RECESSION LESSON:

The silver lining of the economic downturn

DEFINITION:

Savings is the process of setting aside a portion of current income for future use, or the resources accumulated in this way over a given period of time. (Brittannica.com)

Explanation of savings

There may be a silver lining to the recent economic downturn - Americans are saving again. Consumers are closing their wallets and socking money away in a way that hasn't been the norm for quite a while. The nation's personal savings rate, which was almost zero just two years ago, has risen to about five percent. That's the highest rate in 15 years, according to the U.S. Commerce Department. Will this trend continue past the recovery period? Have Americans finally internalized the importance of saving for financial well being?

Changes in savings habits during the recent recession

During the last 10 years, consumers racked up monumental personal debt through the expansive use of credit for purchases. Easy loans and payment plans were enticing to many who wanted the latest and greatest gadgets, TVs and cars. The quest for the best extended to the housing market as qualifications requirements for home mortgages relaxed and consumers were able to purchase houses with little or no down payment, and less regard for their ability to make future payments.

Personal savings rates were very low during this time period. For most Americans, that translated to no saving for a rainy day, no contributions to a retirement fund and no cushion for emergencies. Bad became worse as the recession entered the picture, bringing tighter access to credit, a housing foreclosure crisis and a dismal job market. If that wasn't enough, the coinciding financial crisis made the effects of the downturn even more severe.

Consumers recoiled from spending as the reality of these changes hit. They began to exhibit thrifty behaviors, such as paying only with cash and budgeting for essentials. The importance of "paying yourself first" through saving a portion of disposable income became increasingly popular. Many began to have savings dollars taken directly out of their paychecks and deposited in bank, credit union or retirement accounts. Americans embraced the philosophy of letting their money work for them to build a cushion for emergencies as they hunkered down to withstand the faltering economy. As a result, the personal savings rate began to climb in 2007.

Lessons learned about savings

Saving money is a lot like eating healthy. You know you should, but it's hard to do. To save successfully takes planning, discipline and commitment. Once a savings routine is developed, the habit of setting aside a portion of income becomes more ingrained. This recession jolted consumers out of careless spending behavior and forced them to reassess their wants and needs. They began the task of cutting back on purchases and delaying gratification in order to save for potential emergencies.

There's an interesting twist in the role of savings as the U.S. enters the economic recovery. While savings is good for the individual even in the short run, it's not very advantageous for an economy climbing out of a recession. A recovery somewhat depends on people's willingness to buy, which is why various programs were introduced during the economic downturn to spur consumer spending. That being said, sustained personal saving, preferably closer to 10 percent, is one of the best ways to ensure a strong economy in the long run. The trick is to find the proper mix of saving and spending. It might help to turn to the lessons Goldilocks learned in her search for the perfect porridge: not to hot (spending too much), not too cold (saving too much), but just right (a balance of saving and spending).

Historical example of saving habits: aftermath of the Great Depression

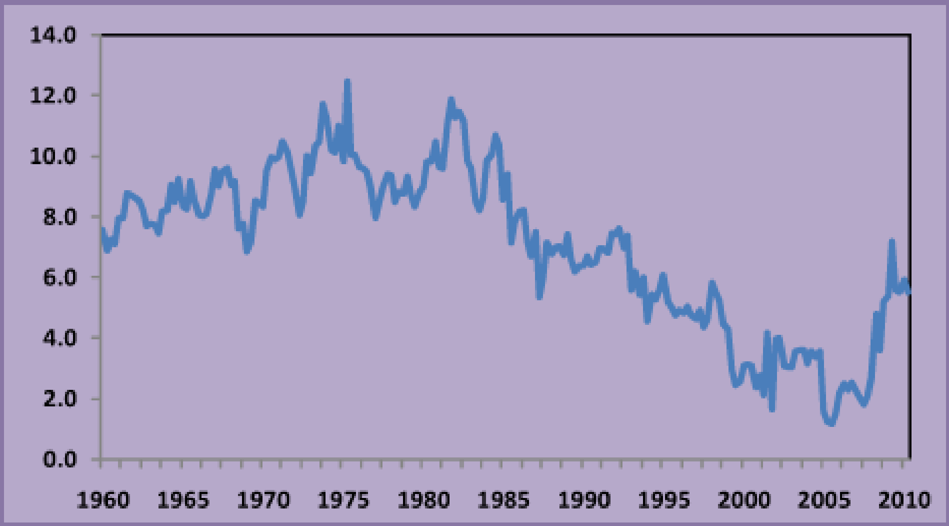
The Great Depression was the worst economic catastrophe of the 20th century and possibly the worst in our nation's history. From 1929-1933, the quantity of goods and services produced in the U.S. fell by one-third, 25 percent of the workforce was unemployed, the stock market lost 80 percent of its value, and some 7,000 banks failed.

This economic disaster was so devastating that it affected an entire generation's view on money and savings. The saying then was that Americans began to squeeze their pennies until Lincoln grinned. The belt-tightening was so severe that it affected people's ability to satisfy basic needs; wants weren't event considered. To exist during this time period, people learned to live below their means and question every purchase. As they survived the lean years, saving money was ingrained in their every though and action. By the start of World War II, the savings rate grew as soldiers' wages were deposited into Victory bonds and passbook savings accounts. By the war's end, savings rates were an astonishing 25 percent.

PICTURING SAVINGS

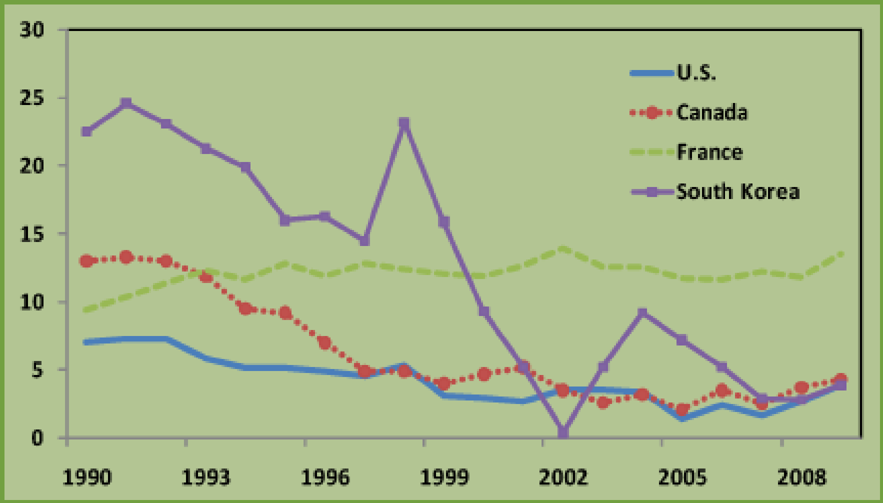
The following charts describe the U.S. savings rate both over time and in relation to other countries.

Personal Savings as a Percent of Disposable Income



Source: Bureau Economic Analysis

Personal Savings as a Percent of Disposable Income



Source: Bureau of Economic Analysis, OECD

RECESSION LESSON LEARNED: SAVING HABITS

Activity 1

Make the topic of savings habits real by discussing the ways students or their families have cut back on purchases in order to save money during the downturn. Ask if any of the money saved was put aside in an account for future use. Discuss the emergency situations that families might need to plan for by accumulating additional savings (for example: job loss; healthcare and hospitalization; home or car repairs, etc.).

Tell students that they will be conducting interviews with friends or family members to better understand changes in savings habits during the downturn. Help students develop possible questions to use in their interviews. Examples of questions might include: Did you try to save money before the recession began? Have you spent less money in the last two years? Did the events of the downturn influence you to save more disposable income? Students should complete at least three interviews on their own and share the results with the class. A comparison of class results could be done to see if the savings rate for the groups surveyed increased over this time period.

Activity 2

To further explore the methods that can be used to save, ask students to brainstorm the types of interest-bearing bank accounts they are familiar with. These examples should include: savings account; interest-bearing checking account; money market account; certificate of deposit; and investing in savings bonds. Tell students that they will be researching different financial institutions to find information on each savings tool, including current interest rates, to see which options are the best for them to increase their savings. Assign small groups to several local financial institutions, including commercial banks and credit unions. Give them website information for class-based research. Students could also visit their bank to pick up financial literature on rates and fees for each method of savings.

Ask groups to develop a chart or table listing each account at their bank, with interest rate and fees, as well as the advantages and disadvantages of using this method as a savings vehicle. Share charts with the class and choose the top three financial institutions with the most competitive rates.