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Procedia Economics and Finance 39 (2016) 625 – 633

Procedia Economics and Finance

www.elsevier.com/locate/procedia

3rd GLOBAL CONFERENCE on BUSINESS, ECONOMICS, MANAGEMENT and TOURISM, 26-28 November 2015, Rome, Italy

(Ir)rational households' saving behavior? An empirical investigation

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Abstract

What is the households' saving behavior during different stages of economic cycle? What is the reaction of households' to the external shocks? Which factors motivate households' to save in foreign currency rather than in national currency? Are households' saving decisions rational and based on fundamentals economic indicators or, in contrary, irrational and resulted by 'herding' behavior? While these research questions are important for various reasons they are investigated in this empirical study. The objective of this study – to identify the economic and psychological factors influencing the households' saving behavior. The research methods: the systemic, logical and comparative analysis of the scientific literature and panel regression. The results of this empirical study show that the households' saving behavior is more irrational especially during economic downturn and financial crisis periods. These empirical findings can be explained by low degree of financial literacy, ineffective communication strategy of the central banks and governments during financial turmoil and economic downturn periods, etc.

Peer-review under responsibility of the Organizing Committee of BEMTUR- 2015

Keywords: households' saving behavior, 'herding' behavior, foreign currency, national currency

1. Introduction

National savings are determined by the behavior of governments, firms and households which may be influenced in different ways by changing socio-economic and demographic factors. The main sector of a national economy that saves is the household sector which savings behavior has been studied most extensively. Households' saving

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Peer-review under responsibility of the Organizing Committee of BEMTUR- 2015
doi:10.1016/S2212-5671(16)30309-4

behavior is determined by a complex of economic, demographic, social, and cultural factors. Economists (Fidrmuc et al., 2013; Crespo Cuaresma et al., 2014 etc.) have only recently begun to study the households' saving behavior from behavioral economics perspective while most of empirical studies focus on the socio-economic and demographic determinants of individual's saving behavior. Investigation of psychological and economic factors of households' saving behavior is important for various reasons. Savings are of interest to economists and psychologists because of savings' importance to both the economy and the individual. The importance of savings to the economy lies in a multiplicity of purposes of savings and influence on two fundamentals of the economy – growth and distribution. Households can use their savings as insurance or a protection means against unanticipated changes in economic circumstances as well as a means for redistribution of economic resources over the lifecycle. Materials goods in a form of savings can be easily transferred from one generation to the next. Savings are used to finance domestic and foreign investment, thereby contributing to economic growth. The households' saving behavior is also important for financial institutions and monetary authorities. Schlueter et al. (2015) argue that "banks face a 'behavioralization' of their balance sheets since deposit funding increasingly consists of non-maturing deposits with uncertain cash flows exposing them to asset liability risk". The sudden decisions of households' to save in foreign currency rather than in national currency could also increase the foreign currency risk of commercial banks' balance sheets. The dominance of savings in foreign currency creates a transmission channel of exogenous monetary disturbances. Foreign shocks increase the pressure on the monetary authorities to adjust these shocks using foreign reserves.

While most of economists focus attention on the role of socio-economic and demographic determinants rather than on psychological factors, psychological concepts almost disappeared from economic discussions on households' saving behavior. Economic theory has traditionally acknowledged some psychological individuals' saving behavior factors such as self-control, pessimism about the economy, and fear of economic uncertainty. However, scientific attempts to predict households' saving behavior using economic and psychological variables have met with limited success. This study aims to answer the following research questions: What is the households' saving behavior during different stages of economic cycle? What is the reaction of households' to the external shocks? Which factors motivate households' to save in foreign currency rather than in national currency? Are households' saving decisions rational and based on fundamentals economic indicators or, in contrary, irrational and resulted by 'herding' behavior? The objective of this study – to identify the economic and psychological factors influencing the households' saving behavior.

2. Literature review

Most of scientists investigate public or private savings behavior employing a Life Cycle Hypothesis (LCH) of individual savings developed by Modigliani (1966). According to Sturm (1983) there are four main motives leading to individuals' decision to save current income rather than to consume: saving for retirement, precautionary saving, saving for bequest, and saving for the acquisition of tangible assets. One of the most important saving motive – saving for retirement – forms the basis of LCH explaining the individual's consumption and saving behavior. This hypothesis generates the time profile of the individual's consumption and saving over the economic life-time of the individual. The individual accumulates net wealth (savings) during the pre-retirement period by consuming less than its disposable income. The maximum level of net wealth of the individual reached at retirement age will gradually decrease during the retirement period to finance current consumption. Sturm (1983) argues that individual's saving decisions can be determined by various motives and "in a rational society, savings decisions should be based on some kind of optimizing behavior by which the levels of consumption and saving are chosen so as to equalize the marginal benefits of these alternative uses of income". Sturm (1983) distinguishes main determinants of aggregate saving behavior. Firstly, Sturm (1983) argues that only in a growing economy the various saving motives of individual will lead to a positive aggregate saving while "in stationary equilibrium the positive retirement saving of "young" (i.e. pre-retirement) individuals' will be offset by dis-saving of individuals in retirement age". Sturm (1983) also states that the bequest motive of saving does not generate any net saving in stationary equilibrium while a constant level of assets is transferred from generation to generation. According to Sturm (1983) precautionary saving motive does not generate positive net saving of individuals' in stationary steady state because once reached its target level will remain constant. Concluding Sturm (1983) states that depending on the individual's income expectations, the implications of the different types of economic growth in terms of sources and nature for the