## Savings in times of lowest interest rates – savings culture at stake?
## Some thoughts on the present and future of savings

A few years ago the term "low interest rates" was something hardly anybody could relate to. Interest rates rose and fell under the influence of economic conditions and inflation expectations. Today however, a simple Google keyword search turns out more than 400,000 results. These include newspaper articles and interest rate comparisons for savings deposits. However, one link leads to the Financial Stability Committee, which deals with the long-term risks in the follow-up of low interest rates. Apparently, the flat yield curve is not without consequences for the financial markets. Nor is it for the behavior of banks and depositors. Are we thus on the brink of a new savings culture?

### *Germans worship saving (so do the French and Italians)*

A variety of studies have dealt with the savings behavior of European households. Despite the long-held clichés among the European nations with which they try to distinguish themselves from each other, their savings behavior is pretty equal: Retirement and rainy-day funds are the most important savings motives for Germans, French and Italians. For said nations the reliability and stability of the savings product through which they try to achieve this goal is the most important determinant for their purchase decision, as a study conducted by German insurance company Allianz has found out. Ever decreasing interest rates, however, jeopardize the importance of this criterion.

A large set of indicators points to a long period of low interest rates: Economic development in the Eurozone has been sluggish and the outlook is not all too bright. Hence the upward pressure on interest rates, from a real market perspective, is low. Secondly, the ECB has reduced the fixed rate to an all-time low of 0.05 percent emphasizing its ambition to ward off deflation and encouraging bank lending to the real economy. The announcement of expanded asset purchases has underpinned these ambitions. President Draghi himself has stressed several times that interest rates will remain low for a long time. And why should one not believe him?

### *Savings under pressure – is it still all worthwhile?*

In light of this, savers may pose a legitimate question: Is saving worth anything at all? You get a minimum yield for savings. These yields are then subject to taxation. And your net return is most often consumed by inflation. Is that really worth it?

Media commentators and financial experts point out that, throughout most of the past decades, inflation has always been well above the interest rate on savings deposits: there is no constitutional right for positive real interest rates. The basic flaw of these comments, however, is the fact that they refer to short term deposits with maximum liquidity. Their

interest rate has always been considerably low and most of the time with a negative yield after accounting for inflation rates. But if one widens the focus of the savings products considered, you get the overall picture. In fact, the interest rate for mid- and long-term savings products has always exceeded the rate of inflation. Of course there is no right to a positive real interest rate. But with positive real interest rates people are at least able to accumulate a moderate wealth little-by-little. Leeway to accumulate retirement funds via safe savings and compound interest is reduced to zero. According to the German Insurance Association, a one percentage-point drop of the average interest rate requires an increased savings effort of 15 percent to keep one’s future retirement funds steady.

A survey commissioned by the Association of Private Bausparkassen, examining savings behavior and motives in Germany on a regular basis, already provides a change in savings behavior. In summer 2014, a mere 40 percent of the respondents were savers, whereas 60 percent didn’t save any money at all. This was a decline not only by 9 percentage points compared with summer 2013, but an all-time low ever since the survey was first conducted in 1997. Consumption or major purchases had replaced retirement funds as the main motive for saving. This too is a remarkable observation – and all this despite the fact that real incomes have risen again.

***Low, lower, lowest – the impact of European monetary policy***

One does not have to do in-depth research to understand the fundamental relationship between savings, deposits and investment. Students of economics usually learn this in the first two semesters of their education. Household savings are a necessary prerequisite for investment. The creation of money and credit knocked-on by central banks, commercial banks and non-banks is dependent on the formation of deposits.

At least one lesson to be learned from the last financial crisis is that market-based funding of banks not only does have limits, but it also poses major threats to the stability of entire economies. Financial innovations such as structured financial products are not the philosopher's stone of banking. The risk aversion of investors, the lack of transparency of structured finance and the new regulatory environment will have an impact on the funding structure of banks. In a working paper published in 2012, Deutsche Bank Research calls for a comeback of good-old savings deposits as a source for funding. In fact, deposits, with an average share of 60 percent, are the main source of funding for European banks. The deposit-based funding is characterized by the exact opposite of structured financial products’ features: deposits are a stable, reliable funding source, they are transparent in the highest degree, they are subject to strict regulations and they are safe.

Hopes were high that the European Commission had finally acknowledged the importance of long-term saving for a stable, long-term bank funding and loan-supply to the real economy respectively. In a Green Paper on long-term financing published in early 2013, the importance of savings is highlighted as a necessary prerequisite for the loan-supply of the real economy. So is the need for synchronization of long-term savings with long-term

investments. Households are the most important source of (short-term) deposits. Thus emphasis is put on the need for greater mobilization of long-term savings.

**Is saving “unproductive” and should savers become investors?**

The central focus then was on how to foster the supply of long-term financing and how to improve and diversify the system of financial intermediation for long-term investment in Europe. The European Commission for the first time expressed positive views on long-term savings products and investments and conducted a public consultation on whether corresponding tax, prudential and other rules should be changed to provide incentives for these products. Specific recognition was given to the French savings account “Livret A”, the German Bauspar contract (contractual savings for housing finance) and the Italian “libretto postale” as examples of measures established at the national level to promote long-term savings. On this basis, the usefulness and feasibility of an EU model for a long-term savings product was to be examined.

Unfortunately, however, the EU-Commission’s current stance, drafted in the Green paper “Building a Capital Markets Union” is a complete reversal of the goals outlined in the Green Paper on long-term financing of the European economy. Among other things, the Commission wants to enhance SME’s access to capital markets, bypassing financial intermediaries and reducing standards, reinvigorate securitizations, channelize the flow of savings into capital markets instruments (away from “less productive uses”).

Neglecting the role of a deposit-based banking system, subject to tough regulation, in favor of a non-transparent global capital market with little regulation at all would jeopardize this sustainability.

The increased shift of private household funds from bank deposits to capital markets, which is the intention of specific incentives in the Green Paper on the capital markets union, ignores most people’s desire for safe and sustainable investments. Rather than luring them into risks inseperably linked to any form of capital market investments, away from savings deposits, the Commission should encourage households to save the safe way.

Yet, with an emphasis on capital markets and their assumed productivity in connection with the ECB’s low interest policy, households get the impression of being able to borrow money on apparently favorable terms and thus creating a preference for consumption in the present.

***The case for targeted saving and a return to sustainable monetary policy***

Is this the key message of the ECB's policy and the above mentioned commentators' advice? Hopefully not. But still, does saving make any sense today?

First of all, saving has a value in itself. The one who learns saving at an early stage in his or her life, may later encounter hardships with greater resilience and is less prone to (over-) indebtedness.

Investing in assets is often proposed as an alternative. The expected higher yield due to dividends and rising stock prices are apparently attractive. However, investing also carries the risk of loss or even total failure in itself – the stock market in the short run can be extremely volatile. In this respect, investing in assets is at best a complement to safe, long-term savings products. For many households – those with relatively small financial reserves and incomes – investing is therefore no alternative to saving. Any short-term goal and emergency fund should be saving-driven, not investment-driven.

The culture of savings and stability that has been growing for decades is therefore worth being preserved. In any case, it is difficult to change at short notice. Better than advocating a culture of indebtedness and risk would be to offer incentives for targeted savings schemes for retirement, home purchase, or other major purchases. Furthermore, more attention should be turned on products suited for these purposes.

Products for targeted savings should not focus on the highest possible return, but for safety and soundness. This calls for strict rules that prohibit hazardous investments with excess liquidity. The long-term nature of the deposit business of Bausparkassen also ensures sustainable funding .

As with any deposit-based banking system Bausparkassen too have come under pressure due to low-interest rates. The ECB's policy and the EU-Commissions new approach, outlined in the green paper on the capital markets union, carry the potential to undermine European savings culture. Today's generations grow up supposing that inflation was a phenomenon of the last century. They have never experienced interest rates fluctuations. A return to a monetary policy which respects the threshold to fiscal policy and the promotion of the savings idea are imperative in order to restore sustainable financial markets in Europe.