have been attributable in part to withdrawals under the new ‘pension freedoms’ regime which was implemented in April 2015; however this would have applied exclusively to those aged over 55 and does not generally seem to have been about funding current consumption;

ROYAL LONDON POLICY PAPER
Has Britain really stopped saving?

The first two of these factors seem wholly unrelated to whether consumers are going on a spending spree. Whilst the third does reflect withdrawals from pension saving, it is concentrated heavily on those relatively close to retirement and is not attributable to the general working age population. Nor does it appear to be a symptom of profligate spending.

In summary, the collapse in the headline savings ratio figure has served to spark an interesting debate about modern attitudes to saving and spending, but policy makers must be sure that they understand what is going on behind the headline figure if they are to effectively manage the modern economy.

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APPENDIX – WHAT HAPPENED IN Q1 2017

The fall in the savings ratio between Q4 2016 and Q1 2017 was particularly marked, reaching a record low of 1.7%, and represented a further sharp drop from the already low figure of 3.3% in Q4 2016. Given that pension saving went up between the two quarters, it seems likely that other factors were driving this change. What might those have been?

The figures for Q1 2017 show a drop in disposable income compared with three months earlier, and the payment of lump sum tax bills in the first quarter may have contributed to this. Commenting on the figures, the ONS said:

“The saving ratio has fallen again this quarter to a new record low, partly as a result of higher tax payments reducing disposable income. Some of the fall could be as a result of the timing of those payments, but the underlying trend is for a continued fall in the saving ratio.”

Looking at the detailed figures for the change between Q4 2016 and Q1 2017, it can be shown that the savings ratio **would not have fallen at all** but for the increase in payments of direct taxes on income. Table A1 shows the actual data underlying the savings ratio calculation in Q4 2016 and Q1 2017 and then an additional ‘what if’ column, assuming that direct tax payments had simply remained at their (nominal) level in Q4 2016 rather than increasing by £5.8 billion.

Table A1. Savings ratio calculation in a) Q4 2016 actual, b) Q1 2017 actual and c) Q1 2017 if no increase in direct taxation

(£ billion)	Q4 2016	Q1 2017	Q1 2017 <i>if no tax rise</i>
	<i>actual</i>	<i>actual</i>	
Disposable income	321.4	318.4	324.2
<i>plus</i> Change in pension entitlements	10.9	11.2	11.2
<i>equals</i> Total Resources	332.3	329.6	335.4
<i>minus</i> Total Consumption	321.2	324.0	324.0
<i>equals</i> Savings	11.0	5.6	11.4
Savings Ratio	3.3%	1.7%	3.4%
(= Savings/Total Resources)			

For the purposes of Table A1 we assume in the final column that the increase in income taxes of £5.8 billion did not happen and was simply added to disposable income. This is obviously a rather extreme assumption

ROYAL LONDON POLICY PAPER
Has Britain really stopped saving?

as (presumably) if large lump sum taxes had not been paid there would have been more money for consumption spending. On the other hand, if people knew that they had lump sum tax bills to pay in early 2017 they may well have put money aside through 2016. In other words, this money has indeed been diverted from consumption spending, but in an earlier period. If it is the case that people have been saving hard to set aside money to pay their tax bills, it would be ironic if the resultant low savings figure for Q1 2017 was taken as a sign of reckless irresponsibility amongst consumers.

