EFAMA
European Fund and Asset Management Association

# MARKET INSIGHTS

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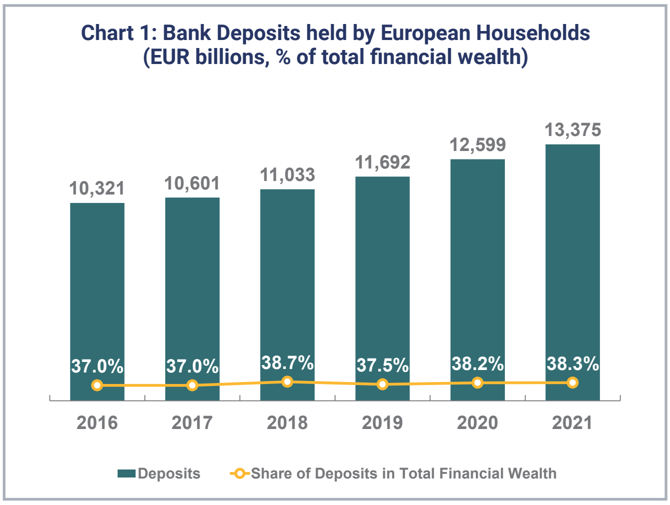
# CALL FOR ACTION TO PROTECT RETAIL INVESTORS AGAINST INFLATION

The vast majority of European households continue to keep a disproportionately high share of their wealth in bank deposits. Between end-2016 and end-2021, the amount of savings held in bank deposits in Europe increased from EUR 10,321 billion to EUR 13,375 billion, as did the share of deposits in household financial wealth from 37.0% to 38.1%.[1]




*Source: ECB and Eurostat*

Turning our attention to the national level, we see considerable variations between the individual countries. In three European countries (Denmark, the Netherlands and Sweden), households are holding less than 20% of their financial wealth in deposits, but this percentage is higher than 70% in Bulgaria, Cyprus, Greece and Poland.

This situation is mirrored by significant differences in the share of savings held in pension funds and life insurance products. These are quite high in the first group of countries and relatively low in the second group.

Most other European countries sit somewhere in the middle. They are generally characterized by a significantly lower share of funded pension savings, as they still rely predominantly on the first pillar pension system. It may be that households in these countries feel that they do not need to save more for retirement because they believe that their state pension will provide them with an adequate retirement income. Unfortunately, it is well established that the generosity of provision of social services by the State will go down in the foreseeable future because of the impact of Europe's ageing population, the Covid-19 pandemic and the current economic slowdown on government debt.[2]

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The good news, however, is that the share of deposits has declined in 16 countries between end-2016 and end 2021. This may be interpreted as an indication that the Capital Markets Union (CMU) project is beginning to produce positive results. Still, the share of deposits remains very high in these countries (55% on average[3]), and the absolute amount of savings kept in bank deposits in this group of countries has increased by 35%.

**European Households' Amounts Kept in Bank Deposits**

| Countries | Share of Deposits in Total Financial Wealth (in %) | | | Bank Deposits (in EUR billions) | | |
|---|---|---|---|---|---|---|
| | End 2016 | End 2021 | | End 2016 | End 2021 | % increase |
| Europe | 37.0% | 38.3% | | 10,321 | 13,375 | 30% |
| Austria | 52.4% | 52.1% | + | 265 | 330 | 25% |
| Belgium | 39.0% | 40.7% | | 390 | 491 | 26% |
| Bulgaria | 75.9% | 71.3% | + | 25 | 36 | 45% |
| Croatia | 64.8% | 60.9% | + | 30 | 39 | 31% |
| Cyprus | 80.6% | 78.2% | + | 29 | 35 | 19% |
| Czech Republic | 68.5% | 67.2% | + | 104 | 162 | 55% |
| Denmark | 19.8% | 17.6% | + | 136 | 171 | 26% |
| Finland | 42.4% | 40.6% | + | 95 | 127 | 34% |
| France | 36.2% | 40.2% | | 1,425 | 1,934 | 36% |
| Germany | 45.0% | 44.2% | + | 2,311 | 3,070 | 33% |
| Greece | 86.4% | 81.8% | + | 168 | 173 | 3% |
| Hungary | 49.5% | 48.9% | + | 41 | 58 | 44% |
| Ireland | 42.6% | 42.0% | + | 136 | 181 | 34% |
| Italy | 40.4% | 41.3% | | 1,333 | 1,629 | 22% |
| Luxembourg | 57.4% | 54.9% | + | 40 | 54 | 35% |
| Malta | 58.2% | 65.7% | | 12 | 17 | 47% |
| Netherlands | 19.3% | 19.8% | | 418 | 534 | 28% |
| Poland | 68.8% | 72.1% | | 209 | 313 | 50% |
| Portugal | 64.9% | 66.6% | | 179 | 220 | 23% |
| Romania | 72.8% | 66.3% | + | 46 | 71 | 55% |
| Slovakia | 66.5% | 62.6% | + | 41 | 56 | 36% |
| Slovenia | 70.2% | 69.9% | + | 22 | 34 | 50% |
| Spain | 52.8% | 52.8% | | 861 | 1,035 | 20% |
| Sweden | 20.2% | 18.0% | + | 186 | 249 | 34% |
| United Kingdom | 27.2% | 30.2% | | 1,820 | 2,355 | 29% |

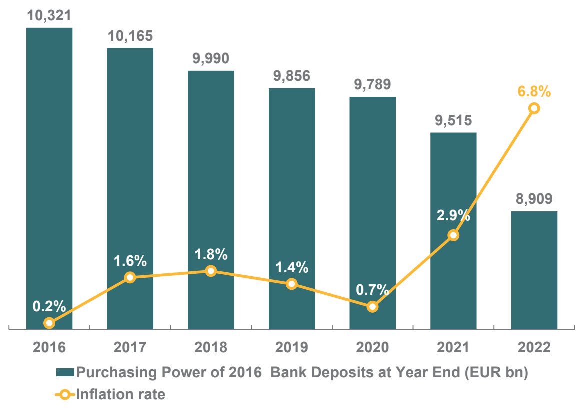
*Source: ECB*

## THE DAMAGING EFFECT OF INFLATION ON YOUR BANK ACCOUNT

One of the goals of the CMU is to incentivize European households to put their savings to better use by investing in capital markets. Indeed, savings sitting in a bank in an environment of ultra-low interest rates are losing money because inflation erodes the value of people's money year on year.

Chart 2 illustrates this by showing that the purchasing power of the amount of bank deposits at the end of 2016 (EUR 10,321 billion) declined to EUR 9,515 at the end of 2021. Taking into account the European Commission's spring 2022 estimation of inflation in the European Union for this year (6.8%), the loss in purchasing power will reach EUR 1,412 billion by the end of this year, or on average, EUR 2,779 per household.

**Chart 2: Purchasing Power of 2016 Bank Deposits (EUR billions, %)**




*Source: ECB and European Commission*

## THE OPPORTUNITY COST OF NOT INVESTING

Another way to look at this problem is to examine what would have happened if households had reduced the share of deposits in their financial wealth to 25% at the end of 2016 and invested 50% of the resulting surplus in UCITS bond funds and the remaining 50% in UCITS equity funds.[4]

The proposed 25% threshold can be considered as a reasonable target for many countries, knowing that households are holding less than 25% of their financial wealth in deposits in the Netherlands (19.7%), Sweden (18.5%) and Denmark (18.1%).

In this scenario, European households would have reduced their bank deposits from EUR 10,321 billion to EUR 6,972 billion at the end of 2016 and invested the residual EUR 3,349 billion.

Chart 3 shows the net annual performance in real terms of UCITS equity and bond funds in 2017-2022, assuming that the average performance in 2022 would be equal to the loss observed in January-April 2022. We have made this assumption to take into account the impact of market declines in the first part of this year, without prejudging how markets will evolve during the rest of the year.

Chart 3 shows that equity funds suffered a steep decline in performance in 2018, due to the slowdown in economic growth and concerns about interest rate hikes. Stock markets rebounded strongly in 2019 before suffering from the impact of the pandemic and the consequent lockdown measures in the first of quarter of 2020. Despite further waves of the pandemic, markets remained resilient and recorded an exceptional performance in 2021 as significant fiscal and monetary stimulus and a robust rebound in earnings boosted investor confidence. Bond funds recorded on average significantly lower returns than equity funds, except in 2018.

If European households had reduced their bank deposits to 25% of their total financial wealth and invested the remainder into money in bond and equity funds, the purchasing power of their financial wealth would have been EUR 1,106 billion higher by end 2021. Assuming the performance of equity and bond UCITS in 2022 would be equal to the performance observed in January-April 2022, the opportunity cost of holding such a high level of bank deposits in 2016 would remain significant (EUR 711 billion).

It is worth noting that the value of bank deposits owned by European households increased by EUR 3,054 billion in the 2017-2021 period. In order to maintain the share of deposits in financial wealth equal to 25% over this period, households should have only increased their bank deposits by EUR 1,769 billion. This means that they could have invested an additional EUR 1,285 billion in capital markets during this period. If they had followed this strategy, their wealth would have increased even more than the amount detailed in Chart 4.

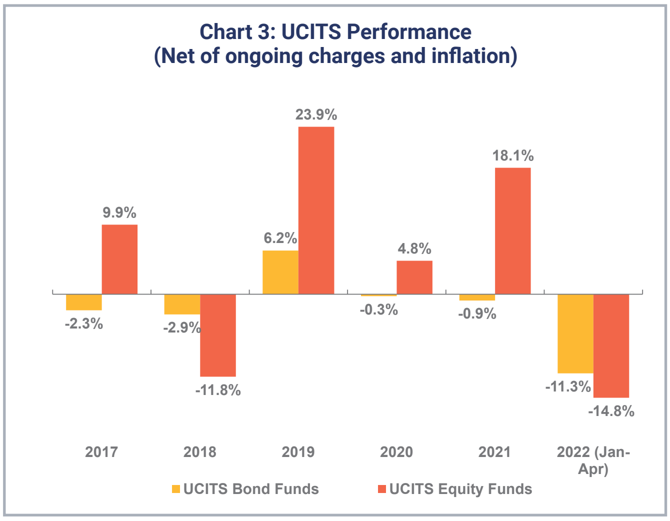


Chart 3: UCITS Performance
(Net of ongoing charges and inflation)

Source: EFAMA calculations based on data from Morningstar Direct

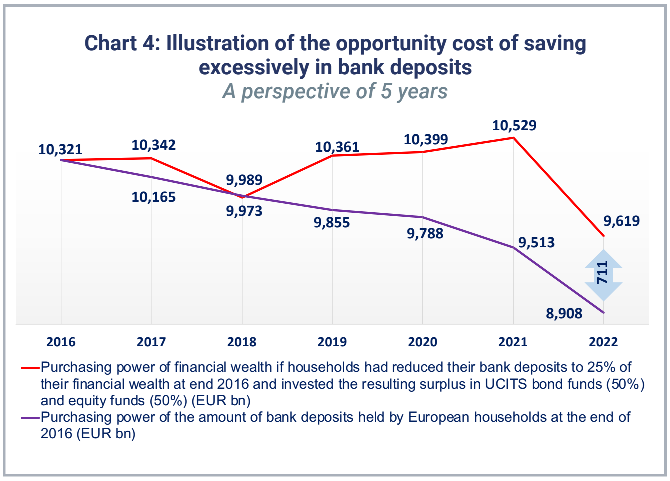


Chart 4: Illustration of the opportunity cost of saving excessively in bank deposits
*A perspective of 5 years*

Source: EFAMA calculations based on ECB and Morningstar Direct data

## ASSESSMENT OVER A MEDIUM TO LONG-TERM PERSPECTIVE

To test the robustness of our assessment of the opportunity cost of saving excessively in bank deposits, we have computed the evolution of the financial wealth of households if they had decided to reduce the share of deposits in their financial wealth to 25% at two other dates – end 2011 and end 2001 – and invested 50% of the resulting surplus in UCITS bond funds and the remaining 50% in UCITS equity funds.

This exercise makes it possible to assess the combined impact of some major macro-trends highlighted in Charts 5 and 6, i.e., the higher volatility of the annual performance of equity funds and in particular the stock market crashes of 2002 and 2008, the fall in the average rate of inflation observed between 2011 and 2016, the fact that the nominal interest rates on bank deposits remained on average above 1% until 2008 , and the current decline in market returns.

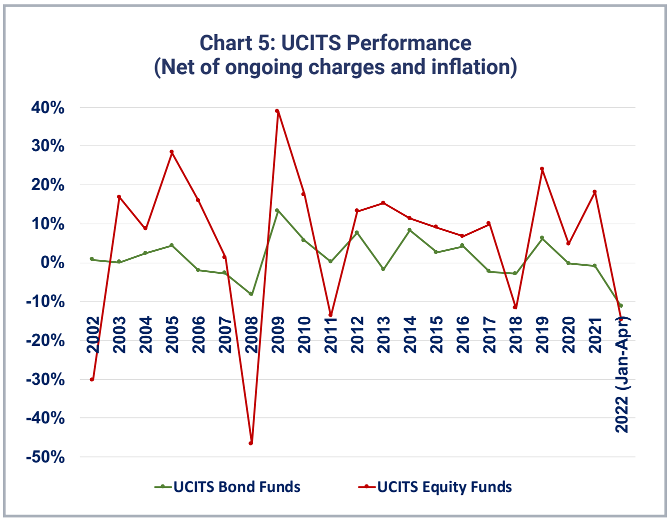


Chart 5: UCITS Performance
(Net of ongoing charges and inflation)

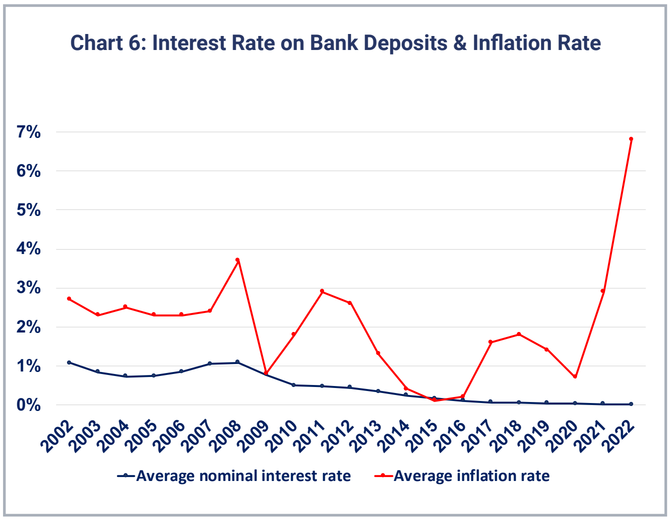


Chart 6: Interest Rate on Bank Deposits & Inflation Rate

Source: EFAMA calculations based on ECB, Eurostat, European Commission and Morningstar Direct data

The results of the simulations are shown in Charts 7 and 8 below.[6]

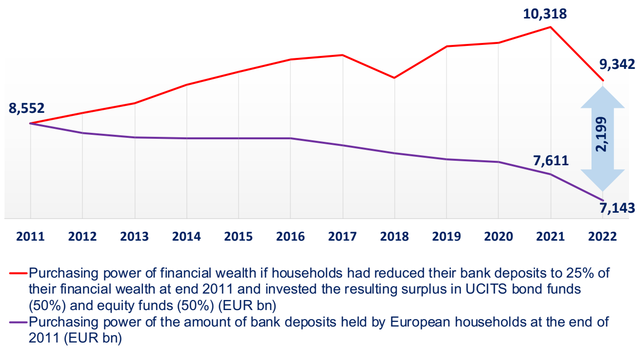
The 10-year scenario is based on the assumption that European households would have reduced their bank deposits from EUR 8,552 billion to EUR 5,461 billion at the end of 2011 and invested the residual EUR 3,092 billion in UCITS bond and equity funds (split in equal shares).

Based on the net annual fund performance shown in Chart 5, it can be estimated that European households would have managed to increase the purchasing power of their financial wealth by a total of EUR 2,707 billion by the end of 2021. Assuming that the negative performance equity and bond UCITS in 2022 would be equal to the decline observed in January-April 2022, the expected loss in the real value of wealth would remain very high by the end of this year (EUR 2,199 billion).

Turning to the 20-year scenario, we have assumed that households would have reduced their bank deposits to EUR 3,910 billion at the end of 2001 and invested the residual EUR 1,403 billion in UCITS bond and equity funds in the same proportion.

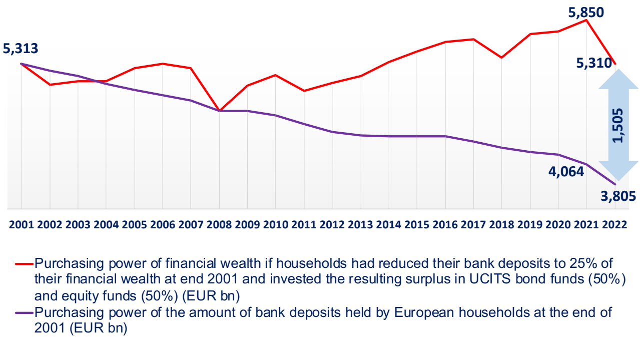
Chart 8 shows that because of the market crashes in 2002 and 2008, the reduction in the share of deposits would have led to a loss in real terms in 2002 and 2003, and to an almost identical level of wealth by 2008. This finding confirms that the volatility in market performance can have a negative impact over a short to medium term. However, the longer the investment period, the more probable it is to get a positive return on investment.

**Chart 7: Illustration of the potential benefit of saving less in bank deposits and more in UCITS equity funds**
*A perspective of 10 years*




Source: EFAMA calculations based on ECB and Morningstar Direct data

**Chart 8: Illustration of the potential benefit of saving less in bank deposits and more in UCITS equity funds**
*A perspective of 20 years*



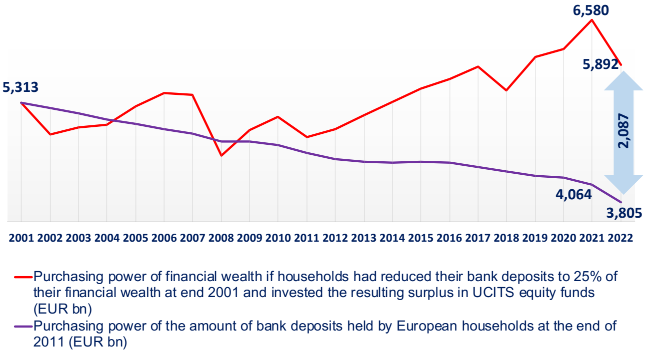

Source: EFAMA calculations based on ECB and Morningstar Direct data

The simulation confirms this as the value of the more diversified financial wealth would total EUR 5,850 billion in real terms at the end of 2021, whereas the purchasing power of the amount held in bank deposits would fall to EUR 4,064 billion. Following the approach outlined above, the total wealth of European households could be EUR 1,505 billion higher in real terms by the end of 2022, despite the decline in market performance in the first part of this year.

Households would also have ended up in a much better place if they had decided to reduce the share of deposits in their financial wealth to 25% at the end of 2001 and invested the full residual in equity funds.

Under this scenario, households would have had to wait until 2009 to see the benefit of this wealth diversification but by the end of 2021, they would have seen their total wealth increase by EUR 2,516 billion in real terms compared to the situation in which they would not have reduced their bank deposits at the end of 2001. The gain in real terms that households could have obtained by the end of 2022 would have remained substantial.

**Chart 9: Illustration of the potential benefit of saving less in bank deposits and more in UCITS equity funds**
*A perspective of 20 years*



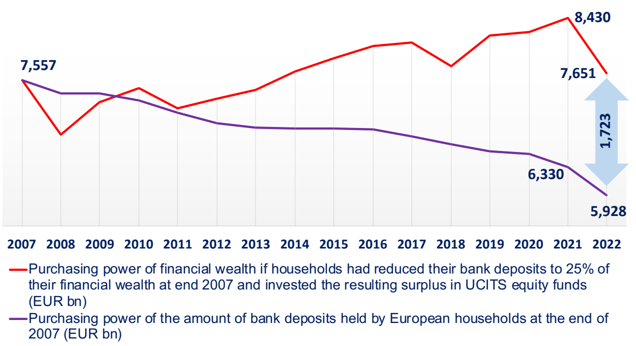

Source: EFAMA calculations based on ECB and Morningstar Direct data

The importance of taking a long-term perspective is also illustrated in Chart 10, where we assumed that European households decided to reduce the share of bank deposits to 25% and invested the full residual in equity funds right before the outbreak of the global financial crisis.

Under this scenario, households would have suffered a 10% drop in their financial wealth in 2008 and would have had to wait until 2012 to see the benefit of their decision to diversify their wealth towards equity funds. However, by the end of 2021, the real value of the wealth of European households would have risen to EUR 8,430 billion, compared to EUR 6,330 billion if they had refrained from reducing the size of their bank deposits.

Following the same approach as above, it can be estimated that the diversification of savings towards equity and bond funds could have increased the households' wealth by EUR 1,723 billion by the end of 2022.

**Chart 10: Illustration of the opportunity cost of saving excessively in bank deposits**
*(provided you don't need your money in the short term)*




*Source: EFAMA calculations based on ECB and Morningstar Direct data*

This illustration confirms the importance of the following principles when investing[7]:

- Investing early in life and regularly is key to helping your money grow over the long term.
- The riskiness of stocks diminishes with the length of an investor's time horizon.
- Balance your investments between risky (high return) and safe (lower return) assets if you need the money in the short term, e.g., in the next 5 years.
- Keep your head cool when markets tumble. Experience shows it pays to hold our nerves and our investment and wait for the market to rebound.
- Do not attempt to predict stock market movements.
- Instead, focus on long-term investment strategies.

Those considerations are particularly relevant today as markets are lower given the current crisis. Whilst 2022 is likely to remain a confusing and worrying year for investors, our calculations suggest that even if we take current reduced market returns, investors are likely to be better off over the longer term if they maintain a well-diversified asset allocation.

It is also worth mentioning that for those people needing an income from their investments, volatility can be of less concern as long as their investments are still paying out dividends and income payments, thus reducing the need to sell investments at a time of loss.

## A CALL FOR ACTION TO TAKE FORWARD THE CMU

This note highlights an undeniable reality: inflation has a very damaging effect on bank deposits. The real value of bank deposits held at the end of 2001 was 24% lower at the end of 2021, and it will be most likely 28% lower by the end of 2022. This loss in purchasing power happened in an environment in which inflation in the European Union remained under control, averaging 1.8% over the 2002-2021 period. The current hike in inflation will further exacerbate the problem. **This development underlines the fundamental responsibility of central banks to do everything in their power to restore price stability and limit the burden of inflation on bank deposits, financial wealth and people's income and public pensions more generally.**

Even if inflation is brought down to lower levels, the fact remains that holding close to 40% of financial wealth into bank deposits will always result over time in a significant loss of income for citizens. A vast majority of EU citizens still consider investing as being too risky and are therefore staying away from capital markets. The upcoming Retail Investment Strategy of the European Commission is an opportunity to address this issue and consider ways to turn depositors into investors.

In a recent advice to ESMA, **ESMA's Securities and Markets Stakeholder Group (SMSG) pointed out to the fact that retail investors suffer from "money illusion"**, as they have a tendency to view their wealth and income in nominal terms, rather than recognizing their real value, adjusted for inflation. The SMSG therefore recommended that the ESAs look into this matter and assess "whether, and if so how it would be feasible and desirable to insert, where relevant, inflation risk warnings in the past and or future performance information section in key information documents". The SMSG is also of the opinion that it is key to increase financial literacy and improve financial education, as "many people fail to understand basic financial concepts such as inflation."[8]

In addition to implementing such measures, **we believe a promising approach would be for Member States to provide a specific tax advantage to encourage people to transfer some of their savings from bank deposits into personal pension products, including the pan-European Personal Pension Product (PEPP)**.

Following this approach would turn what is currently a problem – the loss of income related to the massive amount of savings held in bank deposits in an environment of rising inflation and ultra-low interest rates – into a unique opportunity to increase the potential return on people's savings and help them achieve an adequate standard of living in retirement. Complementing the needed reforms of Europe's pension systems in this way would reduce the need to rely on harsh measures such as a high increase in the retirement age, and therefore make the proposed reforms more acceptable.

To avoid taking position on the amount of savings that people should ideally keep in bank deposits, Member States could allow people to decide how much they would like to transfer to personal pension products, either through a one-off transfer or a gradual shift away from bank deposits. Tax incentives would be needed for people to accept to lock up part of their bank deposits into pension products with limited possibilities for early withdrawal before retirement age. To encourage people to act swiftly, the establishment of the tax advantage should be limited in time and could be part of a campaign to increase people awareness about the opportunity cost of keeping an excessive amount of savings in bank deposits.

**Such an initiative would help deliver on the CMU's overarching goal of making the EU an even safer place for individuals to save and invest long-term. It should also be seen as a concrete policy response to the ageing population and an important opportunity to promote the PEPP.**

### Author:

**Bernard Delbecque**, Senior Director, Economics & Research

## FOOTNOTES

1. *In this calculation, we have regrouped under financial assets six types of financial assets: cash and deposits ('deposits'), pension plans in the form of funded pensions, life insurance products, investment funds, debt securities and listed shares.*
2. *We have highlighted some of the reasons why there are considerable variations between the individual countries in a report entitled "Household Participation in Capital Markets".*
3. *As mentioned above, this percentage is significantly lower in Denmark, the Netherlands and Sweden.*
4. *The results presented in this note do not vary very much for other combinations such as the classic 60% equity/40% bond portfolio split.*
5. *The nominal interest rate shown in Chart 6 is the weighted average of the interest rate offered on oversight deposits owned by households and on new deposits with agree maturity, taking into account that overnight deposits represent about 60% of the total bank deposits held by households in the euro area.*
6. *For the sake of completeness, the value of the bank deposits at end 2001 (2011) do not include Denmark and Croatia (Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Ireland, Malta, Poland, Romania, Slovakia and Slovenia), for which data are missing from the ECB database.*
7. *These principles are presented in a brochure published by EFAMA in 2020, entitled "Investing for a better future: 5 tips to do more your savings".*
8. *The SMSG advice is available here.*

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Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and wellfunctioning global capital markets and engage with international standard setters and relevant third-country authorities.

EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

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Rue Marie-Thérèse 11 | B-1000 Bruxelles | T +32 2 513 39 69 | info@efama.org

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