3 factors affecting retirement income

In Australia, people are living longer and interest rates are lower than ever. While the first is good news, the second carries risks if you're looking for an adequate income to see you through retirement.

Here we look at three elements that affect a post-work reasonable income – interest rates, inflation, and longevity.

1. Interest rates - high valuations, low returns

Historically low interest rates have driven valuations of defensive assets such as cash and fixed interest to unprecedented highs. Generally, a defensive asset is seen as a lower-risk, lower reward investment.

High valuations mean low yields (or percentage income returns in the form of dividends and interest) for defensive assets.

Low interest rates affect variables such as inflation and investment returns, which in turn affect how we save for retirement.

In the high interest rate era of the late 1970s and 80s even relatively low-risk assets like term deposits and bonds offered double-digit returns. These days, rates of return are all closer to one per cent.

Similarly, property yields in Australia are around two to four per cent depending on the type of property and geography. Better yields may be available via Australian equities, but many retirees are not in a position to take on a higher level of risk.

2. The inflation perspective

Inflation has a big impact on retirees who are less able to earn and save more after their working lives have finished. Falling returns mean providing for retirement is challenging, but although returns are low now compared to in the past, the impact is eased when you take inflation into account.

Inflation was running at around 15 per cent in the late 70s and 80s, which ate up much of the bond and term deposit returns. Nevertheless, the combination of low interest rates and low inflation make it hard for retirees to find returns.

There are risks too, should the current global inflation rate of about three per cent shift higher than the defensive asset classes. As these assets are priced for the very low inflation of today, they would face major negative revisions.

3. The longevity conundrum

In Japan, adult diapers are forecast to outsell those for babies within a few years. Many developed countries are having to adapt to the demands of an ageing population.

Australians are also living longer, increasing the risk that a retiree will outlive their savings. Back in 1980, a man starting a pension at age 65 had a life expectancy of 78 – 13 more years. Now, a male starting a pension at 65 has a life expectancy of 86 – an additional 21 years. While this is great news in many ways, financially it means higher income needs and the need to grow the assets over time to make up for rising costs of living.

This is a concern in an environment which sees retirees drawing down on their pool of retirement assets because they can no longer generate sufficient income returns. This means retirement account balances are being depleted relatively quicker than in the past, especially if retirees lack exposure to growth assets to generate some capital growth over their longer lives.

Supporting an ageing population to achieve their retirement goals in a market of lower investment returns is a major challenge. A stable policy framework for superannuation and a long-term approach will be important in giving retirees the best chance of achieving a comfortable retirement.

Source: AMP

To find out more about how you can save for your retirement, please contact Shaun or Vicky a call at Evans Edwards Financial Advisors | Wealth Creators on **4927 4588**.