Savings and consumption in times of pandemic: a historical and international review

Thanks to the effectiveness of the vaccines, the economy has experienced a strong revival and life is gradually returning to a certain degree of normality. But an event on the scale of the COVID-19 pandemic can have a lasting impact on the nature of economic activity. The extent of this impact will largely depend on our confidence, ability and willingness to return to pre-crisis investment and consumption patterns.

Pandemic economics in a historical perspective

The economic crisis triggered by COVID-19 is a black swan, a very rare event. We could refer to historical experience to understand it better, but we would be compelled to compare markedly different times, societies and economies. If we cast our net over the period spanning from the 14th century, with the black death, up until the 20th century, with the Spanish flu of 1918-1920, we will have had 19 pandemics in Europe and a fairly unequivocal view of their economic impact: they have a persistent effect, significantly depressing interest rates and economic activity growth for more than 10 years, and even more than 20 in some cases.[1]

However, the COVID-19 crisis is unique even in a comparison between pandemics. Historically, pandemics concluded with a high mortality and thus created a shortage of labour. This was a relative shortage, with the counterpart of an abundance of capital which weighed down interest rates, fuelled wage growth, and reduced investment and growth. COVID-19 is clearly a different pandemic: medicine and social protection measures have contained the mortality rate (which is also considered to be lower due to the nature of the virus), while economic policies protected the productive fabric of the economy. As a result, it may be more relevant to assess, for instance, the impact on interest rates with factors such as pressure on public debt or fears of fiscal dominance (rather than the mechanism of a relative abundance of capital that prevailed in previous pandemics).[2]

Scars on behaviour

Another way to analyse the consequences of a rare event such as COVID-19 is in terms of our personal beliefs. Over the past 15 years, we have experienced a major global financial crisis and a pandemic, two seemingly atypical events, which may no longer seem so unusual to us. However, the materialisation of an event that we assumed to be unlikely or impossible leads to major adjustments in what we believe is possible and probable, especially if it leaves a mark on our lives.

If it changes the way we look at the world and we become more sensitive to the risk of very severe events, then the COVID-19 pandemic could leave scars in the form of greater risk aversion, higher savings, lower demand, and ultimately lower interest and growth rates. In fact, there is ample evidence that economic crises have lasting consequences for consumption, saving and investment preferences. Enduring difficulties, such as financial losses, low investment returns or periods of unemployment, persistently translates into greater risk aversion,[3] lower consumption,[4] and lower participation in equity markets.[5] Furthermore, these and other such effects arise when comparing people who, beyond differences in their past, are of a similar age today and have similar levels of income, wealth and working status. These after-effects even influence sophisticated economists such as the highest-ranking policymakers at the Fed: it has been documented that they are more hawkish when they have witnessed higher inflation rates during their lifetimes.[6]

The unique economic nature of the COVID-19 pandemic

The legacy of COVID-19 in our beliefs has important implications. As an example, some economists suggest that the shortage of workers in some US companies may reflect a change in preferences among households, who now want more free time to spend with family.[7] This also has important implications for the future of the savings generated during the crisis. As the first two charts show, the increase in savings has been relatively long-lasting and the volumes amassed are significant. As it is a severe crisis, the scars of the pandemic could keep savings captive and weigh down on the performance of the economy. However, once again, we must remember that the COVID-19 pandemic is an atypical and severe event: we have experienced a historic collapse in the

1. See Ò. Jordà, S.R. Singh and A.M. Taylor (2020). «Longer-run economic consequences of pandemics?». The Review of Economics and Statistics, 1-29.
2. See the article «The shadow of fiscal dominance» in the Dossier of the MR04/2021.
3. See S. Andersen, T. Hanspal and K.M. Nielsen (2019). «Once bitten, twice shy: The power of personal experiences in risk taking». Journal of Financial Economics, 132(3), 97-117. They study the rearrangement of investment portfolios received through inheritance due to a sudden death. On average, individuals who had suffered first-person losses as a result of the 2007-2008 financial crisis reduced the proportion of their total portfolio allocated to risk-bearing assets by 9 pps (compared to the control group, which also received an inheritance but had not suffered losses in the financial crisis).
4. See U. Malmendier and L.S. Shen (2018). «Scarred consumption». National Bureau of Economic Research, nº w24696.
5. See U. Malmendier and S. Nagel (2011). «Depression babies: do macroeconomic experiences affect risk taking?». The quarterly journal of economics, 126(1), 373-416.
6. In other words, they are consistently more favourable towards tightening monetary policy. See U. Malmendier, S. Nagel and Z. Yan (2017). «The making of hawks and doves: Inflation experiences on the FOMC». National Bureau of Economic Research, nº w23228.
7. See D. Autor (2021). *Good news: there's a labor shortage*. Opinion article in *The New York Times*.

economy, but we have also witnessed a rapid economic revival, and in some financial markets the rebound has even flirted with exuberance. Similarly, many workers were forced to suspend their activity, but they were not left unemployed: many company-worker employment relations have been maintained through programmes such as furlough schemes, which have facilitated the return to work and have eased uncertainty over job prospects. Moreover, unlike in other crises, the current accumulation of savings is not so much driven by precaution, but rather by an inability to consume because of the restrictions on activity themselves;[8] in fact, the bulk of the savings has been stored in bank deposits, making it easier to quickly convert them into consumption.[9]

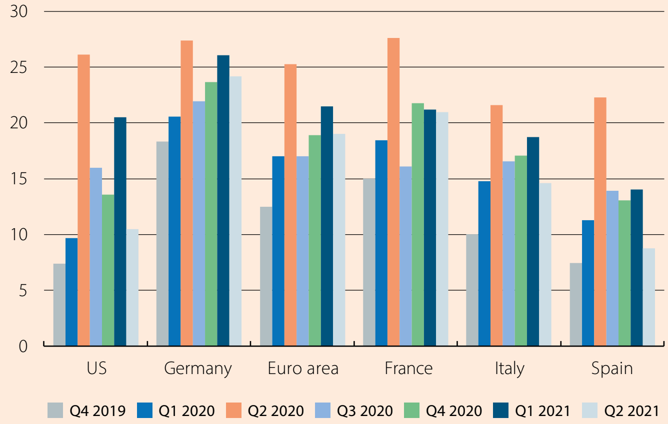
The atypical nature of the crisis is clear if we look at the evolution of three different types of spending: durable goods, non-durable goods, and services. As the third chart shows, the pandemic is still weighing down the consumption of services, which is the category most heavily penalised by the restrictions. However, the consumption of goods, both durable and non-durable, has registered a significant rebound and is already well above pre-crisis levels,[10] seemingly unaffected by the uncertainty and providing another sign of the unique economic nature of the COVID-19 pandemic. This uniqueness is also currently emerging on the supply side: the disruptions to global supply chains, resulting from bottlenecks in global transportation and shortages of some components (semiconductors, microchips, etc.) in a context of strong demand could, to some extent, temper the surge in consumption over the coming months if they become more pronounced.

Thus, while it is tempting to extrapolate the experience of past economic crises and expect persistent scars on savings, consumption and investment, the atypical nature of the COVID-19 pandemic raises many questions, including in relation to the validity of past experiences. Speculating about the future economic consequences of the current crisis is inevitable, but what is really necessary is to have good information about the actual response from consumers, savers and investors. This is precisely what we offer the reader in the following pages of this Dossier: precise and detailed information, based on internal CaixaBank microdata, on the real-time behaviour of Spanish consumers and savers in times of pandemic.

Adrià Morron Salmeron

Household savings rate

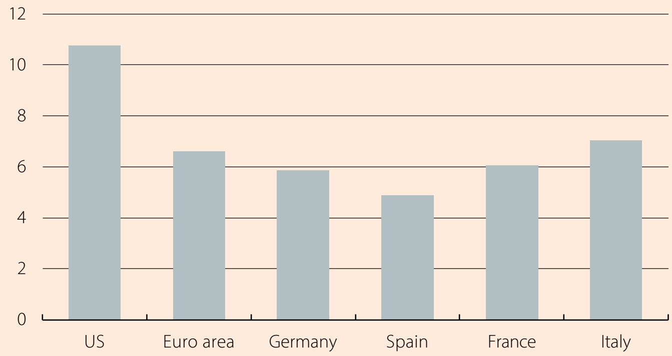
(% of gross disposable income)



Note: *Stationary quarterly data, adjusted for calendar effects and seasonality.*
Source: *CaixaBank Research, based on data from the U.S. BEA and Eurostat.*

Excess savings accumulated between Q1 2020 and Q2 2021

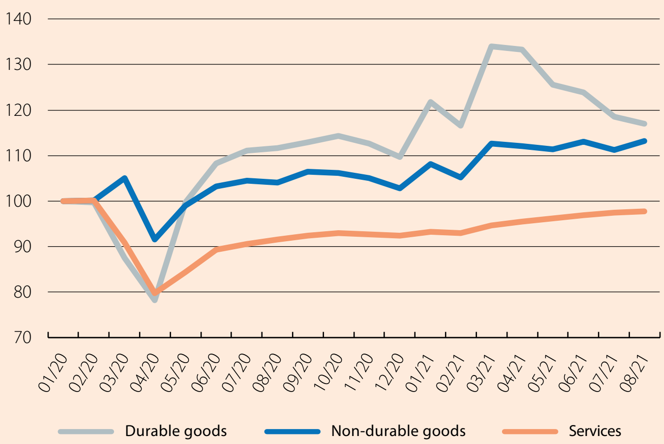
(% of 2019 GDP)



Note: *Excess savings are estimated as the difference between the observed savings and the level of savings which, given the evolution of disposable income in 2020 and 2021, would have occurred if households had maintained their pre-pandemic savings rates.*
Source: *CaixaBank Research, based on data from the U.S. BEA and Eurostat.*

US: real expenditure

Index (100 = January 2020)



Source: *CaixaBank Research, based on data from FRED.*

8. See the Focus «The role of pent-up demand in the euro area recovery in 2021» in the MR05/2021.
9. We estimate that the increase in deposits equates to around 40% of the total accumulated savings in Germany, around 60% in the case of France and Spain, and 50% in Italy. In the US it is around 90%.
10. This composition of consumption is observed both in the US (third chart) and in other countries. See the case of France in D. Bounie *et al.* (2020). «Consumption dynamics in the covid crisis: real time insights from French transaction bank data». Covid Economics, 59, 1-39.