FACTS AND FIGURES

SAVERS NOT SPENDERS

If the New Normal is multi-year austerity, are companies right to run themselves for cash? asks David Bowers

Nearly four years on from the Lehman bankruptcy, and the world is still struggling to show any return to normality. Economic output in the developed world remains far below where it would have been had pre-crisis growth rates been maintained. It is no surprise, then, that government deficits remain large and problematic. But for every big net borrower there has to be an equally big net saver. When people talk about 'structural' budget deficits there must by definition be a structural 'saver'. That is indeed the case. But that net saver is not the household sector, it is the corporate sector. On a national accounts basis, the corporate saving rates over the past three years in the US and the UK are some of the highest ever seen. Corporate saving is now the main counterpart to government borrowing.

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This raises three interesting issues. First, corporate saving rates are going to have to come down if governments are to succeed in reducing their budget deficits. The reasoning is very intuitive: as companies spend more on fixed investment and employment, so tax revenues recover and government finances improve. But make no mistake: there will be major implications for corporate cash flows if governments meet their deficit-reduction targets.

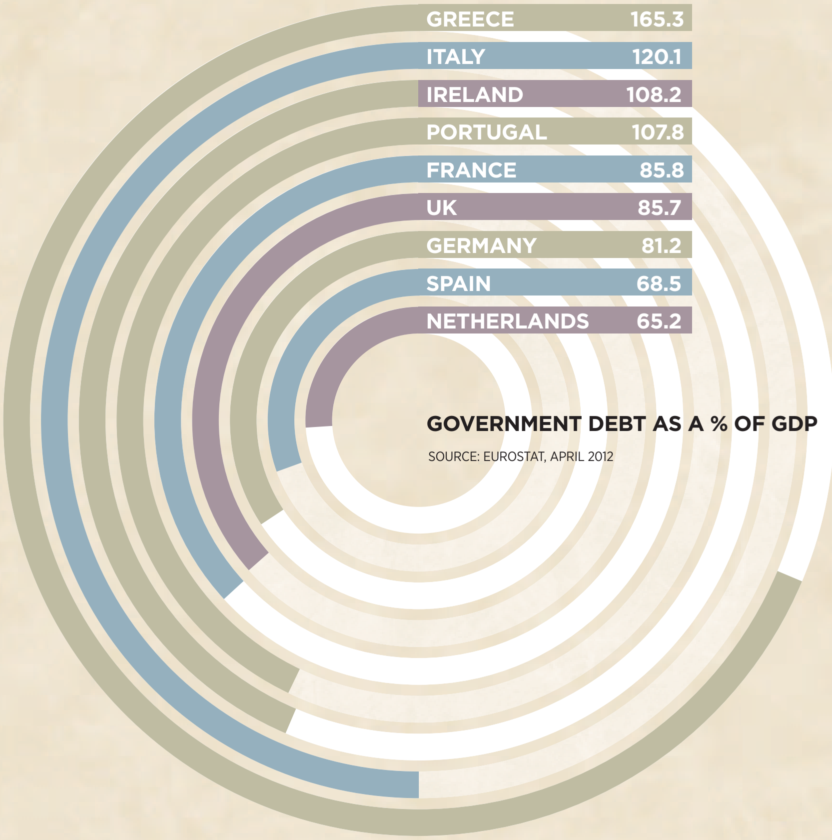
Second, a debate is starting to emerge as to whether this rise in corporate saving is cyclical or whether it is structural. The argument for it being cyclical is that companies have experienced an unusually high level of uncertainty since 2008 and that has caused them to rein in their spending plans. However, as the dust settles and companies feel more confident about the medium-term outlook, corporate spending will resume.

But there are also compelling reasons for thinking that these high corporate saving rates may be structural. The simplest explanation is that if the world is in for a sluggish 'credit-less' recovery as the banks shrink their balance sheets, then there is no rush to invest. If the New Normal is multi-year austerity, then companies are right to run themselves 'for cash' rather than 'for growth'.

Another explanation is that the credit crunch was to multinational companies what the 1998 Asian currency crisis was to Asian central bank reserve policy. In 1998, Asian central banks found they had insufficient foreign currency reserves to deal with the currency crisis. They vowed that never again would they be caught short – and so began a multi-year build-up in foreign exchange reserves. Multinational corporates experienced something similar in 2008/9. Before the credit crunch, their business models took access to cross-border working capital for granted. When the banks withdrew in spring 2009, companies vowed never again would they be dependent on the banks – and so began a multi-year programme to disintermediate the banking sector. If this is the case, then corporate saving rates are likely to stay higher for longer.

One final thought: companies should be worrying about what governments are thinking. The former are flush with cash; the latter are under enormous financial pressure. You don't have to be Einstein to see how the politics could play out. If companies don't use their cash, then the risk is that they may lose it.

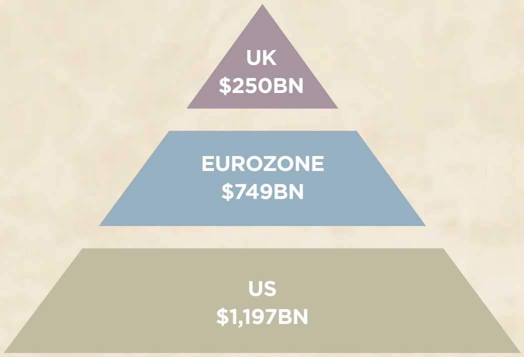
David Bowers is a director at Absolute Strategy Research. For more information, visit www.absolute-strategy.com



GOVERNMENT DEBT AS A % OF GDP

SOURCE: EUROSTAT, APRIL 2012

THE SHARE OF THE UK CASH SURPLUS RUN UP BY THE ENERGY EXTRACTION SECTOR OVER THE PAST DECADE (ACCORDING TO THE BANK OF ENGLAND)

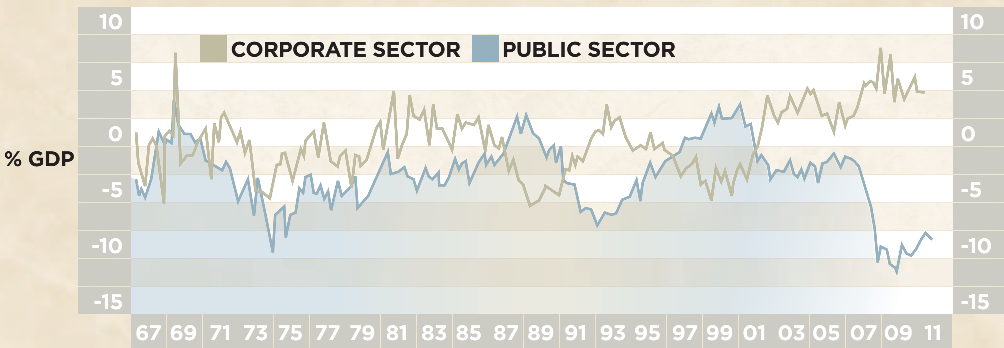


GROSS CASH BALANCE FOR COMPANIES IN THE US, EUROZONE AND UK BY REGION (USD)

SOURCE: ABSOLUTE STRATEGY RESEARCH, LATEST COMPANY ACCOUNTS

THE SIZE OF APPLE'S CASH PILE

SOURCE: REUTERS, MARCH 2012



UK CORPORATE AND PUBLIC SECTOR FINANCIAL BALANCES

SOURCE: ABSOLUTE STRATEGY RESEARCH/THOMSON REUTERS DATASTREAM

> "The manufacturing sector as a whole is currently a net lender to the UK banking sector: it has more cash on deposit than funds borrowed"

Paul Tucker, deputy governor of the Bank of England, speaking at the annual conference of the Association of Corporate Treasurers on 18 April 2012