Economic downturn has more folks stashing their cash

By Sandra Block and Barbara Hagenbaugh, USA TODAY

The Great Depression created a generation of Americans that abhorred waste and considered debt the devil's playground. Long after the economy recovered, they hoarded tin foil, saved little pieces of string and insisted on paying cash for their purchases.

Few economists believe this downturn will become another Great Depression. But the economic slump could have a lasting impact on Americans' savings habits, particularly young people who may be witnessing the worst economy they've seen in their lifetimes.

The personal saving rate, which measures how much people save out of disposable income, was 1.3% in the July-September quarter. Although that's low in comparison with other countries and a far cry from the double-digit percentages seen most recently in 1985, it's more than twice last year's rate.

Mark Zandi, chief economist for Moody's Economy.com, predicts a year from now, the saving rate will top 3%, and will hit 8% in the next decade.

"This feels very much like 9/11. (That) was to our sense of security as this financial panic is to our sense of financial security, " Zandi says.

But other economists predict that once the economy improves, Americans will return to their shop-till-you-drop ways. And it's unclear how much Americans are cutting back.

A USA TODAY/Gallup survey conducted in early November found that only 32% of Americans are saving more as a result of the economic downturn. But the figures for young adults were much higher. Forty-four percent of Americans ages 18 to 29, and 39% of Americans ages 30 to 49 said they're saving more.

Younger Americans also say they're going to cut back on their holiday spending far more than those who are older, according to a recent survey from the Conference Board, a private research firm. Those ages 25 to 34 said they planned to cut their holiday gift spending to an average of $377 this year from $463 in 2007, a 19% plunge. Across all age groups, people said they planned to cut holiday spending by 11% to $418.

Bargain hunting

And those who are still spending are looking for deals. Business at The Encore — A Quality Resale Shop, a consignment store in Kennett Square, Pa., is up about 20% from a year ago, co-manager Trish Clarke says. Customers typically pay a third of what they'd pay at a retail store, she says. The holidays, she adds, "are typically busy, but this year, it's even busier than ever."

Marissa Coren, 27, a speechwriter at the United Nations, says she's saving because she doesn't believe she has any other choice. "I think people my age, if they've been awake, have been raised seeing that we probably can't rely on the government for Social Security, and certainly not for health care," she says. "That has been equal parts empowering and sobering."

While Coren lives in one of the most expensive cities in the world, she managed to put away $5,000 in a Roth individual retirement account. She saves money by bringing her lunch to work and walking instead of taking cabs.

Jonathan Parker, a finance professor at Northwestern University's Kellogg School of Management, says it makes sense that young people are focusing more on saving in the current economic environment. In part, that's because with retirement a long way away, some may be putting money aside to invest in the depleted stock market, knowing they can buy low, then wait for their investments to grow.

Also, "The young are likely thinking that there are now enormous risks in their future earnings, and so this also gives a strong incentive to save," he says.

The economic downturn has fueled a surge of traffic at websites designed to help consumers — particularly those in their 20s and 30s — create a budget and cut back on spending. Mint.com, which lets users aggregate their bank accounts, credit card statements and other financial data, has seen the number of registered users double since the financial crisis began in September, says Aaron Patzer, chief executive officer.

At Wesabe, a social-networking site that also lets users track their finances, traffic has more than doubled in the last four months, Chief Executive Marc Hedlund says. "I do think that people are very motivated to make changes right now," he says. "People are cutting back on discretionary things left and right."

A fiscal diet?

People of all ages likely are saving more not entirely by choice. Banks are tightening credit, making it more difficult for consumers to borrow money to fund larger purchases such as big-screen TVs and cars. Gone are the days of no-money-down loans and huge credit card limits.

"We will not return to such loose credit for a long, long time," Parker says.

And Americans are also seeing their wealth shrink as housing and stock values fall. Rising wealth generally leads to greater spending, and a reverse trend is likely in place, Parker says.

Still, for many, saving is becoming a clear goal.

In October, Kelly Whalen, 32, of Exton, Pa., decided to embark on a "no-spend month," during which her family would spend only on necessities, such as groceries and gas. Whalen, who has four children under age 11, says she wanted to replenish the family's emergency savings fund, which was depleted by recent car repairs.

While there were a couple of slip-ups, the family managed to save $500 during the month and set aside $600 for holiday spending, Whalen says. She plans to continue the diet for two more months.

"We really do need to ramp up our retirement savings and college funds," she says. "All that stuff needs to happen soon, because we have an almost 11-year-old. When I think about that, it scares me."

Trent Hamm, 30, a writer who lives in Huxley, Iowa, observes one "no spend" day during the week and another on weekends. Hamm, who blogs about his finances at www.thesimpledollar.com, says the exercise made him aware of the "leakage" in his budget.

Hamm and his wife are avid readers, and used to buy five or six books a week. Now, they go to their library's website and reserve the books they want to read.

"We buy maybe one book a month," Hamm says. "It's a huge savings."

Nita Singh, 27, of San Jose, a project manager for Yahoo, says most of her friends have good jobs. Still, she says, they've become more careful about their spending. "We're all trying to save up, just for the unknown."

With unemployment rising, Singh says, "We're not going to take our jobs for granted any more. We want to see what we can do to control the situation, and that ties to how we use our money."

A lasting change?

While Americans ages 25 to 34 earn more and are better educated than previous generations of young workers, they also have the most debt, says Christopher Thornberg, founder of Beacon Economics and author of a new study, "Waiting to Save: The Crisis of the Young."

From 1985 to 2005, the most recent year for which statistics are available, this group saw its median debt rise 44%, according to Thornberg's analysis.

He also found that for every dollar of assets, this group is carrying 70 cents of debt, more than double the amount carried by older age groups.

Thornberg is hopeful that the economic crisis will motivate young people to reverse that trend. "Maybe these kids do understand there's no easy way out of this mess, and they have to focus more on the future," he says.

But while there's little question that Americans are saving more, there's disagreement about what will happen when the economy recovers. Mint.com's Patzer believes it will depend on the length of the downturn. "If it's a prolonged recession, I think it (saving) will stick," he says. "If it's a year or two, probably not."

Comerica Bank chief economist Dana Johnson, meanwhile, doubts a permanent change is underway.

"We don't have a very good track record in this country for saving a lot of our income," he says. "I have a real doubt it would persist into the next economic expansion."

Mixed blessing

While an increase in saving improves financial security for individuals, it's not good for the economy in the short term. Consumer spending accounts for 70% of all U.S. economic activity.

In the third quarter, consumers cut spending at a 3.7% annual pace. That was the first decline since the end of 1991, and the biggest drop since 1980, when the USA was in a recession. The decline in spending led to the biggest contraction in the economy in seven years in the quarter.

"The impact is to worsen the recession," Johnson says, noting economists call it the "paradox of saving."

"When people save more, they spend less," he says. "People spend less, producers of goods and services employ fewer people."

Retailers in the past five years have shifted their focus to younger shoppers, away from Baby Boomers, so a pullback on the part of so-called Generation Y consumers could really be felt by some stores, says Richard Feinberg, researcher at the Purdue Retail Institute at Purdue University.

Younger consumers spend a greater portion of their income on non-essential items, such as electronics, while Boomers are paying for necessities for their kids and their parents. Plus, retailers realize Gen Y'ers will someday inherit "trillions of dollars" from their parents, giving them more disposable income, Feinberg says.

"Paying attention to them today will probably have a big impact in 10 years," he says.

In the long run, though, saving is a good thing. It fuels domestic investment and is especially needed, given the long-term funding problems for Social Security, Medicare and Medicaid.

When Americans save more, it also means that the USA has to borrow less from abroad, helping to narrow the nation's gaping trade imbalance. That could help lead to "lower interest rates and more investment and innovation in the economy," Northwestern's Parker says.

"It's sort of like short-term pain for long-term gain," Macroeconomic Advisers President Chris Varvares says.