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SA Savings Institute Review

SPECIAL PROJECTS
SALES REPRESENTATIVE: IAN STARNES
WRITER: ALF JAMES
Published in The Star, Pretoria News, Daily News & Cape Argus

Household savings even more of a priority following Euro debt crisis

Leon Barnard, Director of Inclusive banking at Standard Bank.

THE ongoing debt-crisis in the Eurozone is alarming news for developing countries such as South Africa, according to Leon Barnard, director of inclusive banking at Standard Bank.

He says in the long-term, economic growth and development occur only when there is investment in a country. Thanks to the crisis, investors have fewer funds available to invest. And they have even less confidence about investing – especially in emerging countries like ours which are seen as risky.

"What this means for the developing world is that we may have to look internally to secure funding to finance investment projects.

"And, as we all know, investment is needed to create jobs and prosperity. Every road, factory or shopping mall requires some investor to provide the necessary capital. In these tough economic times, the pool of available capital shrinks dramatically. If as South Africans we saved more, the pool of investment capital would be bigger," says Barnard.

Unfortunately South Africans are known to be notoriously poor savers, with most people prepared to save for death but few making the effort to save their money to cover unforeseen events or even for retirement.

Barnard points out funeral policies are big business in South Africa, with various research findings showing that more than 60 percent of South African adults have funeral policies. But, it seems, that's as far as most of us are prepared to go.

"Among the Brics group of countries – Brazil, Russia, India, China and South Africa, ours has the lowest savings as a percentage of gross domestic product (GDP).

"According to data from the International Monetary Fund (IMF) our savings rate was 16,6 percent in 2010 but fell to 14,7% in the first quarter of this year. Compare that to the other Bric members China and India, which have had savings rate of above 50% and 30% respectively since 2010.

"Russia's savings rate has been well into the 20s for the comparable period. Even Brazil, which also has a rather low savings rate among this community, is doing far better than us with a savings rate that has been hovering at around 18% since 2010."

Barnard says the IMF data further shows that among five African countries that were compared, South Africa and Egypt were the only two countries that saw a decline in savings rate since 2010. In the case of Egypt – the situation is not entirely unexpected given that the country has undergone dramatic social and economic upheavals since the Arab uprisings which began early last year.

"Even Nigeria, our strongest competitor on the continent, has a far healthier savings rate than us which stood at almost 30% this year. In fact Nigerians have been increasing their savings levels in the past two years.

"What's even more alarming in our case is that the bulk of savings are done by corporate rather than households. Ms Elizabeth Lwanga-Nanziri, chief executive of the South African Savings Institute is quoted in an article published by The Star in November last year as saying that household savings amounted to only 0,2% of GDP.

"This means that households are spending virtually all their income. Part of the explanation for this has to be the fact that people generally have low disposable income. But the situation is also caused by the strong consumerist culture which has taken hold in South Africa."

Barnard says although spending is necessary to fuel growth in the economy, savings are needed in the medium and long-term. And when many advanced economies are facing recession, it is foolish to rely solely on foreign investors to help create prosperity.

"To promote savings, financial institutions have come up with a variety of new generation products designed to meet consumer needs for interest on balances, however small.

"And what's more, the terms on these products continue to improve. So there really is no excuse, it is possible to save and earn interest even on a low balance," concludes Barnard.

Turn saving into a norm

Jan-Carel Botha, FPI financial planner of the year for 2012.

A friend received advice from his boss at his first job, to save 10% of every pay cheque for the rest of his life and by doing this he would be ensured financial security for his retirement, according to Jan-Carel Botha, FPI financial planner of the year for 2012.

"Unfortunately he didn't follow the given advice.

"Having learnt the hard way, today, as a small business owner he provides the exact same advice that he received as a young employee to all his employees – save 10% of every paycheque.

"And they don't either," says Botha. Why is it so difficult to save if the benefits are so obvious to us all?

Botha says the answer is simply that instant gratification is our worst enemy.

"Instant pleasure, status and comfort is sold to us daily, but no one is to blame but ourselves if we overindulge in these and never get to save any of our income.

"Most of us fall into the trap of over indebtedness, individuals, companies, governments, all fall into the same trap and hence the biggest economic crisis the world has ever seen."

Botha says that in today's world, education of the young generation on personal money management is more than just telling them to save 10%, first they need to be taught the dangers and consequences of bad debt.

"With merit to every unique situation, study loans, your first car and your first house can be classified as 'good debts'. These need to be paid off as quickly as possible, ensuring that the repayments on these never exceed more than a third of your income. The bad debt is everything else.

"When you have debt in which the interest rate exceeds the reasonable return of a sound investment, you simply can't save or invest. If for instance you are paying the bank 20% interest on a credit card and are trying to save in a unit trust investment at 10%, you will literally be saving yourself into bankruptcy!

"The dangers of over indebtedness are too many to mention, but one of the biggest is that you remain a slave to the lender for the rest of your life and never get to save anything for your own financial security.

"You're constantly at the mercy and control of the lender, which can either be an individual, bank or government, and you have no say," says Botha.

How do you save when one already battles to just survive with life's daily basics?

Botha says the best investment you can make is to become debt free as soon as possible.

"If you are debt free and continue saving 10% of all that you earn in your life you'll be able to spend 90% of everything earned and still be able to grow your savings pool," he concludes.

Starting to save early is well worth the effort

HAVING enough money to be financially independent when you retire may seem like an impossible dream. But if you start saving early enough, you'll be surprised how quickly it adds up.

"A little really can go a long way," says Jeanette Marais, director of distribution and client services at Allan Gray.

"Many of us are reluctant to make the sacrifices needed to save even 10% of our salaries towards retirement, yet we expect a pension that pays us 75% of our final salaries, often for as many years as our saving years," she says.

"The only way we can hope to achieve this replacement ratio is through long-term commitment, good returns and sensible investor behaviour."

Marais says if you start early and save consistently over long periods, less of your total amount saved will be from your contributions and more from growth, which is why it usually doesn't pay to leave your money under your mattress.

"With inflation eroding the spending power of your money, the returns on your investment should be at least enough to compensate you for the length of time you invest so that the value of your money is maintained."

Marais informs that over the very long term (around 100 years), South African equities have delivered, on average, real returns of 7,3%.

"Based on this, if you allowed 40 years for retirement saving, two-thirds of your total amount would have come from returns and compound growth. As the time allowed for compounding increases, so the amount of growth, relative to your contributions, increases exponentially.

"Your first ten years of contributions are more important than your last ten years, as your money has that much longer to grow."

In fact, according to Marais, assuming a return in line with very long-term equity returns and taking historic inflation into account, an investor who contributes a consistent amount of R1000 per month for 10 years (R120,000) and then stops contributing but remains invested for another 30 years will accumulate just as much as one who delays starting for ten years and then contributes R1000 a month for 30 years (R360,000).

"This shows that starting to save a small amount is really worth the sacrifice in the long term," says Marais.

Finally, she says behave sensibly when it comes to your investments. Research has shown that the average investor earns much less than the funds they are invested in. This is because, on average, investors make poor decisions about when to buy, sell and switch between funds.

"The lesson is that investment success is not only about skill. It's also about behaviour. Investment performance doesn't come in a straight line. Investors who are taken by surprise by a period of short-term underperformance and sell their investments at the wrong time often miss out on a substantial part of the return in our unit trusts.

"Changes in your personal circumstances and capacity to take risk should encourage you to rethink your investment strategy, not short-term market fluctuations," concludes Marais.