Box 1: The return of positive interest rates – a blessing and a curse

For almost a decade, interest rates remained at record low or even at negative levels. However, unprecedented high inflation rates forced central banks to change tack. In the Eurozone, interest rates turned positive for the first time in eight years, at least in nominal terms. For pension reforms, this is both a blessing and a curse.

For savers, positive interest rates help build up adequate retirement assets via the compound interest effect. For governments, however, they increase the need to reform pension systems to make them sustainable. Since they can no longer take on additional debt at virtually no cost, governments have less financial leeway to subsidize state pension systems in deficit. In the Eurozone alone, due to the rise in interest rates, net interest payments are likely to have increased by almost +20% to EUR207bn in 2022[1].

Higher interest rates in many emerging economies are likely to increase income inequality in old age in the long term. During the Covid-19 pandemic, lower-income households in particular were forced to tap into their retirement savings to compensate for income shortfalls due to a lack of social security. Early withdrawals left more than 4mn people in Chile and approximately 2mn people in Peru without any retirement savings. In Malaysia, early withdrawals summed up to EUR21bn at the end of 2021 and left 6.1mn EPF (Employees Provident Fund) members with savings of less than EUR2,100 in their account; 3.6mn of them had less than EUR210 in their account. The savings of the bottom 40% of EPF members dropped by -38% and those of the middle 40% declined by -18%, even as those of the top 20% of members aged below 55 increased.[2] While middle- and high-income households can benefit from the compound interest effect, low-income households could struggle to build up any retirement savings at all to close the pension gaps.

Higher interest rates could also indirectly increase unemployment: Less profitable companies that previously benefited from low interest rates will be forced out of the market due to rising debt burdens.

[1] See Holzhausen, Arne and Kathrin Stoffel (2023): Rates not roses.
[2] See Grimm, Michaela and Arne Holzhausen (2023): Wealth without pensions

While Covid-19 dealt a temporary setback in the development of life expectancy, it will have a long-term impact on private households, state budgets and pension systems. Moreover, record-low births in China, Italy and Brazil point to the possibility that fertility rates could remain permanently lower than expected and thus accelerate the aging of populations even further. In their latest World Population projections, UN demographers[3] expect the share of people aged 65 and older to rise from 10% today to 17% in 2050. In Asia and Latin America, this share is set to double from around 10% and 9%, respectively, to 19% until mid-century, while in North America as well as in Australia and New Zealand it is expected rise by around 6pps to 24%. Europe will remain the continent with the oldest population by far, with the share of people aged 65 and older set to increase from 20% to 29%. Africa stands apart from this overall trend: After remaining stable at around 3% for decades, the share of people aged 65 and older is expected to rise to a still modest 6% in 2050 (see Figure 1).

[3] Source for all demographic data used is United Nations, Department of Economic and Social Affairs, Population Division (2022). World Population Prospects 2022, Online Edition. If not indicated otherwise we refer to the medium variant. Latin America refers to Latin America and the Caribbean.