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Home is where the money is:

The economic importance
of savings

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FEBRUARY 2005



EXECUTIVE SUMMARY

Many New Zealanders do not have a meaningful ownership stake in the New Zealand economy. Statistics New Zealand estimate that the median household wealth in New Zealand is just \$68,300 and that 800,000 adult New Zealanders own less than \$20,000. Household wealth is also heavily concentrated among the wealthiest 10% of New Zealand households.

Household savings and financial wealth are low in New Zealand

At an aggregate level this means that New Zealand households have lower levels of wealth than households in other Anglo countries – Australia, Canada, the UK and the US. This difference in total household wealth is due in large measure to significantly lower levels of household financial wealth. The investment of New Zealand households in housing, as a share of disposable income, is approximately the same as in other Anglo countries but New Zealand households have significantly lower levels of financial wealth than households in other countries.

Moreover, New Zealand is one of the only developed countries where household financial wealth has reduced over the past decade, from 112% of disposable income in 1993 to 44% in 2003.

This has occurred because household debt has increased strongly while holdings of financial assets have remained relatively constant, even as home ownership rates have reduced sharply. This contrasts with other Anglo countries, where household ownership of financial assets has increased to more than offset the

strong increase in household borrowing in these countries – even as home ownership rates have also tended to increase.

A significant cause of this declining household financial wealth is New Zealand's low household savings rates, which have consistently been among the lowest in the OECD and have declined significantly over the past decade or so. These low household savings are offset to some extent by high rates of public savings, as the government has run fiscal surpluses, but overall New Zealand has low rates of national savings.

The low levels of household wealth and savings in an aggregate sense matter significantly for the performance of the economy as a whole – in addition to the profound financial and non-financial benefits that asset ownership confers on individuals and communities.

The low level of domestic savings constrains the level and type of investment in New Zealand

The low level of New Zealand household savings means that New Zealand is heavily reliant on foreign savings to finance investment and borrowing. This reliance on foreign capital has significant consequences for the behaviour and performance of the New Zealand economy. The international evidence shows clearly that foreign savings are not a perfect substitute for domestic savings, and that domestic savings and domestic investment remain heavily correlated. Despite the globalisation of capital markets, much investment remains heavily local.

And to the extent that international capital does cross national borders, it is attracted disproportionately to proximate, large markets. This is because information about investment opportunities is often local, creating a home bias for investing, and because the scale of the available market is a key factor in determining the available return opportunities.

Because New Zealand is both small and remote from other markets, the low level of domestic savings is likely to be more of a problem for New Zealand in terms of financing investment than it is for larger economies.

Indeed, New Zealand's business investment rates have been consistently lower than they have been in other developed countries. And although New Zealand has attracted substantial amounts of foreign capital over the past few decades, only a relatively small proportion of this has gone into enhancing the productive base of the economy. Foreign capital has generally financed the purchase of existing assets rather than new investments, has been focused on the domestic economy as opposed to the export sector, and increasingly has financed household borrowing for mortgages and consumption.

New Zealand is an indebted country

New Zealand's low level of savings has generated persistent and large current account deficits. This has led to New Zealand accumulating one of the highest levels of external debt in the OECD as a share of the size of the economy.

This large stock of external debt has significant economic implications. First, it means that about 5% of New Zealand's GDP is consistently exported to foreign savers as the return on their New Zealand investments.

Second, foreign lenders demand a risk premium when lending to New Zealand borrowers because of the highly indebted nature of the New Zealand economy. This is reflected in the high cost of capital that New Zealand borrowers face as seen, for example, in the high cost of mortgage borrowing in New Zealand compared to other Anglo countries.

Increasing household savings is likely to generate improved economic performance

The IMF and the OECD both identify New Zealand's low levels of business investment as an important reason for lower productivity and income in New Zealand. A key challenge in improving the New Zealand economy is to move from a consumption led economy to an investment and productivity led economy. New Zealand cannot spend its way to prosperity, but rather needs to increase investment in the productive base of the economy in order to improve its economic performance.

Foreign savings can be used to finance a portion of this increased investment, but it is unlikely to be sufficient. Increased savings by New Zealand households are also required to finance this investment, because a small, distant country like New Zealand will struggle to attract substantial amounts of productive investment from foreign



investors. To finance more investment in New Zealand, home is where the money is.

Indeed, increasing household savings is important for growth in New Zealand in a way that it may not be in other countries. This is because of New Zealand's unique combination of very low levels of household savings and financial wealth, a particular need to increase its low business investment rates to enhance economic growth, and the constraints that face a small, remote economy in attracting foreign savings to finance productive investment.

Moreover, increased household savings will reduce New Zealand's level of external debt and will place downward pressure on interest rates. Given New Zealand's highly indebted position and its high interest rates, this is also a particular priority for New Zealand.

These economic benefits provide a powerful case for deliberate action to raise savings by New Zealand households, additional to the social and community benefits that are generated by asset ownership. Together, these social and economic arguments create a compelling case for action to raise the level and broaden the distribution of asset ownership by New Zealanders.

