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In Focus
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Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.com

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.com

Royce Mendes
(416) 594-7354
royce.mendes@cibc.com

Katherine Judge
(416) 956-6527
katherine.judge@cibc.com

http://economics.cibccm.com

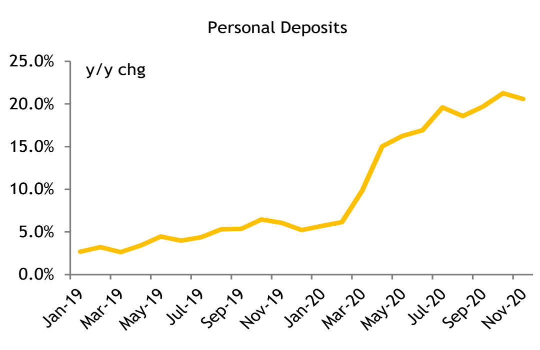
What Will Covid's Passive Savers Do With Their Money?

by Benjamin Tal and Katherine Judge

If you are one of the passive savers that's sitting on excess cash due to reduced spending, the government of Canada is counting on you to ignite a strong recovery by spending that money when it's safe to do so. The hope is that private sector stimulus will work to scale down the need for another round of an injection of fiscal money into the economy. Or at the minimum, it will allow the government to use any extra spending on productivity-enhancing projects as opposed to simply replacing or supplementing income.

The amount of excess cash in the system is a moving target. As of November, the level of cash in personal deposit accounts in the banking system was close to $120 billion above the level seen before the crisis, and was up by 20% on a year-over-year basis.

Chart 1
Deposits Continue to Accumulate as Services Remain Closed



Source: OSFI, CIBC

Today, as we approach the end of winter, that amount in all likelihood, is even larger (Chart 1).

Now, let's picture our lives six, eight, or ten months from now (pick a number). You are vaccinated (hopefully), and ready to restart your life. What will you do with that money?

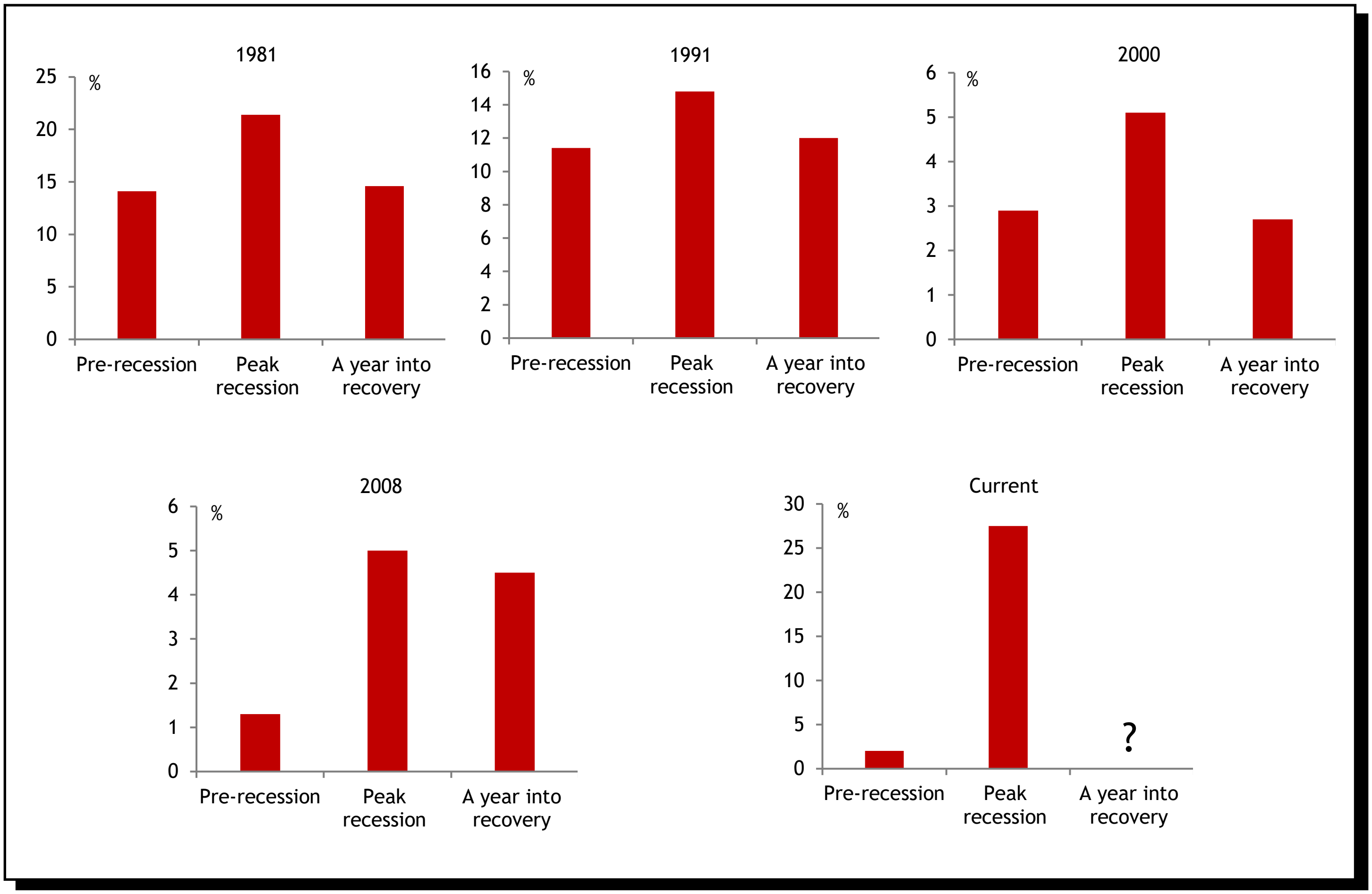
You have a few options: you can spend all or part of it with a vigor to make up for lost time; you might choose to keep the money untouched, but increase your spending by reducing the amount that you usually put aside on a monthly basis; you can use the money to invest or reduce debt. Or you might choose to do nothing.

What you elect to do will have a significant impact on the pace of the recovery in the second half of the year, on the future trajectory of fiscal policy, and even on the timing and scale of the response by the Bank of Canada.

Recessionary Savings

The first step in trying to get inside your head is to examine what you did in the past. Chart 2 tells the tale. All past recessions saw an increase in the savings rate, but it took less than a year on average for that rate to return to its pre-recession level. A notable exception was the 2008 financial crisis. The saving rate rose from 1.1% to 5.0% during that recession and stayed around that level well into the recovery.

Chart 2
Savings Rate Before, During, and After Recessions

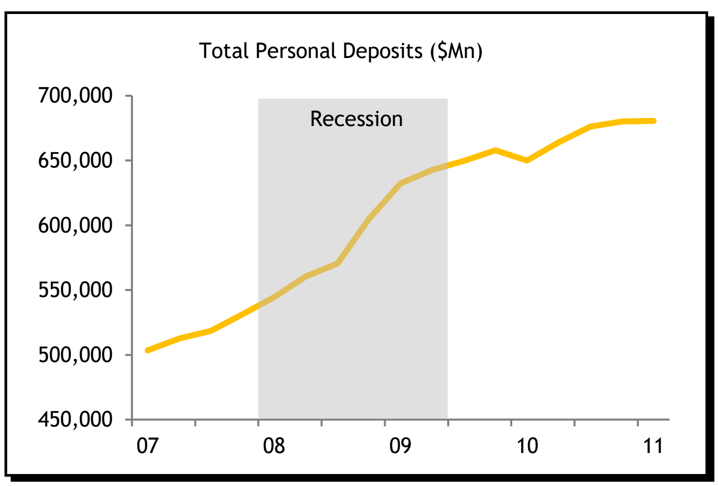


Source: Statistics Canada, CIBC

Chart 3 zooms in on the 2008 recession from a cash position perspective. Overall, the stock of personal deposits rose by 20% during the recession, but instead of reducing those elevated balances during the recovery, households in fact chose to enhance them.

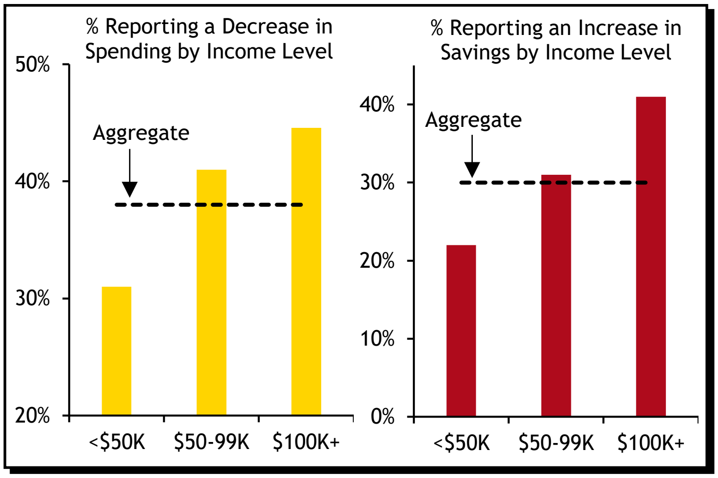
Will households do it again? We doubt it. It boils down to the difference in the nature of that recession versus the current one. The financial crisis resulted in some structural damage to the economy in general, and the financial system in particular. The increase in cash balances and the savings rate back then reflected pure increases in risk aversion. We suggest that the current situation is very different, and the accumulation of cash has very little to do with economic risk aversion and everything to do with public health restrictions and the fear of infection.

Chart 3
Cash Positions Continued to Grow After 2008/9 Recession



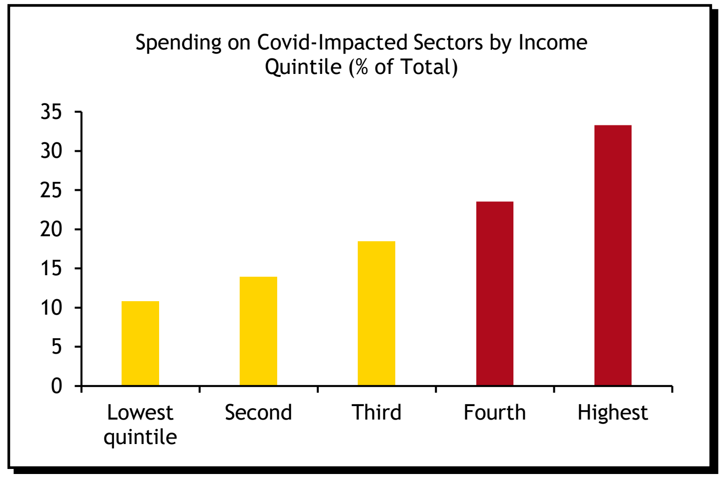
Source: Bank of Canada, CIBC

Chart 4
Decline in Spending (L) and Increased Saving (R), Positively Correlated with Income



Source: CIBC Poll[1]

Chart 5
Covid-Impacted Sectors Rely Mainly on Higher-Income Earners for Demand



Source: Statistics Canada, CIBC

Who Holds the Cash?

So we are comfortable suggesting that, in aggerate, you will not add to your cash position. But will you reduce it? The next step in our investigation is to look more closely at who is holding the cash. Our previous research (see here and here) hints that the vast majority of the excess savings are held by households in the middle and upper bands of the income scale. High frequency data (from the US) suggests that that group is responsible for the totality of the decline in consumer spending since the beginning of the pandemic, while the number of above-average wage jobs in the Canadian labour market has risen by north of 300K since then.

That makes sense, but now we have the data to support that claim. Our survey shows that almost 40% of Canadians reduced spending during the pandemic, with that share rising with the level of income (Chart 4, left). No surprise then, that 30% of households have seen savings rise. And again, the correlation of that with income is positive (Chart 4, right).

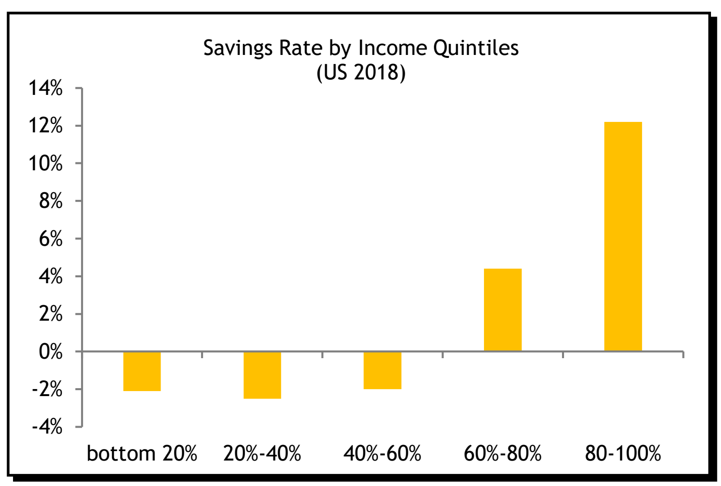
Where Will the Cash Go?

Now, as illustrated in Chart 5, those high earners that sit on the majority of the excess savings also tend to spend more on the sectors most directly impacted by the virus. Income earners in the highest two income quintiles accounted for 57% of spending on recreation, culture, leisure, and accommodations in 2019, suggesting a sharp rebound in demand for those services when they re-open.

And with a savings rate in the double digits, that group can easily finance spending on those sectors through a combination of a reduction in both the flow of new savings and the stock of their existing cash positions. Data from the US shows the wide dispersion in savings rates by income quintiles (Chart 6), and there is little reason to believe that the picture would be any different in Canada.

In line with that, the CIBC survey found that the number one destination for excess cash upon re-opening would be travel, with 36% of respondents that earn at least $100K annually suggesting that they would allocate saved funds to taking trips. Assuming that travel

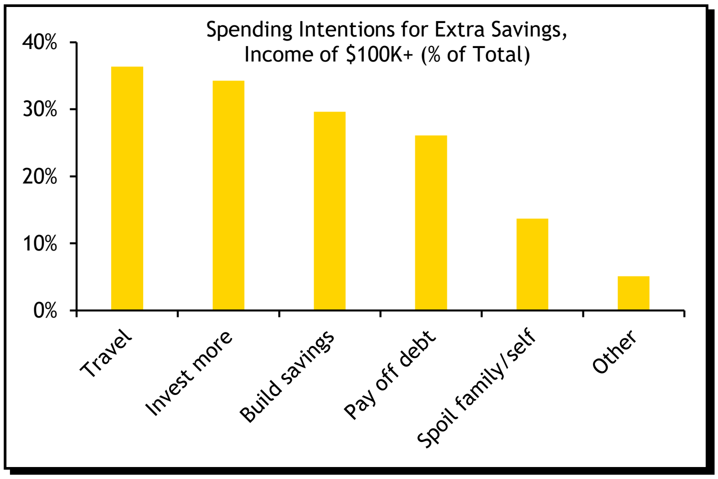
Chart 6
Savings Rate Already Elevated for Higher Income Earners



Source: Census Bureau, CIBC

Chart 7

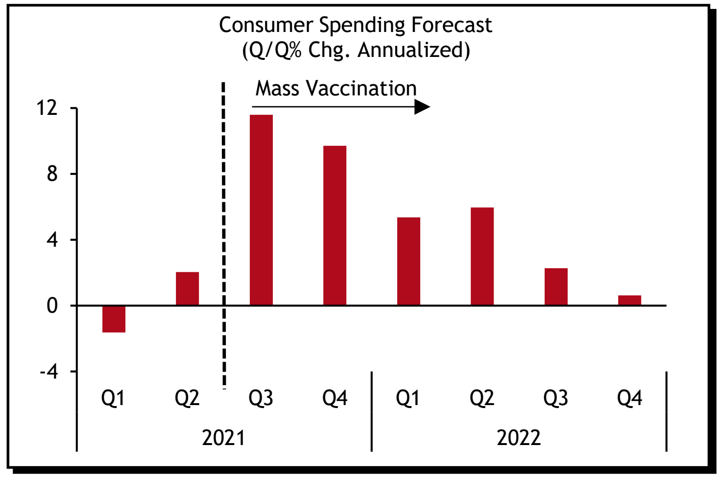
Travel is Top of Mind for Canadians Once Pandemic Subsides



Source: CIBC Poll[1]

Chart 8

Sharp Rebound in Consumption Expected Later this Year



Source: CIBC

restrictions could place limitations on international travel for longer than domestic travel, the Canadian economy will reap the benefits of some of that spending (Chart 7).

We of course do not know the amount of funds that will be allocated to each category, but when it comes to spending, we have to keep in mind that survey-based estimates are likely to be conservative. Even attempts to track daily spending patterns through credit and debit card activity following the $600 stimulus payments sent out in early January this year in the US fell well below actual spending, which was captured in January's massive gain in retail sales.

The Canadian economy is set to rebound by a roughly 7% annualized pace in both Q3 and Q4 of this year. Of that growth, consumer spending will be the main driver, as about 6%-points of each quarter's growth will come from household spending (Chart 8). That would be the case even if we assume that most of the excess cash remains in bank accounts. Excess cash is currently estimated to total up to $100 bn. We assume that a conservative 20% of it could be funneled into spending on services that re-open in the second half of the year, propelling the economic recovery and negating the need for additional fiscal stimulus.

Note

(1) CIBC Poll. From February 16th to February 17th 2021 an online survey of 3,026 randomly selected Canadian adults who are Maru Voice Canada panelists was executed by Maru/Blue. For comparison purposes, a probability sample of this size has an estimated margin of error (which measures sampling variability) of +/- 1.6%, 19 times out of 20. The results have been weighted by education, age, gender and region (and in Quebec, language) to match the population, according to Census data. This is to ensure the sample is representative of the entire adult population of Canada. Discrepancies in or between totals are due to rounding.