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Post-Pandemic excess savings in Ireland

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Over the pandemic, Irish households accumulated an unprecedented stock of savings. Public health restrictions, including lockdowns, led to a sharp reduction in consumption while gross incomes fell by much less as some sectors continued to trade during the pandemic and household incomes were supported by fiscal interventions. The stock of savings accumulated during the pandemic over and above the usual (defined here as the pre-pandemic trend, namely between 2015 and 2019) level of household savings has been referred to as "excess savings". Between the first quarter of 2020 and the first quarter of 2023, the accumulated stock of excess savings rose steadily to reach 24.4 per cent of (gross) disposable income (GDI) in Ireland, compared with 11 per cent in the euro area.[2] As the effect of the pandemic on the economy has broadly ended, the use of these savings will have significant implications for the economic outlook in the coming years.

The impact of these excess savings on developments in the economy in the coming years will be driven by two related factors. Firstly, the type of household who accumulated these savings is important. Previous research (Lydon and McIndoe-Calder, 2021) has shown that savings during the pandemic were primarily accumulated by high-income households with a comparatively lower marginal propensity to consume (amount spent per additional euro of income).[3] Second, as households accumulate savings they have the option to save them in assets with different liquidity profiles, for example cash and overnight deposits represent liquid assets that have the potential to be spent in the

[1] Economists in the Irish Economic Analysis division.
[2] Euro area figure peaks at end 2022 (most recent data available for all countries) the figure remains at 10.8 per cent. In Ireland by 2023Q1 the figure was broadly stable (at 22 per cent of trend GDI).
[3] Households in Ireland in the first income decile have an MPC of around 54 per cent. This falls to 45 per cent for the highest income households.

short-run, while financial assets with longer maturities are more likely to be held on household balance sheets rather than spent. In this regard, Ireland differs markedly from the euro area, with a higher tendency to hold savings in more liquid form.

Revisions to the level of savings

The savings rate is defined in the System of National Accounts as the portion of nominal household gross disposable income (GDI) that is not spent in a given quarter (income minus consumption). These data are measured by the CSO in Ireland. By definition, these savings flows accumulate into a stock of savings held in financial and non-financial assets on the balance sheets of households. Hence saving can be estimated indirectly by measuring financial transactions by households along with new investment in housing assets. The Quarterly Financial Accounts estimate financial transactions, and together with the CSO's estimate of investment in housing this provides a net-asset-based estimate of saving. As different data sources are used, the two savings estimates are rarely exactly the same, and the difference between them is referred to as the statistical discrepancy in the Quarterly Financial Accounts (QFA) publication. In the 2022 Annual National Accounts, the level of consumption during the pandemic years was revised up substantially.[4] However, with only small revisions to income, the CSO has measured a significant downward revision in the savings ratio throughout 2021 and 2022, meaning that households have accumulated a lower level of savings than previously estimated. However, there has been no revision to the flows of financial transactions by households in the QFA, with the data pointing to a continued increase in households' net financial assets and investment in new housing. Accordingly, the changes in the savings rate have been reflected in large changes to the statistical discrepancy recorded between the National Accounts and the QFA. In and of itself this item has iterated between being large and positive and large and negative over time, owing to different compliation approaches and data sources. The scale and volatility of this discrepancy gives rise to a higher level of uncertainty about the level of excess savings and, as such, the projection for consumption.

Excess Savings

Taking these revisions on board, in the decade preceding the pandemic, the savings rate averaged around 8 per cent of disposable income, rising towards 12 per cent in 2019. During the pandemic, the savings rate reached 35.1 per cent at the peak, and remained high throughout the pandemic before falling more recently back to 11 per cent. Figure 1 shows the "excess" savings rate during the 2020-2022 period compared to its 2015-2019 trend.[5]

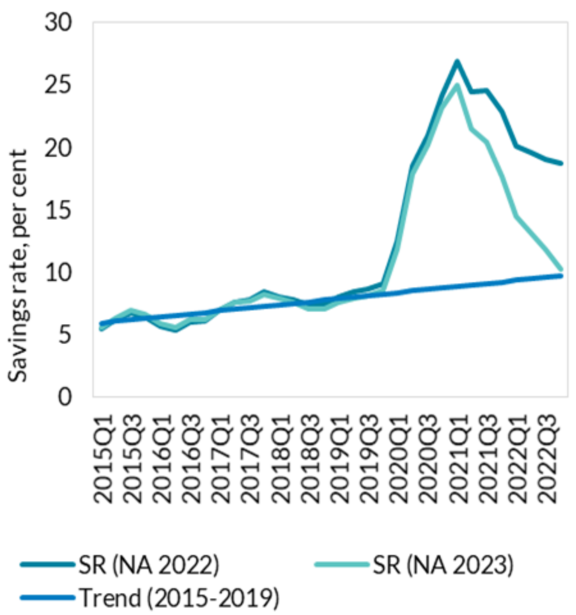
Figure 2 profiles household spending (final consumption expenditure or FCE) and GDI over the same period. Excess savings were generated due to large falls in spending, compared to trend, with a smaller

[4] Footnote consumption revisions
[5] Data are smoothed using a 4 quarter moving average.

role for income growth. Figure 1 plots FCE and GDI as published in the first estimate of the 2022 National Accounts as well as the most recent estimate. The upward revisions to FCE data from early 2021 have seen a substantial downward revision in the household savings rate in the period from 2021Q1, evident in Figure 2.

Savings rate increased substantially between 2020 and 2022, returning to pre-pandemic trend by early 2023

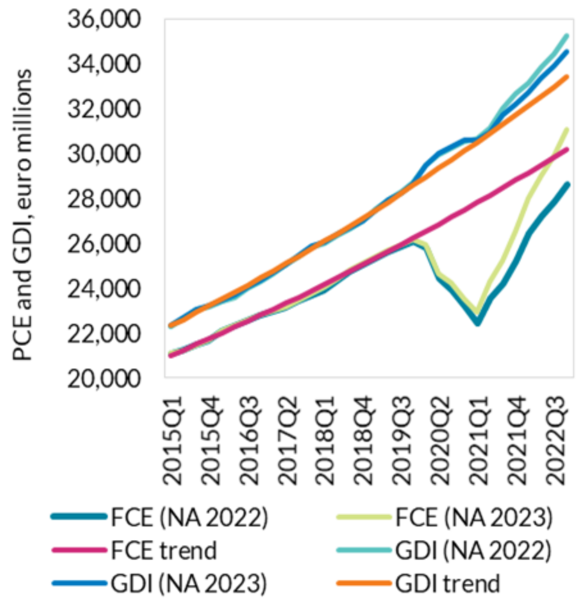
Figure 1: Savings rate: actual and trend 2015-2019



Source: CSO and authors' own calculations.
Note: PCE and GDI series smoothed using 4Q moving average, linear trend calculated over 2015-2019 period using smoothed data. NA are Annual National Accounts.

Revisions to consumption underlying falling savings rate in recent quarters

Figure 2: Excess savings: trend income and spending compared to actual



Source: CSO and authors' own calculations.
Note: Excess savings is calculated as the area between the FCE trend line and actual FCE combined with the area above the GDI trend line and actual GDI. NA are Annual National Accounts.

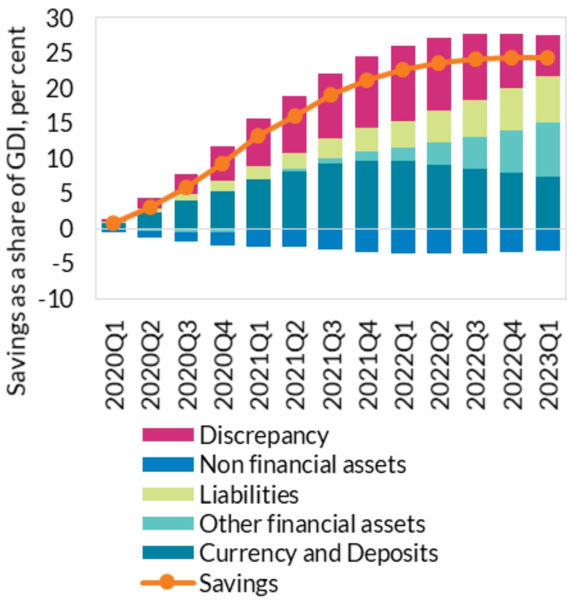
Quarterly Financial Accounts (QFA) (Central Bank, 2023) data provides information on how households allocate their savings in financial assets, tracing the quarterly net flows of financial assets. Using QFA and the CSO's capital investment estimates we examine household savings through the net acquisition of financial and non-financial assets. To estimate how much of these savings can be deemed excessive, we estimate the trend level of each of these savings components in the period prior to the pandemic (2015-2019). The level of savings above this trend during the pandemic represents the excessive portion. This is provides similar results, in aggregate, to an estimation of excess savings flows as the difference between trend and actual income less consumption (Figures 1 and 2).

Figures 3 and 4 represent the cumulated deviations of the flow of savings across assets from their pre-pandemic trends, in percentages of trend GDI for Ireland and the euro area, respectively. The vast majority of non-financial assets in Ireland comprise “New Investment in Housing” although there is also capital formation in other assets by the self-employed. Other Financial Assets calculated as the residual of “Total Financial Assets” less of “Currency and Deposits” and “Loans” in the euro area, and mainly refers to stocks, bonds, insurance and pension assets.

Excess savings increased in both Ireland and the euro area during 2020 and early 2021, falling gradually from the middle of 2021. Savings flows remained above trend into early 2023. However, as a share of GDI, households in Ireland have accumulated more than double the excess savings (24.4 per cent) compared with their euro area counterparts (11 per cent).[6]

Excess savings profile predominantly less liquid financial and real assets by 2023

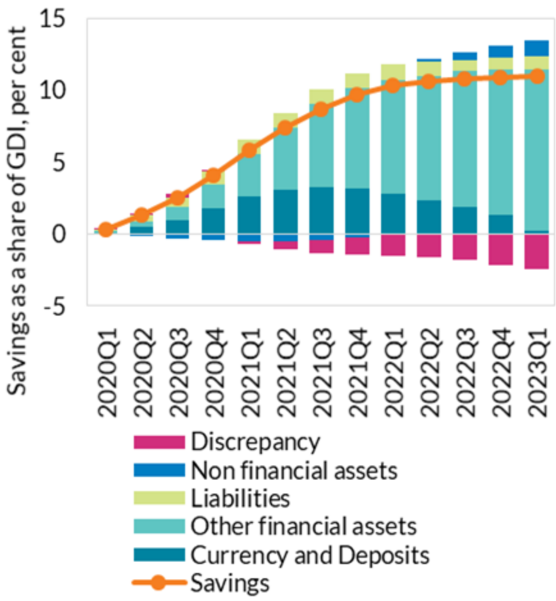
Figure 3: Excess savings in Ireland, by asset type



Source: Eurostat and authors' own calculations.
Note: Excess savings calculated as difference between smoothed actual savings flows and 2015-2019 linear trend.

Euro area households hold lower level of cumulated excess savings with small role for liquid financial assets by 2023

Figure 4: Excess savings in the Euro area, by asset type



Source: Eurostat and authors' own calculations.
Note: Excess savings calculated as difference between smoothed actual savings flows and 2015-2019 linear trend.

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[6] Consistent with ECB (2023) for euro area findings. The estimations in this box are highly sensitive to specific methodology employed. Analysis of excess savings may differ due to filter methods used, measurement definition, trend reference period, etc. While estimates may vary, we find our qualitative conclusions are consistent with ECB (2023).

Asset types

In the euro area most excess savings were accumulated in illiquid financial assets, while over two-thirds of excess savings in Ireland were held initially as more liquid financial assets, predominantly cash and deposits (Figure 3). From 2021 onwards Irish households continued to save at a high rate, holding a substantial portion as deposits, even whilst increasing their holdings of less liquid financial assets and paying off loans (shown as a positive contribution to excess savings in the Figures 3-4). In addition, households in Ireland have saved less in non-financial assets, mostly housing, since the beginning of the pandemic.

The composition of assets held by households in the euro area suggests that the initial surge in excess savings was driven by liquid financial assets (currency and deposits) and other financial assets, in roughly equal parts. Over time, excess savings flows became more dominated by flows into illiquid financial assets, as the flows into currency and deposits reverted to their pre-pandemic trend. Conversely, in Ireland, the early accumulation of excess savings were predominantly in liquid financial assets, and these have remained an important asset class for excess savings flows. Indeed excess liquid savings in Ireland by end 2022 account for 30 per cent of total cumulative excess savings. Less liquid financial assets comprise over 31.8 per cent of the cumulative flow of excess savings, with this share increasing steadily over time.

Why is Ireland different?

The explanations for the size and composition of excess savings in Irish households are complex and interrelated. The size of the savings rate in Ireland between 2020 and 2022 was large compared to the euro area. The accumulation of substantial surplus savings in Ireland, primarily in liquid assets, and in the euro area, predominantly in illiquid assets, reflects a continuation of historical trends, albeit at significantly higher levels. Traditionally, Irish households have invested their illiquid wealth in real assets, particularly property. As the accumulation of savings stabilizes, a portion of these savings in Ireland has indeed shifted toward illiquid assets, but this transition has been slower than in euro area. One explanation for this could be greater constraints on investing in dwellings compared to financial assets.

What does it mean for the economic outlook?

The latest consumption and savings revisions to the National Accounts data suggest a slower pace of consumption growth going forward, with less upside risk. Consumption in 2021 and 2022 was higher than previously estimated, and this means the stock of excess saving available for consumption in the future is lower than understood at the time of the last *Bulletin*. However, as noted above there is some

uncertainty over the precise size of the stock of excess savings at present and current data may be subject to further revision in future quarters. As interest rates rise and inflation moderates, households may have much higher incentive to allocate a larger portion of their savings into less liquid assets – which would further weigh on consumption over the forecast horizon.