

Independent Healthy Ageing conference  
Glasgow Royal Concert Hall  
13<sup>th</sup> November 2008



# The Silver Economy

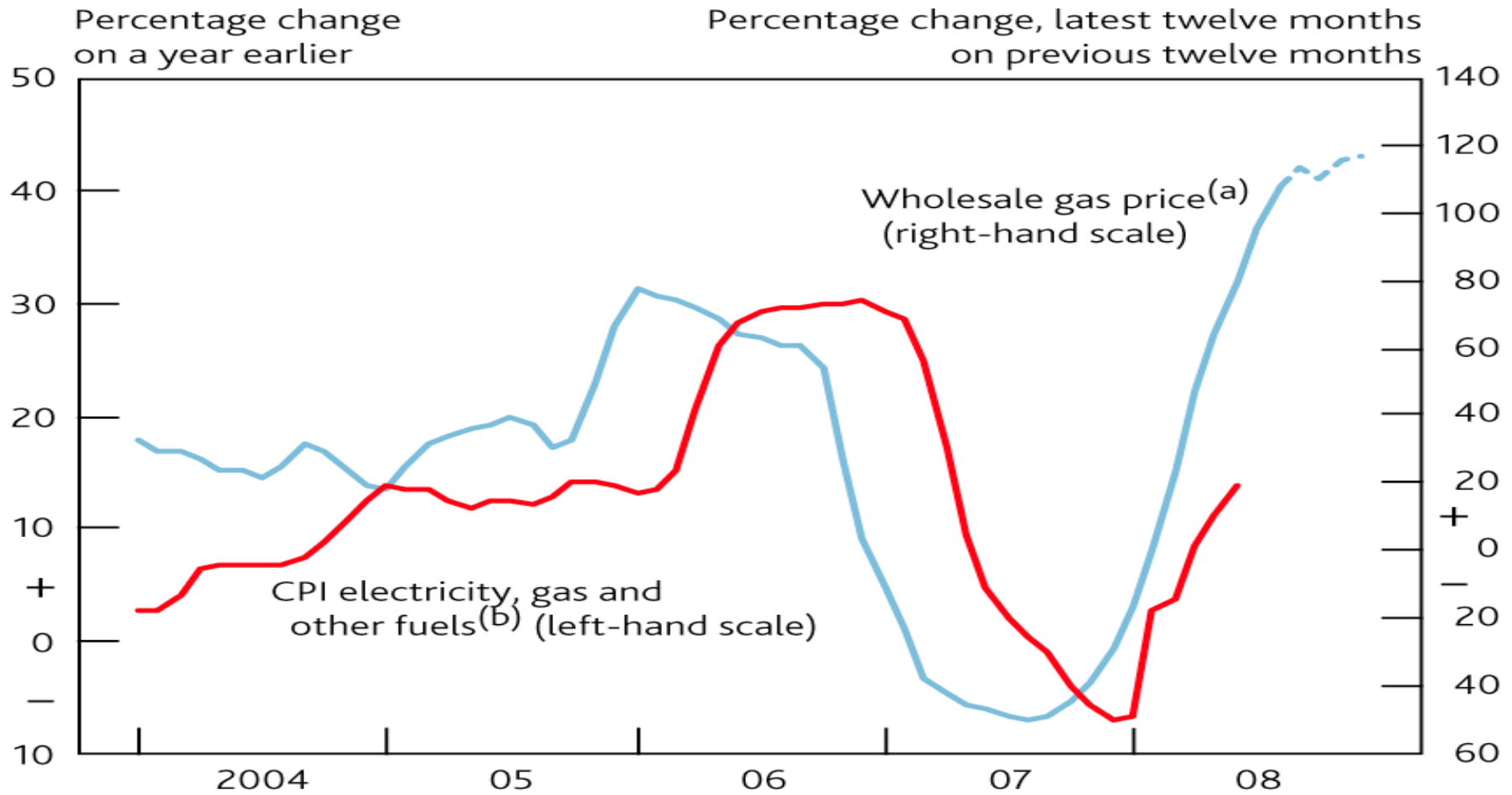
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Standard Life

# Agenda

- Inflation
- Interest rates
- State pensions
- Private pensions

Inflation –  
the pensioner's No 1 enemy

# Energy prices still rising



Sources: Bloomberg, International Exchange ([www.theice.com](http://www.theice.com)), ONS and Reuters.

(a) One-day forward price of UK natural gas, monthly averages of daily data. Data for August and the futures curve are based on the fifteen working days to 6 August. The dashed line shows estimated increase between September and December 2008, assuming that spot prices follow the futures curve.

(b) Data to June 2008.

# Annual inflation rates within the CPI basket<sup>(a)</sup>



Per cent

	Frequency of purchase <sup>(b)</sup>	Averages		2008	
		Since 2000	2007	Q1	Q2
Food (9.5%)	Monthly	2.3	4.6	6.2	8.9
Domestic energy (3.5%)	Monthly	7.1	8.2	0.1	11.0
Petrol (3.8%)	Monthly	5.0	3.1	20.0	20.7
Services (45.3%)	n/a	3.7	3.6	3.3	3.8
Other goods <sup>(c)</sup> (37.9%)	n/a	-1.5	-0.3	-1.1	-0.9

*Of which:*

Clothing and footwear (6.2%)	Quarterly	-5.6	-3.8	-5.1	-6.9
Audio visual, photographic and data processing goods (2.6%)	Less than once a year	-10.4	-11.3	-15.2	-14.0

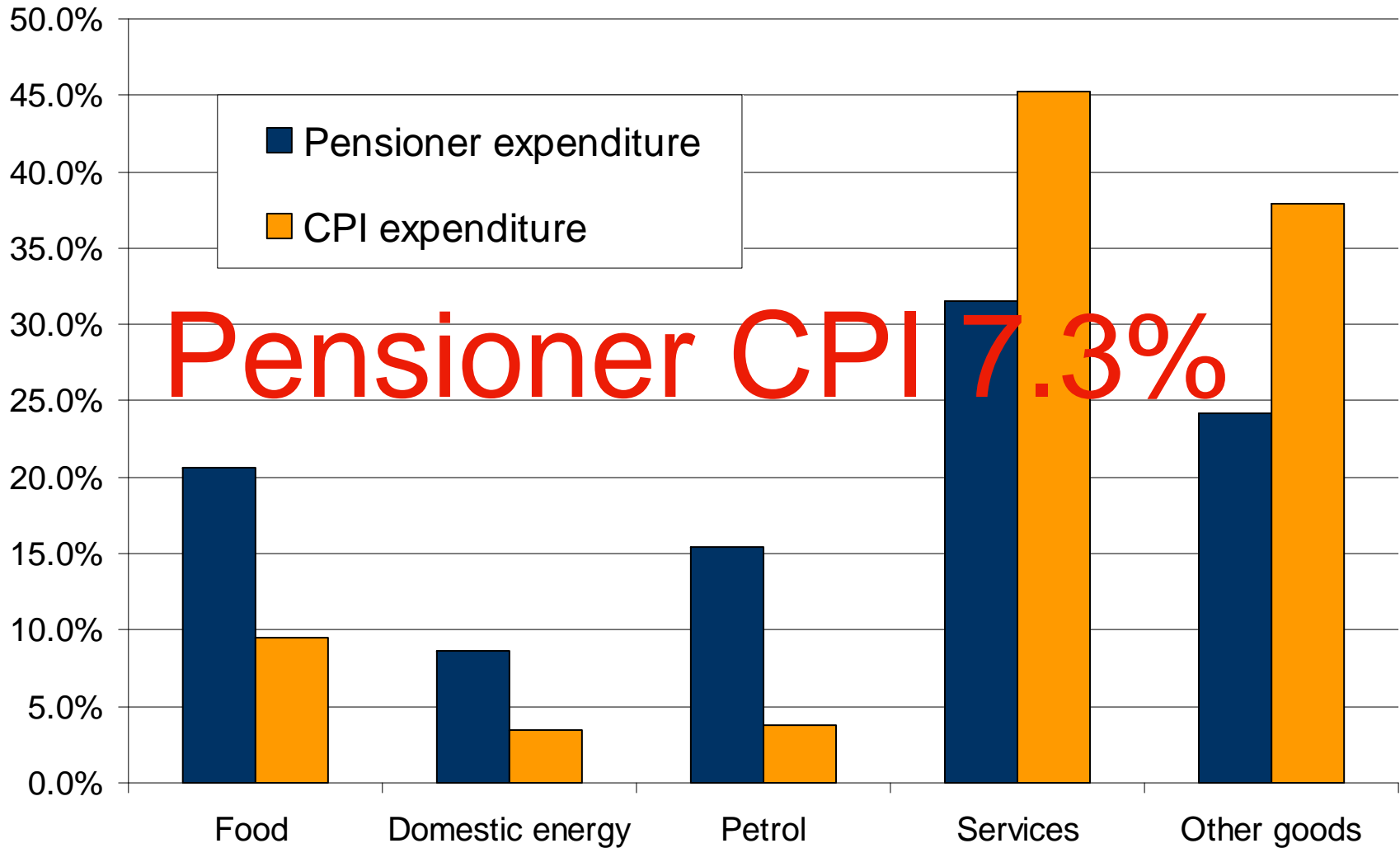
n/a = not applicable.

(a) Figures in parentheses are CPI expenditure weights in 2008.

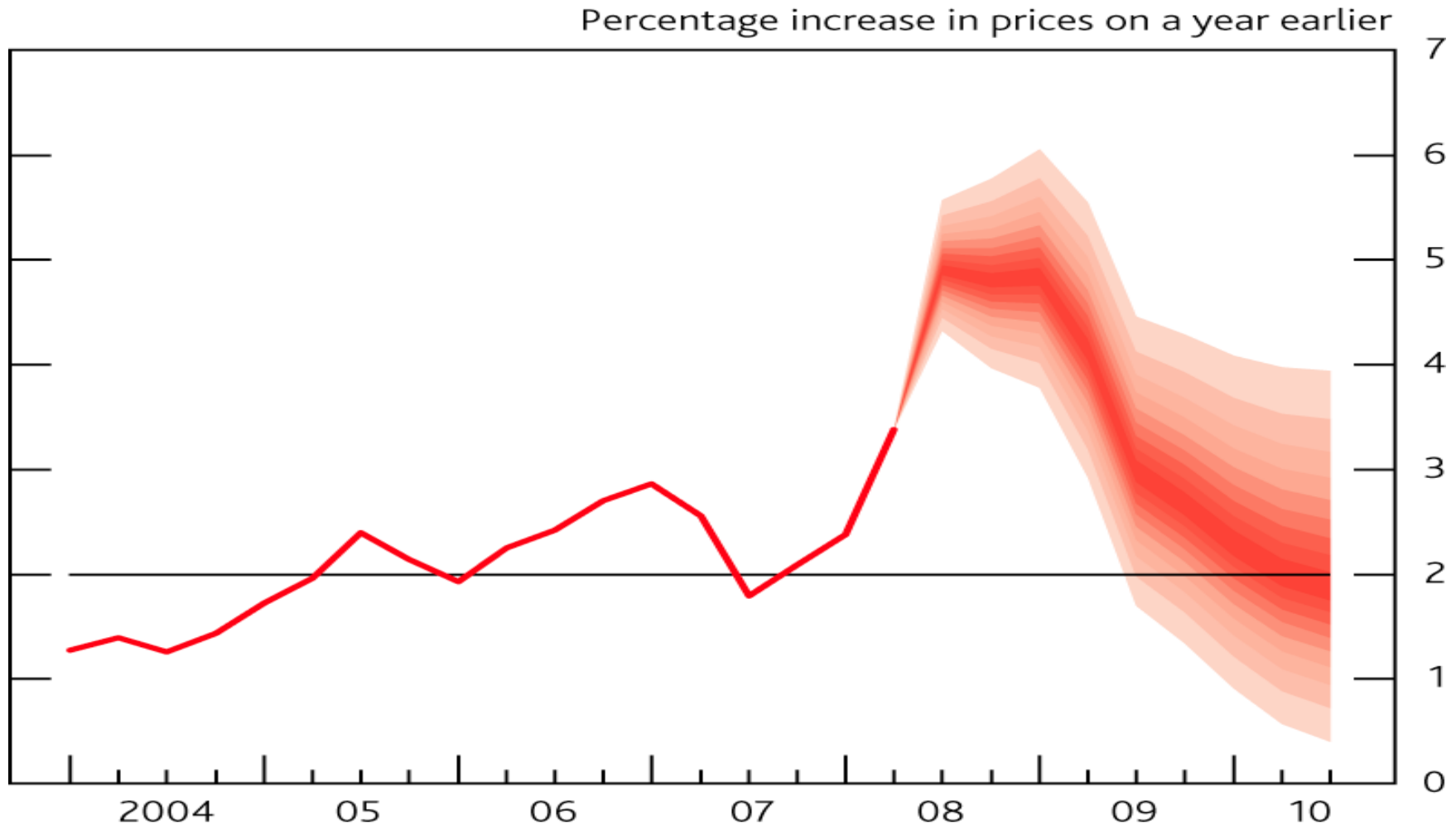
(b) Indicative frequencies of purchase based on ONS classification of RPI categories into items bought at least monthly, at least quarterly, at least annually and less frequently than once a year. See O'Donoghue, J (2007), 'Inflation — experience and perceptions', *Economic and Labour Market Review*, Vol. 1, No. 1, pages 33–39.

(c) CPI goods excluding food, petrol and domestic energy.

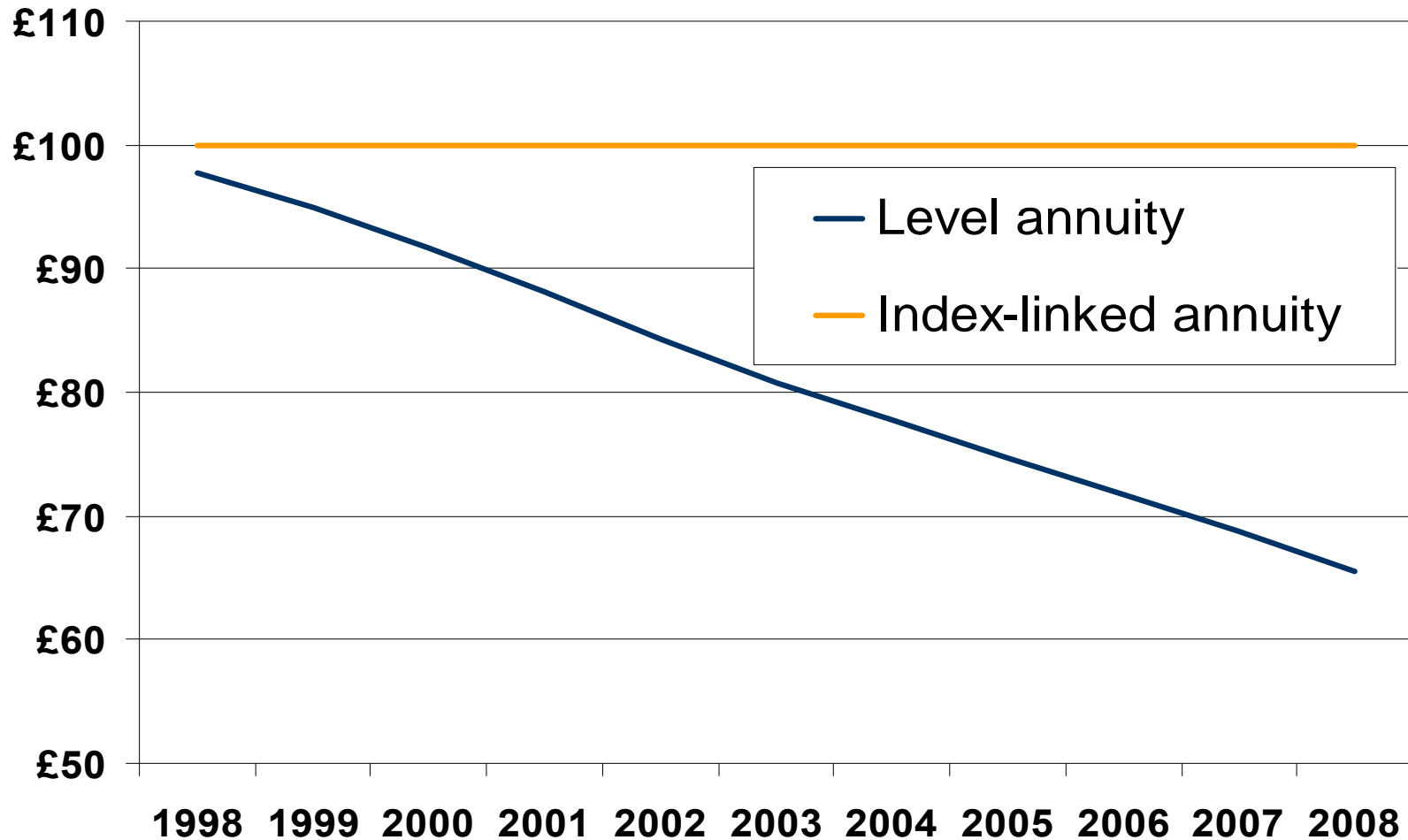
# But pensioners don't spend in line with CPI



# Bank of England CPI inflation expectations



# Purchasing power of annuities



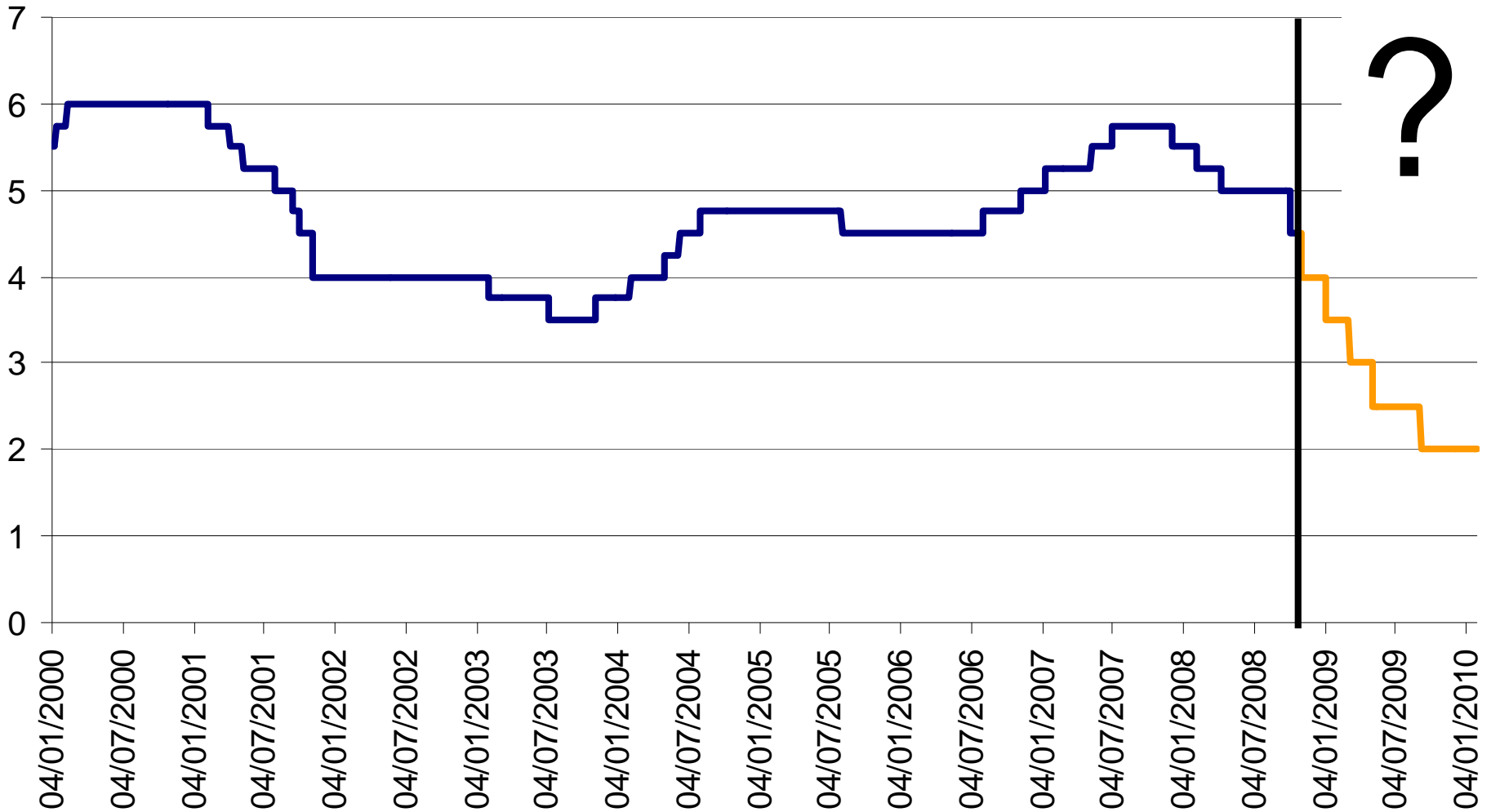


# What does the future hold?

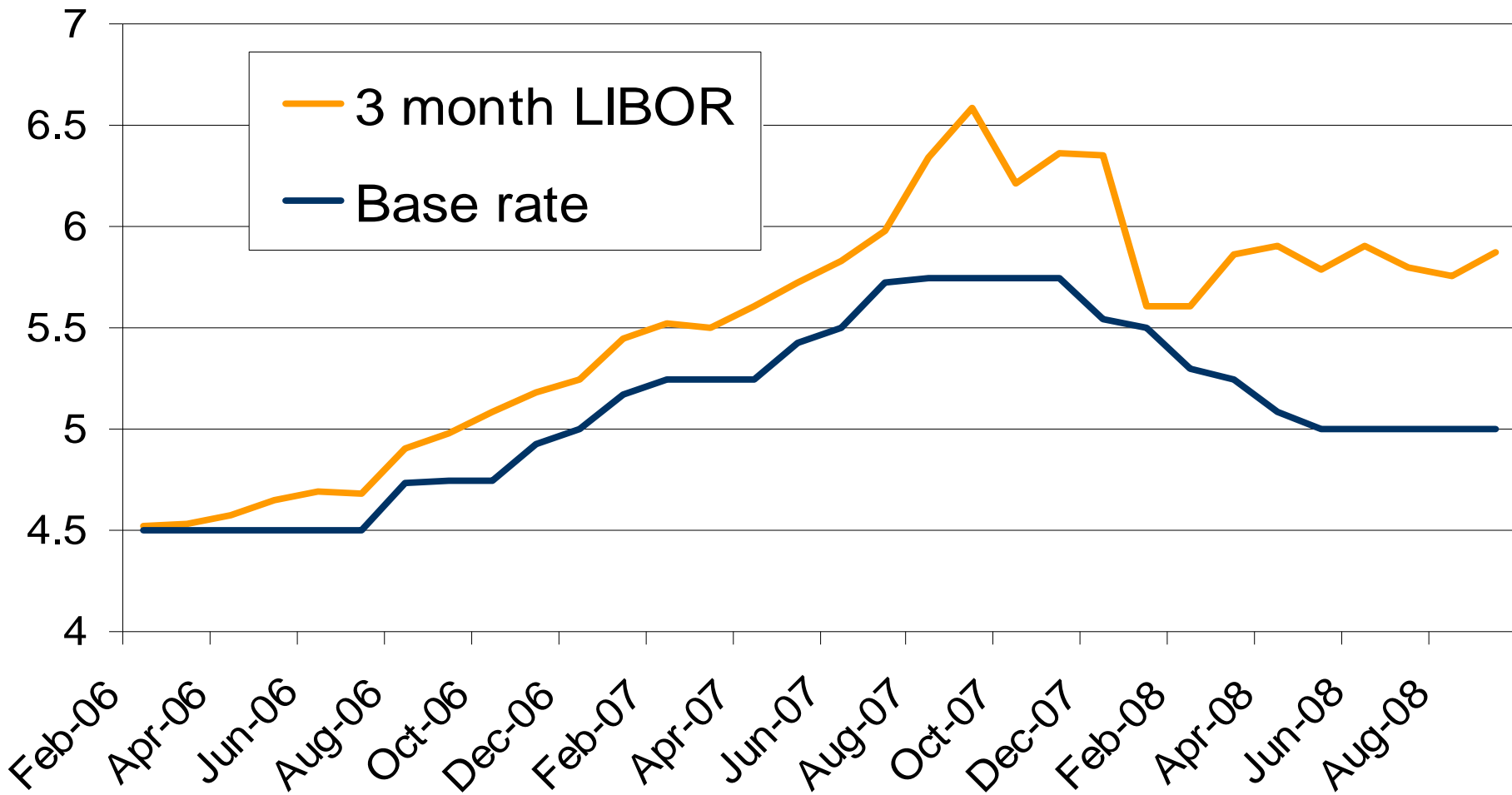
- Demand for scarce energy will continue to rise as Asian middle classes burgeon
- Demand for food will increase as world population grows
- Prices will continue to rise in the longer-term
- Easing of UK monetary policy may lead to pick-up in inflation in the medium term

Low interest rates –  
the pensioner's No 2 enemy

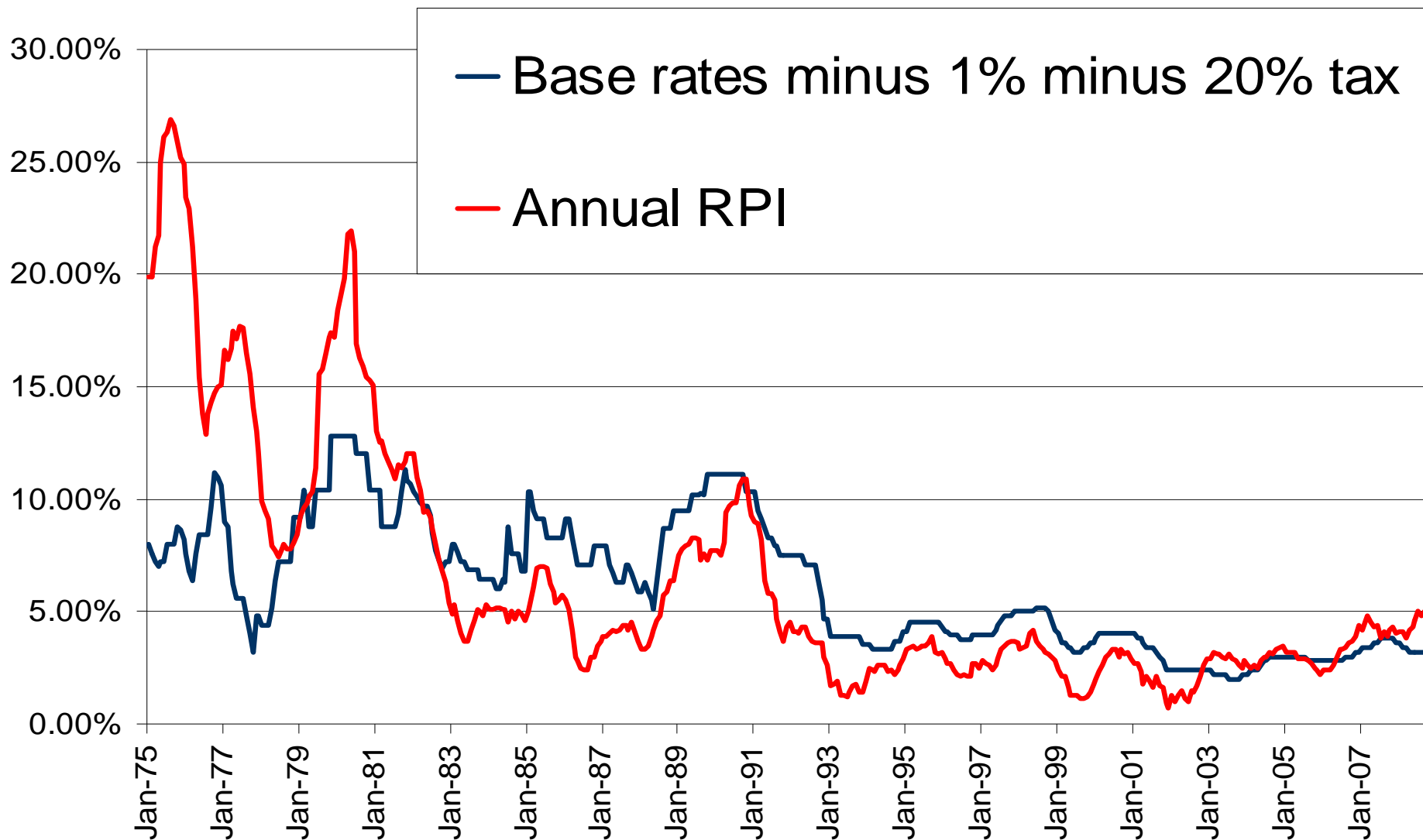
# Base rates expected to fall further



# Market rates may not follow...



# Net deposit rates and inflation



# Interest rate pointers

- Base rate falling
- Interbank rates falling more slowly
- Liquidity measures will start to feed through in Q1 2009
- But banks still competing for deposits rather than loans
- Interest rate spreads set to widen as banks rebuild balance sheets
- Will government allow inflation to erode debt?

# State pensions

- Basic state pension indexed to RPI, to link to NAEI between 2010 and 2015
- Qualifying years reduced to 30 – good news for women
- State second pension targeting lower earners
- State second pension will become flat rate in 20 years time
- Replacement rate for average earner (30 years work) = 33%
- Replacement rate for min wage earner = 80%



# Saving in the UK's new personal accounts



- Male joins scheme at age 22 – earns UK minimum wage £10,500
- Pays in £400 a year until age 65 – Fund £31,400 (2.5% real growth)
- At current annuity rates, provides an income of £1,450
- Replacement rate from Pillar 2 savings approx 14%
- Replacement rate from state pensions (Pillar 1) 80%
  
- Should he be forced to save at all?
- Should pensions for lower earners be based on redistribution of wealth?

# Is 100% coverage desirable? Reward for saving in the UK dubious for low earners



- 20 years saving in a personal account
- No saving

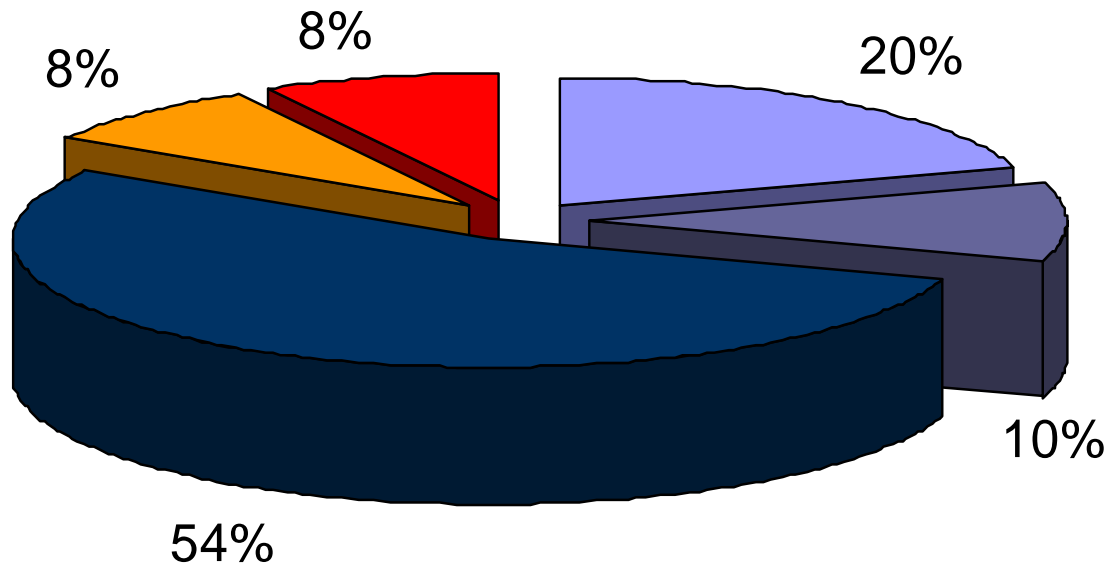
Based on Govt figures from Parliamentary answer 3/7/08. Full Basic State Pension, 30 years State Second Pension, join personal account at age 22 pays for 20 years

# Private pensions

# Defined benefit pension issues

- Defined benefit provision dying out
- Underfunded – will need to make good deficits
- Against the backdrop of falling profits...
- And more corporate failures increasing insurance (Pension Protection Fund) levies
- Local government schemes not immune
- Council tax rises or service cuts necessary
- Can DB survive in public sector?

# Sweden's default fund AP7 (98% of new participants\*)



Jan 2008 to 17 Oct 2008

UK All Share ↓ 37%

Dow Jones ↓ 32%

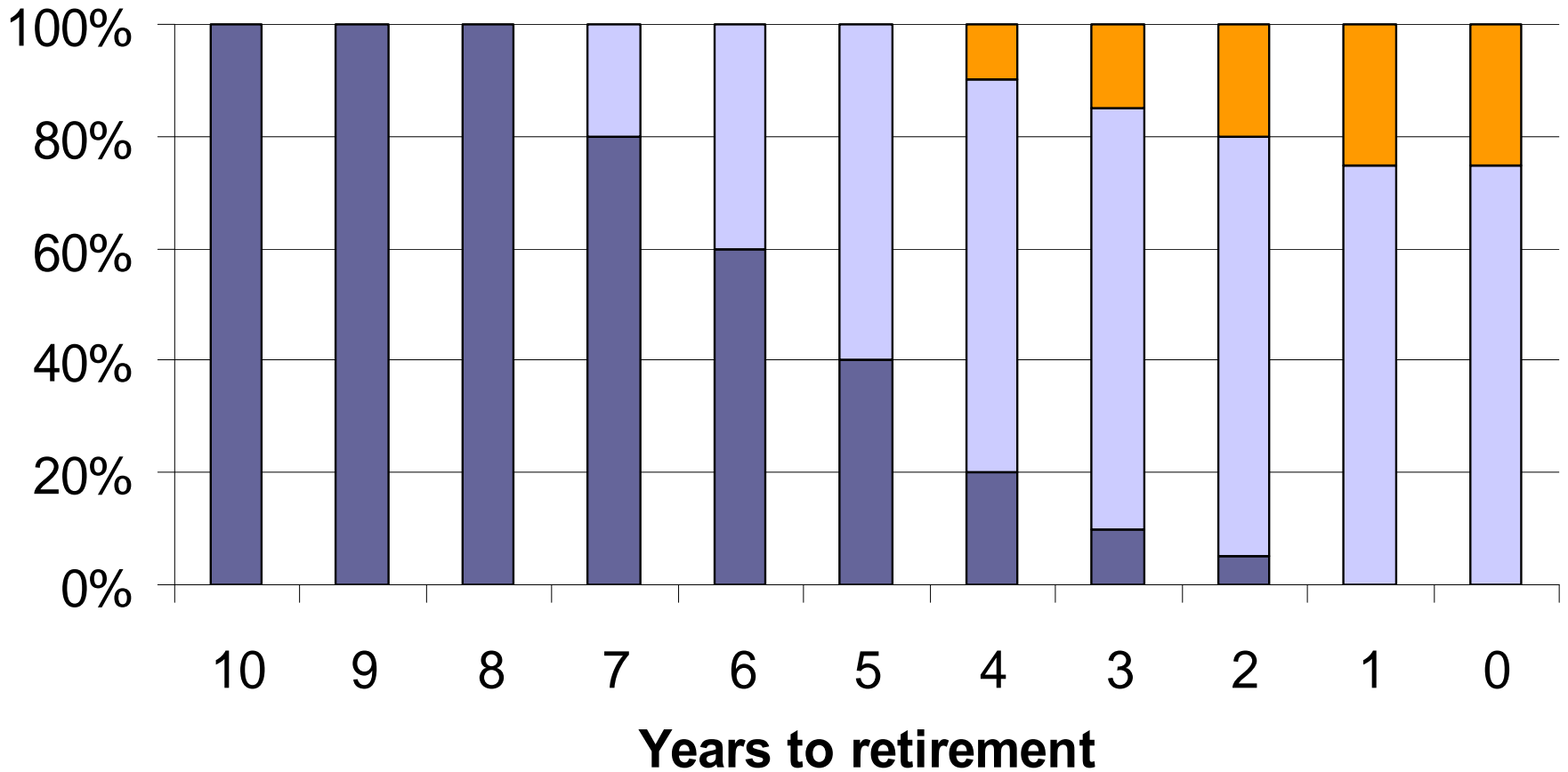
Stockholm 30 ↓ 42%

AP7 ↓ 35%?

- Swedish equities
- Emerging market equities
- Global equities
- Bonds
- Hedge funds and private equity

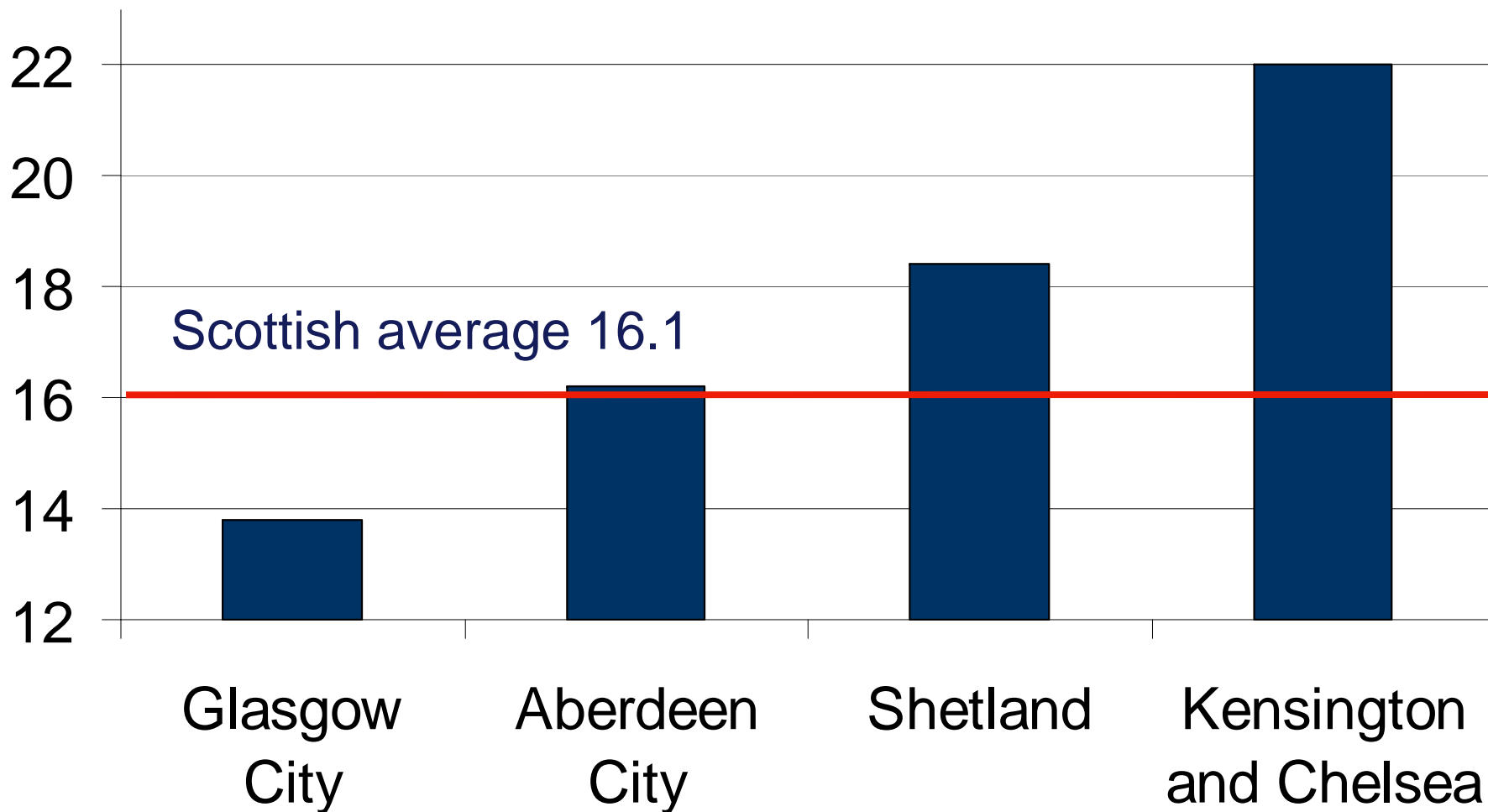
# Lifestyle funds in the UK

■ Equities/Balanced Fund    ■ Bonds/Protected fund    ■ Cash



- Fund values falling
- Worrying for those in equity and managed funds
- People may need to defer retirement
- New anti-age discrimination rules default retirement age to 65
- Lifestyle funds have proved useful in current environment
- But is gilt/bond investment the optimum strategy for people with 35 years still to live?

# Life expectancy of 65-year-old males

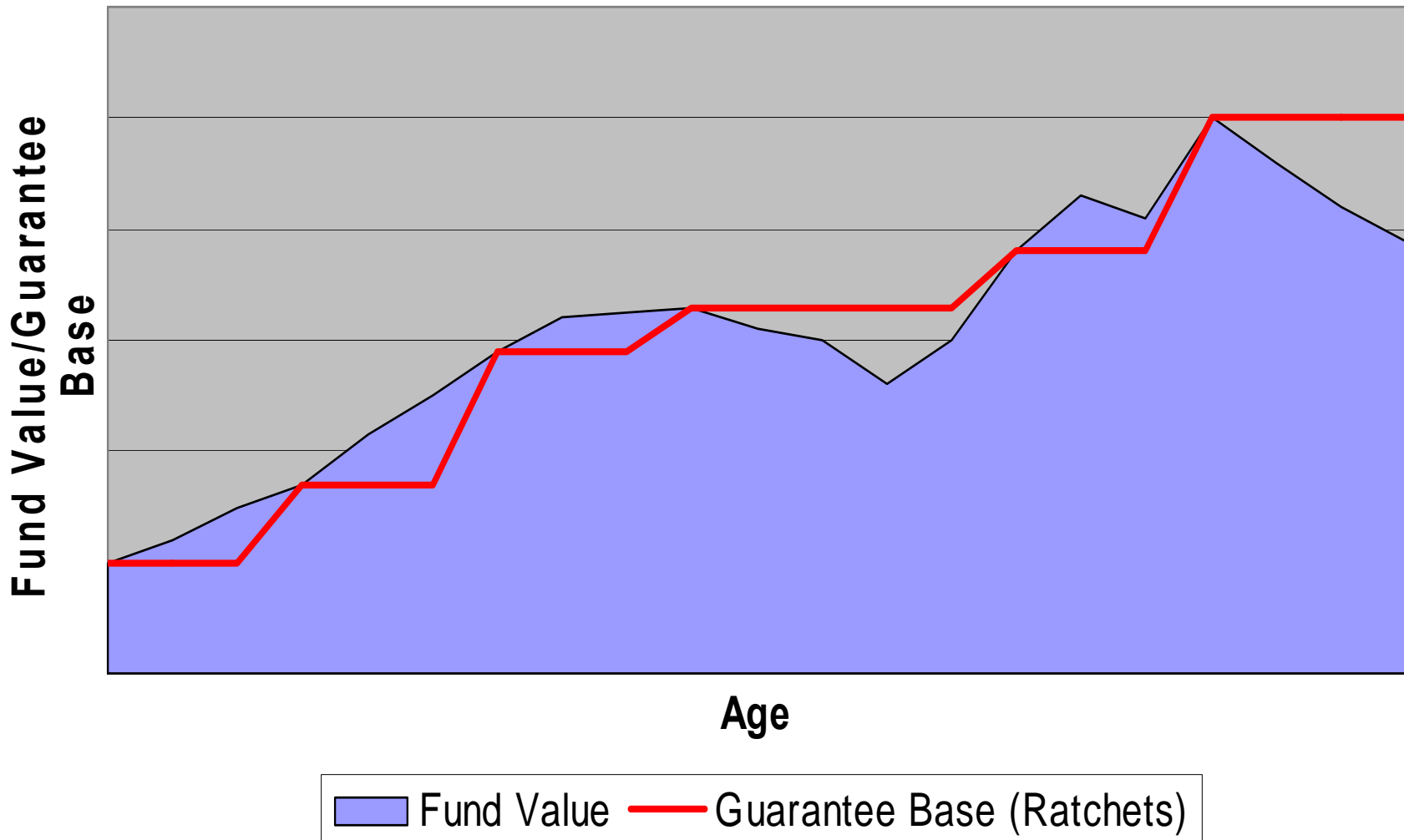




- Around one tenth of new annuities are now enhanced rate (smoker, impaired life)\*
- Prudential, Norwich Union and Legal and General launch postcode annuities in 2008
- Market must follow to avoid selection
- Good news for those in Glasgow City, bad news for those in Shetland
- Will wealthy people self-insure?

# New retirement products are arriving

The amount guaranteed can increase if funds perform well



# In summary...

- Inflation set to fall in short term
- But interest rates will follow suit
- Beware of governments attempting to inflate debt away – unfair to savers
- State pensions set to become more generous for some
- But new savings accounts could disappoint for less well off
- Private pensions under the economic cosh
- But continuing to innovate



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