Changes in China's savings rate, determinants and impacts[1]

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Abstract: In this paper, the authors analyze the changes of China's savings rate, the reasons behind the changes, and the impacts they bring on the economy. They point out that China is facing an aging population and a declining birthrate. One of the important countermeasures is to improve savings and investment. The article also pointed out that "we must be highly vigilant and prevent any sharp decline in the savings rate" and "recognize that consumption is never the source of growth."

I. Trends of China's Savings Rate during the 14th Five-Year Plan Period

The average national savings rate of all countries peaked before the outbreak of the global financial crisis in 2008, and then declined. Countries of different income levels vary significantly in the level of savings: the national savings rate of high-income countries is about 3 to 4 percentage points lower than the world average; that of upper middle-income countries is higher, and was 6.8 percentage points higher than the world average in 2018. **East Asian economies generally have higher savings rates than economies in other regions,** with the number being 10.1 percentage points higher than the world average in 2018.

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The composition of savings has shown the following features: First, the savings generated by the private sector such as residents and enterprises is the most important part of national savings, accounting for about four-fifths of the latter. Private sector savings are relatively more stable, especially after 2000, when public sector savings became the major cause of fluctuations in total savings; second, the savings behavior has shown huge differences among different types of economies; third, the savings rate of the corporate sector has been on the rise globally, while the share of household savings in the private sector savings has declined.

China’s savings rate has stayed at a high level, but has shown a downward trend after reaching a peak of 52.3% in 2008. The national savings rate in 2017 was as high as 46.2%, more than double the world average of around 20%, and higher than that of other East Asian economies.

The decline in the national savings rate occurs as the country’s economic structure moves towards a more balanced state, reflecting positive change.

The decline in government savings has been the main cause of the decline in national savings since the historical high in 2008. However, since private sector savings account for a larger proportion of national savings, future declines in the national savings rate will mainly come from the decline in the private savings rate, especially in the household savings rate.

In 2017, household savings accounted for 47% of national savings. Changes in household savings during the 14th Five-Year Plan period will have a decisive impact on the overall changes in national savings.

Wage income has seen rapid growth in the past ten years, and at a pace faster than labor productivity growth. **It is expected that the growth of residents' income during the 14th Five-Year Plan period will slow down and cause a decline in the residents' savings rate.** The uncertainty caused by the COVID-19 will have a smoothing effect on consumption in the early period of the 14th Five-Year Plan and drive the savings rate down.

During the 14th Five-Year Plan period, the corporate savings rate may maintain a slight upward trend. As industry concentration increases, the savings behavior of large companies has increased the overall level of corporate savings. These trends will continue during the 14th Five-Year Plan period. In addition, the uncertainty arising from events such as China-US frictions and the COVID-19 pandemic will encourage enterprises to save so as to cope with possible risks.

The public savings rate during the 14th Five-Year Plan period will continue to decline due to the increase in social security expenditures such as pensions and medical care caused by the aging population, tax cut and fee reductions as well as expansionary fiscal policy. In addition, the blow of the COVID-19 still lingers and no one is certain how long it will last. Post-pandemic economic recovery will require a large amount of public expenditure, which also reduces public savings. However, as the proportion of public savings in national savings is declining, the marginal contribution of its change to the overall change of national savings will become increasingly smaller.

II. Demographic changes may determine future savings rate changes

China's private sector savings rate accounted for 92.7% of national savings in 2017, of which 45.4 percentage points were corporate savings and 47.3 percentage points household savings. The rise in the dependency ratio and changes of a series of structural factors are the major causes of household savings changes.

The unique process of China's demographic transition and the resultant demographic structure change can shed light on the future trend of savings rate. **The rapid increase in the elderly population and the sharp decline in the working-age population are the main factors driving the rising dependency ratio and the falling savings rate.**

In 2019, the proportion of people aged 65 years and older in the total population in China reached 12.6%, and the proportion of people aged 60 years and older in the total population was 18.1%. The ageing process will continue to accelerate in the future, and will result in a rapid rise in the dependency ratio. Since 2013, China’s working-age population between 16 and 59 years old has been decreasing, with a cumulative fall of 23.14 million people during the six years.

During the 14th Five-Year Plan period, the total population of this age group will further decrease by 25 to 30 million people, much faster than during the 13th Five-Year Plan period.

In China, the working age refers to 20-59 years old, and the dependency ratio will rise from 0.68 in 2020 to 0.88 in 2030. If we calculate using the international standard which defines the working age as 20-64 years old, and population dependency ratio will rise from 0.54 in 2020 to 0.63 in 2030. Regression analysis indicates that **changes in the population structure may become the most important determinant of the future decline in the savings rate.**

In addition to the demographic structure, there are other factors that could influence the household savings rate.

The growth rate of wage income may slow down. **The expectation of income growth decline may become an increasingly important driving force for the decline in the savings rate;** in the future, it will be more difficult to rely on wage growth to improve income distribution. The relationship between income distribution and savings indicate a smaller possibility of high savings rate.

China’s urbanization process is not only an important driving force for expanding employment and promoting residents’ income growth, but also boosting consumption. After the various types of social security programs and public services are integrated, the system will cover more migrant population. With positive future expectations, the migrant population will be inclined to increase current consumption.

Therefore, the impact of urbanization on the savings rate in China may be closely related to the reform process, and it is difficult to tell what impact it brings on the savings rate. China’s social security system has been constantly improving, and it is inevitable that China will try to reduce the pension replacement ratio or prevent it from rising due to increasing pressure from population aging. This will surely have an impact on people's current savings behavior. **Specific impact will depend on the content and intensity of China’s reform.**

III. The effect of savings rate changes on the macroeconomy

The interplay between the savings rate and economic growth in China has its own distinctive features.

First, a high savings rate drives economic growth. The sustained high growth of the Chinese economy is correlated with the high savings rate in the country.

Second, according to empirical studies, **savings of the private sector work better in stimulating economic growth, while government savings hardly have any effect in this regard.** This means the decline in government savings and the rise in the proportion of the private sector in national savings in China in recent years both have positive implications for economic growth.

Third, economic growth exerts an influence on government savings, but not on the savings of the private sector. China's government revenue is closely related to economic growth, however and government expenditures have become increasingly rigid, therefore higher economic growth tends to push up government savings; in contrast, **the savings behavior of the private sector is determined by long-term structural factors, and is less sensitive to economic growth in the short run.**

Many empirical studies have revealed a robust correlation between savings and investments, which is stronger in economies of larger scale, and the correlation coefficient is higher than 0.6 according to estimates with different databases. The correlation coefficient between investment rate and national savings rate in China stands at 0.804, that between investment rate and household savings rate is 0.715, and that between investment rate and business savings rate 0.825.

There is also dynamic correlation between savings and investments, which is the influence of savings rate of prior periods on current investments. Empirical studies indicate that **investments have obvious effects on the savings behavior, with high-return investments boosting demands for capital goods and thus, stimulating savings. However, for** government savings, only savings lagging one period have significant impact on current investments. This shows the influence that the Chinese government has on investment decision-making.

On the other hand, savings rate of prior periods has influence on current investments, and savings play an increasingly important role in driving investments in the business sector. At the same time, household savings rate also has a lagging effect on business investments, with a long lag of 4 years. **This highlights the importance of deeper institutional reforms going forward for household savings to translate into business investments more efficiently and rapidly.**

How the savings rate affects the balance of payments can be seen in the national income formula. Past research on the balance of payments, savings and external imbalances tended to focus on the early years of the 21st century until the financial crisis in 2008, a period with surging current account balance. But if we look over a longer period, we will see that the rise in the proportion of current account balance in GDP is actually phased, with decreasing effect in distorting the economic structure.

China's GDP now is almost 4 times that in 2007 when the proportion of current account balance in the GDP was at historical high. Correspondingly, the effect of current account surplus on the economic structure is also diminished.

Empirical studies tell us that if we only use samples before 2008, we would see significant influence of the savings rate on the current account surplus, while the latter has hardly any effect on the former; but if samples after 2007 are included, the interplay between the savings rate and the balance of payment is no longer that obvious.

IV. Step up transfer payment and adjust the population policy in a timely manner

The level of the savings rate and change of its composition are determined by various factors, and the savings rate itself is not necessarily a direct target of policy intervention. However, as the savings rate is closely associated with many structural indicators, its fluctuations and determinants of its change could offer a clue to desired reform and policy directions.

First, it's important to forge an economic growth pattern in tandem with changes in the savings rate.

The high savings rate in China has much to do with the economic growth pattern at certain phase of development. The rich demographic dividend and relatively high investment return in previous periods have inevitably led to an economic growth model dominated by factor accumulation, while the high return has boosted savings.

However, as the demographic dividend diminishes and the factor-driven growth model can hardly sustain, there will be weaker correlation between a high savings rate and economic growth. On the contrary, a high savings rate may repress the growth momentum by squeezing consumer spending.

Second, the high savings rate in China betrays, to a large extent, inadequate social support policies.

The social security system in China has taken big strides forward over the past decades. But with economic growth and rising living standards, requirements on social security have also been higher. While China is about to enter the rank of high-income economies, its social security system lags far behind those in other high-income countries.

With insufficient social security support, households have to save more to deal with all types of uncertainties. Stepping up transfer payments to low-income groups and poor people, making the social security system more inclusive, and increasing support for public services such as healthcare, education and senior care will help forge a savings-spending relationship that is in line with the level of economic development.

Third, China's unique population policy has become an important factor shaping the savings rate. **Rapid population aging will be a key driver behind falling savings rate.**

We cannot tell the direction in which the savings rate will change as a result of change in the demographic structure. However, acute changes in the latter could trigger rapid fluctuations in the savings rate as well as other related macroeconomic indicators.

In the near and medium term, **the trend of population aging can hardly be reversed; however, timely adjustment of the population policy and allowing families to decide the number of children to have will help shape a more balanced demographic structure, thus flattening out fluctuations in the savings rate.**

Fourth, provide SMEs and private businesses access to regular financial services.

The rise in corporate savings rate is, to some extent, due to the fact that small- and medium-sized enterprises and private businesses hardly have access to regular financial services. They have to rely on internal accumulation of funds to finance their investments. On the other hand, excessive credit received by state-owned enterprises (SOEs) could also cause higher savings rate in these enterprises. Eliminating discriminatory treatment in credit and other financial services will increase the efficiency of fund allocation of businesses.