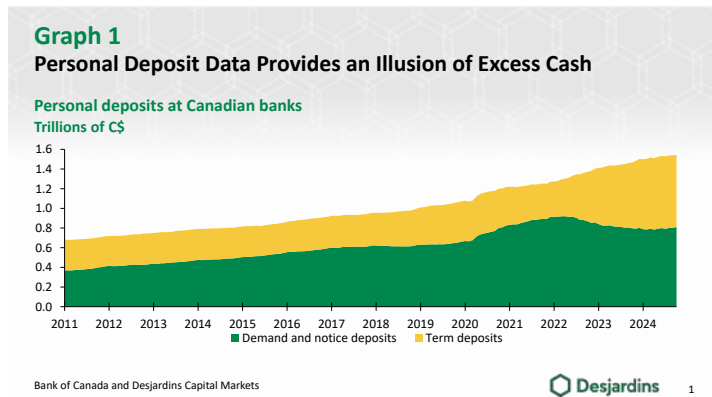


ECONOMIC VIEWPOINT

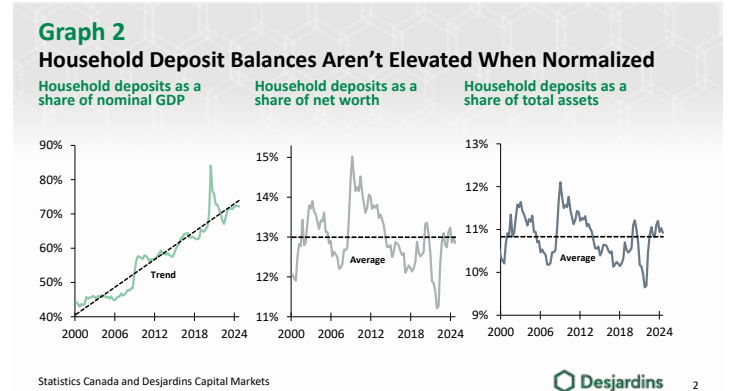
Strategic View: Revisiting the “Excess Cash” Hypothesis in Canada

By Royce Mendes, Managing Director and Head of Macro Strategy, and Tiago Figueiredo, Macro Strategist

It’s tempting to conclude that as interest rates on term deposits decline, some of the \$500 billion increase in bank deposits since 2019 will find its way into stocks (graph 1). But this so-called excess cash isn’t all that excess when viewed in the appropriate context. Our analysis shows that even if interest rates fall materially from current levels, there’s limited scope for those funds to flow into other asset classes. Our hypothesis is that much of the money currently in term deposits will be used either to pay down mortgages or to beef up demand deposit balances that have been on an unusual downward trend.



at household deposits as a share of total assets or net worth similarly shows that these holdings aren’t very different than pre-COVID norms (graph 2, middle and right).

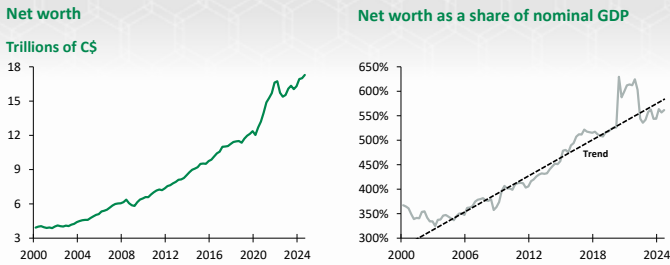


To accurately analyze the increase in savings, we must compare the dollar value to other variables such as the size of the economy or view the dollar value in the context of households’ total portfolio. Adjusting for the size of the economy accounts for changes in population, prices and, more generally, the overall capacity of the economy to generate such savings.

After normalizing for the nominal size of the economy, we find that total personal deposits are simply tracking the uptrend seen over the past quarter century (graph 2, left). Looking

It’s true that Canadian households are some \$5 trillion wealthier than they were pre-pandemic. But once again, that increase needs to be contextualized by normalizing net worth by the size of the economy (graph 3 on page 2, left). Household net worth as a share of GDP peaked in late 2021 (graph 3 on page 2, right) when the economy was still weak, inflation was under control and home values were at their highs. Rebounding economic activity, a sharp rise in consumer prices and a decline in house prices have since erased much of those gains. Net worth as a share of the economy is now undershooting its 20-year trend.

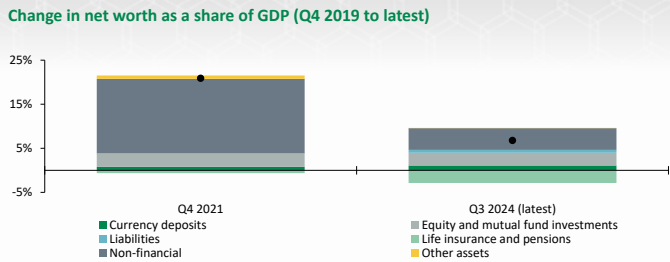
Graph 3
Higher Post-Pandemic Net Worth Is Also an Illusion



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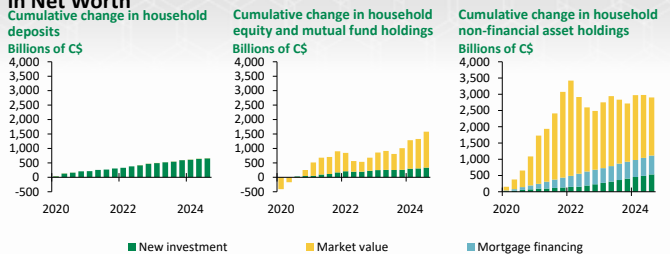
The below-trend 7% increase in net worth-to-GDP since 2019 is made up almost entirely of greater real estate, equity and mutual fund holdings (graph 4). The rise in stock and real estate values on household balance sheets is largely a result of increasing equity and home prices (graph 5, middle and right), although the past few quarters have seen non-financial assets and equities receive slightly greater allocations of new money.

Graph 4
Household Net Worth Peaked in Late 2021



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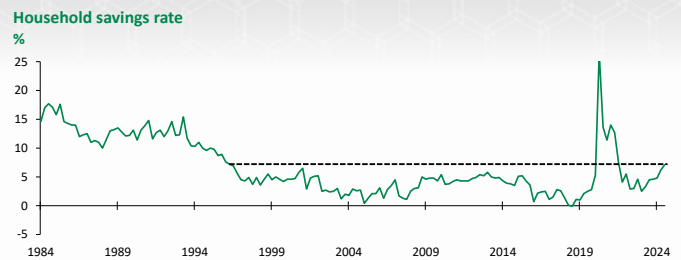
Graph 5
Rising Stock and Home Prices Contributed Significantly to the Increase in Net Worth



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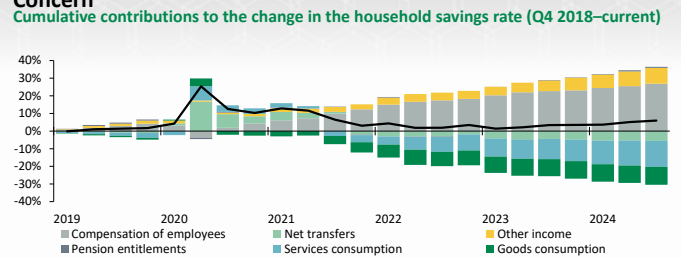
If Canadians were feeling flush with cash or wealthy, households would probably be spending significantly more of their incomes. Instead, the personal savings rate is higher than it's been in three decades, aside from the pandemic (graph 6). Employee compensation growth has easily outpaced growth in consumption of goods and services, with households taking a cautious approach to new spending (graph 7).

Graph 6
The Household Savings Rate Is Elevated



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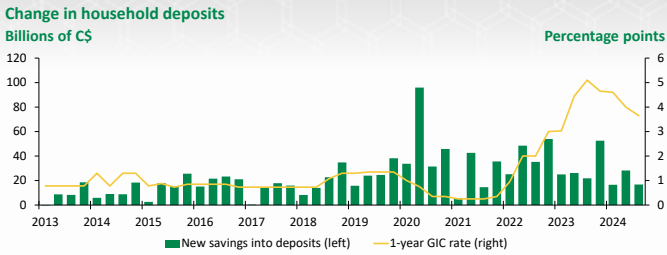
Graph 7
Savings Patterns for Households Reflect Caution Rather Than Concern



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But the elevated savings rate does leave some room for optimism. Recently, the flow of new savings into deposit accounts has slowed in line with the decline in term deposit interest rates (graph 8 on page 3). As mentioned, this has translated into slightly more of household savings going into equities and housing lately. The question then is whether high household savings rates will persist and continue to drive incremental money towards homes and stocks.

Graph 8
Deposit Accumulation Is Slowing as Interest Rates Fall



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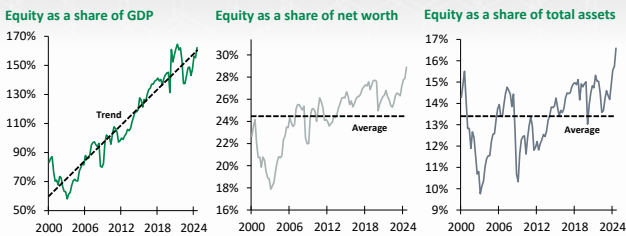


Our research suggests that the currently elevated rate is in part due to cautiousness about the economic outlook and in part due to mortgage holders prepositioning for mortgage renewals. With economic uncertainty rising and turmoil potentially on the horizon, it's possible that households will increase their precautionary savings. But most of that money won't likely be allocated to stocks, with households already having a greater-than-usual exposure to equities (graph 9). In the past when consumers have pulled back on spending in the face of economic volatility, deposit balances have increased (graph 10). In such a scenario, we see more money flowing into demand deposit accounts, meaning cash holdings could at least temporarily move above some of the trendlines previously noted.

Our revised hypothesis regarding "excess cash" puts us at odds with those who believe that money is set to move from term deposits into stocks. Cash is most likely to migrate from term deposits to demand deposit accounts. Even in a scenario where the savings rate remains elevated, new money saved is likely to head into bank accounts and safe fixed income products this year given the economic uncertainty. As a result, we expect only limited retail flows into equities as term deposit balances decline.

Separately, the lack of excess savings also means that there's little room for lower interest rates to unleash a wave of new consumer spending. So we're sticking to our call that the Bank of Canada cuts rates another 100 basis points this year, with the possibility of more if tariffs turn out to be worse than feared.

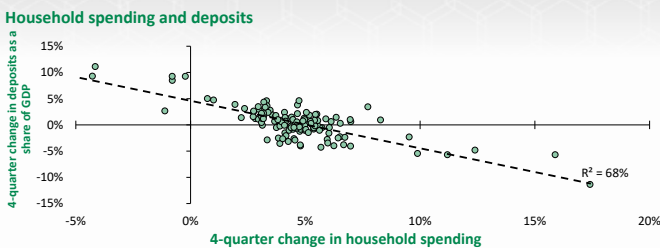
Graph 9
Household Equity Exposure Is Elevated by Some Measures



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Graph 10
A Pullback in Household Spending Typically Drives Bank Deposits Higher



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