Consumer Outlook – Health and Financial Anxiety during the Pandemic

The COVID-19 pandemic has multiple and profound implications for all of us. First and foremost, it is normal to feel anxious about uncertain health and financial effects related to the coronavirus. Individuals did not have to deal with this form of anxiety in previous recessions. Besides the panic buying observed at the beginning of the pandemic in supermarkets, one of the most striking studies about the consumer psychological shift was published early May by the University of Copenhagen. In Denmark, one of the first countries to adopt strict lockdown measures, consumer spending dropped by 29% relative to pre-virus levels. In Sweden, where less stringent social distancing measures were proposed by the government, consumer spending dropped by 25%, only 4 percentage points less than in Denmark. Clearly, consumers became deeply cautious because of COVID-19 while governments' shutdowns had a minor impact on their behaviour.

Accordingly, it is not surprising to find out most individuals are not in a spending mood despite the progressive reopening of the economy. In the U.S., the Conference Board consumer sentiment index stabilized near a 6-year low in May. In Canada, the Bloomberg Nanos consumer index rose softly for a fourth consecutive week in mid-May but remains in depressive territory. Consumer spending could expand at a tepid or moderate pace at best until a vaccine gets distributed worldwide, the cure necessary to eliminate anxiety. The NYC investment firm Fundstrat compiled slightly over 100 vaccines in preclinical stages and a dozen experimental studies on humans. Mass testing, tracing programs and new safety measures in reopening stores are steps in the right direction. Nonetheless, surveys indicate several consumers will limit activities requiring a high degree of social contact. In Canada, an Angus Reid poll states that 43% of households will resume normal activities only when there are no new reported coronavirus cases for two weeks; 17% will do so only when a vaccine is developed. A CBS poll found that 48% of Americans will not return to public places when stay-at-home orders are lifted. In Germany, the Google mobility data related to retail and recreation stores indicates a timid increase in traffic since late April but movements of individuals remain 35% below pre-virus levels.

COVID-19 also cloud income expectations, a motive for precautionary savings. For instance, the April NY Fed consumer survey reveals the lowest expectations on record for household income and spending. Still half of respondents to a Cleveland Fed survey reported fears of losing their job mid-April. In turn, 80% of Americans will refrain from making large purchases, up from 40% in March. The same survey indicates 40% of respondents had increased savings, echoing the most recent U.S. income and spending report penciling the personal savings rate at a 4-decade high of 13.1% in March. A very weak second infection wave this fall could abate risks and lead consumers to spend precautionary savings in late 2020 and 2021. Inversely, consumer anxiety could increase to new heights if a large second wave hit the world.

Also, the pandemic curve will determine future labour market conditions, another key driver for the consumer outlook. In Canada, total nominal compensation of workers declined by 23% between February and April. It could take a long period of time to fill this gap. Including discouraged workers and part-timers unable to work full time, Canada's unemployment rate reached a post-WWII record high of 17.3% in April. Under our base case scenario, about two-thirds of unemployed Canadians will get a call from their employers before the end of 2020.

This being said, elevated household debt and balance sheet stress are factors supporting the view of a slow pace of recovery in consumer spending. Former BoC Governor Mark Carney said on multiple occasions that "*while asset prices can rise and fall, debt endures*". The negative wealth effect is small so far considering the rally in global equities observed since late March. However, home prices could still fall in the coming quarters, depending again on how the virus evolves. A 2004 BoC paper found that future consumption is more sensitive to housing prices than equity prices variations, a situation even truer today due to the sizzling appreciation in home values since. The principal residence is the largest asset for Canadians, accounting for more than one-third of the total value of assets according to Statistics Canada's survey of financial security. Thus, the strength of the recovery in housing activity will provide additional clues on the evolution of the net worth of Canadians and their ability to spend. But record-high debt loads lean us to think households won't be able to bring this recovery into a sustainable high gear as they were able to after the financial crisis of 2008-09, unless federal and provincial governments bring down sales tax rates to zero. Consumer spending's contribution to economic growth during the last decade was elevated at 63%, precisely adding 1.4 percentage points to Canadian real GDP growth during the 2010-19 expansion.

Finally, let us touch upon adaption and substitution generated by health and financial anxiety. First, anxious consumers over COVID-19 seek comfort, an environment favourable for the most trusted and popular brands as suggested by the Harvard Business School and Ipsos. Second, poorer consumers stopped indulging in some luxury items and turned towards affordable alternatives. Third, concerns about closer social interactions fueled online deliveries and pick-ups. In March, Canadian traditional retail sales crippled by 10% m/m and e-commerce sales soared by 19%. This habit should persist as brick and mortal retailers re-opening are unable to operate at full capacity due to social distancing measures, leaving the door open to companies using reliable e-commerce strategies. Accordingly, online orders contribute to an increased demand for warehousing and distribution centers and will likely take its toll on retail and commercial REITs overtime.

Remote work is the other reaction to health anxiety we want to highlight today. One-third of U.S. occupations are compatible with work from home according to a Dallas Federal Reserve paper published in April. In Canada, 27% of workers who do not usually work from home did so in late March according to Statistics Canada. Also, a quarter of employed Canadians are aged 50 years and over. This older cohort will prefer to work from home until a vaccine is found or until they retire, supporting e-commerce and creating an unprecedented challenge for the office real estate market. The work-from-home growing popularity, in addition to remote learning platforms and travel restrictions, also strengthens demand for teleconferencing, cloud computing and cybersecurity. Inversely, the remote work trend could taper off demand for autos and crude oil. The U.S. Census Bureau reports the average American commute 19 full work days per year driving to work in their cars. In Canada, the 2016 census reported that two-thirds of Canadians commuted to work by car.

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