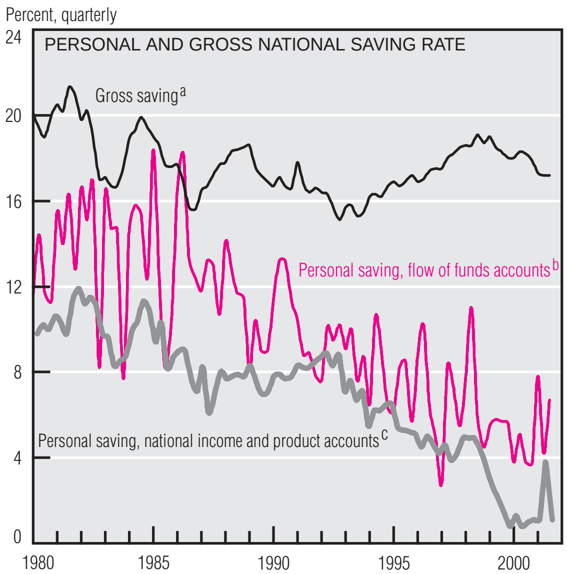
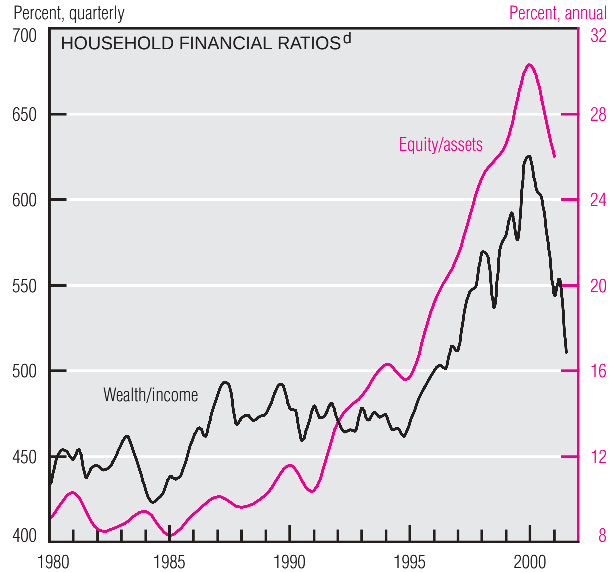
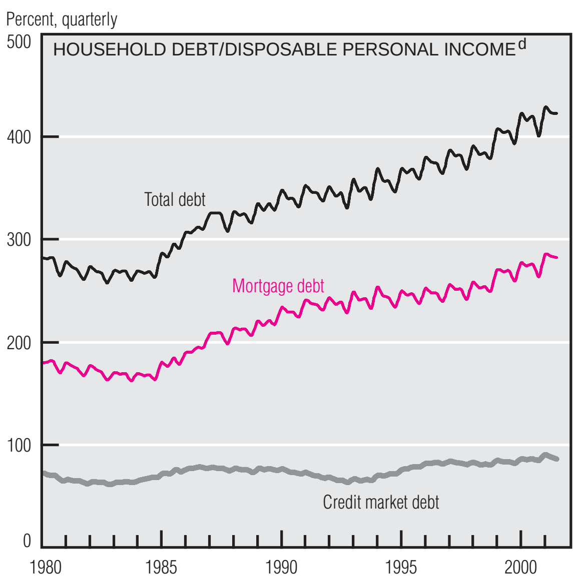
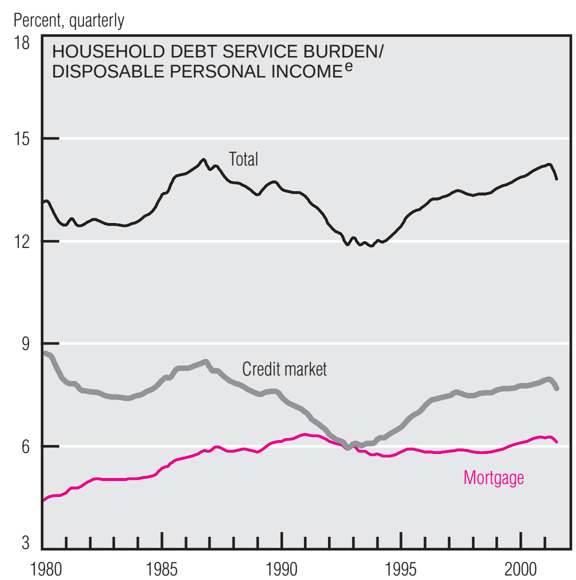
Household Financial Conditions









a. Seasonally adjusted at an annual rate. Expressed as a percent of gross national product.
b. Seasonally adjusted at an annual rate. Expressed as a percent of disposable personal income. Includes net investment in consumer durables.
c. Seasonally adjusted at an annual rate. Expressed as a percent of disposable personal income. Does not include net investment in consumer durables.
d. Not seasonally adjusted.
e. Seasonally adjusted.
SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

The national income and product accounts' measure of personal saving spiked in 2001:IIIQ because of tax rebates, then retracted in 2001:IVQ. The rate has generally been declining for more than 20 years. This may not reflect household saving behavior accurately, however, because it excludes items such as net investment in consumer durables. But the flow of funds measure, which includes these items, shows roughly the same trend. In both measures, disposable personal income removes capital gains taxes but does not include capital gains. Increased tax liability from capital gains reduces disposable personal income, lowering the saving rate. To the extent that capital gains finance additional consumption, they increase the saving rate's downward bias. The ratio of gross saving to GNP, which is invariant to how saving is allocated between the household, government, and business sectors, rose during much of the 1990s and declined in recent years.

The wealth-to-income ratio has also fallen dramatically, almost entirely because of declines in the market value of household equity, mutual funds, life insurance, and pension reserves. Equity is a larger share of household assets now than in the past, so the wealth-to-income ratio may show further large gains or reductions in the next several years.

The Tax Reform Act of 1986 eliminated deductions for consumer interest payments. Since the act's passage, total household debt relative to disposable personal income has risen steadily, mostly because of tax-favored mortgage borrowing. The debt-service burden fell from 1986 to 1993, but has risen since 1995.