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SAVINGS + REPORT

A report on South African Savings. There are no limits to what the country can achieve by pooling savings and leveraging the financial services industry to service the financial needs of the population.

Ndivhuho Netshitenzhe
STANLIB
Economist

Kevin Lings
STANLIB
Chief Economist

SAVINGS REPORT

INTRODUCTION:

The impact of the global COVID-19 pandemic quickly highlighted how unprepared South Africans are for unforeseen financial shocks. Left without a steady income flow, many have had to dip into long-term savings to fund day-to-day expenses which will no doubt affect longer-term savings plans. This lack of precautionary savings and buffers to absorb unexpected financial shocks for households, businesses, and government is forcing South Africans to review both their future savings and consumption habits, highlighting the importance of precautionary savings.

With the financial industry's traditional emphasis and prioritisation of retirement or long-term savings over discretionary savings, it can be challenging to address the gap that has been magnified by the pandemic – and this report attempts to encourage the dialogue around precautionary savings.

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A LOW SAVINGS RATE STIFLES GROWTH AND INCREASES THE COUNTRY'S VULNERABILITY DURING A TIME OF CRISIS.

The past six months have been extremely challenging for South Africans and the South African economy. COVID-19, and the subsequent extended lockdown of society, has disrupted every major component of the country, resulting in a significant contraction of economic activity, a surge in government debt and a sharp rise in unemployment.

This period of social and economic hardship has also highlighted the importance of households, businesses and government all having access to financial resources to help cope with a wide range of unexpected and urgent challenges. This included the loss of household earnings, the downsizing of business or outright business failure, as well as the need to provide critical social support to the most vulnerable people in society.

Unfortunately, SA went into the COVID-19 crisis with an exceedingly low level of savings, which has been under increasing downward pressure over the past ten years. In fact, in 2018 SA's total gross savings averaged a mere 14.4% of GDP, which was a record low, and well down from 18.9% of GDP at the end of 2010. In 2019 the level of savings was little changed, ending the year at only 14.6% of GDP.

Actually, SA's savings rate can be described as structurally weak, given that it has not been above 19% of GDP since 2000 and has been trending lower for the past thirty years. In contrast, before the 1980s, not only was SA's gross savings relatively high, but it was also increasing, peaking at 42.6% of GDP in the first quarter of 1980, up from 26.5% of GDP in Q1 1960.

SA's current savings rate is also extremely low by global standards. With gross savings of less than 15% of GDP in 2019, it has one of the lowest savings rates in the world. This rate is far below the world average of 25.1%, the average in sub-Saharan Africa of 18.8% and that of middle-income countries, which saved 30.5% of GDP in 2019. Some of the few countries that are in a worse position than SA in terms of gross savings are Zimbabwe, Namibia, Venezuela, Kenya, Greece and Egypt.

Along with having the one of the lowest savings rates by world standards, the trend of falling savings over the last 40 years seems to be unique to SA. Granted, savings in many regions of the world have been on a downward trend since 2009, hurt by a slowdown in income growth after the global financial market crisis. However, despite this slowdown, the savings rates in most countries remain above the level achieved in 1980, unlike SA, which has experienced a consistent decrease in savings to historical lows.

It is worth highlighting that the relatively high level of world savings has been largely driven by middle-income countries, particularly China and India. In fact, savings by middle-income countries have remained above 25% of GDP since 1980. The growth in savings by Asian countries has been especially impressive, increasing from only 15.5% of GDP in 1980 to 28.9% in 2019.

WHY DOES THE LEVEL OF SAVINGS MATTER?

From a macro-economic perspective, level of national savings is vital for the successful and sustained development of the country, especially fixed investment activity and job creation.

This is simply because, to achieve and sustain a relatively high level of economic growth, the country needs to undertake a healthy level of fixed investment activity. However, because the savings-investment identity dictates that the level of savings equals the level of investment, meaningfully increasing SA's fixed investment activity would require it to have a much higher level of savings than currently exists.

Under these circumstances, changing Regulation 28 of the Pension Funds Act to divert an increased percentage of pension fund savings into infrastructure investment (which has merit, if the initiative is done on a voluntary basis) does not reduce the overall savings constraint on the country. It merely re-directs how the existing pool of savings is utilised.

In SA's case, a robust level of economic growth would be around 6% each year on a sustained basis. Under these circumstances the country would expect to create roughly 500 000 to 700 000 jobs a year. However, a GDP growth rate of 6% would require that the level of fixed investment remains around 25% to 30% of GDP, up from the current level of 17.4%. In fact, the government's National Development Plan (NDP) set a long-term fixed investment target of 30% of GDP, split between government (10% of GDP) and the private sector (20% of GDP).

To make this a feasible objective, SA would have to achieve a domestic savings rate of at least 20% to 25% of GDP, compared with the current level of less than 15%, with the remainder of the savings (5% of GDP) being provided by foreign investment.

This means over the next few years the growth in household income would have to persistently exceed the growth in household consumption, while at the same time government would have to bring its fiscal deficit firmly under control, providing room for the private sector to increase investment. At the same time, the level of foreign investment would have to expand on a sustainable basis, even though SA's international credit rating has been pushed to below investment grade by all three of SA's credit rating agencies. Clearly not an easy task!

The situation is even more dire if you consider that at the end of 2019 SA recorded a savings shortfall equivalent to roughly 2.8% of GDP, or around R140 billion - and yet fixed investment spending declined in real terms, and GDP per capita continued to fall.

In other words, the current level of fixed investment activity in SA is currently barely enough simply to maintain the country's base of capital stock, let alone expand the productive capacity of the country and create job opportunities. And yet this low level of fixed investment activity still leaves SA with a significant savings shortfall.

This highlights that the country has become highly dependent on attracting foreign savings (even if this is mostly in the form of foreign portfolio investment) to supplement the poor level of domestic savings, to fund a relatively low level of investment activity. Under these circumstances, the country should very actively encourage further foreign investment, especially foreign direct investment, while at the same time ensuring that the existing small pool of domestic savings is incentivised into productive investments that boost the country's productivity, thereby creating employment opportunities.

More concisely, the low level of savings means that SA is not able to fund its own economic success and cannot be economically successful without attracting a sustained inflow of foreign savings.

It is also clear that introducing policies aimed at trapping domestic savings within SA or coercing the existing pool of savings to be deployed into politically-motivated investments would be counter-productive, sparking a wide array of unintended consequences.

It is not unusual for a country that is embarking on a period of rapid development and expansion to rely, in part, on foreign capital to modernise and expand the capital stock and infrastructure – including the use of the World Bank to fund the larger infrastructure projects. Conversely, using foreign savings to fund a domestic consumption binge can prove disastrous.

> "Irrespective of the mix of domestic spending, a large savings shortfall leaves the country more exposed to possible episodes of turbulence in international financial markets, such as the global financial market crisis in 2008/2009 as well as the COVID-19 crisis in 2020."

SAVINGS MATTERS HUGELY FOR HOUSEHOLDS AND BUSINESSES.

From an individual company perspective, the level of savings can dictate a business's ability to survive an economic crisis, including many weeks of economic lockdown, ensuring that staff salaries can be paid together with a range of fixed costs such as rent or debt repayment. Over the longer-term, savings can provide a vital source of capital for the development and growth of the business, including the upgrading of technology, or expansion of productive capacity.

Equally, at a household level, having easy access to a pool of savings during an economic crisis can, literally, make the difference between life and death, while over the medium term, it can help the household to achieve a number of important goals, such as the funding of a university education, the purchase of a vehicle or an overseas trip. Longer-term savings in the form of a pension fund or unit trust are critical as a source of income during retirement, especially since the South African government is not able to provide most individuals with any retirement benefits.

Unfortunately, many businesses do not divert enough of their annual earnings into a "retained-income fund" in order to ensure the longevity of the business during a crisis, while for most households in SA personal savings remain an extremely low priority. Currently, many individuals do not undertake any form of savings on a regular basis, while those individuals that do save, tend to save less than would be considered ideal.

Stated differently, most people are not saving enough to deal with any financial emergency that may arise or to afford a comfortable retirement.

TRENDS IN HOUSEHOLD SAVINGS

The trend in household savings (as a percentage of disposable income) can be divided into three distinct phases. The first phase took place between 1960 and 1981 and was characterised by high savings, where households saved an average of 10.1% of their disposable income. At its peak, households were able to save 23.8% of their disposable income, with consumers typically being advised to save anything from 10% to 33% of their income to ensure financial security.

The second phase, which occurred between 1981 and 2001, saw household savings drop significantly to an average of only 3.9% of disposable income. During this time, savings outside contractual savings became less important for households amid a visible increase in household consumption and growth in consumer credit, including store credit. Unsurprisingly, the ratio of household consumption to GDP increased from 53% in Q1 1981 to 62% in Q4 2000, as SA became a consumption-orientated society.

The third phase of household savings, post 2000, is characterised by negative savings. Between 2001 and 2019 the ratio of household savings to disposable income averaged -0.5%. Household savings have declined every year since 2006 (except for 2017), and by Q4 2019 household savings were -0.2% of disposable income. At the lowest point, households saved -2.5% of their disposable income at the end of 2013. While consumption remained elevated during this time, staying well above 55% of GDP, it did not rise significantly, highlighting that a range of additional factors, which are discussed below, led to a decline in savings.

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TRENDS IN CORPORATE AND GOVERNMENT SAVINGS

Corporate savings rose markedly before the 1990s. For example, between 1979 and 1984, corporate sector savings rose substantially, helped by an increase in retained earnings within the mining industry that was boosted by the gold price boom. After peaking at 10.9% of GDP in 1980, corporate savings moderated, averaging 4.9% of GDP from 1981 to 2019 and falling to only 2.8% of GDP in 2019. Despite this decline, corporate savings have become the backbone of SA's gross savings, especially since both government and households' savings have turned negative in recent years.

Following years of stable savings during the 1960s and 1970s, government savings quickly dropped in the 1980s, marking a definitive shift in government's savings behaviour. Government recorded dissaving for the first time at the beginning of 1982. After recording an average savings rate of 3.3% of GDP prior to 1981, government's dissaving peaked in 1994 at -7.6% of GDP. Since 2009, government has been consistently dissaving and by Q4 2019 the ratio of government savings to GDP was -2.1%. It is forecast to decline significantly further in 2020, given the current severe recession and substantial tax revenue shortfall.

EXPLORING THE FACTORS DRIVING SA'S LOW SAVINGS RATE

"The drop in SA's savings rate in recent decades is alarming, especially the fall-off in households' savings. Many explanations have been provided for the decline in household savings, however only a handful of reasons provide a compelling explanation."

1. Low- and slowing-income growth

The single most important driver of low savings in South Africa is slowing income growth and a decline in income per capita. Real household disposable income growth has decelerated over the years, particularly since the 1980s. Before the 1980s, real disposable income growth averaged a healthy 5.3% year-on-year, before falling to 3.3% in the 1980s and 1990s. Unfortunately, since 2010, household real disposable income has only grown by an average of 2.2%, and in 2019, the growth rate was a mere 0.3%.

The same trend is evident in South African corporates' operating profits. Since 2000, real growth in operating profit dropped significantly from 15.3% year-on-year to -0.6% in 2019. In fact, since the global financial market crisis in 2009, corporate profit growth has not recovered to its pre-crisis levels, staying below 5% year-on-year.

Understandably, the low income growth for households and corporates since 2010 is in line with weak domestic economic growth.

Given that tax on income and profits accounts for over 50% of total tax revenue, the slowdown in both disposable income and operating profits has also affected government income. This has resulted in five consecutive years of tax revenue undercollection, causing large, unintended dissaving by government.

While income growth has slowed, resulting in a deceleration of the savings rate, an additional and very significant factor that has also contributed to the fall in savings is the dynamics of income distribution in SA, in particular the structurally-high unemployment rate. SA's broad measure of unemployment has increased substantially to 39.7% in Q1 2020, one of the highest unemployment rates in the world. Currently, around 10 million people who are a part of SA's labour force are not earning a wage, putting a significant dent in disposable income growth. Consequently, the country continues to experience a high level of poverty and inequality, which significantly hinders the ability to save.

Not only does the top 20% of the population in SA earn around 68% of income, but 49.2% of the adult population lives below the upper-bound poverty line, which is R1 227 per month.

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With the introduction of a national minimum wage in 2020 of around R3 500 per month, it is evident that a high proportion of wage earners in SA (around 29%) have been earning below that amount. In the agricultural and domestic work sectors, for instance, the wage has been as low as R1 700 per month. Using the national minimum wage as a proxy for a person's required living wage (the income needed for food, housing, transport and basic household goods), it is clear that many South Africans spend most of their income on necessities, leaving nothing or very little for saving. This liquidity constraint is also an important reason why savings in SA, as in many other low- and middle-income countries, are less responsive to interest rate changes.

Adding to this is the high dependency ratio in SA, especially among low-income households. According to the National Income Dynamics Study (NIDS), 75% of workers are the sole income providers for their families. SA has an average household size of three, meaning that a breadwinner would need to earn around R6 570 per month to cover living costs for an average household (according to the Wage Indicator Foundation). Based on this, around 70% of households earn below the household living wage.

SA's social security system is one of the ways that the government is trying to address the high levels of poverty and inequality in the country. Since the end of apartheid, the government has been committed to the redistribution of resources to assist low-income households and fight poverty. Almost 18 million people received social grants in 2019, with the highest grant payment being R1 880 per month for war veterans. This means that around 31.1% of the population is dependent on the government for financial assistance to live (which is lower than the living wage) and thus cannot afford to save.

The high and increasing dependency on government for social security over the years has also affected government's ability to save. The ratio of transfers by general government to households relative to GDP has increased substantially since the 1980s, when it averaged 2%, increasing to 5.4% in 2019. Government has been required to allocate more of its budget to social grant payments than to savings or other more productive projects.

2.

Increased culture of consumerism

There has been a rise in consumerism in SA over the decades, despite low incomes. In this context, consumerism refers to the tendency of households to engage in excessive materialism, resulting in overconsumption at the expense of adequate savings. This is based on the belief that the accumulation of goods and services is desirable and is key to happiness.

This has fuelled growth in credit and loans rather than saving for retirement or shorter-term goals such as university education or overseas travel.

Two broad aspects of SA's consumption behaviour have led to a culture of consumerism over the years.

Firstly, South African consumers have become highly present-biased, affecting their willingness to save. This focus on instant gratification means that households place greater value on current consumption than on saving for future, potentially higher, consumption. Since debt is used to finance current consumption, present-biased consumers tend to borrow more. Therefore, the preference for current consumption over future returns can be seen in the high level of household borrowing and debt, especially the high prevalence of unsecured credit such as store cards, revolving credit and payday loans.

While financial literacy plays a role in determining the level of patience practised by consumers, according to the S&P Global Finlit Survey SA's literacy levels are no worse than other emerging markets, which generally have higher savings rates. Therefore, SA's high present bias is related more to the fear of losing the money if not consumed immediately and a general mistrust of financial services providers. Uncertainty about future returns if consumption is delayed makes people more present-biased.

Adding to this is the availability of social security, including social pension payments. In March 2020, the government paid out 3.7 million old age grants, reducing the incentive for individuals to save for old age. In addition, these safety nets in general (regardless of how small they are) guarantee some income for households, thus reducing the need for saving for future income uncertainty. Finally, low-income households have a high average propensity to consume (given their constrained liquidity) and thus the redistribution of resources to low income earners tends to increase the proportion of domestic income allocated to consumption.

The second aspect of South African consumer culture is the prevalence of conspicuous consumption. There are five dimensions making up conspicuous consumption: materialistic hedonism (buying products that feel unique and trendy); communication of belonging (buying products wanted by others); social status demonstration (buying products that are a symbol of success and wealth); interpersonal mediation (buying products that induce respect from others); and ostentation (buying a product because of its high price). In SA, conspicuous consumption has, over time, become much stronger than the culture of saving.

An academic study argues that, for non-white South Africans, consumption is seen as a display of freedom and aspiration. One way that households can show social mobility is through the conspicuous purchase of visible consumption goods (a way of status signalling between and within communities). The introduction of democracy in SA and the growth of the black middle class meant that not only could more people afford the things they wanted, but they had the freedom to choose where, how and when to acquire those things, making them more likely to overconsume.

SA is therefore greatly influenced by the idea of trying to 'keep up with the Joneses', driving consumerism that is similar to that seen in 'Western countries'. Exposure to industrialised economies that have naturally become more dependent on consumption to drive economic growth has made South Africans hyper-aware of the amount of 'things' they can accumulate. Increased access to consumerist media, especially US media and entertainment content, has normalised this form of accumulation. As such, SA has developed the typical Western consumption habit. In addition, the development of shopping hubs has not only made consumption spending easier but has also made shopping a form of entertainment for households. Helping this is the ample space in SA, allowing consumers to buy a lot of these things without worrying about where to store them.

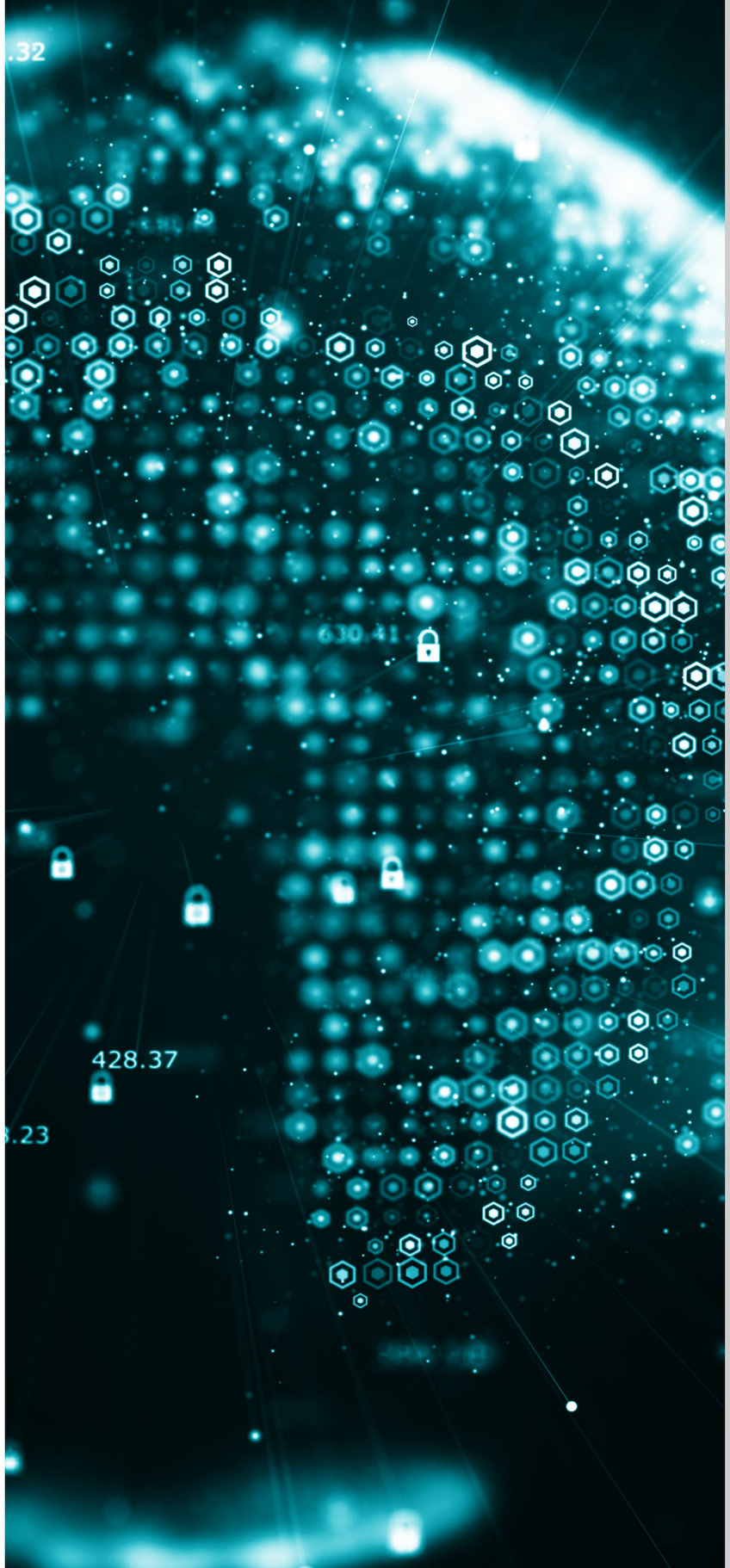
Given SA's level of industrialisation compared with other African countries, many international companies have used SA as a gateway into Africa and its 1.2 billion consumers. As a result, a lot of companies have pushed the agenda of consumerism in SA through increased marketing campaigns and persuasive advertising. The advertising industry has become very good at convincing consumers to purchase products and has become one of the key influencers of increased consumerism in SA. For example, the domestic advertising and marketing industry has been successful in building awareness of Black Friday and Cyber Monday sales in SA. From relative obscurity, Black Friday has grown in popularity to become the country's busiest shopping day.

The visible inequality in SA has added a layer of complexity to the rise in consumerism. The proximity of places like Sandton and Alexandra, along with the need to commute into affluent suburbs for work, has exposed poorer consumers to a desirable lifestyle that they want to emulate. This has limited their willingness to save.

This is why, despite SA's high structural unemployment and huge income inequality, the retail sector continues to perform relatively well compared with other parts of the economy. As such, South African economic growth has become more consumption-based, rather than production-based. A combination of demographics, history and a need to 'keep up with the Joneses' has driven SA into a consumerist culture that has decreased household savings. The increase in the tendency to overconsume has not only meant that households save less but it also makes households more likely to use existing savings to maintain a certain level of consumption.

This is far from ideal, especially since most of what is bought by households is made internationally. In other words, the vast majority of what South Africans buy in the shops is imported, except for the food retailers. Consequently, there is a tendency for the growth in shopping to simply translate into sustained high imports and an outflow of South African savings.

Initiatives to encourage consumers to buy locally-produced goods have largely failed to achieve any significant change in spending patterns. This is partly because consumers have become very brand conscious and are willing to pay the premium required to own branded goods, and partly because local manufacturers simply do not make the array of merchandise that local consumers now demand.



3.

Financial liberalisation and deregulation

The liberalisation of SA's financial sector since the 1980s resulted in the removal of interest and credit controls; the reduction in bank liquidity ratios; and the abolition of credit ceilings. This, along with increased competition in the banking sector, resulted in an increase in the availability of credit. In addition, the increased popularity of credit cards and store accounts from the 1990s, thanks to aggressive marketing, increased credit facilities available to households. While these developments have been good for financial inclusion, they have affected SA's savings in two ways.

The first effect explains the initial drop in savings in the 1980s. The increased availability of credit meant that households could increase their spending without having higher incomes, and thus did not need to save in order to afford certain goods and services. Secondly, higher debt as a result of increased credit availability means that households must dedicate a rising proportion of their income to servicing debt in lieu of saving (household debt increased considerably from 41.7% of disposable income in 1969, peaking at 87.8% of disposable income in 2008). Before 1990, households spent an average of 5.4% of their income on servicing their debt. Since then, the average has increased to 9.4% of disposable income.

Increased financial regulation, with the establishment of the National Credit Regulator, more stringent Basel requirements on banks, and the introduction of interest rate ceilings on credit, has not necessarily helped savings. The consumerist culture has kept household debt elevated, despite moderating to 73% of disposable income in Q4 2019. This continues to make it challenging for households to save. Furthermore, the additional regulations may have led to a rise in credit extension in the unregulated financial sector that charges higher interest.

4.

Availability of savings products that appeal to the country's demographics

SA has long had a sophisticated, well-developed financial system and has hardly ever experienced financial repression on the scale seen in many less-developed countries.

Granted, in the 1960s, South Africans had limited savings products, which were mainly provided by banks and insurance companies. With the development of the Collective Investment Schemes (CIS) industry, however, the number of savings products available to South Africans increased exponentially. From the first South African unit trust fund in 1965, worth R3 million, the industry has grown to over 1 600 funds worth R2.4 trillion in 2019. Most of the growth in the number of funds took place in the 1990s and 2000s. The expansion of this industry has allowed savers to diversify their portfolios, giving them choices to suit their risk profiles and goals, all at a lower cost.

Unfortunately, the high sophistication of the financial sector along with the different product offerings has not helped the savings rate. In fact, at the time when unit trust funds were increasing the most, SA's household savings rate decreased significantly and even went negative.

High minimum contribution requirements, complicated regulations like Know Your Customer (KYC) and lack of trust serve as barriers for many households and even companies. Given the high poverty rate, in many instances the minimum contribution requirements are simply too high for a lot of South African households. Numerous households have made use of the informal sector, such as stokvels, to meet their savings needs. With an average contribution of only R357 a month and 11.6 million members, stokvels offer the poor access to flexible, convenient and affordable savings products.

In recent years, the entrance of banks like Capitec and African Bank and the growth of mutual banks has brought low-cost banking, including savings opportunities, closer to poorer consumers. In addition, the big four banks have introduced stokvel savings products to take advantage of this R49.5 billion industry. Even with these initiatives, however, household savings remain anaemic. It is important to note that Financial Service Providers (FSPs) that target low-income consumers have also made credit easier to obtain, effectively counteracting the savings drive.

Therefore, in general and unlike other African countries, a lack of savings products does not explain SA's low savings rate, although there is some truth in the fact that a range of savings-based FSPs outside the banking industry indirectly find themselves excluding low-income consumers willing to save. The CIS industry needs to build more accessible savings products that attract lower income savers in a cost-effective manner.

5. Tax incentives for saving

One of the ways that government can try influence savings behaviour in the private sector is through tax policies that incentivises saving. Allowing for tax benefits on savings products is equivalent to an increase in the rate of return for these products. While theoretically, this should increase the savings rate, practically, an increase in the rate of return for a specific product will have two effects on savings decisions. On one hand, it may change the total amount saved by an individual as intended. On the other hand, it may just result in a shift in the product composition of savings towards that particular product. Therefore, the net effect on saving flows from tax incentives is uncertain.

Such tax incentives have not necessarily worked in SA, because, among other things, consumers may be unaware of them. The Tax-Free Savings Account introduced in 2015 to encourage private sector savings, while well known, did not increase savings as expected. While there has been some decrease in household dissaving since 2015, the decrease has been marginal, as most savers most likely transferred their existing savings from other products into tax-free products.

On the corporate side, a recent research paper found that variations in taxes on dividends could not explain the rise in corporate savings in SA (many studies have argued that dividend tax increases lead to reduced dividend pay-outs, with the extra liquidity increasing corporate savings), but it may have helped maintain the level of savings by corporates until 2000.

From government's perspective, reduced tax revenue from tax incentives to save may be counterproductive. While the benefits of tax incentives on private savings are ambiguous, they do result in a decline in government savings if these incentives are not accompanied by an equivalent fall in government spending.

Overall, while many ideas have been put forward to broaden the base of domestic savings in SA, none have been implemented successfully. Some of the suggestions clearly have merit, including better education at a tertiary school level, but it seems reasonable to argue that in SA a higher level of household savings is highly dependent on an increase in household income. This does not mean increasing wages consistently well in excess of inflation, but rather increasing the level of employment so that more people have regular income. Under these circumstances, even if everyone saved very little, the pool of national savings would rise.

CONTRACTUAL VS. DISCRETIONARY SAVINGS

A fascinating component of the South African savings industry is the massive difference between contractual and discretionary savings.

Contractual savings, which refer mostly to pension funds, retirement annuities and unit trusts, are relatively large in relation to the size of the economy, especially compared with many other emerging markets, and are extremely sophisticated by global standards. This level of development reflects a combination of factors, including the legacy of relatively high levels of personal savings in the 1960s and 1970s, a significant level of mandatory pension contributions within the formal sector of the economy, the development of a wide range of innovative investment products that have become increasingly accessible, and a rigorous set of regulations that ensure the industry remains highly professional.

For several decades, especially the 1980s and 1990s, South African investors (both households and corporates) had to invest most of their savings in the local financial markets, as they were largely prohibited from investing offshore. This 'trapping' of domestic savings led to the formation of a relatively large and vibrant domestic contractual savings industry. Over time, the securities industry became increasingly sophisticated and well regulated, encouraged by the existence of a captive market. Although there has now been a significant relaxation of exchange control, the legacy effect remains, making the country's equity and bond markets attractive to global investors and relatively large in relation to the size of the South African economy.

It also seems appropriate for SA to maintain prudent limits on offshore investments by pension funds and unit trusts, since most of the members of these funds live and work in SA and will eventually need the money to be available in this country.

Consequently, SA's asset management industry is relatively large and world-class. In the latest Willis Towers Watson survey of the global asset management industry, SA has seven asset managers on the top 500 list, which is more than Russia, Mexico, Hong Kong, Taiwan, Portugal, Denmark, Belgium, Finland, Norway, Austria, Sweden, Eastern Europe combined and the rest of Africa combined.

The pooling of South African savings into pensions funds or unit trusts has provided a meaningful and vital source of funding for the country, especially government. Given SA's low level of savings, the ability to pool the limited savings that the country has and channel it efficiently has allowed government to borrow most of the money it needs domestically, which is in sharp contrast with many emerging markets that have been forced to substantially increase their offshore borrowing.

The pooling of domestic savings has also allowed for the development of a sophisticated corporate bond market, instead of companies being forced to rely exclusively on the banking system for credit. Again, this is in sharp contrast with many emerging markets.

Lastly, the pool of savings also allows capital raising within the equity markets. Without this size and depth of capital markets, SA would have to rely much more heavily on banks and offshore credit to fund economic expansion.

In contrast, the level of discretionary savings, which reflects mainly cash deposits in the bank netted off against overdrafts and personal loans, is extremely negative, reflecting the fact that many individuals live from month to month and are not able to build up any safety net for emergency purposes, much less invest in unit trusts or retirement annuities.

A practical illustration of negative discretionary savings is when a household has invested some money in a unit trust – for example, R15 000, and has a positive bank balance of R5 000, but at the same time the household has an overdraft of R10 000 and a personal loan of R15 000. This means its contractual savings are firmly positive (+R15 000), but its discretionary savings are deeply negative at -R20 000. On a net basis, the household's savings rate is effectively negative (-R5 000), but South Africans rarely net off the balances. Rather, they manage their savings and debt separately, which effectively provides business activity for both the bank and asset managers.

All of this means that the financial position of many households is extremely precarious and vulnerable to an unexpected shock, such as the COVID-19 extended lockdown, despite households having invested some money on a contractual basis. This is a vital lesson to be learned from the COVID-19 crisis.

From a savings industry perspective, this is also perhaps where the greatest opportunity lies. In other words, a modest re-prioritisation of monthly household expenditure, such as the purchase of alcohol, the latest fashion item, or data for online gaming, in favour of increased savings can make a significant difference to most households' financial as well as physiological well-being over time.

This is especially the case given the breadth of expertise in SA's savings institutions. In general, the more sophisticated the financial system, the more a country is able to prosper. A lack of financial depth is a major limitation to growth. A country needs to have pooled enough savings and attracted enough foreign investment to have the financial instruments available to be able to advance credit. Sophistication of financial markets is what gets the private sector to invest in companies, to grow companies, and to develop and fund projects.

THE NEGLECT OF PRECAUTIONARY SAVINGS

While there is a lot of information and advice on saving for retirement, including the existence of a large and well-informed group of financial advisers, there is little information on or encouragement of precautionary savings. Precautionary savings, which are sometimes referred to as 'emergency savings', are a pool of savings established by a household or business as a precaution against the sudden and unexpected loss of income or earnings – as unfortunately occurred during the recent severe lockdown restrictions that accompanied the spread of COVID-19.

The amount of precautionary savings required would, obviously, vary from business to business as well as from household to household. However, knowing that you can access a pool of funds during a time of crisis can ease the level of anxiety that normally accompanies the crisis.

In the case of households, the aim would, typically, be to establish a pool of funds that equates to three months of household expenses. This would provide the household with some comfort that should key members of the family suddenly lose their jobs or simply not be able to earn any income for a period of time, they could continue to meet their daily expenses, including the payment of rent or a mortgage, without being concerned about having assets repossessed (for example a motor vehicle), or being evicted from their home. It would also allow the household to avoid incurring a large amount of debt at exactly the wrong time or having to cancel a long-term retirement investment to meet monthly expenses.

The same principle would apply to a business, allowing the company to retain staff and vital assets necessary for the future prosperity of the business. Knowing that the business has access to a pool of savings at very short notice would provide staff and management with a high level of confidence and loyalty during times of crisis.

It is also worth considering the characteristics of an ideal precautionary investment. Firstly, setting a goal of accumulating one month of household expenses over a 12-month period for three consecutive years is not an unreasonable or completely unobtainable goal for many households. This is especially the case if they are willing to revisit their monthly expenses and consider foregoing some purchases for a relatively short period in order to derive the comfort of knowing that the household can cope with an immediate and unexpected financial crisis.

Secondly, the precautionary funds should, ideally, be invested in a low-risk investment, since the household will have to access these funds during a period when financial markets are likely to be weak. The money also needs to be available within days rather than weeks, so utilising a long-term deposit or investment would not be ideal, especially if accessing the funds will result in some form of penalty for early withdrawal.

Lastly, the funds need to earn an above-inflation return, otherwise the household or business will be forced to constantly top-up the investment. This will tend to exclude simply placing the funds in a bank account. Added to which, under these circumstances, a bank account has the disadvantage of the funds being too easily available. When funds are very easily available, they can more readily be accessed for a spontaneous or impulse purchase.

In contrast, using a low-risk unit trust, such as an income fund, would tend to meet all the household's objectives when it comes to precautionary savings, including generating a return in excess of inflation while incurring relatively little risk. The funds would be available within a very short period, although accessing them would require a purposeful cancellation of the investment, thereby helping the household to avoid using the funds for an impulse purchase.

CONCLUSION

Savings are important to a country for a variety of reasons. At a macro-economic level, they fund growth. A country needs capital to finance the expansion of its industrial base and to build vital infrastructure, which in turn leads to more job opportunities and higher economic growth. Conversely, if a country does not have enough savings, it cannot undertake enough investment to meet its social and economic needs. Under these circumstances, it would either have to borrow money offshore or simply not invest and grow.

From a micro-economic perspective, savings can provide a vital safety net during times of crisis, which is a lesson that has been highlighted by the COVID-19 crisis. Over the medium term, a modest level of savings can facilitate the achievement of near-term goals like education or home improvements, while over the longer-term they can provide individuals with a comfortable retirement.

Unfortunately, SA's current low level of savings leaves the country, and especially small businesses and households, much more exposed to possible episodes of turbulence in international financial markets, such as the global financial market crisis or the COVID-19 crisis. This vulnerability will not change if SA maintains a very low savings rate.

Ultimately, there are no limits on what the country can achieve by pooling savings and leveraging the financial services industry to service the financial needs of the population.

STANLIB Economics Team
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STANLIB

17 Melrose Boulevard Melrose Arch 2196
PO Box 203 Melrose Arch 2076
T 0860 123 003 (SA only)
T +27 (0)11 448 6000
E contact@stanlib.com
W stanlib.com
GPS coordinates S 26.13433°, E 028.06800° W