Flush: What Record Savings Mean for Spending

The recent sharp upturn in the saving rate means U.S. households are sitting on more cash than they have in a long time (Figure 1). We estimate that the extra funds that have been built up through money that hasn’t been spent due to the lockdowns and an unprecedented surge in transfer payments adds up to as much as $460 billion in aggregate savings.

There is no guarantee consumers will rush out and spend all of this windfall, and to be clear that is not what we are forecasting. We look for record household savings to help fuel the sharp pick-up in spending we anticipate in the third quarter that might not be possible through monthly income alone. Still, even after the extra savings have fueled spending for the next year and a half, we still anticipate that the real level of personal consumption expenditures (PCE) will end 2021 about 2.5% below where it was at the end of 2019.

Source: U.S. Department of Commerce and Wells Fargo Securities

Keynes wrote about the “paradox of thrift,” the notion that if we all cut back on our individual spending, we are collectively much poorer. If he was right, that means personal savings are a drag on the economy during a recession. That is certainly the case with the personal spending figures rolling in now, which show unprecedented declines (Figure 2). However when the country reopens, U.S. consumers will change out of their sweat pants and step back into public life with unprecedented savings burning a hole their pocket. We are not going to bet against them.

Lockdowns Meant Huge Drop in Spending, but Also Huge Savings

“This time is different.” When we hear that phrase, we are immediately skeptical, so naturally we would not blame you if that is your reaction as well. Note, however, that we are not saying this time will be different, but rather we are simply observing that it already is different.

Never before have Americans been asked to stay in their homes and avoid social interaction as they have these past few months. That behavioral shift alone has resulted in some transitions in spending behavior that are casually observable (e.g. more spending at grocery stores rather than...
restaurants). More significantly, this behavioral shift has also meant an outright inability for consumers to spend on particular services. When was the last time you got a haircut, got on an airplane, visited the doctor for a routine check-up, or went to the movies? These are only a few examples, but they emphasize how large swaths of typical consumption have been halted. More plainly, even if households had the means and desire to spend on certain goods and services, they have not had the ability to spend at their normal rate, and this has resulted in a ‘forced savings’ effect.

We have written in recent months about the pent-up demand in services spending. If you missed any of those reports, the quick version is this: consumer spending on services usually makes up more than 60% of overall consumer outlays and typically does not decline, even in bad recessions. Instead, the volatility is usually in spending on goods. This is evident in Figure 3, which plots the average trajectory for the main categories of consumer spending over the past six economic downturns and subsequent recoveries.

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Figure 3

Average Change from Prior Cycle Peak
Real Spending, Average of Past 6 Cycles

Figure 4

Real Personal Consumption of Services
Month-over-Month Percent Change

Source: U.S. Department of Commerce and Wells Fargo Securities

The sudden and unprecedented stop in spending due to the lockdowns has already resulted in the largest drop in services spending on record (Figure 4). But the income that would have been spent during that time has not completely vanished. It has largely gone into savings, which can help underpin spending in the months and quarters ahead.

Some of that service spending is lost forever. Nobody is going to go get three haircuts for the ones that were missed during quarantine. But some of it will be made-up. Some missed vacations will eventually be taken; American Airlines recently announced a 74% increase in flights for July versus June. Going out to eat at an increased rate may be more challenging with social distancing, but a lot of people are tired of doing dinner and doing dishes. Anecdotal evidence suggests diners are eager to partake in whatever version of services restaurants are able to provide, be it alfresco or in parking lots, or simply leaving every other table empty.

They Call It “Stimulus” for a Reason

In addition to the forced restrictions on spending, the higher savings rate has also been driven by a surge in income. Personal income rose a record 10.5% in April, which was the same month that saw nonfarm payrolls decline by 20.7 million. How is it possible that the largest month-over-month increase in personal income in modern U.S. history occurred amid unprecedented job loss? As one would expect, wages & salaries, which typically account for the bulk of personal income, fell $740 billion in April. But, government transfer payments to persons increased nearly $3 trillion, more than making up for the lost wage & salary income (Figure 5).

The bulk of that increase is attributed to the “economic impact payments” distributed by the federal government. These direct payments to households were $1,200 for single filers making up to $75,000 and $2,400 for joint filers earning up to $150,000, with gradual phase-outs past those income thresholds. These one-off payments totaled roughly $300 billion, but since all of the
personal income data are reported on annualized basis, the annualized total in April was roughly $2.6 trillion. In addition, unemployment benefits rose $360 billion, replacing about 43% of the lost wage & salary income. However, we suspect this 43% replacement of wage & salary income is being understated, in part due to the well-documented delays in processing jobless claims during April. The combination of regular, state-level unemployment benefits plus the extra $600 per week from the federal government has led to average wage replacement levels that exceed 100% in some states (Figure 6).

All told, the $2.0 trillion annualized increase in personal income in April coupled with the $1.9 trillion annualized decline in personal outlays, caused personal savings to rise a record $337 billion (or $4 trillion on an annualized basis) during the month. Thus, personal savings as a share of personal disposable income, or what is known as the personal savings rate, shot-up to 33%. For perspective, prior to COVID-19 the personal saving rate was hovering just below 8%. If we were to hold this pre-COVID saving rate steady for March and April as a proxy for the level of “excess saving,” consumers are sitting on roughly $460 billion (not annualized) in excess savings. This leaves consumers with an ample cushion to tap when lockdowns are lifted and they are able to once again spend freely. Of course, some of this saving may be due to uncertainty about the economic outlook, a topic we cover in the next section.

Figure 5

April Personal Income
Change in Income by Category, $Trillions of USD

Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

Going forward, personal income will likely contract sharply in May. Unemployment benefits may be higher, but economic impact payments will likely be much lower. Combine that with a further decline in wage & salary income and we would not be shocked to see one of the largest ever monthly declines in income in May. Looking through the noise, the surge in personal income in April will still help offset weaker readings over the next few months, such that the average level of personal income over Q2 is at or above Q1 levels. Given that we expect personal consumption to collapse in Q2, this implies an unusually high personal saving rate in Q2.

But as the effect from the one-time payments fades, and with the extra $600 per week for unemployment set to expire on July 31, the medium-term outlook suggests that personal income will likely be below February levels through the second half of this year and well into 2021. Fortunately, the higher stock of savings discussed above should help make up for some of this lost income, such that consumption growth can moderately outpace income growth through the end of the year.

Our forecast implies an unusually high personal saving rate in Q2.

1 When economic data is “annualized” it is scaled up such that the number represents what the variable would be over a year’s time. For example, when personal income is reported to be $80.6 trillion in April, this is an annualized number, and the actual amount of personal income in the month of April is roughly one-twelfth of that.
A Fool and His Money

There is no way of knowing for certain how households will draw down this higher stock of savings, but our baseline expectation can be summed up as: a bump at the front-end, then more gradually after the initial surge. We do not expect households to carelessly rush out and blow their savings in single shot.

We made the case earlier in this report for a third quarter surge in services spending, part of which is attributable to pent-up demand. That implies that households are likely to spend some of the funds from those stimulus checks and perhaps even the unemployment benefits on long overdue services. This is not to suggest that those who are fresh out of work will be out on a shopping spree, but it does make sense that a jobseeker might make a trip to the barber or the salon prior to any potential interviews.

Also, for those who have merely been furloughed and plan to return to work, there might be less apprehension about depleting savings if they feel they can count on returning to the payroll at a certain date. This is reflected in the consumer confidence numbers; the forward-looking expectations component is roughly where it was in the autumn of last year before COVID-19 was on anybody’s radar (Figure 7).

Don’t Spend It All in One Place

There are a few key risks that would make us reassess the outlook as we have spelled it out thus far. The most ominous would be if the re-opening from the lockdowns is rushed and brings with it a renewed outbreak of the virus. Fed Chairman Jay Powell has referred to this as a “false start” and cautioned that it could diminish the efforts the Fed has provided with its monetary policy easing. Were the virus to come back and case counts were to start spiking, like they did in March, all bets are off and our forecast would require massive restructuring.

Source: The Conference Board, U.S. Department of Commerce and Wells Fargo Securities

For these temporarily laid-off workers, the accumulation of a few weeks of the supplemental $600 per week unemployment benefit from the federal government may result in increased spending. That was the whole idea of the stimulus program: make whole those who have been impacted by this crisis.

Our PCE forecast looks for spending in the second quarter to drop at an annualized rate of more than 40%. Outside of a lockdown, such a cratering in spending would defy any realistic expectation. The rebound in the third quarter is expected to be about the same growth rate but with a positive rather than a negative sign. If all those numbers are right, the level of consumer spending after the surge in Q3 would still be about 7.5% lower than where it was at its peak in the fourth quarter of 2019. By the end of the year, PCE is still down about 5% from its peak and even by the end of 2021 it would still be down around 2.5%. So the trajectory of spending is V-shaped, but it might be until the middle of 2022 before the right side of that V matched the left (Figure 8).
On the other side of that same coin, what if people remain too cautious? If too many consumers are afraid to ever leave their homes, or simply lack the confidence to tap their savings, then we are back to the paradox of thrift, where a lack of spending makes the recession worse.

But even during the Great Recession, the personal saving rate rose only a few percentage points over the course of the recession, far less than what has been seen so far. This suggests a great deal of the excess savings was of the “forced” variety. And so far, consumers generally seem eager to get back out. In recent weeks in the Carolinas, for example, a major retail outlet center recently reported customer traffic being back to 80% of pre-pandemic levels. So a possible upside risk, though rather less likely in our view, would be if consumers went out and blew the whole kitty in a single bacchanalian quarter of unrestrained spending. Given still-low levels of consumer confidence and the fact that the unemployment rate still stands at 13.3% as of May, this seems wildly unlikely, but a scenario in which the drawdown of savings is more front-end loaded could easily be imagined and it would not be the first time U.S. consumers exceeded modest expectations.

Barring these less likely scenarios, our bottom line for this report is that due to a combination of forced-frugality and an unprecedented surge in transfer payments, households are flush with cash. This money should help pay for a modest surge off a low base in the third quarter though we expect it to last much longer than that. We expect the windfall to augment incomes that may have been hobbled by the crisis and allow for consumer spending to grow faster than might otherwise have been possible.