

Commentary



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A tale of two outcomes: Pandemic relief has hit households and businesses unevenly

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Overview

The economy rebounded in the third quarter but remains well below its level before the recession began. Growth was concentrated in housing, retail goods and exports, while personal services and business investment lagged.

This commentary pays particular attention to household and business savings during the pandemic. Contrary to a CIBC report based on data covering only bank deposits, more comprehensive results from Statistics Canada shows that household savings soared during the second and third quarters at more than twice the rate of businesses.

Moreover, almost all corporate savings were in the financial sector, as non-financial corporations struggled to cope with plunging revenues and profits. This is consistent with the messaging from the federal government throughout its pandemic relief efforts of generosity in its approach to households and parsimony and suspicion in dealing with businesses.

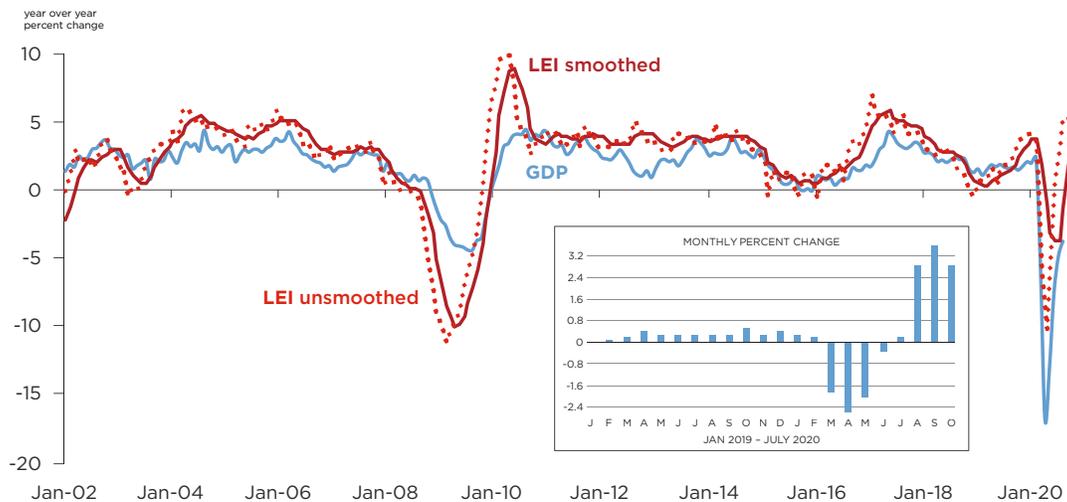
Uneven recovery in the third quarter

The economy rebounded from the shock of government mandated shutdowns due to the coronavirus, with real GDP rising 8.9 percent in the third quarter. However, after declines of 1.9 percent in the first quarter and a record 11.3 percent in the second, real GDP remained 5.3 percent below the level before the downturn began.

Some parts of the economy have completely recovered from the pandemic-related lockdowns in the spring. Housing boomed, with residential construction 10.3 percent above where it started the year as new home building, renovations and house sales all soared. Similarly, consumer spending on goods rose 4.8 percent in the first three quarters, fuelled by government-supported income transfers and the inability or unwillingness to buy many consumer services.

However, the recovery has lagged in other sectors. Consumer spending on services remains 12.4 percent down so far this year, as spending remains weak for areas such as travel, accommodation and food, gambling, and many personal services. Business investment also continues to lag, as its 13.5 percent decline this year mostly reflects a reluctance to spend in an uncertain business environment and plunging oil prices in the spring. Exports and imports have recovered about half their losses in the first half of the year.

Chart 1: MLI's Leading Economic Indicator (LEI) and GDP



Households and business finances behaved quite differently in 2020

A recent CIBC report claimed that households and businesses in Canada are “sitting on no less than \$170 billion of excess cash” that is almost evenly divided between households (\$90 billion) and businesses (\$80 billion) (Tal and Judge 2020). However, this assessment defines excess cash loosely as deposits in banks compared with their recent trend. This ignores the possibility that both households and businesses, faced with the unprecedented uncertainty surrounding the shutdown of large parts of the non-essential economy that threw millions of Canadians out of work, chose to restructure their balance sheets in favour of holding cash above all other assets and that other types of savings declined. For example, personal term deposits have declined since the start of the year, hardly surprising given the drop in their yield to near zero. Furthermore, the analysis lumps all businesses together, when the condition of financial and non-financial corporations has diverged sharply during the pandemic.

Fortunately, Statistics Canada publishes detailed data on household and business net savings and net lending. Savings as defined by the National Accounts is current income (net of government transfers and taxes) less spending on goods and services (excluding capital assets). Net lending is a more comprehensive measure which takes account of dealings in the capital account. For households, this mostly means accounting for spending on residential construction. For corporations, the capital account is more complicated, as depreciation allowances are added before investment spending is deducted. Statistics Canada also produces a breakdown within the business sector for non-financial corporations and financial corporations.

These data tell quite a different story than the CIBC’s limited focus on bank deposits. What emerges instead is a picture of a household sector holding substantially more savings during the pandemic than corporations. Both net savings and net lending by households showed huge increases during the second quarter and remained at historically high levels in the third quarter. By comparison, savings by corporations on balance turned negative in 2020, while net lending showed a small increase compared with households. Moreover, financial firms were the only corporate sector able to post net savings and they accounted for most of the net lending by businesses so far this year.

None of this analysis is meant to be a criticism of financial firms in 2020. Their robust financial position is unequivocally positive for our recovery moving forward, unlike the 2008-2009 financial crisis when many financial firms around the world (although not in Canada) needed government bail-outs to survive.

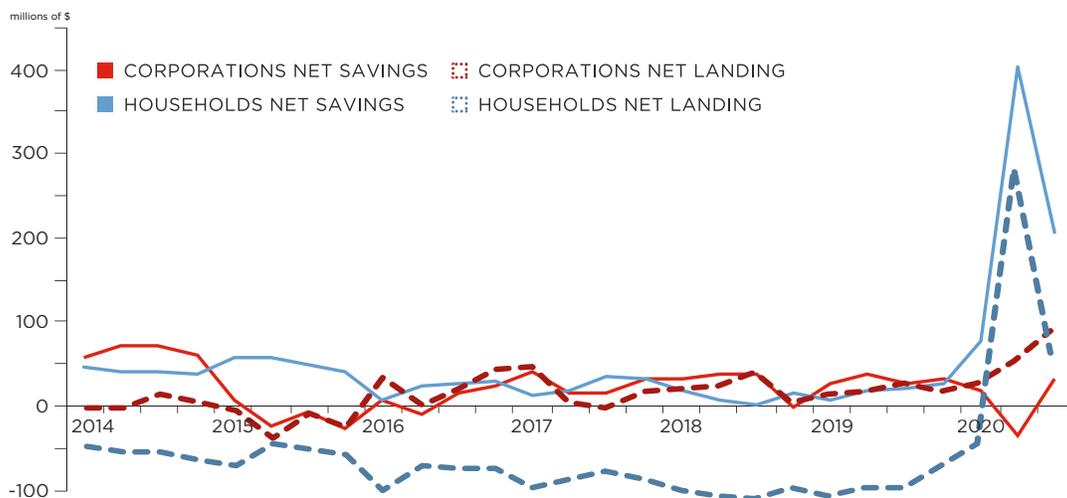
Financial firms are faring well in 2020 because the pandemic has not materially interfered with their operations. Indeed, the enormous increase in debt

during the crisis benefits banks since, as stated bluntly by renowned banking expert Gary Gorton (2012), “The output of a bank is debt” (5-6). And it is prudent that financial firms increase their reserves in anticipation of higher loan losses after many of the loan and tax deferral programs introduced in 2020 expire. The point is that the condition of financial firms contrasts markedly with non-financial businesses and data for the total corporate sector masks this important divergence.

Households savings surge in 2020 while business savings decline

Household savings soared from 2.0 percent before the arrival of the virus to 27.5 percent in the second quarter and 14.6 percent in the third quarter of 2020. Despite a sharp drop in earned incomes as jobs disappeared and hours worked plummeted, household disposable income rose by 12 percent in the second quarter and remained high in the third quarter entirely due to a massive increase in transfers from governments. As a result, household savings jumped from \$77 billion (at annual rates) in the first quarter to \$402 billion in the second and \$207 billion in the third quarter (Chart 2). Even after deducting outlays for housing, households swung suddenly from many years of net borrowing to a position of net lending of \$306 billion (at annual rates) in the second quarter and \$70 billion in the third quarter.¹

Chart 2: Corporations and households net savings, 2014 - 2020



Source: Statistics Canada, Table 36-10-0111-01 and 36-10-0112-01

Conducting this same exercise for corporations reveals a much more muted response of savings and net lending during the pandemic. Net savings by corporations slowed to \$16.8 billion (at annual rates) in the first quarter, fell outright by \$34.3 billion in the second quarter and recovered by only \$31.6 billion in the third, leading to a net increase of \$14.1 billion so far this year. This is distinctly different from the net increase of \$686.4 billion in household savings over these three quarters. Moreover, all of the net saving was concentrated in the financial sector, totalling \$104.4 billion. By comparison, net saving by non-financial corporations fell by \$90.4 billion. Net lending by firms fared slightly better, because firms slashed their investment; as a result, net lending rose by \$183.3 billion, just over half the increase of \$328.3 billion posted by households over the same period.

Financial firms account for most corporate cash holdings

Statistics Canada's Financial Flow Accounts² present data on how different sectors of the business community responded financially to the pandemic into the third quarter. While these data are not seasonally adjusted and are not at annual rates, they do provide strong evidence of which sectors were building up the cash deposits noted in the CIBC analysis.

Overall, corporation holdings of currency and deposits rose by \$565.0 billion in the first three quarters of the year. Of note is that \$424.9 or 75.2 percent of this increase was for financial corporations. Meanwhile, non-financial corporations raised their cash holdings by \$140.1 billion over the same three quarters.

Almost all of the increase in cash held by non-financial corporations originated in private firms, as government-controlled businesses only added \$4.7 billion to their cash reserves in the first three quarters of 2020. While private business firms radically changing their spending and balance sheets to cope with the unprecedented shock of pandemic-induced shutdowns and disruption of supply chains, there was almost no change in the behaviour of government-owned businesses whether looking at their net saving, net lending or cash holdings. Assured of their survival and not having to respond to either the marketplace or the stock market, government-owned corporations behaved as if nothing of consequence was happening in the business landscape in the first two quarters of 2020.

Bank of Canada data on household and business credit demand supports the portrait of business finances labouring under much more pressure than households during the onset of the pandemic in the spring.³ The annualized three-month growth of business credit accelerated sharply from 4.8 percent in February to 13.4 percent in April as firms scrambled to finance their operations while revenues nose-dived. Meanwhile, household credit demand

slowed from 4.3 percent annualized growth in February to a decline of 0.7 percent in June, a measure of how lavish government transfers alleviated the need for households to borrow. Since then, households resumed borrowing to finance their home-buying spree over the summer. Business loan demand subsided over the summer as large firms turned to the bond market to lock in historically low rates, once the Bank of Canada restored order to the corporate bond market by stepping up its purchases after corporate rates initially soared in the spring.

Finally, it would be wrong to assume all of the increase in cash holdings since the pandemic began represented an “excess” of money being held by either households or businesses. Both persons and firms began increasing their cash holdings at banks from the moment the pandemic began, presumably motivated by the massive uncertainty surrounding both the pandemic and how government would respond. These cash holdings rose even before governments began transferring record amounts of income support, especially to households.

It is also likely that this increased preference for cash will not be a temporary response to the pandemic. The pandemic, and the massive loss of both income and jobs that resulted, demonstrated clearly to both households and firms the virtues of having a strong balance sheet and abundant liquidity. It is quite possible that people and firms will continue to hold above-trend levels of cash long after the pandemic has been vanquished.

About the author



Philip Cross is a Munk Senior Fellow at the Macdonald-Laurier Institute. Prior to joining MLI, Mr. Cross spent 36 years at Statistics Canada specializing in macroeconomics. He was appointed Chief Economic Analyst in 2008 and was responsible for ensuring quality and coherency of all major economic statistics. During his career, he also wrote the “Current Economic Conditions” section of the Canadian Economic Observer, which provides Statistics Canada’s view of the economy. He is a frequent commentator on the economy and interpreter of Statistics Canada reports for the media and general public. He is also a member of the CD Howe Business Cycle Dating Committee.

References

Gorton, Gary B. 2012. *Misunderstanding Financial Crises: Why We Don't See Them Coming*. Oxford University Press.

Tal, Benjamin and Katherine Judge. 2020. "Excess Cash." CIBC Economics, November 17. Available at https://economics.cibccm.com/economicsweb/cds?ID=11759&TYPE=EC_PDF.

Endnotes

- 1 All data in this paragraph is from Statistics Canada, Table 36-10-0112-01: Current and capital accounts-Households.
- 2 See Statistics Canada, Table 36-10-0578-01: Financial Flow Accounts.
- 3 This data is from Bank of Canada, Historical selected credit measures, available at www.bankofcanada.ca/rates/banking-and-financial-statistics/selected-credit-measures-formerly-e2/.

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