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THE SALIENCY EFFECT OF COVID-19

Relevant for: Developmental Issues | Topic: Health & Sanitation and related issues

Previously, we have discussed how your risk attitude could be influenced by the recent stock market uptrend. We now discuss the saliency effect of COVID-19 on your personal finance. Saliency refers to our tendency to focus on information that catches our attention and ignore others that are less visible.

Positive saliency

Consider the positive saliency effect of COVID-19. It has made you more health conscious. This action impacts your personal finance; your healthcare costs in the future could be lower if you take continual steps to stay healthy. There is an associated positive impact. Watching friends and extended families spend sizeable amounts on medical expenses has made most individuals realise the importance of having adequate healthcare insurance cover for their families.

The other aspect is the importance of cash to meet emergency situations. You would have heard from individuals who had to arrange for hospitalisation of their friends or family members as to how various institutions involved in the process require cash payment for treating patients. True, we pay using debit and credit cards for most of our transactions. But, we are far from being a cashless society. So, it is important that you have emergency cash at home. You could keep half of your month’s living expenses or an ad hoc amount you think is reasonable to meet an emergency.

Negative saliency

Negative saliency effect of COVID-19 is the present bias — ie, our tendency to take actions that improve our present happiness even if such actions can have a negative effect on our future well-being. Take discretionary spending. Spending more today can increase your present happiness at the cost of saving less for the future.

The question is: have you increased your discretionary spending recently? It refers to non-essential spending that can increase your happiness, albeit temporarily. This pandemic has shown that life can be short. So, why not enjoy life while we can, the argument goes.

Typically, such an argument would lead to individuals spending more on experiences such as taking an exotic vacation. With the current restriction on travel, the focus has shifted to acquiring material goods, especially electronics that provide for a comfortable living.

The other negative saliency effect is the behaviour caused by the remarkable recovery in the stock market after initial crash last March when the country went into its first pandemic-related lockdown. The sharp rise in investment value has encouraged many individuals to increase their discretionary spending. This phenomenon is referred to as the wealth effect.

Individuals typically do not keep sizeable funds in savings accounts or have emergency cash at home because they do not want to lose the opportunity to earn higher returns. Yet, they hold loss-making investments for long not minding the associated opportunity cost. Why? Losing an investment opportunity is more salient than holding on to unrealised losses.

Similarly, individuals buy extended warranty for air conditioners and laptops but are reluctant to buy healthcare insurance or term life insurance products. Why? Till now, most individuals did not face large healthcare costs. So, healthcare was not a salient factor. This behaviour could change because of COVID-19.

There is a caveat. The saliency effect may last till you fear the pandemic and its impact on lifestyle. Once the fear subsides, the saliency effect too could fade.

You have to act quickly to capitalise on the positive saliency effect. So, arrange to have some emergency cash at home and get adequate health insurance protection for your family. To address discretionary spending, first set up systematic investments to meet your life goals. Then, spend the rest of your monthly income.

(The author offers training programmes for individuals for managing their personal investments)

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