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Family debt crisis - 5 lessons from the Eurozone

You are secretly commiserating with Greece, Italy, Spain and Ireland, because your family finances are not looking much better. The difference is, you don't have any super powers rallying to save you and your family.

You also know that tough austerity measures are desperately needed, but after watching Greece burn you are reluctant to announce budget cuts with the festive season around the corner. And so you remain in a state of denial, hoping that things will sort themselves out in the New Year.

Peter Dempsey, deputy CEO of the Association for Savings and Investment South Africa (ASISA), says while there are a number of important lessons to be learnt from the eurozone debt crisis, the following five are critical:

1. Acknowledge the crisis

Dempsey points out that all of the countries currently on the bailout list had to publicly acknowledge that they got it wrong and that their debt had become unmanageable.

"Therefore, the first step towards improving your financial situation is to face up to your own debt crisis while there is still room to negotiate a rescue plan. This does involve telling the members of your family that there is a problem and possibly your creditors."

Dempsey advises that you play open cards with your bank and other lenders if you are no longer in a position to repay them. "You just may find them willing to help you work out a plan that will enable you to settle your debt."

And then, you will have to reprioritise your finances.

2. Austerity measures are non-negotiable

Dempsey comments that in order to qualify for help from fellow eurozone partners, the countries concerned had to agree to implement severe austerity measures.

"You are likely to face revolt when you start drastically cutting costs in your household. Cancelling the satellite television subscription and switching to limited internet access just before the holidays will not make you a popular member of the household."

But remember what happened to former Greek Prime Minister George Papandreou when he called a referendum on proposed spending cuts? Therefore, says Dempsey, impose necessary budget cuts, which are non-negotiable.

"It is important, however, to explain to your family what the long-term consequences will be of not reducing costs. Poor financial discipline now may cost you your house later."

Also, cutting unnecessary spending does not mean stopping your insurance premiums. "Life and disability cover, medical insurance and short-term insurance are a necessity," says Dempsey. "Should something serious happen to you and you do not have the necessary insurance cover in place, your family will be even worse off financially."

3. Excessive borrowing got them there

Dempsey says it is widely acknowledged that excessive borrowing by some of the eurozone countries played a big role in the crisis that now holds much of Europe in a painful grip.

He comments that this problem was not created overnight. “Consistent poor fiscal discipline and failure to address unsustainable social security spending contributed greatly to the current debt crisis in Europe.”

Equally, says Dempsey, households do not suddenly sink into unmanageable debt.

“The common denominator for most households drowning in debt is the absence of a budget and a long-term financial plan,” says Dempsey.

“A budget will help you prioritise your spending. You will also need to draw up a budget if you want to impose meaningful spending cuts. Once you have a solid plan in place, your financial situation may no longer seem so dire.”

4. Expect a painful process

The eurozone crisis has been making global headlines for almost two years, with no end in sight. In fact, it seems that the situation may just get worse before it improves with concerns being expressed about the possibility of a breakup of the eurozone.

Dempsey warns that similarly your household is likely to experience significant pain in trying to resolve the financial crisis you and your family are facing.

However, the sooner you implement the necessary changes the sooner you are likely to escape the debt trap, says Dempsey.

“Use this opportunity to teach your children about the importance of budgeting and planning and about the dangers of uncontrolled and unnecessary spending.”

5. Stay calm and rational and work as a team

Much of the delays in finding a workable solution to the eurozone crisis can be blamed on a lack of common goals, both within countries that are most affected by the debt crisis and within the European Monetary Union.

According to Dempsey you and your family are far more likely to resolve your own debt crisis if you work together as a team towards a common goal.

“Should the eurozone break up as a result of this crisis, this will have far reaching effects for the rest of the world, including South Africa. Don’t allow your own financial woes to break up your family. Denial will not get you out of financial trouble, but a plan that has buy-in from your family will.”

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ASISA represents the majority of South Africa's asset managers, collective investment scheme management companies, linked investment service providers, multi-managers, and life insurance companies. ASISA was formed in 2008 by members of the Association of Collective Investments (ACI), the Investment Management Association of South Africa (IMASA), the Linked Investment Service Providers Association (LISPA) and the Life Offices' Association (LOA).