Richard Cluver is away overseas and so this is the last issue of The Investor until the end of June

South African rich are in the firing line!

by Richard Cluver

The release this past month of the details of some 12 million private client wealth details by a Panama law firm which has specialised in the creation of tax haven accounts for a growing list of wealthy clients from every part of the globe, has been greeted with a sanctimonious collective global pursing of lips from people who see tax havens as criminal entities developed to deprive the world's poor of aid money.

And indeed that is fair comment if the people responsible for hiding away money are banana republic dictators who have plundered their state coffers in order to fund future dynastic ambitions. But the sheer numbers involve make it clear that something quite different is at play. After all, how many dictators and despots are there?

At the heart of the issue, however, is a growing tug of war between ordinary citizens and increasingly voracious global tax collection regimes. Globally governments have run out of money as they have striven to pursue a socialist dream that sees governments as national nannies responsible for the guaranteeing living incomes for every one of their citizens regardless of the ability of their economic systems to deliver such largesse. The consequence of this phenomenon has seen MOST governments indulging in reckless borrowing such that the interest costs alone now frequently come perilously close to total tax revenue. The table below provides an insight into how much nation owes as a percentage of their Gross National Product…and this is only the top 27:

Country	Average of CIA and IMF data[note 1]	Public debt as % of GDP (CIA)[1]	Date	Total (Gross) government debt as % of GDP (IMF)
Japan	174.3125	226.1	2013	237.918
Greece	158.339	161.3	2012	158.546
Jamaica	135.029	127.3	2012	146.591
Lebanon	131.04	127.9	2012	139.527
Italy	114.654	126.1	2012	126.978
Eritrea	120.887	118	2012	125.785
Portugal[3]	121.3	131	2014	122.985
Ireland	110.162	118	2012	117.122
Grenada	111.2835	110	2012	112.567
Cape Verde	90.176	83.1	2012	112.199
Singapore	109.782	111.4	2012	111.017
Bhutan	73.215	64	2011	107.511
Cyprus	80.9	80.9	2012	107.106
United States	95.4195	102.98	2012	106.525
Barbados	77.681	83.1	2012	100.351
Iceland	93.565	118.9	2012	99.083
Antigua and Barbuda	109.575	130	2012	98.692
Sudan	96.1135	89.3	2012	97.642
Spain	78.6155	85.3	2012	97.2[citation needed]
United Kingdom	90.314	90.0	2012	90.314
France	86.9825	89.9	2012	90.291
Austria	64.0455	74.6	2012	86.824
Canada	59.3315	84.1	2012	86.515
Saint Lucia	80.8805	77	2012	84.761
Saint Kitts and Nevis	113.481	144	2012	82.962
Seychelles	54.391	39.3	2012	82.528
Germany	69.462	79.9	2013	81.964
Croatia	55.8175	52.1	2012	80.926
Egypt	76.9035	85	2012	80.155
Mauritania	77.105			79.703
Jordan	74.968	75	2012	79.586
Hungary	75.686	78.6	2012	79.003

Happily in this instance South Africa comes far down the list with indebtedness at just 42.28 percent when the last figure was collected back in 2012 which means that we have not yet gone over the fiscal precipice which by common consensus among leading economists is that once national debt exceeds 60 percent of gross domestic product, interest payments begin to gobble up so large a proportion of state revenue that it becomes impossible to repay the debt. And the real truth is that 65 nations exceed that 60 percent figure including practically ALL the world's top economies.

In simple terms, the leading nations have run out of money and with each day that passes their indebtedness is increasing leading from unsustainability to gross impossibility. Not surprisingly then, we have seen the rise of socialist pseudo economists like Thomas Piketty who see the solution to this problem as a global wealth tax. Having analysed some 20 years of data Piketty came to the conclusion that the top one percent of the world's population owned as much wealth as the remaining 99 percent.

However, as his critics have so frequently pointed out, if you were to strip this top one percent of all they owned and parcelled it out to the poor, all that wealth would be dissipated in just a few months. In the process, however, you would have stripped the world of its entrepreneurial class; the people by whose endeavours the great majority of the world's employment is created

So who are the wealthy that are being eyed with increasingly hungry eyes by the tax collectors of the world? Simply stated, if you have more money or easrn more than the average person, you are wealthy in the eyes of the Pikettys of this world. So, if you own assets of greater that R343 000 then you are classed as wealthy everywhere on this planet because that is the per capita wealth figure of this planet.

As a South African, if you own more that R137 000 or if you earn more than R10 000 a year you are thus among this country's wealthy. So note that the minimum wage of a domestic worker in this country is R20 952 placing them squarely in the "wealthy" group.

It clearly follows that going after the wealthy will not solve the problems of global governments and, even if a general moratorium was declared on national indebtedness – if governments could start over once more, they would soon be back in the same fix as they are now because they are attempting to do the impossible. The stark truth is that governments cannot afford to run nanny states with universal doles, unfunded pension plans and national health schemes. There is simply not enough money being generated in this planet to afford such a luxury.

What governments need to do is everything in their power to foster the role of the entrepreneur for only in that way will we be able to create jobs on a scale that will offer full employment to everyone and to ensure that only the completely disabled need to be cared for by the state. Instead of spending around 90 percent of state revenue on the salaries of a bloated public service, we should be diverting as much as we can possibly afford on infrastructure development that will inevitably knock on to increased national productivity.

Sadly however, since those dependant upon the welfare systems of the world are generally the most eager to vote for socialism, it is inevitable that politicians who espouse socialist economic theory will increasingly occupy dominant roles in global economics and ordinary citizens who work hard and save diligently throughout their lives in order to try to guarantee themselves a dignified retirement will increasingly need to seek the services of people like the Panama lawyers.

Thrivers and Strugglers: A Growing Economic Divide

By Ray Boshara, Federal Reserve Bank of St. Louis

Originally published on Ecointersect.com

Bravo to MacKenzie. When she was born, she chose married, white, well-educated parents who live in an affluent, mostly white neighbourhood with great public schools. She also chose her birth year wisely, making sure that she graduated from college and entered the job market when the economy was rebounding from the Great Recession. Thanks to the wealth and financial savvy of her parents, MacKenzie graduated from a private, four-year selective college debt-free, giving her many career options as well as the ability to start saving for a home and retirement.

Because of her great "choices," MacKenzie is likely to accumulate wealth and achieve financial health over her lifetime. She and her parents belong to the roughly one in four American households we can call "thrivers."

But too bad for Troy. Despite being just as bright as MacKenzie, he chose non-white parents who never married and live in a poor, highly segregated neighbourhood with lousy public schools and few opportunities to be involved in music, sports and civic activities. Troy's young, hard-working, conscientious mother was never able to start college. In order to manage the frequent ups and downs in her financial life, she has accumulated debts to family members and credit cards. She also lacks the know-how and networks to get Troy on a college-bound track, something his school fails to do as well. And Troy unwisely chose to finish high school just as the Great Recession was getting underway. So, finding any job, let alone a decent-paying one with benefits, eludes him.

Because of his bad "choices," Troy is not likely to accumulate much wealth or feel financially healthy over his lifetime. He and his family belong to the roughly three in four American households we can call "strugglers."

Research from the Centre for Household Financial Stability at the Federal Reserve Bank of St. Louis suggests that three demographic drivers – age/birth year, education and race/ethnicity – increasingly matter for building wealth and financial security. MacKenzie and her family's efforts to build wealth are buoyed by these demographic tailwinds, while the lack of them creates headwinds that hamper Troy and his family's efforts to succeed financially.

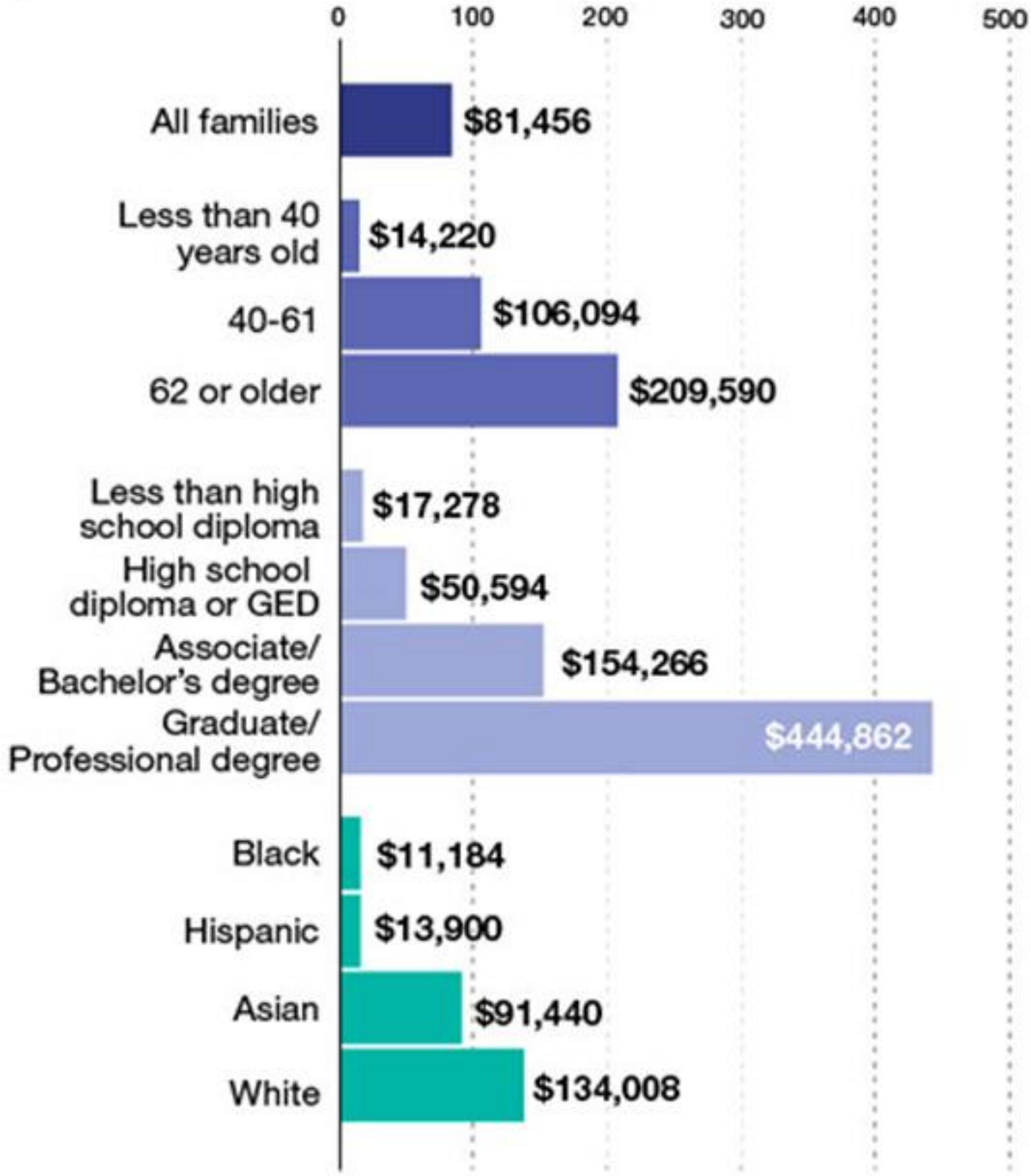
Let us consider each of these characteristics, or drivers, separately.

Race, Ethnicity and Wealth

Beginning with race or ethnicity, a few facts stand out.[1] First, the wealth gaps are disturbingly large and the rankings have persisted since 1989. White families rank first, followed by Asian families, Hispanic families and then black families. With the exception of Asians, the median net worth of all groups in 2013 was about the same as in 1989; the Great Recession wiped out most of the post-1989 gains. However, prior to the recession, whites and especially Asians had seen dramatic increases in their wealth. Since 2010, they have seen their wealth begin to grow again, while the wealth of blacks and Hispanics has continued to decline. (See Figure 1.)

FIGURE 1

Median Real Net Worth in 2013 (in thousands of dollars)



SOURCE: Boshara R: The Future of Building Wealth: Can Financial Capability Overcome Demographic Destiny? In *What It's Worth: Strengthening the Financial Future of Families, Communities and the Nation*, Federal Reserve Bank of San Francisco & CFED, 2015.

Also, wealth disparities are starker than income disparities. Median wealth for Hispanics and blacks is about 90 percent lower than that of whites. In contrast, median income of Hispanics and blacks is only 40 percent lower. This suggests these two groups may have had few opportunities to “convert” their diminished incomes into wealth, such as through homeownership and retirement plans. And although one would expect age and education to help explain the persistent differences in wealth accumulation across racial and ethnic groups (whites are generally older and better educated than blacks and Hispanics), our research shows that the wealth gap is largely unchanged even among equally educated, similarly aged whites and nonwhites. Stated more starkly, education does not appear to be an equalizer, at least in terms of wealth. Therefore, other factors must be in play, including early childhood experiences, parental influences and, of course, deep and historical discrimination against blacks and other minorities.

Education and Wealth

Not surprisingly, the association between a family's education and its wealth is very strong and has become stronger with time, leading to large gaps in wealth by level of education.[2] Only families with college degrees or higher have seen their wealth increase since 1989 (even though all groups saw their wealth decline in the Great Recession). Those lacking a high school diploma saw their wealth plummet 44 percent between 1989 and 2013, while families with a high school diploma saw their wealth decline 36 percent. Meanwhile, families with a two- or four-year college degree experienced a 3 percent increase since 1989, while the wealth of those with advanced degrees spiked 45 percent.

Notably, however, the correlation between education and various measures of economic and financial success does not represent causation. That is, the college degree itself may only partially explain differences in wealth. The degree serves as a marker of many other factors also correlated with educational attainment, such as native ability, family background, marriage patterns (i.e., the tendency of college graduates to marry other college graduates), being read to as a child and the likelihood of receiving gifts or inheritances.

Age and Wealth

Finally, let's look at age or, more precisely, year of birth. Of course, older families are expected to have more wealth than younger families. But what we are observing is something deeper, even historical.[3] To our surprise, age is the strongest predictor of balance sheet health, even after accounting for race and education. Americans in their 20s and 30s lost the most wealth in the recession and have been the slowest to recover. The wealth of younger adults is concentrated in homeownership, which suffered greatly during the recession. Younger adults also have significant mortgage and consumer debts, and few liquid assets. In addition, they faced severe labor market challenges during and following the recession. But this is not just a recession story; it's a generational, more troubling story: An American born in 1970 is projected to have 40 percent less wealth over their lifetime than an American born in 1940. Clearly, some larger economic and social forces are underway, reshaping economic opportunity in the U.S.

Policy Implications

In a world where uncontrollable factors – birth year, race/ethnicity, parents – and education – a choice, but influenced by all of the above factors – appear to increasingly matter for building wealth and financial success, three policy responses hold particular promise:

1. Give greater weight to demographic factors in targeting public resources.

Although income has been the primary benchmark for safety net and tax benefits, our research suggests that age or birth year, race or ethnicity, and education must play a greater role in targeting scarce public resources. The U.S. has dedicated massive resources, ruled on issues such as desegregation and voting rights, reduced discrimination in housing and lending practices, built schools and universities, subsidized higher education for disadvantaged students and otherwise striven and often succeeded in helping less-educated and minority families move forward. College attendance rates have been steadily rising, and minorities now hold more elected offices than ever, for example. However, millions of these families remain economically vulnerable; in some ways, they are now even more fragile, given growing economic penalties on less-educated and minority families. Therefore, broad, ambitious efforts to invest in these families must not only continue but be strengthened.

With regard to age, the U.S. has invested less during the earlier years of life, and the country lags in per capita spending on children compared with other advanced nations. In fact, the U.S. social contract has relied on the ability of younger workers to finance the safety net of older Americans. However, because that social contract is now threatened, and given the challenges facing younger Americans, smarter and more robust investments earlier in life are merited. For example, could we consider more of an age-based social contract, where new-borns, school-aged youth and young adults starting their careers and/or families receive a public benefit to help them build human capital and net worth? These investments could be modelled on the “pay it forward” idea, where public investments in individual families (through, for example, no- or low-cost tuition plans) are paid back later in life directly through earnings or, indirectly, through greater productivity and economic growth.

2. Create ways for families to save when children are young and integrate savings plans into other early interventions.

In the assets field, there is a growing body of evidence that savings accounts and assets early in life lead to better outcomes later in life. The Assets and Education Initiative finds that “early liquid assets (ones the household has when the child is between ages 2 to 10)... work with children’s academic ability to influence whether they attend college. The effect is stronger for low-income children than it is for high-income children.”[4] Two studies using randomized trials in the SEED OK experiment in Oklahoma show that Child Development Accounts (CDAs)[5] have a positive impact on social development for children around age 4. This effect was greatest in children in disadvantaged groups.[6] A second study finds that CDAs increase the psychological well-being of mothers, and again the effect was greatest among disadvantaged groups.[7]

Consideration should be given to strategies that integrate CDAs and similar early asset strategies into the fabric of other interventions aimed at young children. For example, a CDA might be offered to every mother who enrolls in a prenatal health program, or to every child entering Head Start or a preschool program. Reading programs might offer an education-focused CDA. Pell grants might be “front loaded” so that income-eligible children at age 5 receive a small portion of their Pell in a CDA, which would then reduce their Pell grant at age 18 accordingly. The College Board has, in fact, advanced a similar idea. It will be difficult, in my view, for stand-alone CDA interventions to reach all economically vulnerable children. Accordingly, integrating early assets and early childhood interventions holds promise for both impact and scale.

3. Help parents and other adults build liquidity and financial assets.

Of course, we cannot build family financial health and well-being by investing only in kids and ignoring their parents and other adults. Accordingly, we should adopt a "two-generation" approach.[8] Struggling families need a range of sound balance sheet investments, including better banking options, credit repair, more college and retirement savings, fewer debts and paths to sustainable homeownership and small-business opportunities. But one intervention in particular cuts across family balance sheets and promotes both financial stability (a family's first priority)[9] and economic mobility: creating liquidity.

The need for liquidity is well documented. The Federal Reserve Board's Survey of Household Economics and Decision-making (SHED) finds that an unexpected expense of just $400 would prompt nearly one-half of all households to borrow funds, sell something or simply not pay at all.[10] Fed data also show that the top savings priority for families is emergency or liquid savings, yet only about half of all Americans have such savings. And CFED finds that 44 percent of households are "liquid asset poor."[11]

When families have more liquid savings, they can better manage their cash flows and volatility; rely less on friends, family and payday lenders to meet cash shortfalls; have better banking options; and save for education, training or a small business, as well as a home or apartment in a better neighbourhood. In my view, no intervention better cuts across the health of U.S. family balance sheets – and does more to promote family stability and mobility – than building emergency savings and liquidity.

To be most effective, these three policy recommendations must be integrated into other efforts. Although one or two interventions, including the most promising ones, are not likely to erase enormous gaps in education, earnings or wealth, they are likely to significantly reduce the financial health disparities experienced between future thrivers like Mackenzie and strugglers like Troy.

Adapted from Boshara, R: "The Future of Building Wealth: Can Financial Capability Overcome Demographic Destiny?" In *What It's Worth: Strengthening the Financial Future of Families, Communities and the Nation*, Federal Reserve Bank of San Francisco & CFED, 2015.

Notes

1. Emmons W. and Noeth B.: "How Age, Education and Race Separate Thrivers from Strugglers in Today's Economy: Race, Ethnicity and Wealth," The Demographics of Wealth Series, St. Louis: Federal Reserve Bank of St. Louis, February 2015, www.stlouisfed.org/household-financial-stability/the-demographics-of-wealth/essay-1-race-ethnicity-and-wealth.
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4. Elliot W. and Sherraden M.: "Assets and Educational Achievement: Theory and Evidence," Economics of Education Review 33(3), 2013: 1-7, www.sciencedirect.com/science/article/pii/S0272775713000174.

5. CDAs are also referred to as Child Savings Accounts, or CSAs. Many prefer CDAs because it emphasizes the developmental aspects of savings accounts early in life. CDAs/CSAs refer to savings accounts in a child's name that are usually restricted to higher education and are often supported by community organizations, foundations, and state and local governments. See CFED, New America, or the Center for Social Development for specific examples and policy recommendations of how to expand CDAs.

6. Huang J. et al.: "Effects of Child Development Accounts on Early Social-Emotional Development: An Experimental Test," JAMA Pediatrics 168(3), 2014: 265-271, http://archpedi.jamanetwork.com/article.aspx?articleid=1815478.

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The rand: A welcome question of specifics optimum competition policy

by Brian Kantor, chief economist and strategist, Investec Wealth & Investment

Is the recovery of the rand for global or SA reasons? Whatever the explanation, it is surely very welcome.

A recovery of the SA economy needs a stronger rand. A stronger rand will mean less inflation to come and lower interest rates. Unfortunately a weaker rand leads interest rates in the opposite direction making it just about impossible for the business cycle to turn higher. A combination of higher prices on the shelves and the petrol station forecourts following rand weakness, depresses household spending. And the higher interest rates that follow add to the inability of households to spend more – and to borrow more. Household spending, which accounts for over 60% of all spending, leads the economy in both directions. Without a recovery in the propensity of households to spend more, the best the SA economy can hope to do over the next 24 months would be to avoid recession.

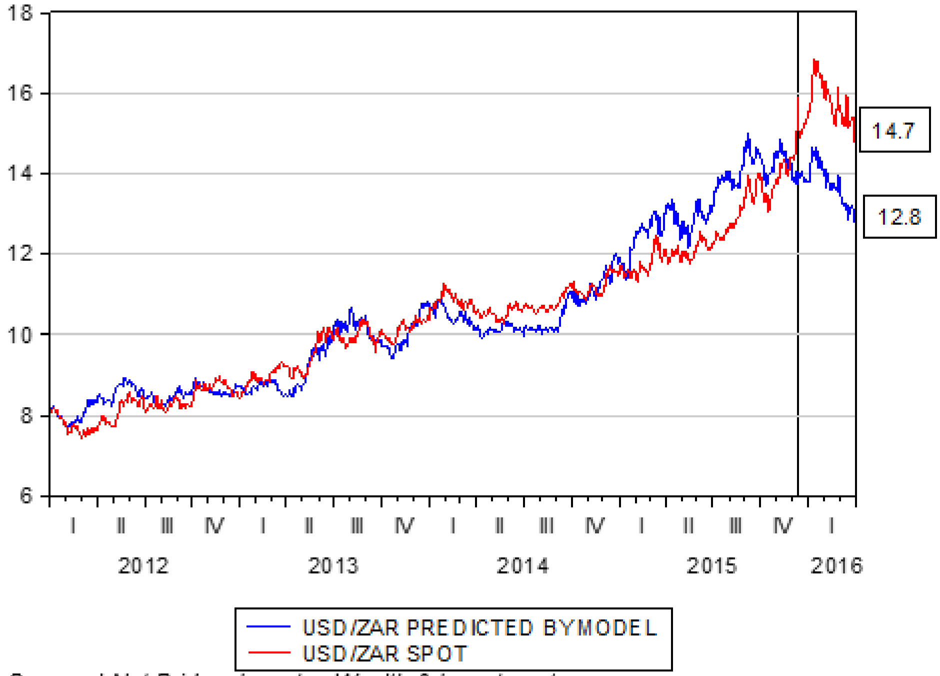
The foreign exchange value of the rand responds to both global forces – that is global risk appetites that drive emerging markets and currencies lower or higher (including the rand) – and SA-specific risks that encourage capital flows to and from SA.

An obvious example of SA-specific risks driving the rand weaker and interest rates higher was provided by President Jacob Zuma in December. The week of Zuma interventions in the Treasury saw the rand sharply weaken and sent long term interest sharply higher. These interventions added about R2 to the cost of a US dollar – according to our model of the rand – and about 100bps or more to the cost of raising long-dated government debt.

Our model of "fair value" for the USD/ZAR relies on two forces, the USD/AUD and the emerging market risk spread. Had Zuma not acted as he did, the US dollar might well have cost no more than R14 in early December 2015. With the recent recovery in the USD/AUD and emerging market bonds, the current fair value for the rand would be closer to R13 than R14. This suggests that the Zuma danger to the rand has not left the currency or bond markets. And that the welcome recovery of the rand is mostly attributable to global rather than SA forces. We attempt below to isolate the impact of global from SA-specific risks on the exchange value of the rand and show that the recovery of the rand is mostly global rather than SA specific.

If indeed the recovery of the rand is mostly attributable to global rather than SA forces, there is the possibility that a revived respect for SA's fiscal conservatism – demonstrated in the Pravin Gordhan Budget for 2016-17 – can still prove more helpful to the SA bond market and the rand, global forces permitting.

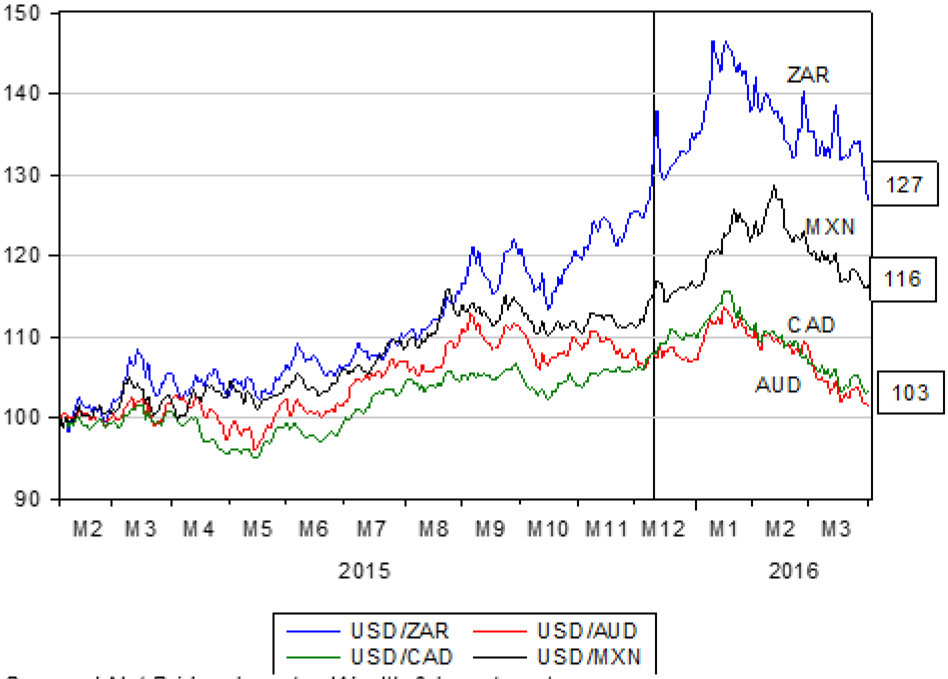
The predicted and spot value of the rand



Source: I-Net Bridge, Investec Wealth & Investment

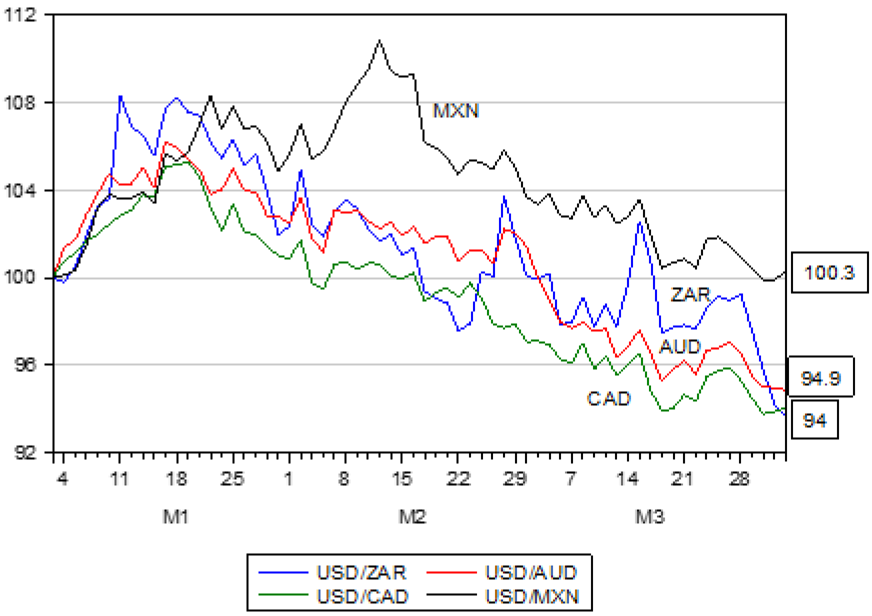
In the figure below we compare the performance of the rand to other currencies including a basket of emerging market currencies. The rand weakened against all currencies in 2015 – including other emerging market currencies. Furthermore the significant recovery of the rand in 2016 is in line with that of other commodity and emerging market currencies. This suggests again that global rather than SA forces explain the recent rand recovery.

The rand and other currencies vs the US dollar, daily data (January 2015=100)



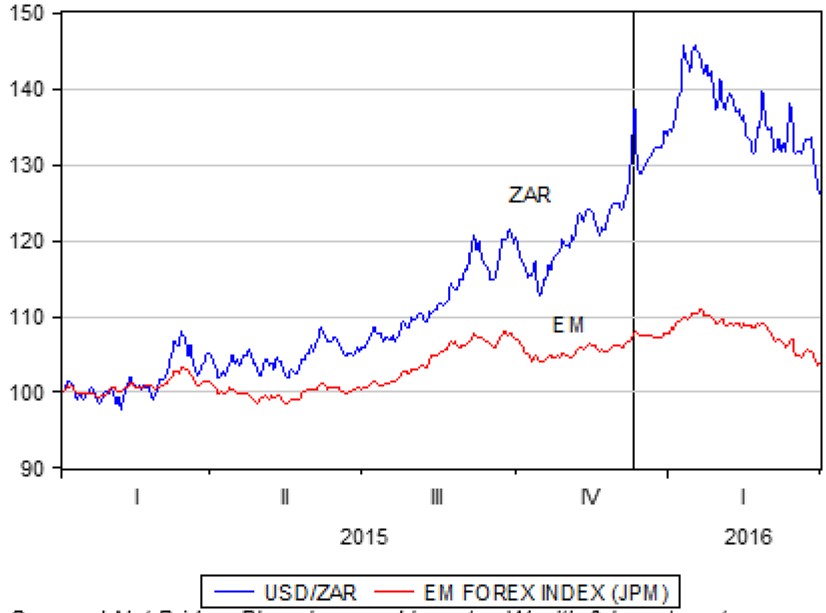
Source: I-Net Bridge, Investec Wealth & Investment

The rand and other currencies vs the US dollar, daily data (January 2016=100)



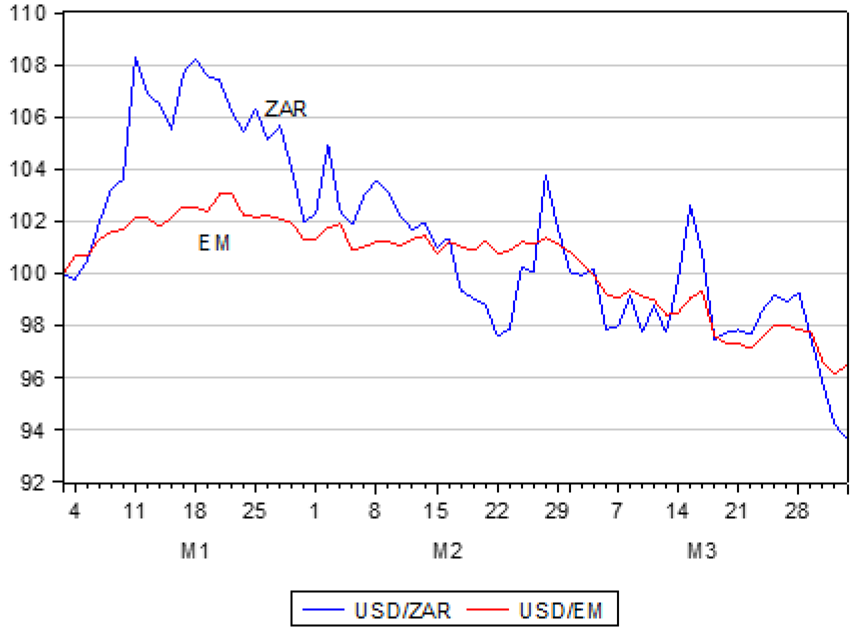
Source: I-Net Bridge, Investec Wealth & Investment

The rand vs the US dollar and the EM average exchange rate (January 2015=100)



Source: I-Net Bridge, Bloomberg and Investec Wealth & Investment

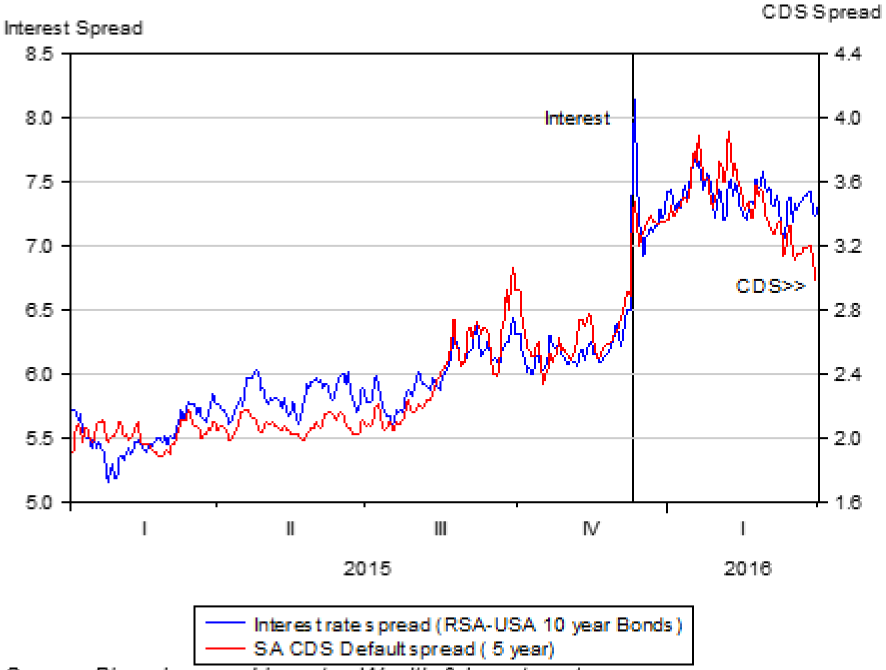
The rand vs the US dollar and the EM average exchange rate (January 2016=100)



Source: I-Net Bridge, Bloomberg and Investec Wealth & Investment

A similar impression of predominant global forces is provided by the bond market. The spread between RSA 10 year bond yields and US Treasury Bond Yields of similar duration have stabilised at more than 7% p.a. having widened dramatically in December 2015. These spreads are significantly wider than they were in early 2015. This spread may be regarded as a measure of SA specific risk, or more particularly as a measure of expected rand weakness. The rand has weakened – and is expected to weaken further. An alternative measure of SA specific risk is provided by the CDS spread paid to insure SA US dollar denominated debt against default. This spread has moved very much in in line with the interest rate spread.

Interest rate and default spreads, daily data



Source: Bloomberg and Investec Wealth & Investment

The recent narrowing of this insurance premium has however also been accompanied by a narrowing of the more general emerging market CDS spread, reflecting global forces at work. The gap between the higher emerging market CDS spread and the lower RSA spread narrowed sharply in December 2015, indicating a deterioration in SA's relative credit standing. This relative standing has not improved much in 2016, as may be seen by a difference in spreads of only about 120bps. Note that the wider this spread, the better SA's relative standing in the global credit markets.

EM bond spread – RSA spread (five year), daily data (inverse scale)

Source: Bloomberg and Investec Wealth & Investment

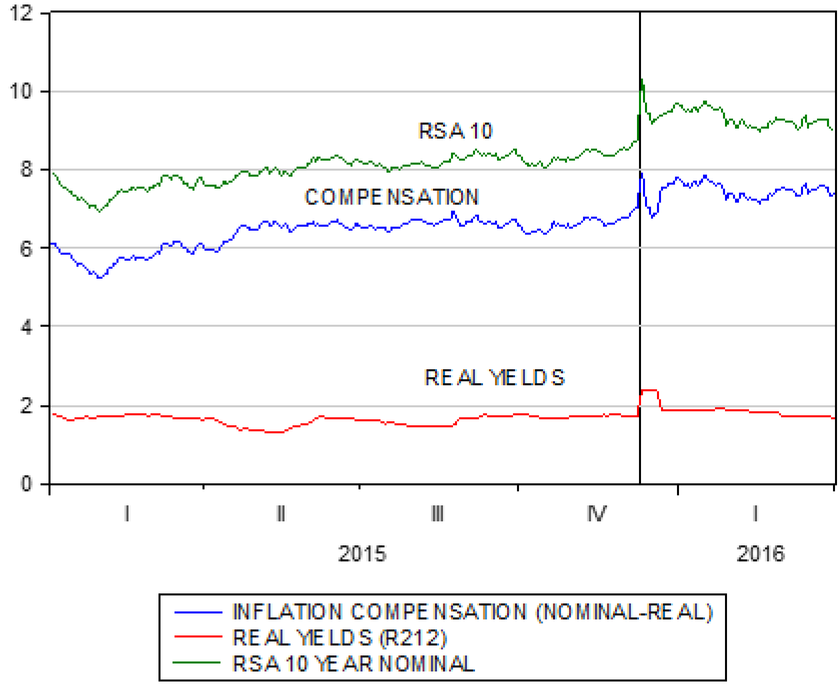
The spread between RSA rand yields and their US Treasury yields of similar duration are by definition also the average rate at which the rand is expected to depreciate over the next 10 years. The fact is that the rand has weakened and is expected to weaken further – despite the wider interest carry in favour of the rand.

Given these expectations of rand weakness it is not surprising and entirely consistent that inflation compensation provided by the RSA bond market being the difference between an inflation linked yield and a nominal yield. This is a very good measure of inflation expected and has also risen and remains above 7% p.a.

The Reserve Bank pays particular attention to inflationary expectations, believing that these expectations can drive inflation higher. But without an improvement in the outlook for the rand, it is hard to imagine any decline in inflation expected. It is also very hard to imagine how higher short term interest rates can have any predictable influence on the spot or expected value of the rand and therefore on inflation to come. As we have emphasised the risks that drive the rand are global events or SA political developments, for which short term interest rates in SA are largely irrelevant.

The only predictable influence of higher short term interest rates in SA is still slower growth in household spending. Less growth without any predictably less inflation is not a trade off the Reserve Bank should be imposing on the SA economy, even though but may well continue to do so. The only hope for a cyclical recovery is a stronger rand – whatever its cause, global or South African.

RSA bond yields and inflation compensation



Source: Bloomberg and Investec Wealth & Investment