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A reminder of the role of savings (1)

- Who saves?
  - *Households* – for future big expenses & retirement
  - *Companies* – retain part of profit to finance replacement & expansion
  - *Government* – when it uses *surplus* of tax income over current spending to finance social & physical infrastructure investment
- Trouble for each entity of saving too little
  - *Households* - financial stress during retirement
  - *Companies* - resultant underinvestment will harm efficiency & growth
  - *Government* – underinvestment in human & physical infrastructure
- What happens if we save too little *as a nation*?
  - Investment in productive capacity of the economy will suffer (factories, roads, bridges, ports, power stations, etc)
  - Investment in social infrastructure will suffer (schools, hospitals, etc)
  - A huge social burden awaits Govt in future (caring for pensioners)

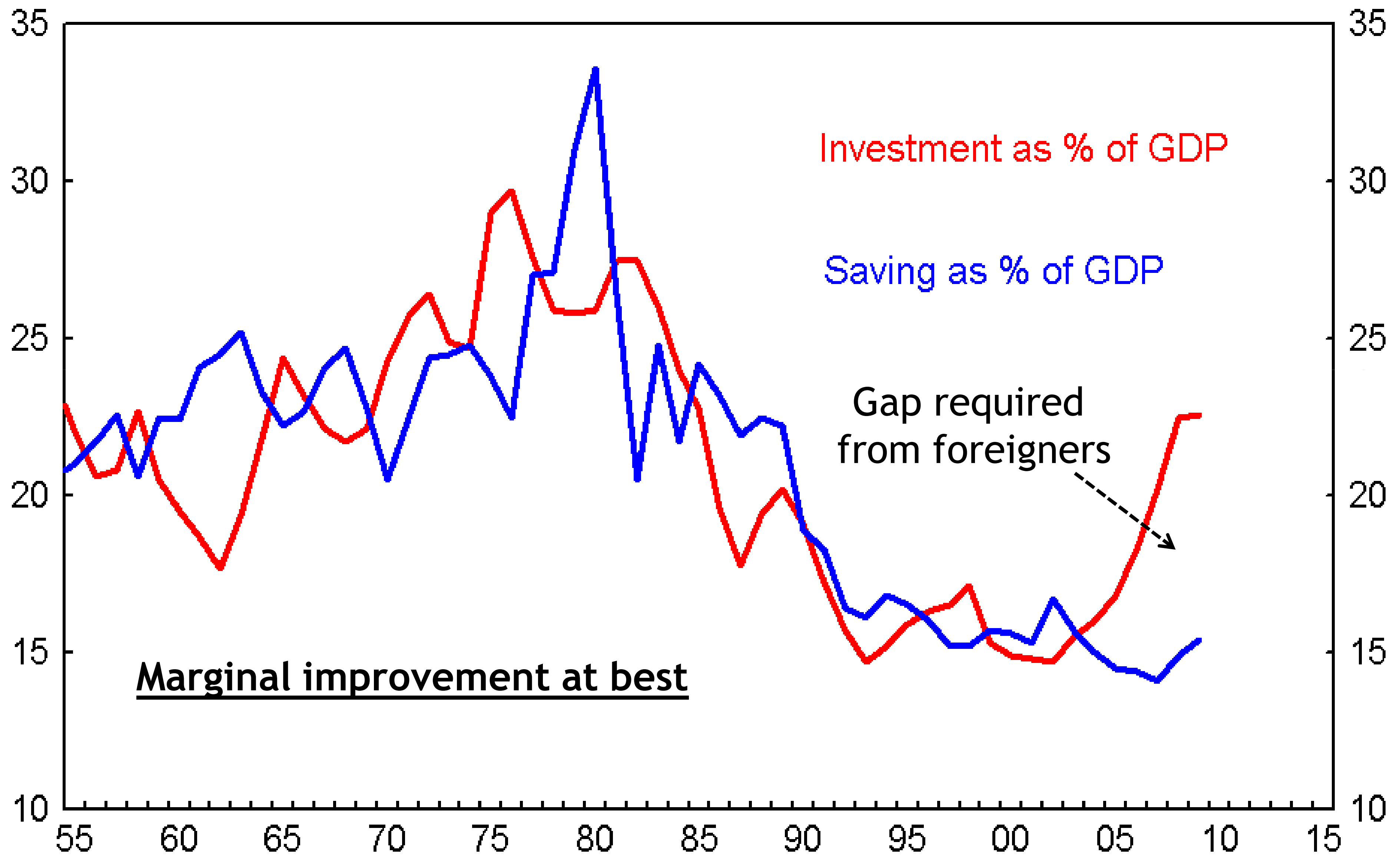
The role of savings in the economy (2)

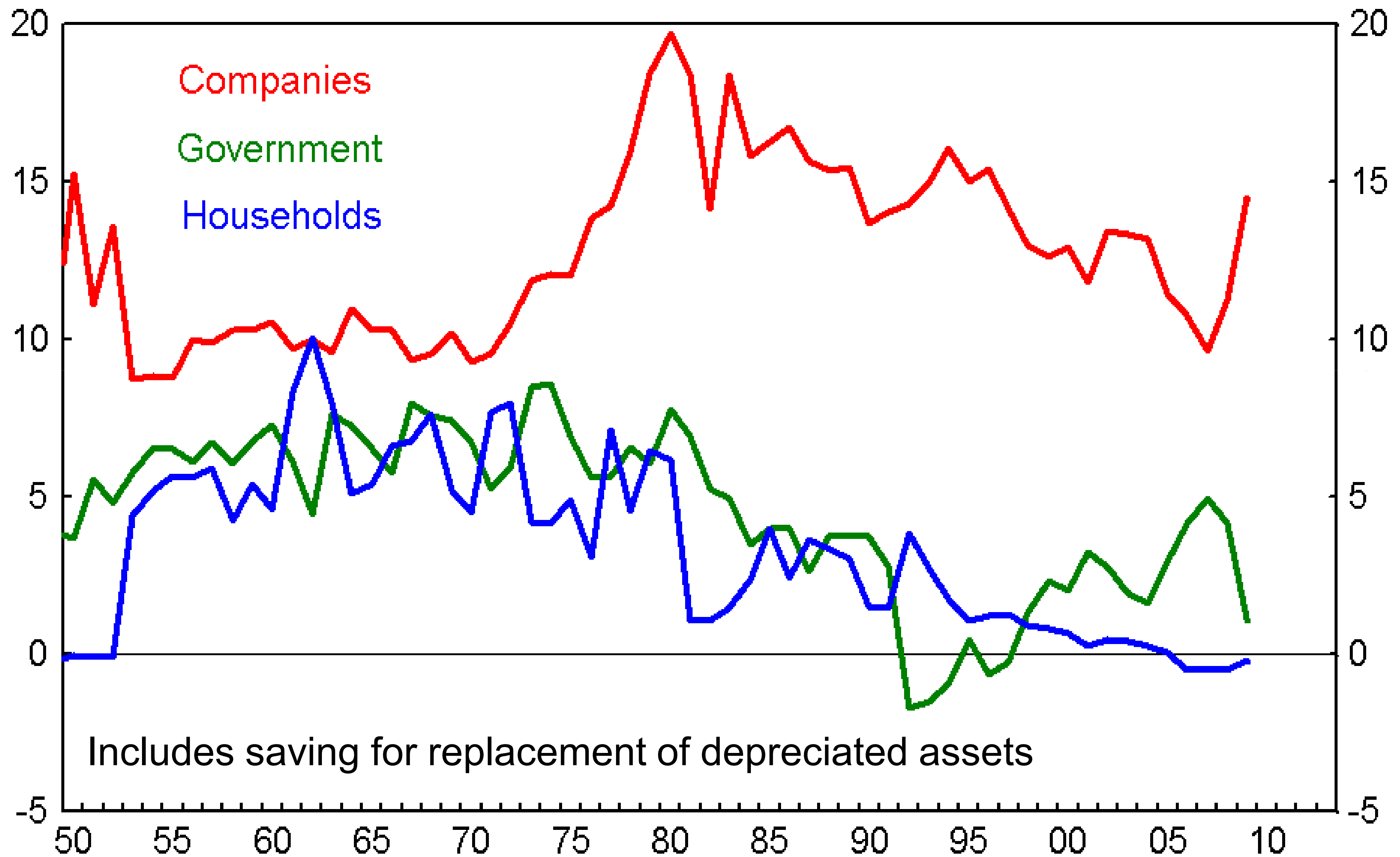
- Foreign savings (capital inflows) to the rescue?
  - Big inflows over the past decade have eased our savings shortage
  - But, inflows are fickle and can leave at the drop of a hat – often leaves you with a painful adjustment process, involving investment & job cuts
  - *Bottom line*: we can only rely on foreign capital to a limited extent

- Only real solution: *we have to save more as a nation*
  - High savings rates typically associated with high growth & employment
  - High savings associated with less severe cyclical economic volatility
  - High savings a necessary, but not sufficient, prerequisite for high growth
  - Other requirements also need to be in place – sound policies, political stability, rule of law, property rights, etc

SA savings constraint on growth

Both investment and saving needs to rise back to 1950's & 1960's levels

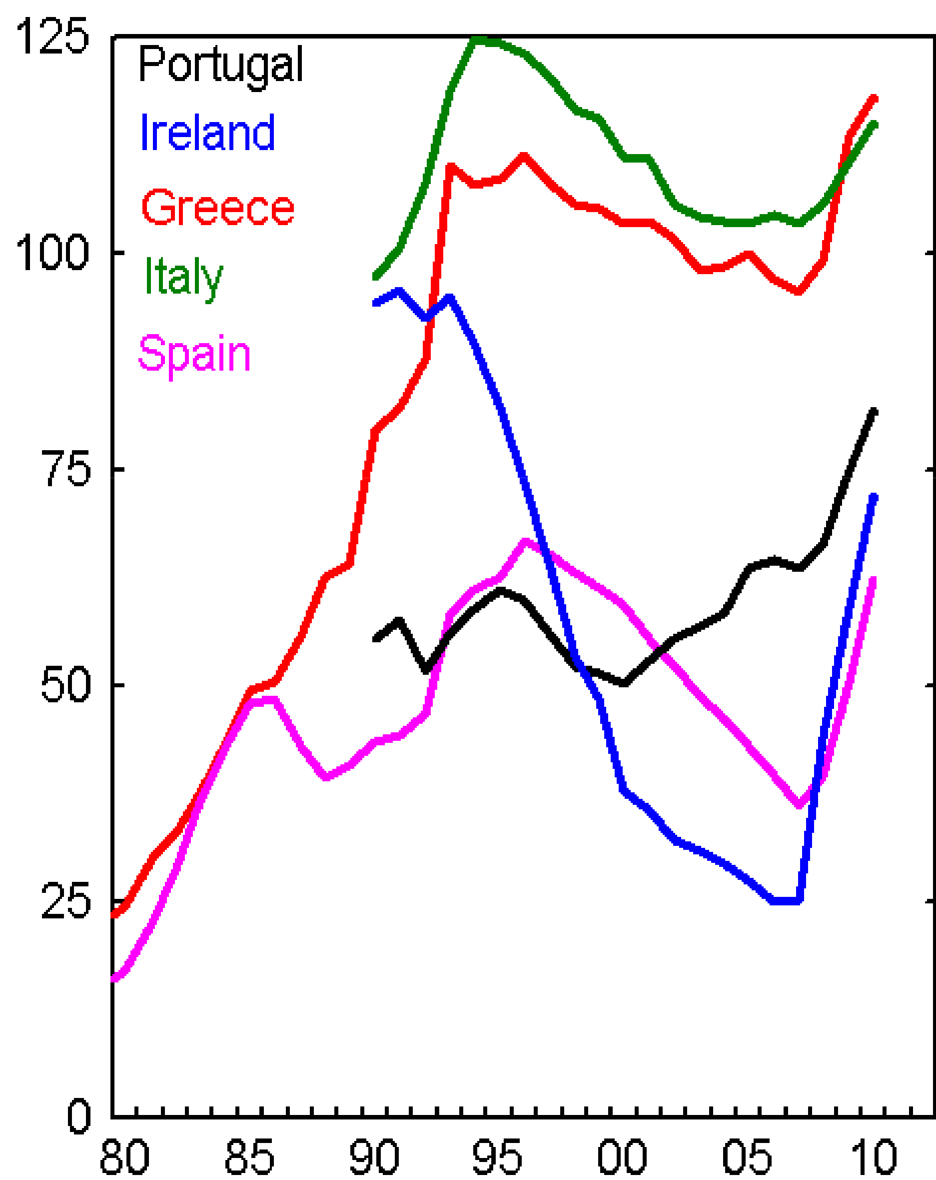


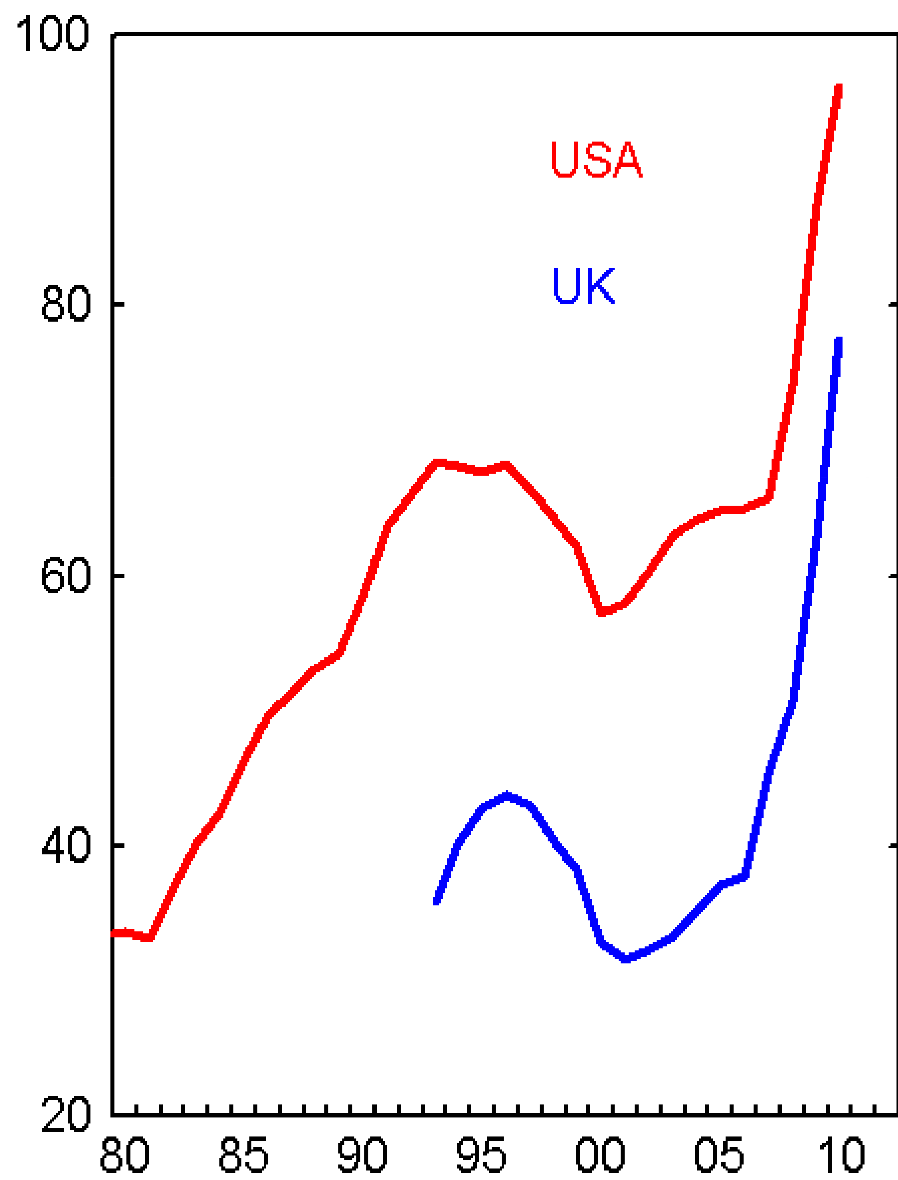

Who is saving?
Saving as % of GDP
Companies
Government
Households
Includes saving for replacement of depreciated assets
20
15
10
5
0
-5
50
55
60
65
70
75
80
85
90
95
00
05
10

Recent global economic developments (1)

- Global fiscal troubles cause financial market panic
  - Panic about sovereign defaults as a number of Govt's around the world's budget positions become unsustainable
  - Debt levels very high and rising fast – investors in their bonds fear they may not get all or part of their money back
  - Demand for those Govt's bonds collapses, bail-outs by other Govt's & Central Banks required to prevent complete disaster
  - Focus of budget troubles is Greece (and Spain and Portugal and Italy and Ireland and to a lesser extent the UK and the USA and…)
  - *Reactions of affected governments*: tighten fiscal policy through spending cuts and higher taxes, aggressive actions in some cases

Govt debt as % of GDP



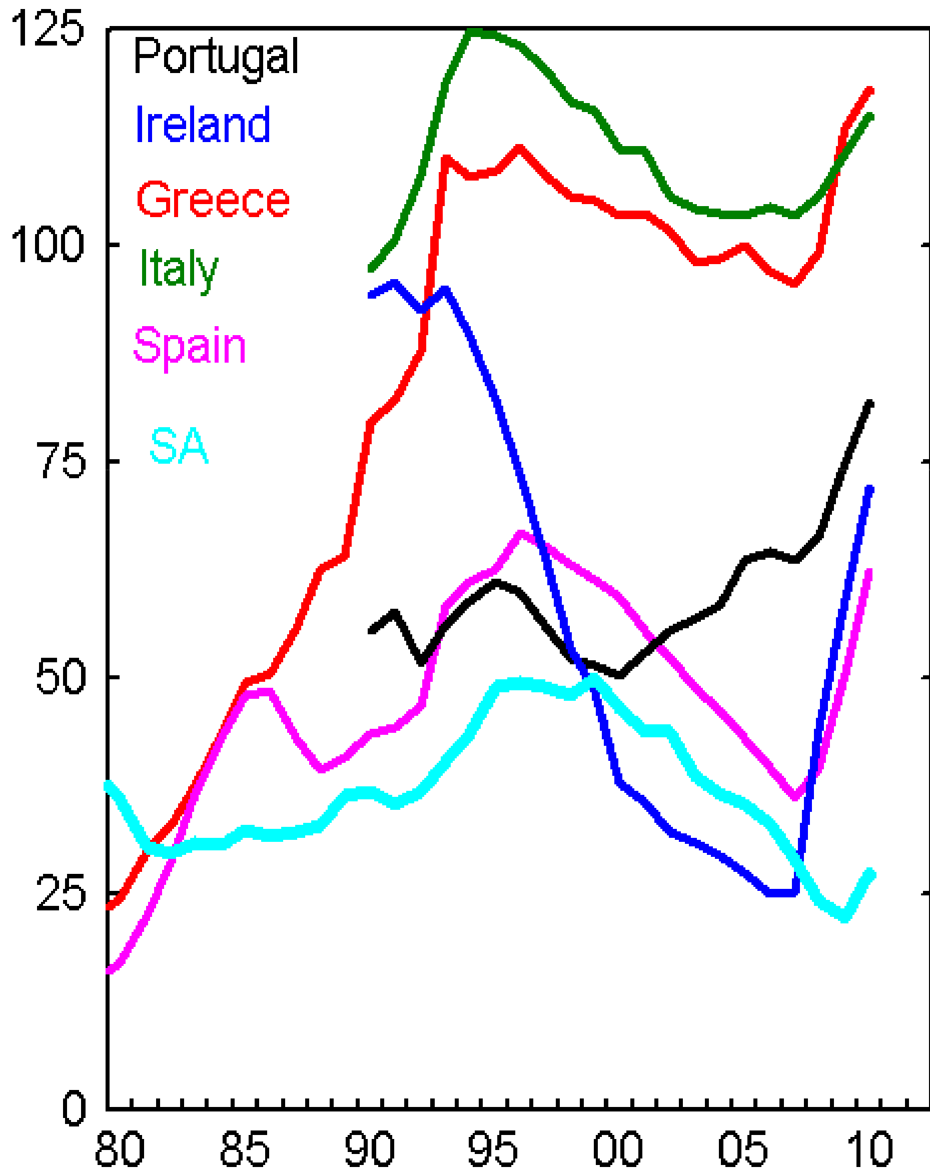


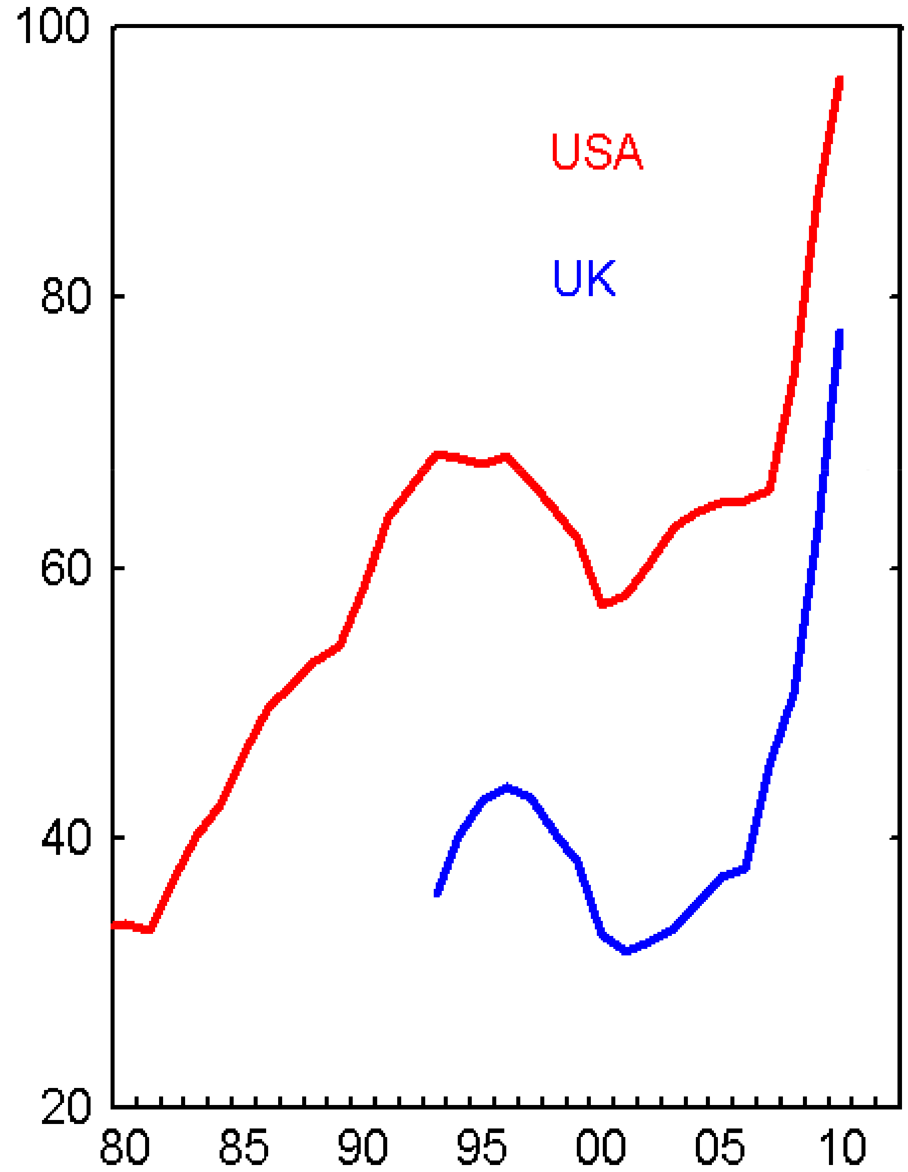
Recent global economic developments (2)

- **Implications for economies & citizens**
  - Structurally *slower economic growth ahead* as fiscal policy is tightened
  - Implies *structurally higher unemployment* & higher dependency ratios
  - It likely also implies *structurally low investment returns*
  - A key focus of fiscal tightening was *cutting state financed social benefits*, & cutting state financed pension benefits
  - Calls to raise retirement age to 70 (from average of 61 currently) *as pension funds seen as highly vulnerable to collapse*
- **Bottom line for affected households**
  - Govt's budget constraints imply people must *come to expect the bare minimum social benefits* in future
  - As years (decades?) of fiscal consolidation lie ahead for many countries, *people will be increasingly be forced to provide for their own retirement*
  - Likely *structurally low investment returns will require a very high level of savings* for those on DC funds, DB members face stagnant pensions
- **Questionable whether people have really fully realised implications**

Govt debt as % of GDP

Our fiscal situation much better – so do the implications not apply to us?





Implications for SA? Not much different …

- While we are fiscally better off, ***deficit reduction / control will also have priority*** *i.e. Govt will act to ensure we do not land in the same situation*
- **Implications for economies & citizens**
  - Also here growth will be relatively mediocre (3% - 4%)
  - Also here unemployment will remain high
  - Also here investment returns will be structurally lower
  - Also here social benefits will be curtailed (already 14m people on aid)
- **Bottom line for affected households**
  - Also here people must come to expect limited growth in social benefits
  - Also here people will be increasingly forced to provide sufficiently for their own retirement – **but, SA retirement age low (55?) & falling?**
  - Also here likely structurally low investment returns **will require a very high level of savings for those on defined benefit funds**
- **Questionable whether people have really fully realised implications**

A word to households

- **South African households save way too little**
  - For future liabilities: Children's education, depreciation of residence, etc
  - For retirement (most discover this with a shock, **far** too late)
- **A few very common financial errors made by households**
  - Underestimate future liabilities, relating to kids *and* retirement
  - Have no idea about whether their retirement provision is sufficient
  - Oblivious to the implicit risks they are taking with building too little capital
- **A few words of advice**
  - The greatest present you can ever give your children is to never become dependent on them (*many fail here*)
  - Fully understand your future financial liabilities (*few do*)
  - Start saving early – time is your best friend (*few do*)
  - ***Never*** spend pension money when you change jobs (*many do*)
  - Beware of quick-rich schemes – they seldom work (*many have lost much*)
  - Entrust your money to reliable institutions with proven track records

The vexing question – how much must you save? (1)

- **Problem is there is no easy answer – the answer depends on many things**
  - Savings period, expected investment returns, required income at retirement, expected inflation/investment return ratio during retirement
- **Most basic example: you must save all you will need in retirement**
  - No inflation, no increases, no investment returns
  - Work 35 yrs, retire at 60, live another 25 years on 75% of work-income
  - Need to save 54% of income (& make sure you die on time)
  - If you work only 30 yrs, % goes up to 75%
- **Implications**
  - You require *high real investment returns* over your working life
  - You have to *save much more than you think*
  - Once in retirement, *you still need a growing income*
  - A few years *early retirement can cost you very, very dearly*
  - Beware of *defined benefit pension funds – they are not obliged to give you pension increases*

The vexing question – how much must you save? (2)

- **A more realistic example: Assumptions**
  - 6% p.a. inflation
  - 9% p.a. salary growth (i.e. 'real career progress')
  - 3% real investment return over time is a realistic assumption
  - DC pension fund: 6½% contribution each from employer & employee,
  - At retirement retiree takes 6½% p.a.
  - So, % of income saved, investment return & years worked the key variables in determining pension size at retirement
  - **Remember**: in a DC fund *there is virtually zero direct correlation between your income and what you will ultimately have available in your Fund*

- And, remember, what follows is only a ***very, very rough guide***
  - Assumes smooth inflation, income & investment returns over time

How much must you save? - A guide

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30 years worked			
% saved	Inv. Return	% of pension taken	Pension as % of last salary
13	9.0	6.5	28
35 years worked			
13	9.0	6.5	32

All examples above assume 9% p.a. salary gain & 6% p.a. inflation

How much must you save? - A guide

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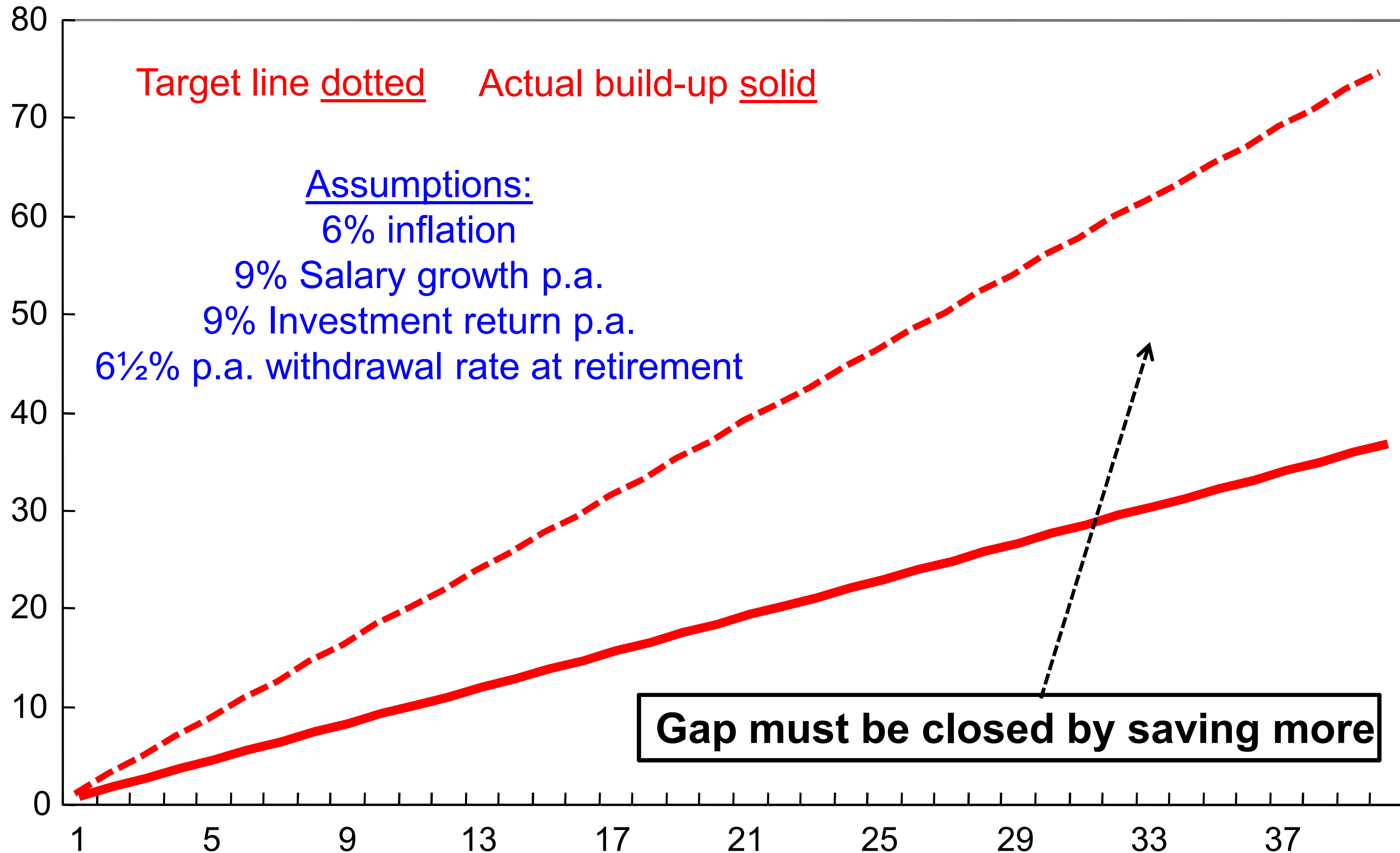
% saved	Inv. Return	% of pension taken	Pension as % of last salary
30 years worked			
13	9.0	6.5	28
35	9.0	6.5	75
13	15.5	6.5	75
13	9.0	17.5	75
20	12.5	6.5	75
35 years worked			
13	9.0	6.5	32
30	9.0	6.5	75
13	13.5	6.5	75
13	9.0	15.0	75
17.5	12.0	6.5	75

All examples above assume 9% p.a. salary gain & 6% p.a. inflation

Savings build-up vs target of 75%



The vexing question #2 – how long will your money last ?

- Assumptions
  - Close to retirement, on a DC fund
  - Fund has a fixed yield, say invested in a money market fund

- Once again, what follows is only a ***very, very rough guide…***

How long will your money last?

OLD MUTUAL Investment Group | Equity Research

Assumptions: R3m capital, starting income requirement R210k p.a. (= 7% of fund), escalating at inflation

Yield on fund % p.a.	Inflation % p.a.	Yrs to zero capital	Real income after 20 yrs
7	0	Infinity	Same forever
7	1	36	-18%
7	2	29	-33%
7	5	20	-64%
7	7	18	-77%

How long will your money last? The importance of more capital

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Assumptions: R5m capital, starting income requirement R210k p.a., escalating at inflation

Yield on fund % p.a.	Inflation % p.a.	Capital change over 10 yrs	Capital change over 20 yrs
7	0	+38%	+114%
7	1	+36%	+100%
7	2	+34%	+87%
7	5	+26%	+32%
7	7	+19%	-17%

The more you have, the safer you are & inflation is prime evil …

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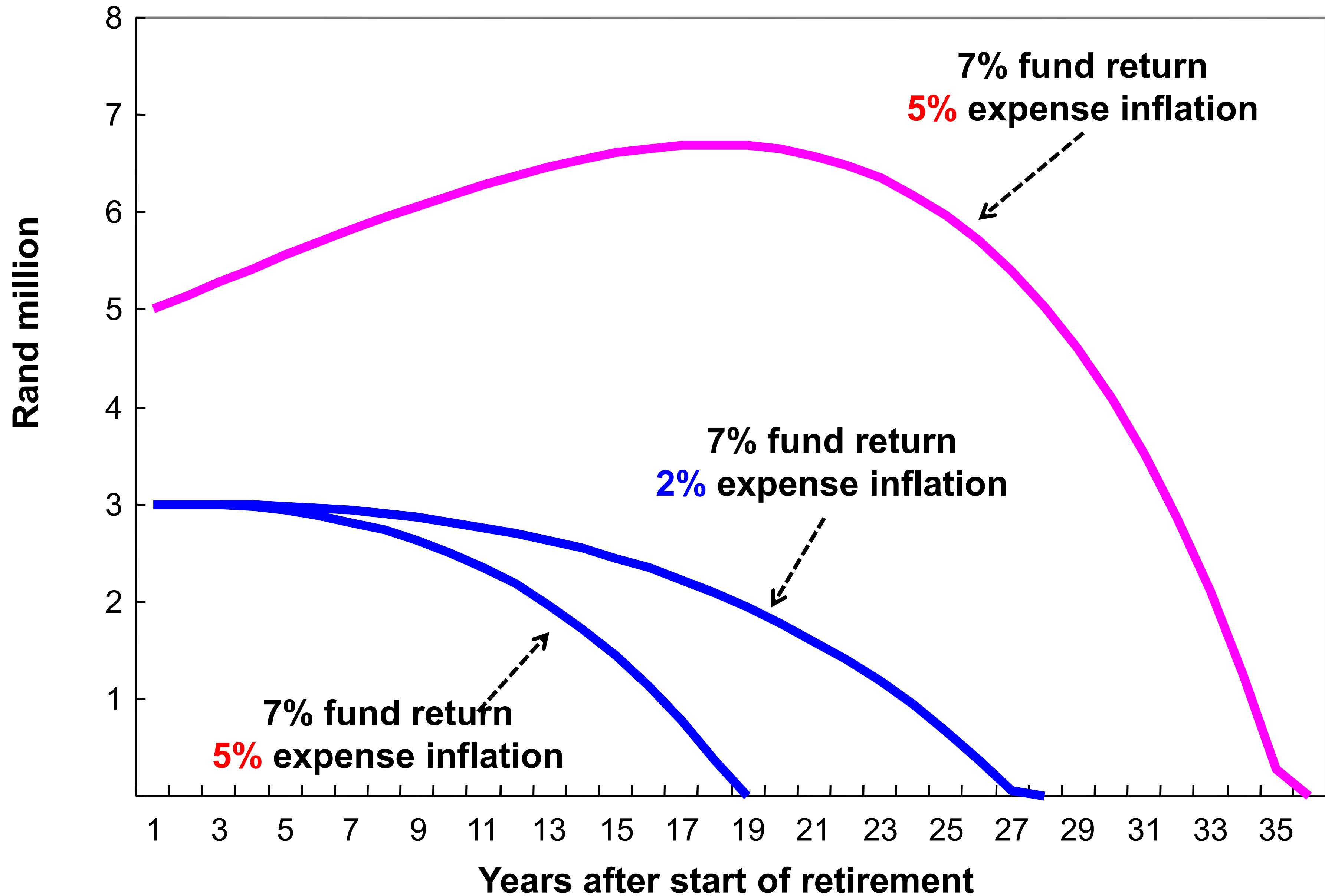

The more you have, the safer you are & inflation is prime evil …

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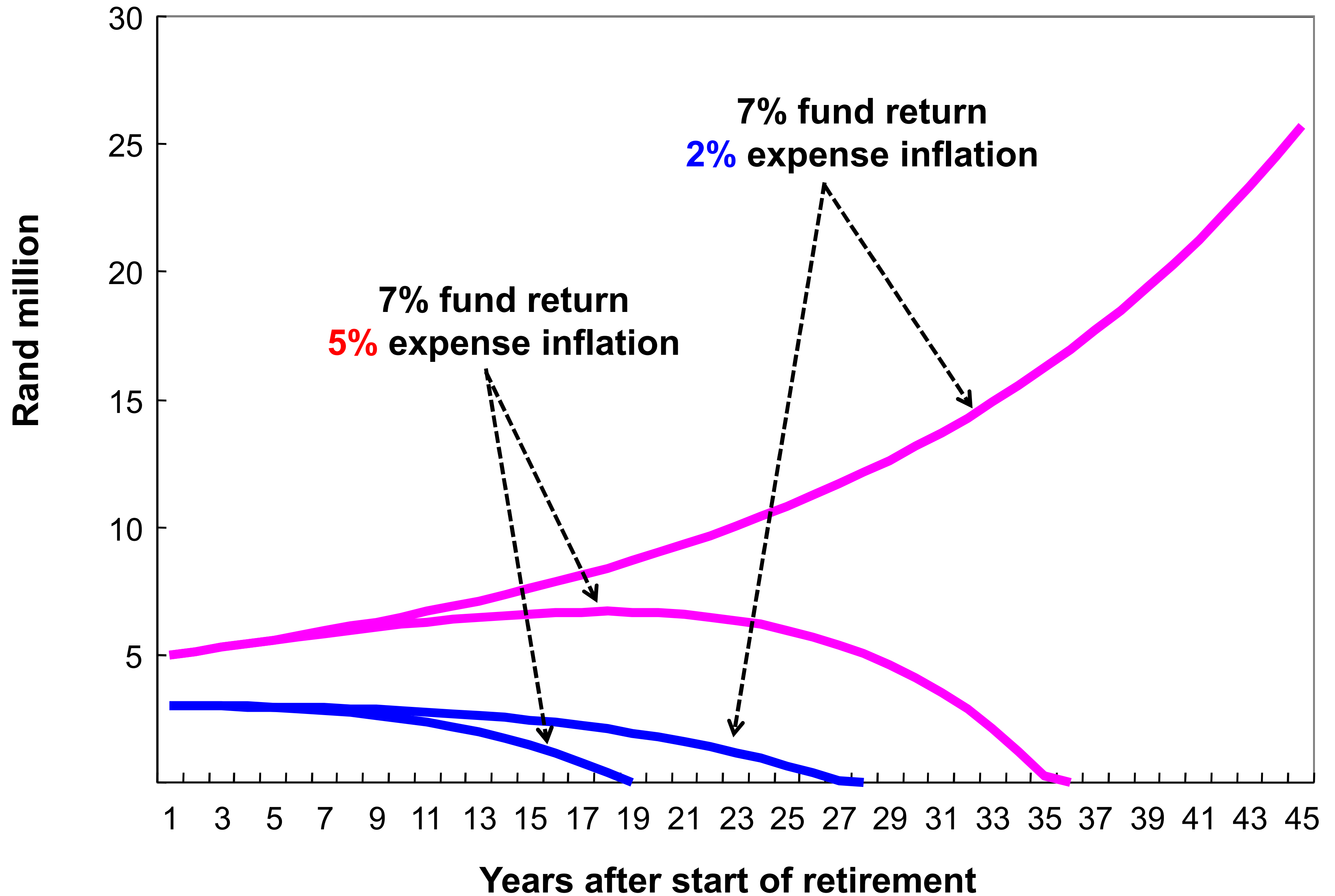

Thank you !