ECONOMIC RESEARCH

Working Paper 180

November 4, 2014

} MACROECONOMICS } FINANCIAL MARKETS } ECONOMIC POLICY } SECTORS

Dr. Arne Holzhausen

The return of the long-term saver?

AUTHOR:

DR. ARNE HOLZHAUSEN
Phone +49.89.3800-17947
arne.holzhausen@allianz.com

THE RETURN OF THE LONG-TERM SAVER?

Judging by media reports, today's low yield environment is a fatal threat to the life insurance & pension industry. With depressed yields, long-term savers are bound to become extinct, liquidity is king. Or so goes the siren song of the self-proclaimed augurs.

Certainly, life & pension products cannot defy low investment returns which are today well below levels seen 20 years ago. Given the economic environment, subdued growth and inflation, low interest rates are no surprise. Since the financial crisis, however, the secular drop in interest rates has taken on new dimensions. The forces pushing interest rates down to ever new lows have less to do with fundamental factors and largely to do with unconventional monetary policy. The result: real returns, i.e. those after adjustment for inflation, are in many cases close to the zero mark – or even below. This is financial repression at work.

So, the value of life insurance in today's environment lies not in shielding clients completely from falling yields but in protecting their assets against financial repression: Life insurance & pensions have to enable savers to pursue long-term real asset accumulation, building a nest-egg for maintaining their living standard in old-age.

In this respect, hard data seem to tell a different story than media reports which focus only on falling returns. Savers around the world still trust insurance & pension products. The development of insurance & pension assets since 2007, obtained from the Allianz Global Wealth Report 2014, paints an encouraging picture: With an average annual growth rate of 4.8% since the collapse of Lehman Brothers, they outgrew total financial assets (4.3% a year since 2007). Moreover, this holds true for all regions – with the notable exception of Japan. (see Chart 1)

Not surprisingly, market size and growth are closely correlated. Annual growth since 2007 is a meager 0.7% in Japan and a moderate 4.1% in Western Europe and 4.4% in the USA. The only mature regional market that fared better (7.2% increase a year since 2007) is Australia / New Zealand. In contrast, the markets which boosted double-digit growth throughout the previous five years, Eastern Europe, Latin America and Emerging Asia, are not only much smaller but also far less developed if insurance & pension assets per capita are taken into account. (see Chart 2)

Chart 1: Insurance & pension assets outgrow total financial assets

Average annual growth of gross financial assets and insurance & pension assets since 2007, in %

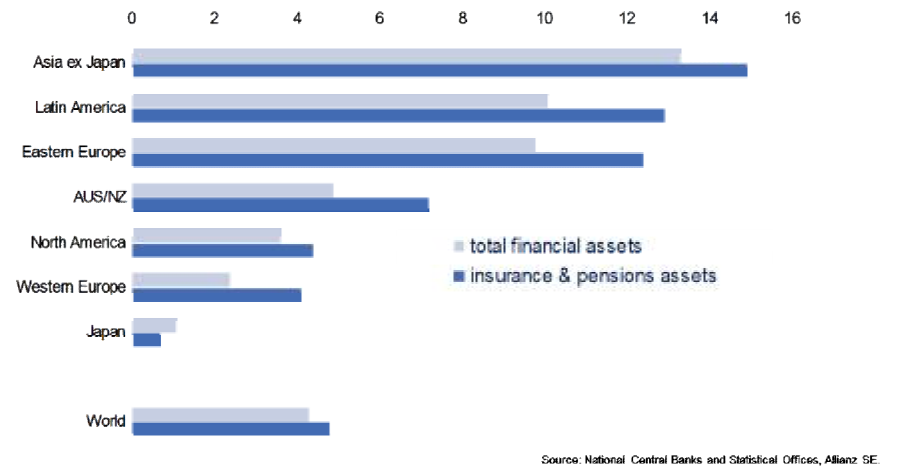
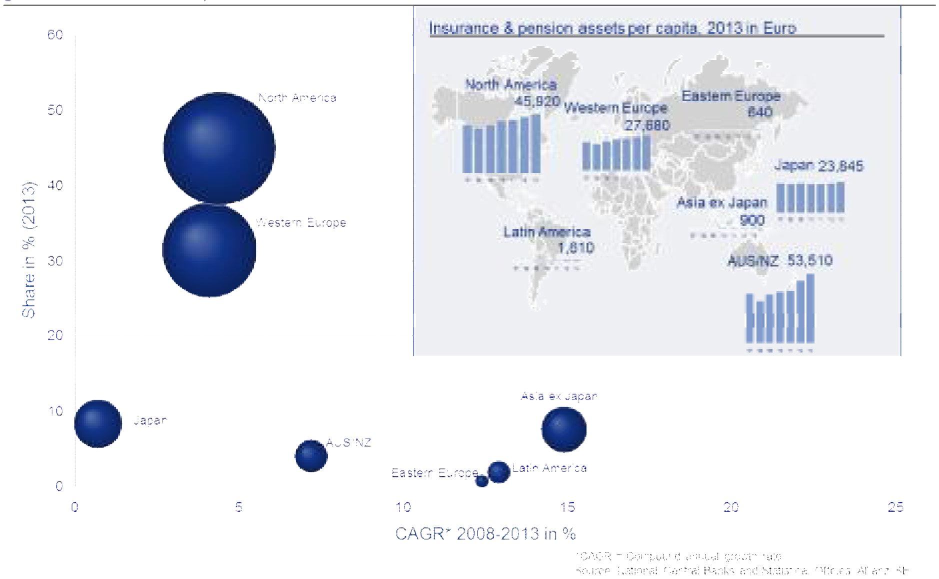


Chart 2: The bigger markets are the laggards

Insurance & pension assets' share of global total financial assets (2013) and growth of insurance & pension assets since 2007



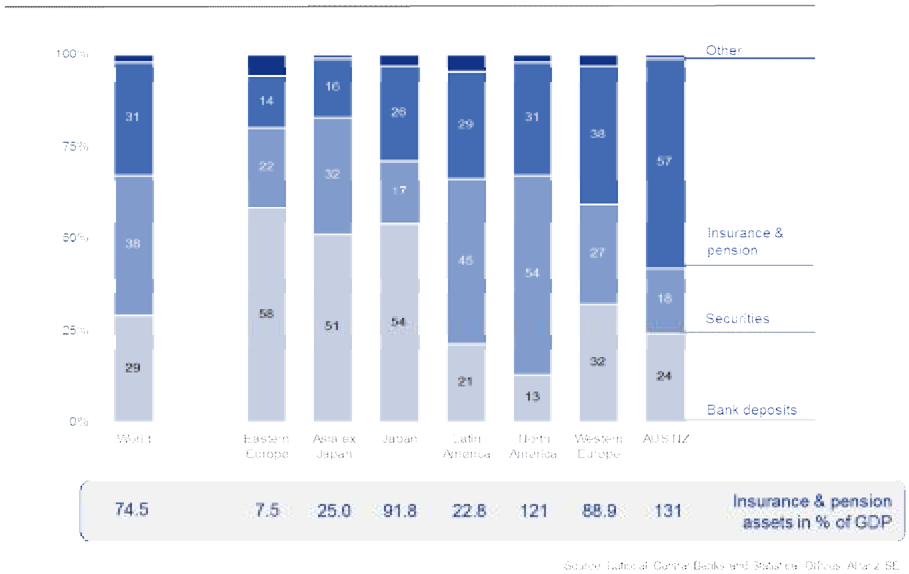
The upshot is clear: Eastern Europe, Latin America and Emerging Asia were not only fast growing in the past but they still offer plenty of catch-up potential. In all three regions, insurance & pension assets as a percentage of GDP are still low and nowhere close to levels seen in the mature markets: The (simple) average of the emerging regions is 18.4%; the corresponding figure for the four mature regions (Japan, North America, Western Europe and Oceania) is 108%.

The lowest figure (7.5%) is displayed by Eastern Europe: Although the region has witnessed the strongest growth since 2000, with an average annual growth rate of 23%, the pot of insurance & pensions assets is still relatively small. Against the backdrop of the sometimes far-reaching pension reforms implemented in recent years, this might be a surprise. However, it only underlines the fact that building a decent nest-egg is a lifelong endeavor; with insurance & pensions you save for the long haul. Eastern Europe is still a late-comer with regard to private, capital-funded pensions.

Another perspective for assessing future growth potential is looking at insurance & pensions assets' share in total financial assets. Again, in Eastern Europe and Emerging Asia this share is way below the global average, offering another source of above-average growth – if households start to structure their portfolios in a more balanced way. This means first and foremost reducing the overweight of bank deposits. (see Chart 3)

Chart 3: Emerging markets in Eastern Europe and Asia offer huge potential

Asset classes as % of global gross financial assets, 2013



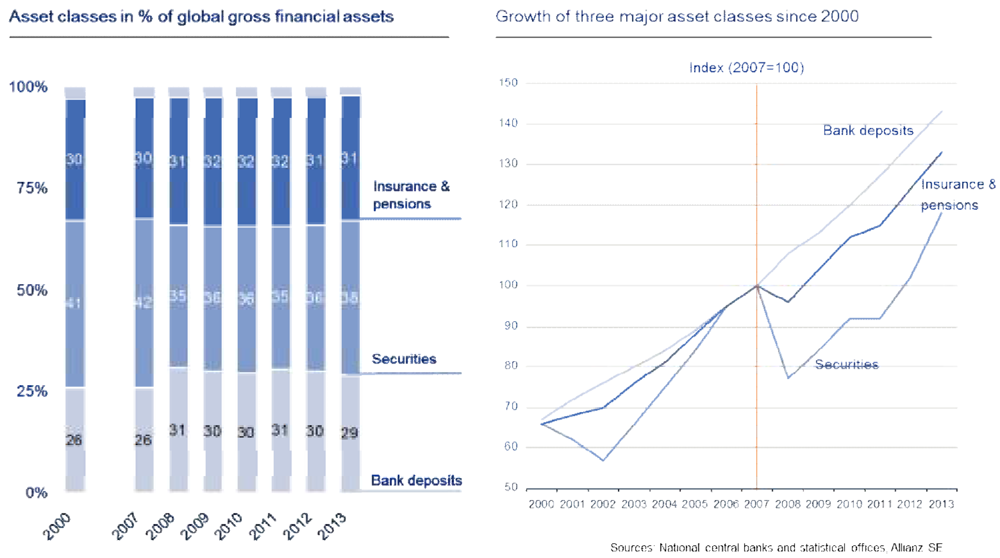
However, savings behavior at times when interest rates are rock bottom seems to point in a different direction: savers adopt a marked preference for liquidity, meaning that the majority of fresh funds end up in bank deposits. In the years marred by the crisis, the slice of the financial asset accumulation cake consisting of banking deposits has become much bigger. This process has not only seen savers entrust more of their new investments to banks, but has also resulted in them pulling money out of other investments, especially equity investments.

The risk aversion lurking behind this behavior is fueled by the high levels of volatility on the markets and considerable uncertainty about future economic development. While the tentative attitude adopted by many savers is understandable in this sort of environment, the implications are serious nonetheless. After all, it would be more rational, at times when interest rates are in the doldrums, to move a few steps up the risk ladder to compensate for the dwindling returns. This would also imply a preference for long-term investments, for example.

In that respect, last year's developments offer some encouraging signs. Private household claims vis-à-vis insurance companies and pension institutions not only experienced strong growth totaling 7.2% at global level in the course of 2013 but, unlike the securities asset class, this growth was also driven mainly by substantial fund inflows: it was this asset class that registered the highest inflow of funds of all. Whereas private households were still putting most of their savings into secure bank deposits in 2011 and 2012, they started investing more in long-term assets again last year. This shift in the pattern of saving is most pronounced in the US. It might be interpreted as an early sign that savers have actually digested the crisis psychologically as well and are ready to leave the "crisis mode" behind.

However, previous years of investors' rising risk aversion and liquidity preference have left their mark on asset composition: bank deposits, the laggard of pre-crisis years, became the front-running asset class worldwide. They have upped their share of global financial assets by almost 3 percentage points since 2000; insurance & pension assets, in contrast, managed a global increase of only 1 percentage point. (see Chart 4)

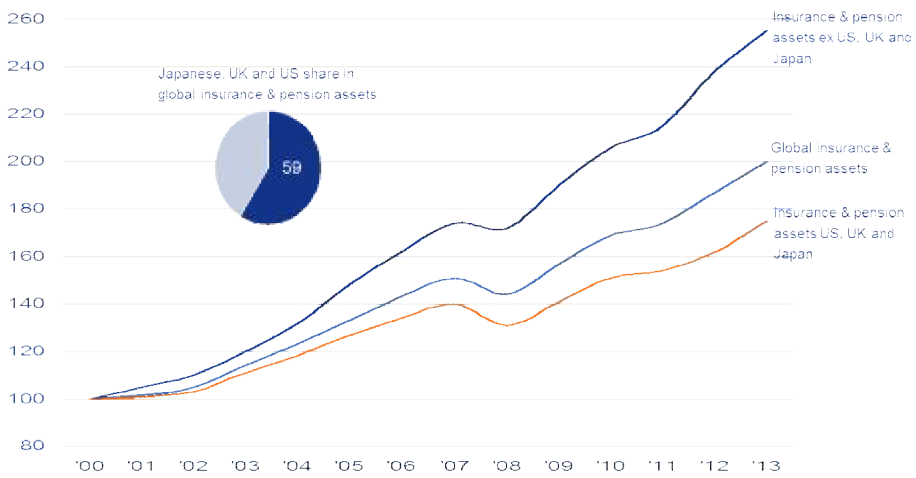
Chart 4: Increasing risk aversion is mainly a boon for bank deposits



But the, in comparison to bank deposits, rather muted development of insurance & pension assets is not only the result of a more "myopic" savings behavior. It also reflects the rather dismal performance of the three biggest markets, the US, the UK in particular and Japan. Excluding these three, global growth since Lehman jumps to 6.5% a year. Moreover, insurance & pensions assets increased by more than 150% since 2000 (average annual growth rate: 7.5%). The growth gap between the three biggest markets and the rest of the world has become more pronounced in recent years – for similar reasons: They are huge mature markets where baby boomers are retiring or are about to retire soon; they exemplify markets on the verge of the transition from asset accumulation to decumulation. (see Chart 5)

Chart 5: Insurance & pension assets ex US, UK and Japan more than doubled in the last decade

Development of different asset classes since 2000, Index: 2000 = 100



Source: National Central Banks and Statistical Offices, Allianz SE.

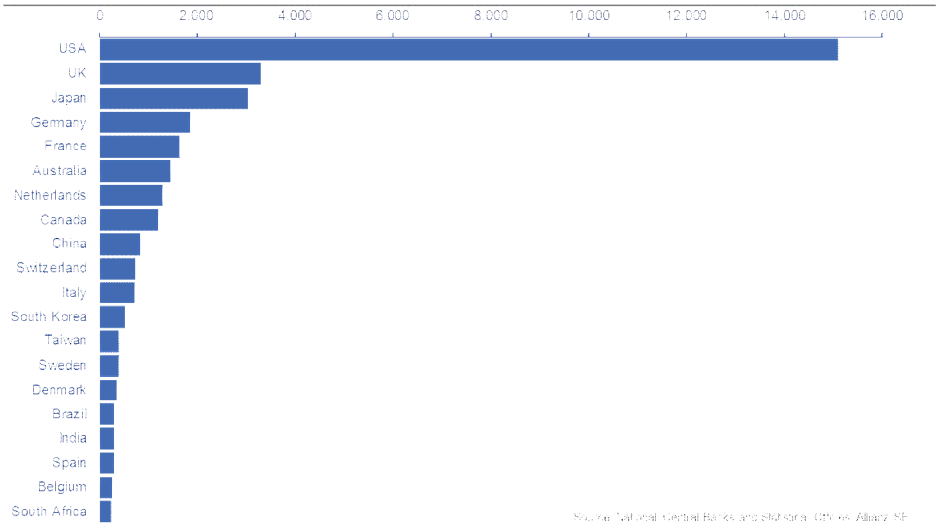
Bottom line: The outlook for insurance & pension assets is not bleak at all. They already weathered the crisis years rather well, and the "wall of cash" might become the fuel for future growth: Once confidence returns, short-term funds are not expected to linger for too long in no- or low-yielding bank accounts. Life & pension products offer an attractive risk-return-profile even in a low-yield environment – because they open access to a highly professional risk management and investment process, exploiting the opportunities today's market environment has to offer to big, long-term and smart investors.

On top, life insurance is not only a superior vehicle for long-term real asset accumulation at times when interest rates are in the doldrums, but can also be combined with financial protection against existential risks, from death to disability and long-term care. In a nutshell: Life insurance offers safety, assuring financial well-being in turbulent times. It is as valuable as ever. Fortunately, savers seem to have rediscovered the charms of insurance and pension assets recently.

Appendices

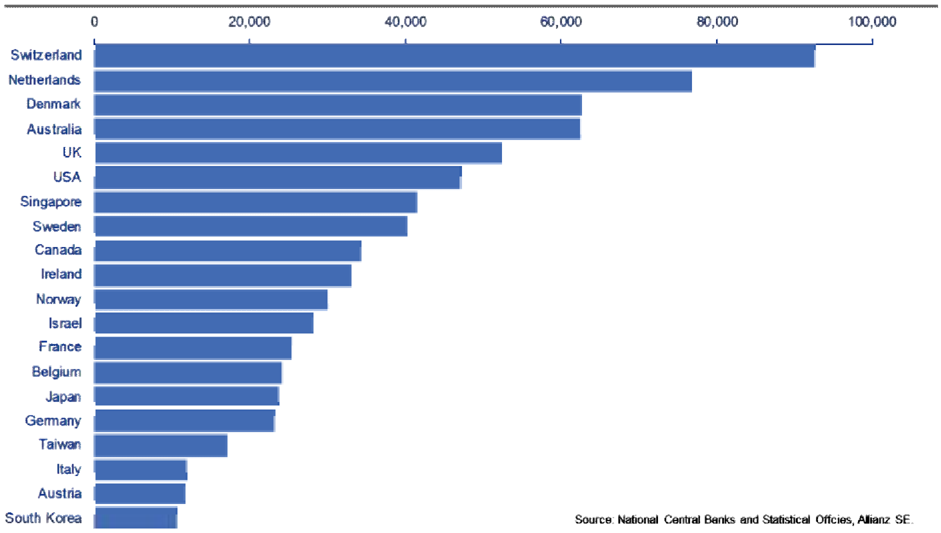
Appendix 1: Top 20 insurance & pension markets: Total assets

Insurance & pension assets in EUR bn, 2013



Appendix 2: Top 20 insurance & pension markets: Per-capita assets

Insurance & pension assets per capita in EUR, 2013



These assessments are, as always, subject to the disclaimer provided below.

ABOUT ALLIANZ

Together with its customers and sales partners, Allianz is one of the strongest financial communities. Over 83 million private and corporate customers insured by Allianz rely on its knowledge, global reach, capital strength and solidity to help them make the most of financial opportunities and to avoid and safeguard themselves against risks.

In 2013, around 148,000 employees in over 70 countries achieved total revenues of 110.8 billion euros and an operating profit of 10.1 billion euros. Benefits for our customers reached 93.9 billion euros.

This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an aging society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events) (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the Euro/U.S. Dollar exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.