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Old lessons for a new world

Returns on private financial assets in selected EMU countries

Summary

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- **Over the last decade, zero interest rates in Europe did not hold back growth in private households' financial assets, particularly in Germany (+5.2%).** However, the growth drivers were quite different between countries: Whereas German households relied on fresh savings (mainly out of earned income), most other countries benefited from value gains (i.e. the rising prices of securities).
- **We find huge differences between the implicit returns on households' financial assets, which range from 2.5% in Austria to 6.0% in Finland.** Implicit returns refer to the total sum of gains in value and investment income in relation to portfolios. As such, they are an intriguing gauge to visualize the differences in investment strategies. Germany performs rather poorly (3.1%), while France (4.1%) ranks in midfield. In the last two years, however, German savers have started to embrace capital markets, pushing their returns above the average of the group of countries under consideration, resulting in additional savings of around EUR1,000 per capita.
- **Returns can act as an amplifier of inequality. In most countries, there is a significant spread between the lowest and highest income groups in terms of returns: they increase – more or less – in tandem with income as higher income groups invest more in higher-yielding (i.e. riskier) assets such as equities.** But there is one notable exception: the Netherlands, where returns are very similar for all income groups. This is testament to the role of a strong, capital-funded pension system that can work as a wealth equalizer.
- **Looking ahead, savers will need to adapt to a world with higher-for-longer inflation – but the old rules still apply.** Rising inflation already ate into returns dramatically in 2021, with the average total return falling by more than -60% in real terms. 2022 will be worse: With an average inflation rate of over 8% in the Eurozone, the real return will be pushed deep into negative territory. In 2023, as inflation is expected to fall from its recent peaks, the situation should improve. Nonetheless, with annual inflation at around 5%, real returns are very likely to remain in the red. Furthermore, as inflation is expected to remain elevated for the time being, it is all the more urgent for households to adapt their savings behavior, focusing on long-term value creation rather than short-term liquidity holding.

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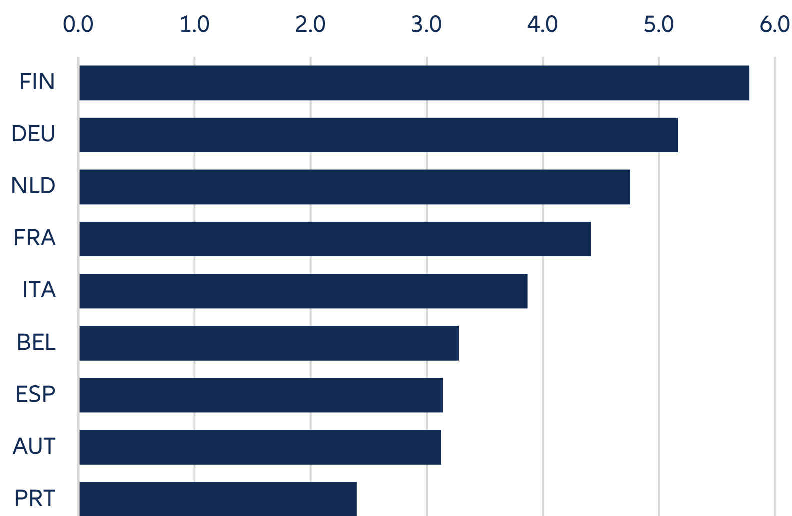
Different strokes: asset growth and wealth in the Eurozone

Over the last decade, despite the euro and Covid-19 crises, household financial assets increased in all the seven biggest Eurozone countries we study in this report.[1] In fact, households in Finland and Germany even recorded quite substantial average annual growth rates of more than +5%. At the bottom end of the scale is Portugal, where there, average asset growth was well below the +3% mark, while Austria (+3.1%), Spain (+3.1%) and Belgium (+3.3%) managed to be just above it (see Figure 1).

1 Ireland is not included, for the lack of appropriate data.

Figure 1: Financial assets per capita*, CAGR 2012-21 in %

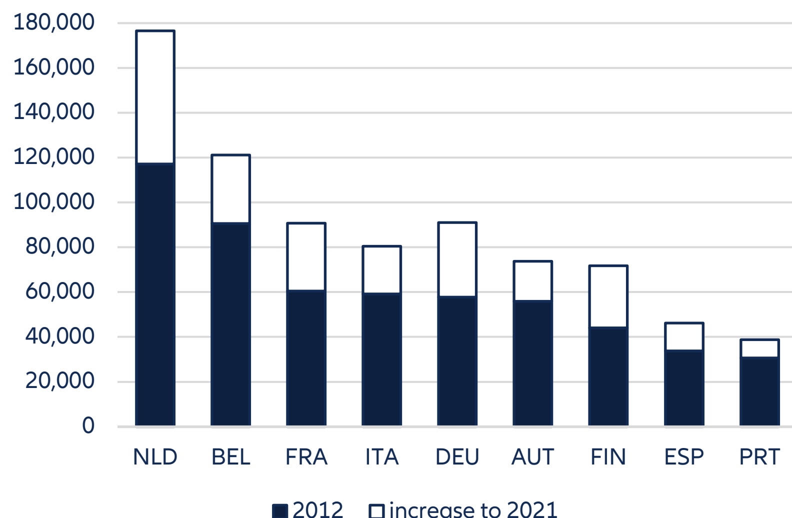


*without other equity
Sources: Eurostat, Allianz Research

In absolute numbers, growth differentials are even starker, reflecting the different wealth levels in the Eurozone. Total annual average increases in financial assets per capita, i.e. the sum of changes in value, property income and savings out of earned income, range from only EUR740 in Portugal to a whopping EUR7,230 in the Netherlands. Germany and Belgium follow in second and third place with nearly the same figures (EUR3,840 and EUR3,830, respectively). In addition to Portugal, absolute growth has been significantly below average in Italy (EUR2,510), Austria (EUR2,340) and Spain (EUR1,290) (see Figure 2).

At the end of 2021, average per capita financial assets in the Netherlands came to EUR176,510, more than 4.5 times the amount of private savings in Portugal (EUR38,810). The wealth gap even widened during the observation period: the same factor came to only 3.8 back in 2012. What explains this wide lead? Primarily the strong role played by company retirement provision. In comparison, German households are in the upper-middle range of the ranking, with average per capita financial assets of EUR91,090.

Figure 2: Financial assets per capita*, 2012 and increase to 2021, in EUR

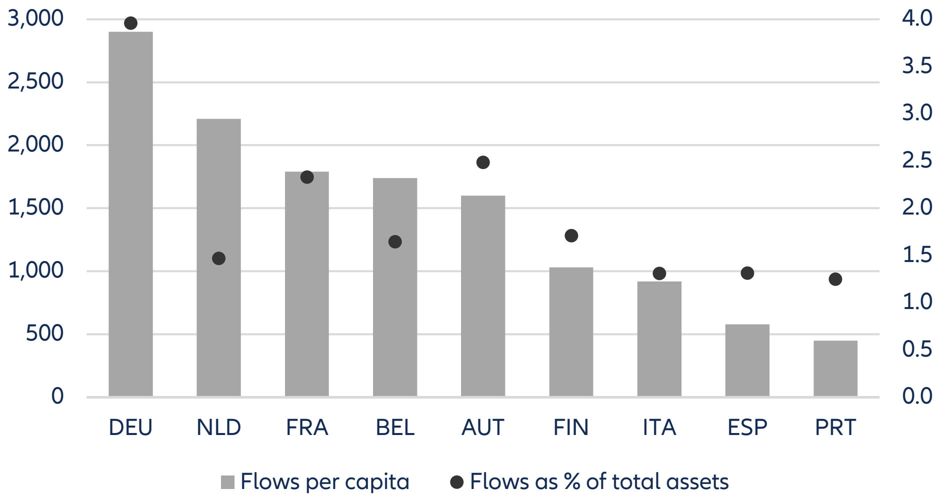


*without other equity
Sources: Eurostat, Allianz Research

Financial accounts statistics confirm the stereotype of Germans being keen savers. Between 2012 and 2021, German households spent the highest amount on acquiring new financial assets ("fresh savings"): on average EUR2,900 per capita and year, a whopping 72% more than the average of all countries analyzed. Households in the Netherlands (EUR2,210), France (EUR1,790) and Belgium (EUR1,740) also put aside an above-average amount. At the bottom of the scale we find Southern European households: Italy (EUR920), Spain (EUR580) and Portugal (EUR450), who were forced to cut back on savings during the euro crisis (see Figure 3).

Germany also leads the field when it comes to annual savings in relation to total financial assets: at 4.0%, this figure comes in at almost twice the average (2.3%) and no less than 1.5pp ahead of Austria, which ranks second. As with financial asset formation per capita, households in Southern Europe are below-average in this respect as well.

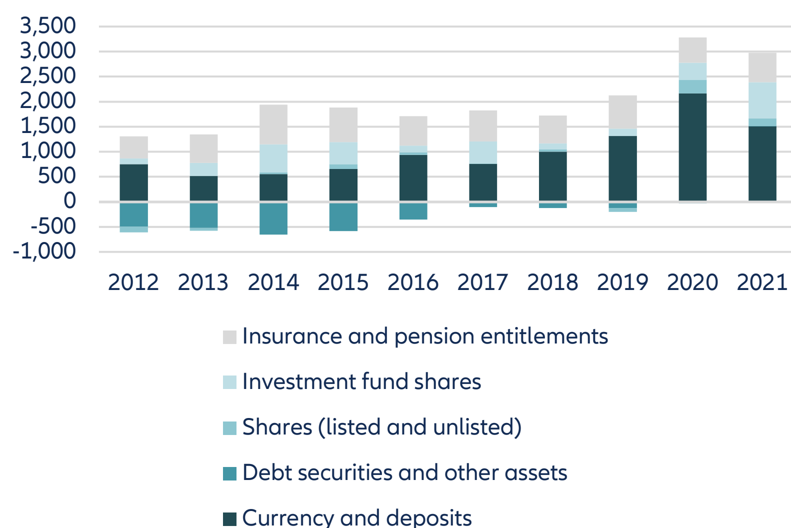
Figure 3: Annual flows per capita (in EUR, lhs) and as a percentage of total financial assets (rhs)*, average 2012-2021



*without other equity
Sources: Eurostat, Allianz Research

It is worth mentioning that in all countries fresh savings during the two pandemic years were many times higher than the respective long-term averages (see Figure 4, following page). And this time, households in Southern European countries saw the largest increases: Spain (nearly +190%), Portugal (+180%) and Italy (over +140%). In Germany, savings increased by only +59%, though this can be explained by the already high tendency to save. Across all countries, average flows per capita totaled EUR1,690 from 2012 to 2021; if only the two pandemic years are considered, the average value almost doubles to EUR3,110. Bank deposits remained the most favored savings vehicle and counted for around 50% of fresh savings in 2021. However, their share in total flows decreased significantly compared to the previous year (66% in 2020) in favor of investment funds and insurance and pension products, which increased from 11% to 24%, and 16% to 20%, respectively.

Figure 4: Flows per capita* by asset class, average across all countries, in EUR



*without other equity
Sources: Eurostat, Allianz Research

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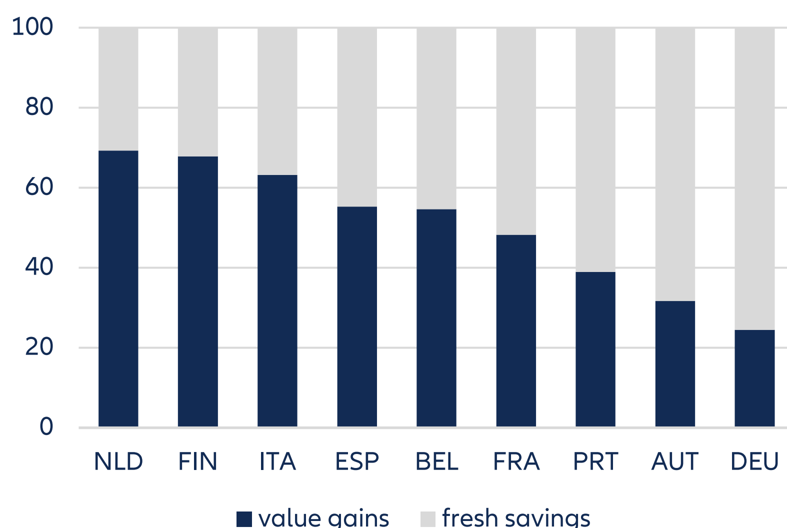
Value gains trump fresh savings

There are two growth drivers for financial assets: value gains, triggered, for example, by rising equity or bond prices, and fresh savings, i.e. the acquisition of new financial assets. So what drives growth in household financial assets in the Eurozone? The answer differs from country to country. Whereas in the Netherlands and Finland, more than two-thirds of asset growth was driven by value gains, in Germany it was less than a quarter. Not surprisingly, a high share of value gains corresponds with higher growth rates, and vice versa: the poor performance of households' financial assets in Portugal must been seen against the backdrop of generally weak capital markets. Only Germany does not fit into this pattern – high share of value gains, high growth rates – as above-average growth coincides with only low value gains (see Figure 5). In other words, in Germany, financial asset growth is almost solely the result of the acquisition of new financial assets.

Figure 5: Growth composition of financial assets*, average 2012-2021 in %



*without other equity
Sources: Eurostat, Allianz Research

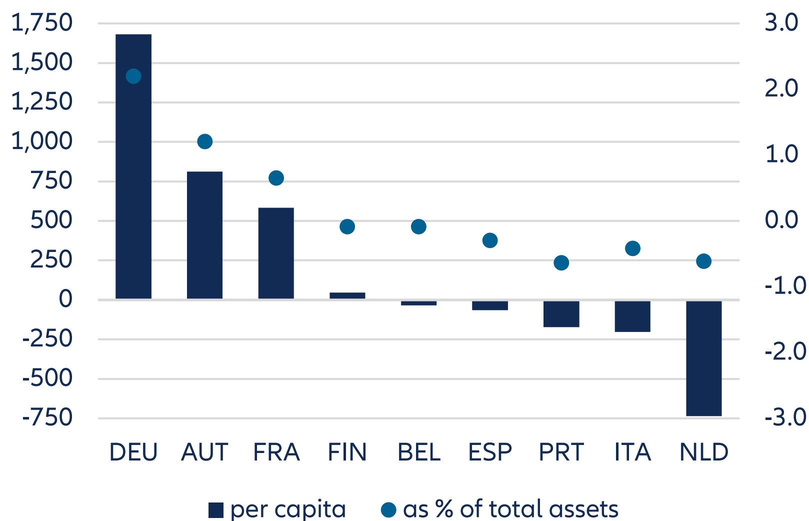
Not all fresh savings are equal: they can come either from investment or earned income. Using investment income means that received interest or dividends are earmarked for buying new financial assets, sometimes even automatically (e.g. funds with retained earnings). And if the investment income is larger than desired savings, part of that income can be used to prop up consumption. On the other hand, if desired savings exceed investment income, part of the earned income must be used to close this "savings gap". As a consequence, less earned income is available for consumption. In three countries, households had to use earned income in a sizeable way to close their savings gaps: Germany (EUR1,680 on average per capita and year from 2012 to 2021), Austria (EUR810) and France (EUR580, see Figure 6). Whereas in Germany the high savings rate (i.e. high desired savings) plays a key role, in Austria relatively low property income is to blame. France is an interesting case: Before the euro crisis, French households – like their German neighbors – used earned income to increase savings; during the crisis years, it was the other way round. But since 2014, French savers have again returned to their pre-crisis pattern.

Finnish households, too, used earned income for the acquisition of new financial assets, albeit only very small amounts (EUR50). This is somewhat surprising as they are among the households with the highest share of value gains in asset growth. This fact seems to be a consequence of the Covid-19 pandemic and related excess savings: If we only look at the development up to 2019, the opposite was the case, with households in Finland using investment income to prop up consumption (-EUR250). During the pandemic, on the other hand, households did not feel the need (or simply did not have the opportunity) to increase their consumption expenditure – and instead saved more.

The situation in the Netherlands is precisely the opposite: There is no other country with larger changes in value and income from investments. The total of these two components is even higher than the total increase in assets, producing a "surplus" for private households. This means that households have no need to "save" income from employment to reach their savings objectives. Rather, the surplus (EUR740 on average per capita and year) boosts their disposable income and can be used for consumer spending (thus explaining the minus sign).

The situation is similar in the three Southern European countries in our sample (Italy, Spain and Portugal), albeit at a different level: Savings are low (as said before, see Figure 3) but as in the Netherlands, they are entirely sourced from investment income. A small amount is even left for consumption, reflecting the poor income development during and immediately after the euro crisis. In other words: these countries rather faced a "consumption gap", forcing them to use investment income to make ends meet. Their below-average rates of growth in financial assets are the inevitable consequence of little being saved. The fact that private assets in these countries have increased at all during the euro crisis, and despite zero interest rates, is largely thanks to the positive changes in value (albeit at a very low level, as in Portugal, for example) and (declining but at least) positive income from investments.

Figure 6: Savings out of earned income per capita (in EUR, lhs) and as a percentage of total financial assets* (rhs), annual average 2012-2021



*without other equity
Sources: Eurostat, Allianz Research

There is also another way of describing the relationship between value increases, income from investments and savings based on income from employment: the higher the asset yield (= value increases and income from investments expressed as a percentage of total assets), the lower the "real" savings efforts can be.

How is the total return on the asset portfolio calculated?

The financial accounts published by the European statistics authority, Eurostat, which form part of the national accounts, provide an overview of the financial assets of households. They provide information not only on the amount and structure of the asset base by asset class, but also on annual fund inflows and outflows.
The (nominal) total return on an investment is calculated based on the value gains, the amount of which can be derived directly from the financial accounts (level at the end of a period less the level at the start of the period and financial asset formation during this period) and current income, e.g. interest and dividends. These constitute household income, which is also recorded in the national accounts.

In particular, the calculation of the total return uses data on the income from investments, i.e. interest and other capital gains. The latter comprise income from insurance policies, receivables from pension systems and from investment fund units. These are allocated to the corresponding items in the asset balance sheet. We calculate a weighted annual average interest rate[2] for investment income from overnight money deposits, savings and term deposits with banks, while applying a return of 0% to cash. We also calculate a residual parameter for income from investments in bonds and other receivables, i.e. the total investment income from interest (taken from the national accounts) less the income on bank products resulting from the weighted annual average interest rate. Since some countries do not make any distinction between profit distributions and withdrawals in their national accounts, the income on assets held in equities is calculated based on the Euro Stoxx 50 dividend yield.

We create an average annual portfolio for all items in the asset balance sheet (bank deposits, bonds, equities, investment fund units, receivables from provisions relating to insurance companies and pension systems and other receivables) and calculate the average return generated in the current year in each case. We leave out assets and income from other equity interests.

The nominal total return for a given year, less the average annual rate of change in consumer prices, produces the real total return.

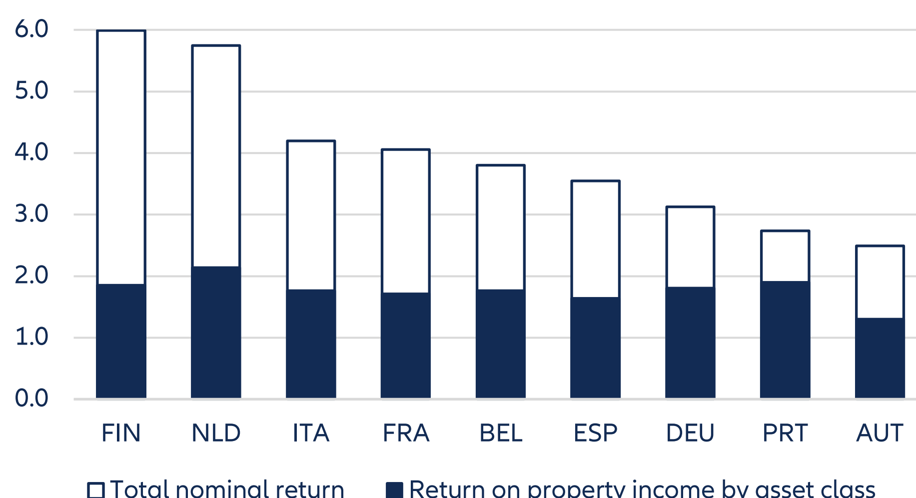
2 The calculation is based on the bank interest rate statistics published by the European Central Bank.

However, from 2012 to 2021, across all the countries we analyze, yields on private financial assets have fallen noticeably from 5.7% to 4.0% on average. The biggest outliers were the years 2018 and 2019, with yields of -1.3% and 7.3%, respectively. 2018 was marked by high uncertainty from the escalating trade conflict between the US and China, the drawn-out story of Brexit and mounting geopolitical tensions. In addition, central banks around the world continued their attempts to normalize monetary policy: The US Federal Reserve, for example, increased its target rate range four times in that year. The next year (2019) was still marred by escalating trade conflicts, social unrest and an industrial recession, but as central banks reversed course and embarked on broad-based monetary easing, stock markets decoupled from fundamentals and had one of their best years on record – shielding private savers from the repercussions of an unruly world.

Despite their high savings efforts, German households have generated less from their financial assets than peers in most other countries (see Figure 7). Our calculations indicate that the average nominal return came in at only 3.1% a year, with the lion's share (1.8pp) coming from income from investments; the remaining 1.3pp were due to value gains. Only Portuguese and Austrian savers fare worse, with a total return of 2.7% and 2.5%, respectively. Among other factors, this is likely because these households invest even more in low-return bank deposits. However, there is one silver lining for Germany: Comparing countries according to the amount of total returns achieved in individual years, Germany has risen from sixth to fifth place compared to 2012. This may seem like only a small step, but the development since 2019 is particularly interesting: In 2019, Germany fell from fourth place in the previous year to seventh (cue: price fireworks on the capital markets) but rose one place again in each of the following two years. In these two years alone, German savers bought securities totaling around EUR209bn, while the long-term average was only a good EUR29bn. The newly burgeoning openness towards capital market products thus has (already) paid off: German households' returns exceeded the average return of the countries under consideration in 2021 by 0.4pp. Compared to the "normal" performance – Germany trails the rest by almost 0.8pp – this "return boost" translates into additional savings of around EUR1,000 per capita.

At 6.0% and 5.7%, respectively, households in Finland and the Netherlands achieved (by far) the highest average yields, which, unlike in Germany and Austria, consisted largely of value gains. This can be explained by the fact that Dutch investment portfolios feature a well above-average percentage of insurance policies and pensions, allowing households to benefit indirectly from the positive capital market performance, not least the rising prices of fixed-income securities. Households in Finland, which held an average of 35.6% of their portfolios in shares in 2021, have reaped direct benefits from the strong stock market performance.

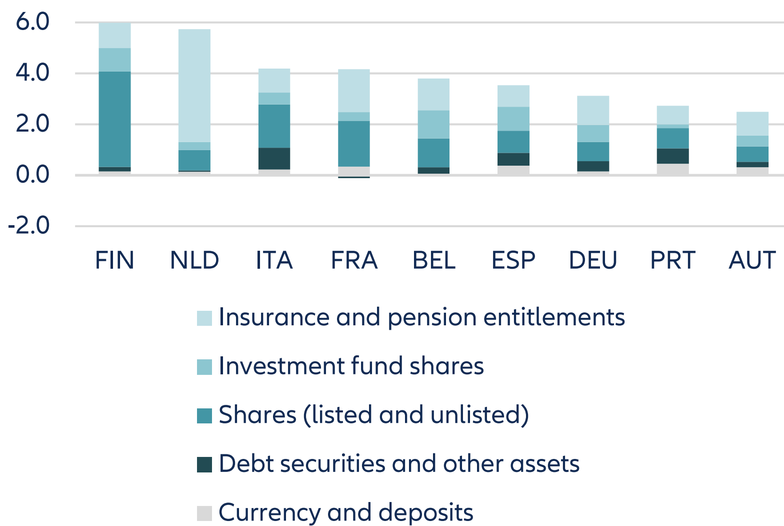
Figure 7: Return on property income and total return*, nominal, average 2012-2021 in %



*without other equity
Sources: Eurostat, Refinitiv, Allianz Research

All in all, this analysis shows that the returns based on income from investments are moving within a relatively narrow range, meaning that there are no major disparities between the individual countries. To a certain extent, this reflects the integrated European financial market: interest rates have been at basement levels everywhere. The biggest differences in returns arise mainly as a result of value gains: the level of the total return depends first and foremost on whether or not the portfolio contains assets that offer the potential for (substantial) value gains, and if so, how much.
Figure 8 highlights this by demonstrating what contribution the individual asset classes have made to the total nominal return. This also shows that in the Netherlands, once again, the pension system is the main factor promoting personal asset accumulation (+4.4pps) – even if households will have to wait until retirement until they can really feel the benefit in their wallets. The Netherlands is, however, the exception here, at least among the countries included in our analysis. Elsewhere, receivables from pension companies and insurance funds make much less of a contribution to the overall return, ranging from 0.7pp in Portugal to 1.7pp in France.
As expected, bank deposits generated the lowest contribution to total returns (0.2pp on average across all countries). Even for German, Austrian and Portuguese households, whose investment strategies focus on bank deposits, this asset class only makes a well below-average contribution to the total return despite accounting for a fairly sizeable share of the investment portfolio as a whole. In other words, securities (equities, bonds, investment funds) drive returns. On average, almost 86% of the total returns generated come from this asset class; even in the countries with rather risk-averse savers, this share amounts to at least 50% or more. But returns on this asset class vary considerably from country to country because it is the one in which the biggest value gains – or losses – tend to arise.

Figure 8: Contribution of individual asset classes to total nominal return*, average 2012-2021 in pps.



*without other equity
Sources: Eurostat, Refinitiv, Allianz Research

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Returns as amplifiers of inequality

So far, the international yield comparison has looked at private households as a whole, or at a simple average (per capita analysis). But total assets and asset structures do not just vary from country to country, they also differ across income groups within the individual countries. This means that if we delve deeper into the figures that make up the average national yield, we can find that completely different results apply to individual household groups.

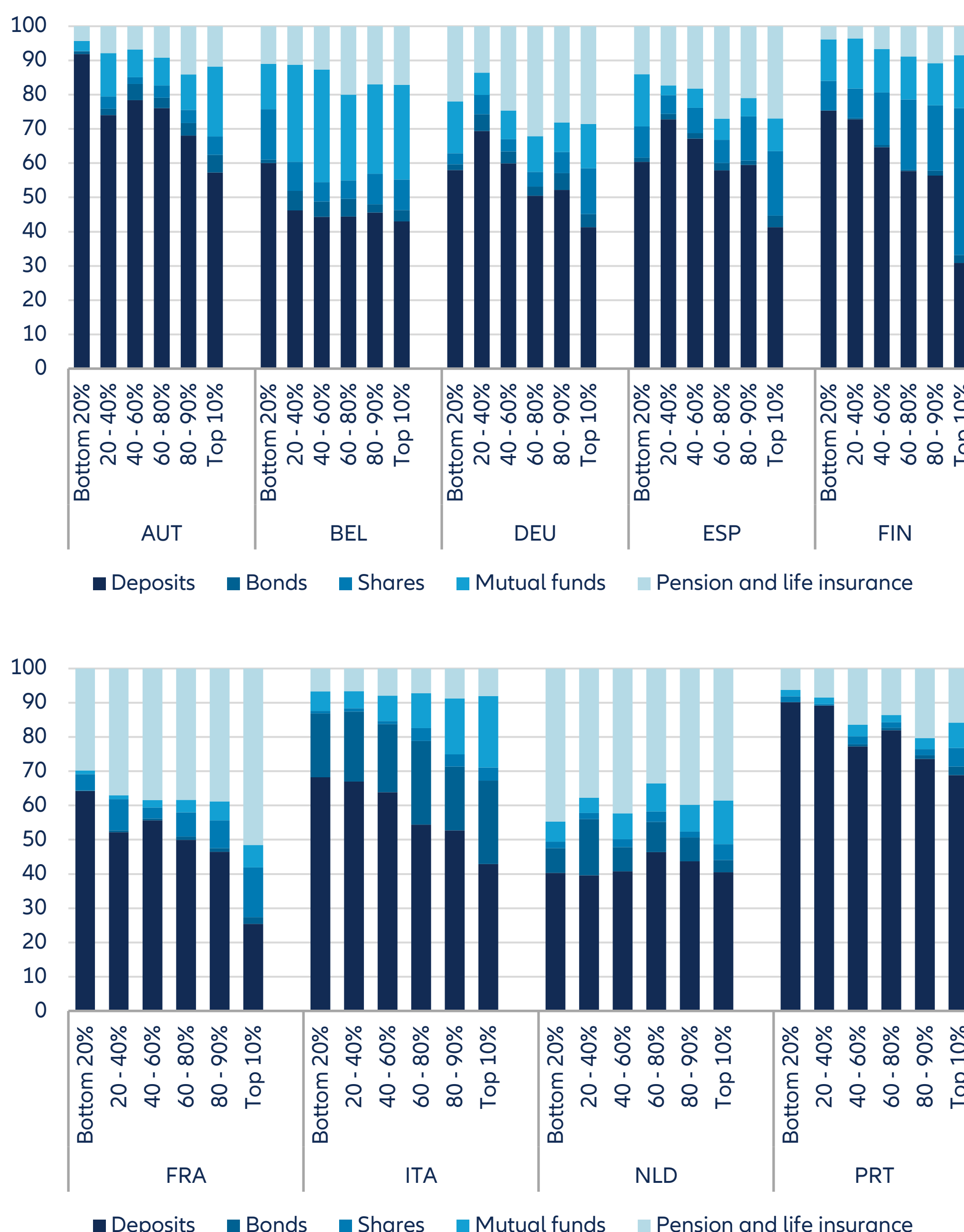
We look at the asset yields of individual income groups in detail with the help of data from the ECB's large-scale asset survey, "The Eurosystem Household Finance and Consumption Survey" (HFCS). We follow the same methodology as before, but instead of looking at a single asset portfolio, for example for the German household sector, we now examine a total of five different portfolios for the individual income groups.[3]

Figure 9 provides an overview of the asset structures of the different income groups for the countries included in our analysis. This confirms the expectation that, on average, households start investing less in bank deposits as their income levels rise. Higher earners tend to hold more securities and have more receivables from insurance companies and pension funds.

3 There are two reasons, however, why a direct comparison with the previous calculations is impossible: first, this analysis is static, i.e. it ignores changes in the portfolio structure over time, and second, different data is taken as a basis, because the asset data for each income group is based on surveys - and deviates, sometimes substantially, from the "official" wealth account data. Nevertheless, we can arrive at a satisfactory estimate of the deviations in the yields caused by differences in asset structures for the different income groups.

However, this does not apply to all countries. It is striking, for instance, that poorer sections of the Dutch population have (slightly) more receivables from insurance companies and pension funds in relative terms due to the popularity of occupational pensions: nearly 90% of the working-age population is covered by mandatory or quasi-mandatory retirement savings plans. In Spain, on the other hand, securities are particularly popular among the lowest income group. This does not necessarily mean, however, that this income group has opted for a particularly long-term risk-oriented investment style. It may simply be the case that this group is also home to a large number of people who have inherited substantial amounts and other rentiers who have no income to speak of but have substantial assets at their disposal. Note, however, that the survey method can never ensure 100% precision.

Figure 9: Portfolio structure by income groups based on HFCS data



Sources: ECB Household Finance and Consumption Survey (wave 2), Allianz Research

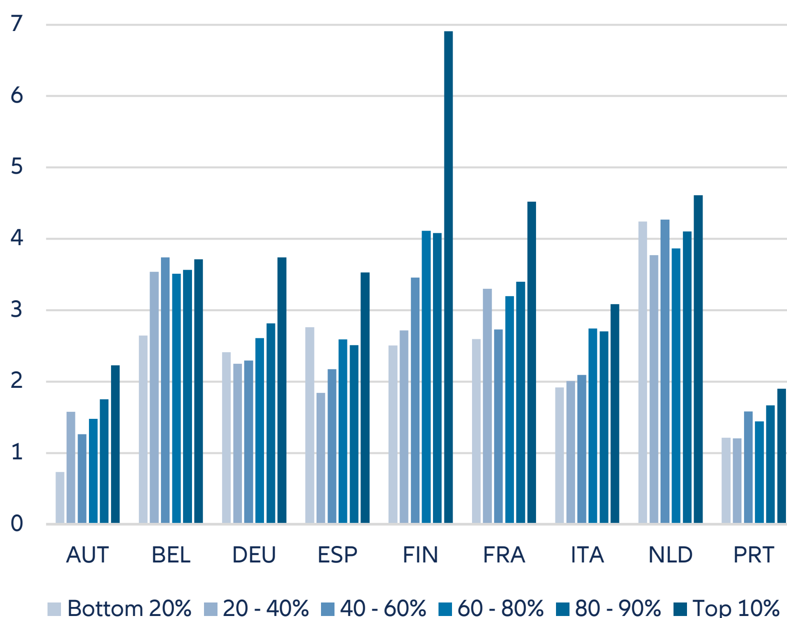
Next, we use the different portfolio compositions to calculate a total asset return for each individual income group. Due to the differences in the pool of data, however, these results can only be compared to a limited extent with the figures for the household sectors as a whole, as set out above. But when comparing income groups, the absolute return levels are less interesting than the differences between the income groups.

The figures confirm that when interest rates are low, investing in longer-term, riskier assets pays off. Figure 10 illustrates the expected picture: In most countries, there is a significant spread between the income groups with the lowest and the highest returns; yields increase – more or less – in tandem with incomes and the highest income group is also the one with the highest return. In absolute terms, the gap between the income group with the lowest returns and the one with the highest returns is largest in Finland, where the 10% of households with the highest incomes achieve an average return of 6.9%, 4.4pps more than that of the lowest income group. The former invests more than 40% of their financial assets in shares, while the bottom 20% only less than 10%. In relative terms, however, the return gap is largest in Austria: at 2.2%, the return achieved by the top 10% is three times as high as that of the bottom 20%. With a share of more than 90%, the lowest income group invests – or rather "parks" – almost their entire savings in bank deposits, while the top 10% held nearly one-third of their portfolios in the form of capital market products.

Belgian and Dutch households, on the other hand, show a less pronounced yield gap between the different income groups. In Belgium, all income classes are more or less equally predisposed towards bank deposits, which serves to even yields out to some extent. Furthermore, the return on assets achieved by the 40-60% income group is on a par with the one achieved by the highest income group since the former holds more mutual funds than all other income groups. This asset class was the one with the highest return during the observed period.

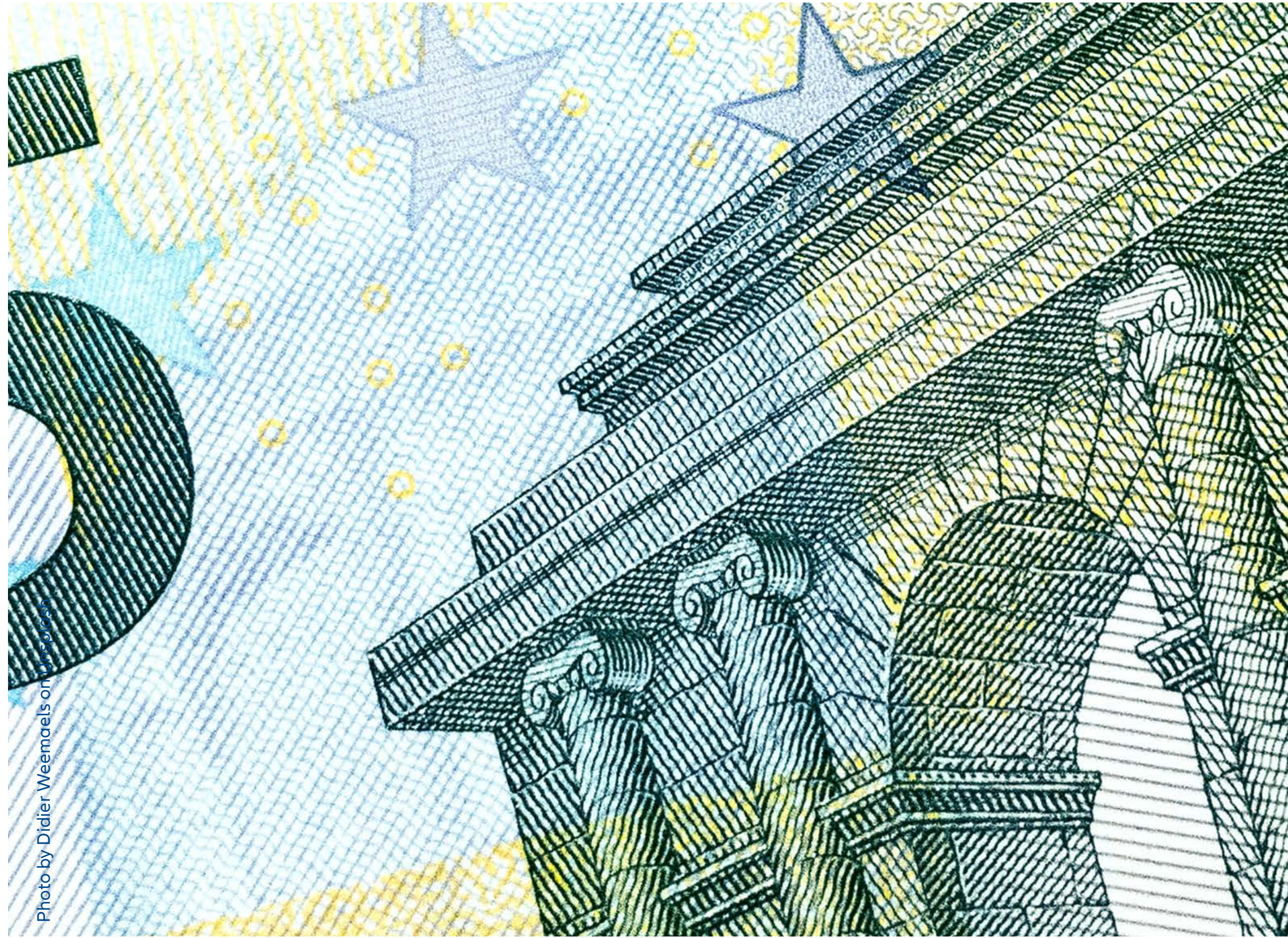
In the Netherlands, the rather small yield gaps between income groups once again reflects the strength of the Dutch pension system, which places particular emphasis on funded occupational pensions that not only cover almost every household, but also operate very successfully on the capital markets, thanks to their long-term investment policy and high proportion of share investments. No other country analyzed has a smaller (relative) gap between the lowest and the highest yields achieved by the individual income groups (22%). Although analyses based on survey data should always be treated with caution, the asset yields by income group in times of historically low interest rates offers a sobering lesson. In general, a low-interest-rate backdrop exacerbates wealth differences as higher income groups generate higher returns, thanks to their greater tolerance for risk and the long-term nature of their portfolio structures. As a result, their assets can grow much faster than the average even without additional savings efforts. But the example of the Netherlands shows that this connection is by no means immutable. A prudent pension policy can help to achieve inclusive wealth growth by at least counteracting the trend towards an automatic widening of the wealth gap.

Figure 10: Total nominal return by income groups, average 2012-2021 in %



Sources: ECB Household Finance and Consumption Survey (wave 2), Eurostat, Refinitiv, Allianz Research.

Photo by Immo Wegmann on Unsplash

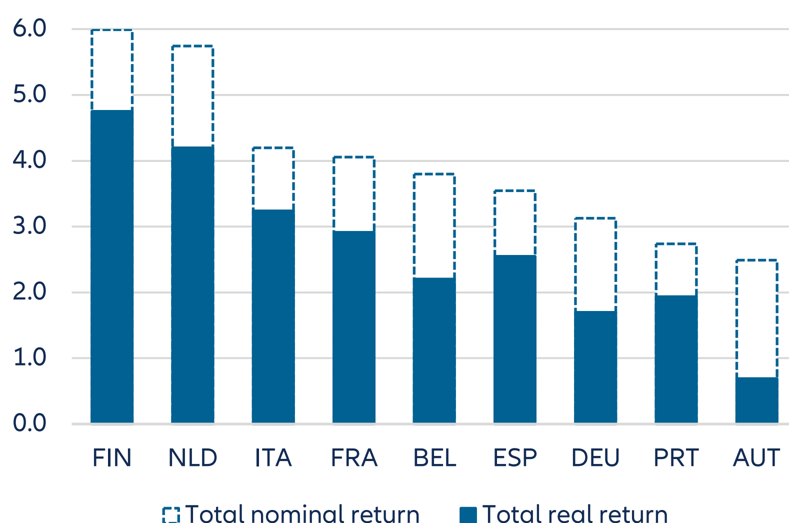


The return of savers´ old nemesis: inflation

Over the past decade, on average, almost one-third of total returns was eaten up by inflation across all countries – even before the current record-breaking surge in the Eurozone. Even in 2014 and 2015, when deflation was considered a risk, the average loss from inflation was -11% and -6%, respectively. Figure 11 shows the extent to which inflation-induced losses have an impact on the nominal yield. Austria comes at the bottom of the league, with a real return of only 0.7%, behind Germany (1.7%) and Portugal (1.9%).

In 2021, the return of inflation pushed the average total return down by more than -60% in real terms. But 2022 will be even worse: With an average inflation rate of over 8% in the Eurozone, the real return will be pushed deep into negative territory. For Germany, for example, we expect a real return of -11.5%. In 2023, as inflation is expected to fall from its recent peaks, the situation should improve. Nonetheless, with annual inflation at around 5%, real returns are very likely to remain in the red.

Figure 11: Total return – nominal vs real, average 2012-2021 in %



*without other equity
Sources: Eurostat, Refinitiv, Allianz Research.

However, it is not just inflation that will cause problems for savers in 2022 and beyond. The dramatic turnaround in monetary policy has caused a tremor on capital markets: almost all asset classes will lose significant value this year. Household wealth will feel the pinch: according to the Deutsche Bundesbank, total financial assets of private households decreased by 1.8% in the first half of the year alone. The inflow of fresh savings fell by -29% compared to the same period in 2021 to just under EUR162bn and the losses in value added up to almost EUR300bn or an average of EUR3,600 per capita. At the same time, the turnaround in interest rates has barely reached deposit rates. On average for the year, the (nominal) return on all bank deposits is likely to remain at a measly 0.1% in Germany. Overall, the return before inflation is therefore likely to settle at -3%, the lowest level since the global financial crisis in 2008 (-4%). In 2023, capital markets could regain their footing and interest rates on deposits are set to increase, albeit not enough to compensate for inflation. A return to the happy years of accommodative monetary policy and ample liquidity is not on the cards.

2022 will be a year to forget for savers; in the following years, the environment will be more challenging than in the past. However, this will not devalue the lessons of the last decade. A more capital market-oriented savings behavior will generate the highest returns in the long term – albeit at the price of higher volatility. In fact, Finland and the Netherlands – the two countries with the highest average returns in the last decade – also have the highest volatility: there are more than 1,000bps between the highest and lowest annual returns; in Germany, the figure is just over 500bps. This shows once again that security and supposed stability do not come for free. German savers should not allow themselves to be diverted from the course they have taken in the last two years toward the capital markets; a bad year for stocks is no reason for savers to despair. Despite the resolute (albeit belated) countermeasures taken by central banks, the low inflation rates of the past 10 years are unlikely to return for the time being. Three long-term trends set the stage for persistent higher prices: The transition from market-driven hyper-globalization to a more politicized global economy; the demographic shift toward shrinking workforces and finally the green transition with – at least during the transition phase – higher energy prices. This context is just one more reason for changing savings behavior to focus on long-term value creation rather than short-term liquidity holding.

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