In Focus

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ECONOMICS

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Excess Cash

by Benjamin Tal and Katherine Judge

Covid-19 has triggered the largest cash accumulation in recorded history. We estimate that households and businesses are currently sitting on no less than $170 billion of excess cash. Redeployment of that cash will have a notable impact on the future trajectory of consumer spending and the economy as a whole.

Surging Household Savings and Cash Positions

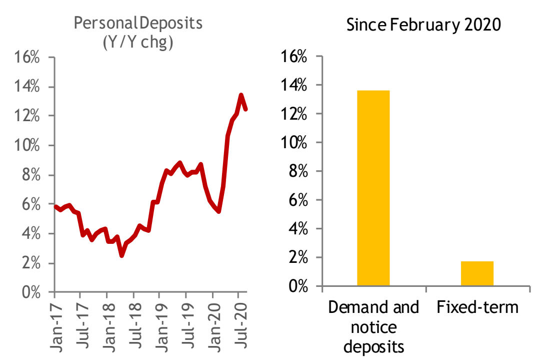
In the second quarter of 2020, labour income plummeted by just over $100 bn saar, while government transfers grew by close to $225 bn saar, with "other" benefits including the pandemic emergency programs growing by $151 bn saar. That spike in disposable incomes coincided with a notable decline in spending, which resulted in the savings rate surging from 3.6% to 28.2% as of June.

Since then, government support has become increasingly more tailored to those who need it the most, while the re-openings have seen a nascent recovery in consumer spending.

Using US data for the third quarter as a guidepost, the Canadian savings rate likely fell to 13% in Q3—still miles above the 3.6% level seen prior to the pandemic. With the second wave of infection upon us, that rate is likely to remain elevated during the winter.

Those new savings are quickly finding their way into households' chequings and savings accounts. On a year-over-year basis, consumer deposit balances are currently rising by an estimated 12% (Chart 1, left). And with current interest rates not so inviting, nearly all of that new cash is parked in notice and demand accounts, as opposed to term-deposits (Chart 1, right)—ready to be redeployed in short order.

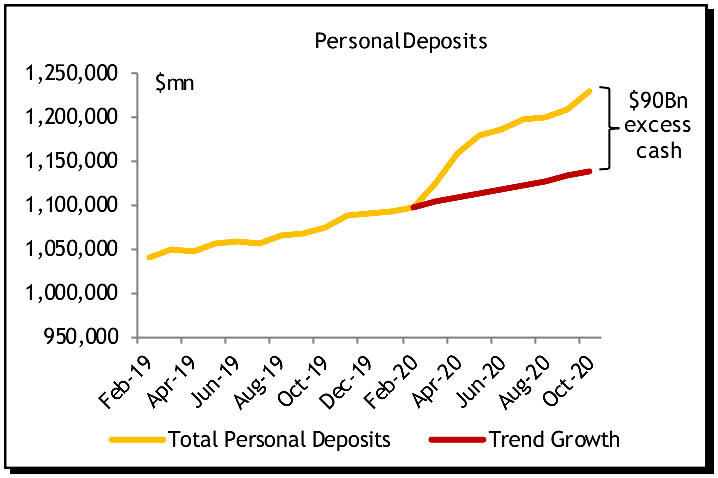
Chart 1
Strong Growth in Personal Deposits



Source: OSFI, CIBC

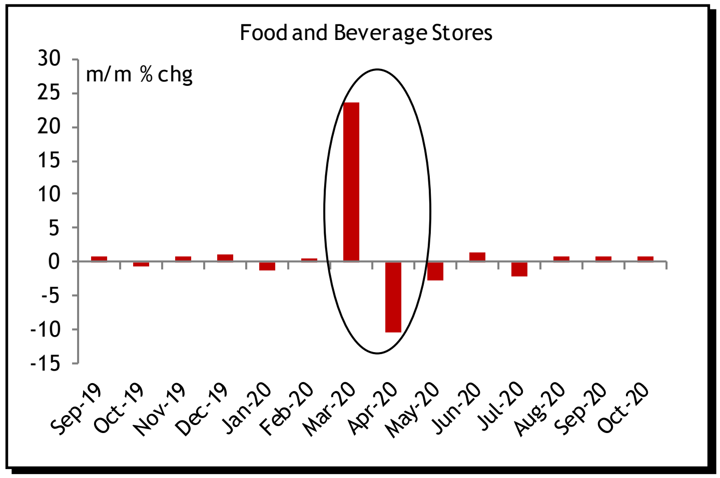
We estimate that the recent surge in deposits has led to an accumulation of no less than $90 billion of excess cash—beyond what we believe would have been the level of deposits were it not for the pandemic (Chart 2). That amount of excess cash is by far the largest on record and is equivalent to 4% of consumer spending.

Chart 2
Households Sitting on $90 Billion Excess Cash



Source: OSFI, CIBC

Chart 3
Panicky Shopping Experience in March Was Not Fully Reversed



Source: Statistics Canada, CIBC

Consumer Spending Growth To Slow in the Coming Months

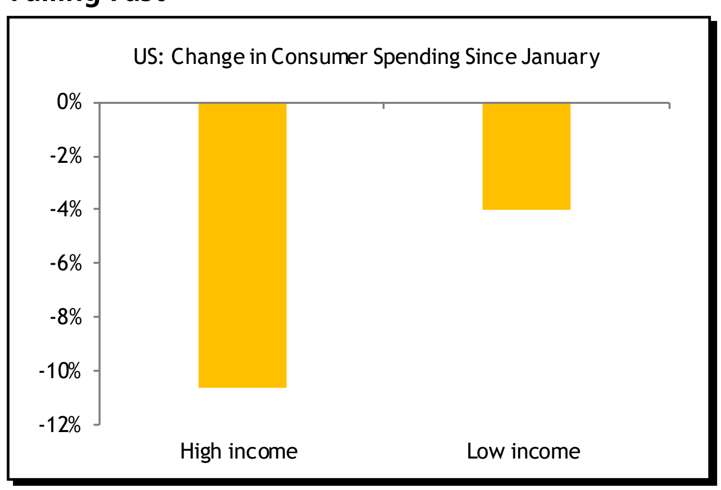
How quickly will households deploy that extra cash into the economy? We don't think it will happen in the near future. The coming 4-5 months will see a notable slowing in consumer spending growth while income levels will remain relatively elevated. Here's why:

- **The fear factor**: The second wave of infections and its overlap with the flu season will work to elevate the fear factor, which we believe will soon take over the availability factor as a major driver of consumer spending. That is, the economic benefit of a business remaining open will diminish in the coming months relative to what was seen during the happy days of the summer.

- **No panic**: As illustrated in Chart 3, the panicky consumption diverted to grocery stores early in the crisis was not fully reversed, with recent months seeing a more normal trajectory. We are currently in the midst of a second wave, but another run on stores is unlikely, as the experience of the spring worked to alleviate any fears of essential supply shortages.

- **Asymmetrical distribution of cash**: We suspect that the vast majority of excess cash is parked in the chequing accounts of mid and high-income households. As is well documented, the vast majority of job losses since February were amongst low-income Canadians. And those households did not reduce their consumption dramatically, given that a large portion of their income (be it government transfers or wages) goes to necessities. Where we see a much more dramatic decline in spending is amongst mid and high-income households that usually spend much more on "non-essential" goods, and more so on services. We do not have current data on spending by level of income for Canadians, but utilizing high-frequency US data, we learn that spending amongst high-income households is currently 10% below its January level—notably weaker than the 3% drop seen amongst low-income households. With the happy days of summer over, it is reasonable to assume that mid and high-income households will, in fact, reduce consumption of non-essentials again (Chart 4).

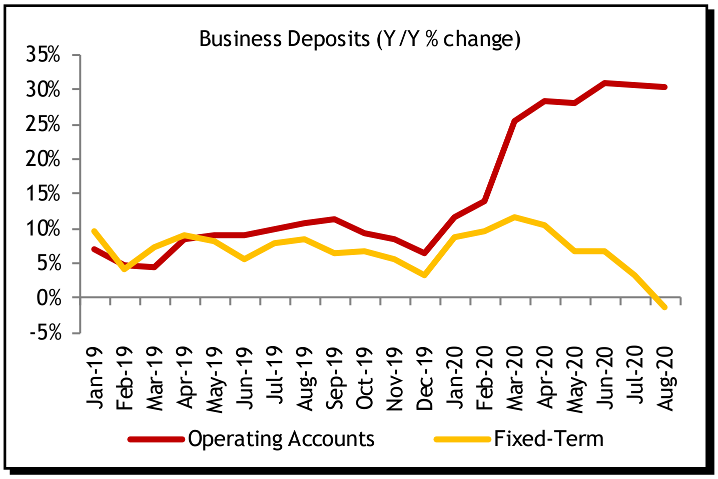
Chart 4
Spending Amongst High-Income Households Falling Fast



Source: Opportunity Insights, Harvard University, CIBC

Chart 5

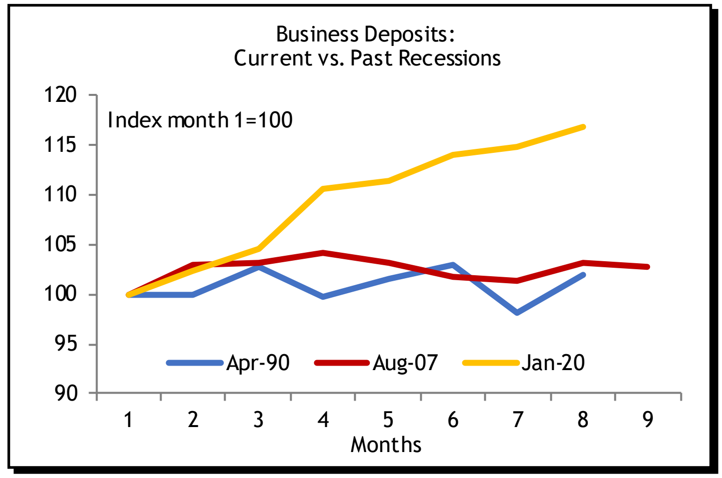
Strong Growth in Business Deposits



Source: OSFI, CIBC

Chart 6

Business Deposits Usually Do Not Rise in Recessions



Source: Statistics Canada, CIBC

- **Front Loading**: Sure, those high-income individuals will find it difficult to consume non-essential services in the coming months, but nothing is preventing them from consuming non-essential goods. However, they may have had their fill already. Their home office is already well equipped. There is no need to buy another computer, printer, desk or office chair. Most of the landscaping work has already been done, and there is no need for another exercise bike. Those spending categories are already notably above pre-pandemic levels, but have shown signs of levelling off or have fallen in recent months, and there is no reason to expect a reversal of that trend.

Income Will Remain Elevated

While consumption growth is projected to slow, we suggest that the level of personal income will remain elevated in the coming months. Sure, the modified EI system and the CRB program are more targeted than their predecessors, but a closer look suggests that disposable income will not see a notable decline from current levels. Estimates from the PBO put the cost of the CRB program at $17.9 bn through 2022. Combined with the modifications to the EI system, which are expected to cost an additional $13.5 bn over that time frame, these new programs amount to less than half of the almost $82 bn in CERB funds that have been doled out to households since the pandemic began. However, that estimate does not include the base cost of regular EI payments apart from modifications, which are expected to bolster incomes substantially, in conjunction with a rise in labour market income as jobs are gained back. Those sources of income will work to reduce the need of low-income Canadians to deploy any cash that might be currently sitting on the sidelines, or to increase borrowing (negative savings) to finance ongoing consumption.

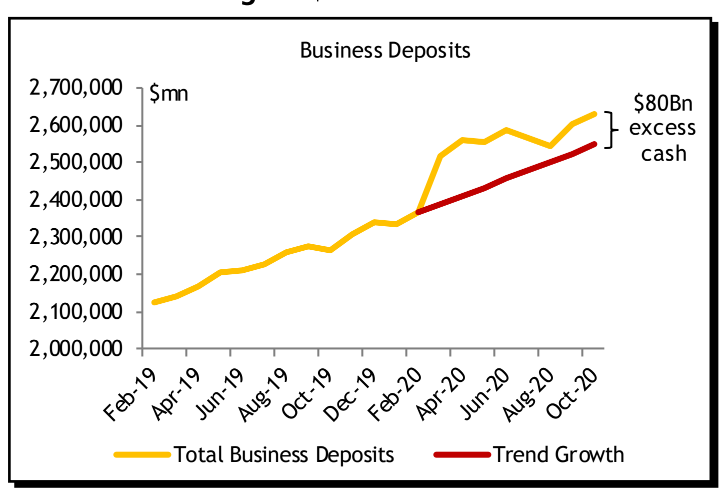
Cash Held by Businesses Also on the Rise

Cash is also king for Canadian businesses, which are now growing their cash positions by close to 15% on a year-over-year basis. All of that growth is coming from operating accounts, which are experiencing a dazzling 30% y/y pace of growth (Chart 5).

This trajectory is very different than what we have seen in previous recessions where the risk aversion factor was offset by reduced profitability and resulted in a relatively flat trajectory for biz deposit balances (Chart 6).

Chart 7

Businesses Sitting on $80 Billion Excess Cash



Source: Statistics Canada, CIBC

We estimate that Canadian corporations are currently sitting on no less than $80 billion in excess cash that is ready for deployment (Chart 7).

Here again, we expect little change in cash positions in the coming months given that we suspect that the vast majority of that extra cash is held by sectors that were not damaged notably by the crisis. Another factor here might be the $32 billion of CEBA loans taken by no less than 785,000 businesses. It is very possible that many companies took these loans as insurance, but kept them in deposit accounts—hence adding to their overall cash position.

Redeployment

Keeping cash positions at current levels is hardly optimal and is thus unsustainable. While households and businesses will keep cash positions elevated during the winter, we expect a relatively swift deployment of excess cash in the Spring and into the summer. Pent-up demand from mid and high-income households will be utilized rapidly, while businesses will be eager to deploy their cash in a more productive way. Repayment of CEBA loans will also play a role here.