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Wealth without pensions in Asia

Capital-funded pension provision needs a shot in the arm to sustain 1bn pensioners

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EXECUTIVE SUMMARY

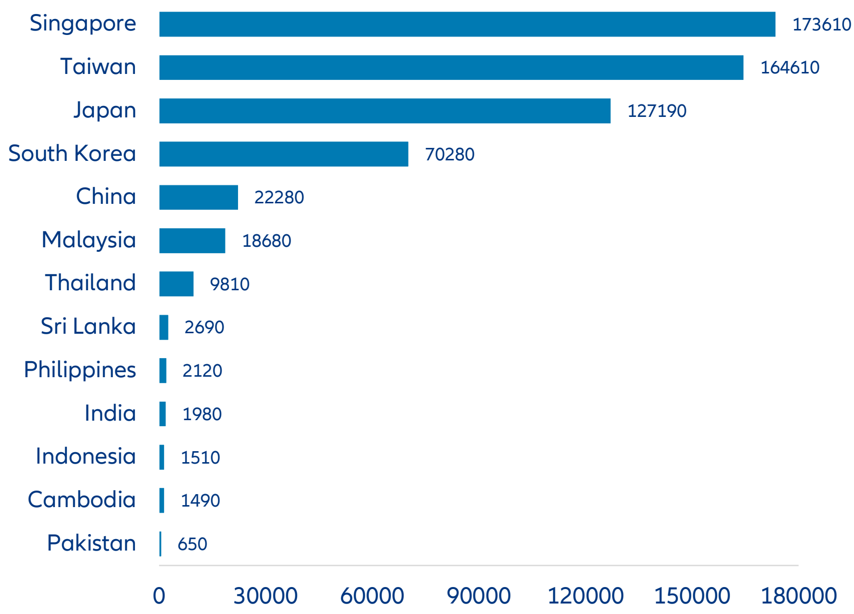
- **Total gross financial assets in Asia reached a new record high, but the share of life and pension assets in private households' portfolios kept declining.** Total gross financial assets increased by +9.4% and reached a new record high of EUR62.4trn in 2021, 25% above the corresponding figure for Europe. However, the gradual decline of the share of life and pension assets continued: Since 2008, this has dropped by 5pps to 18.4%; in Europe, life and pension assets are almost twice as important.
- **Asia's old-age dependency ratio set to more than double until mid-century.** In Europe, the same demographic shift took almost 60 years. By 2050, 1bn pensioners will live in Asia. Supplementary capital-funded pension pillars have to play an important role in emerging markets as merely pay-as-you-go or tax-financed pension systems will not be sustainable in the long run.
- **Tax-incentives and subsidies to reverse the decline in popularity of private, capital-funded pension provision are essential.** Moreover, Asia's emerging markets have to increase their efforts to improve the accessibility of financial services and financial literacy. Both are essential for building up a capital stock and private pension provision.

Gross financial assets have hit a record high in Asia, but pension assets are not keeping up.

Total gross financial assets of Asia's private households increased by +9.4% in 2021, reaching a new record high of EUR62.4trn. This corresponds to EUR16,380 per capita, compared to the global level of EUR41,890. China and Japan account for 75% of the region's gross financial assets total, with China's private households holding an estimated EUR31.8trn or 51%, while those in Japan hold EUR15.8trn or 25%. Ten years ago, the roles were reversed: Japan's private households held 45% of the region's financial assets and China's share was 30%. What has not changed is their huge lead compared to the other countries in the region. Private households' gross financial assets in the third-richest country Taiwan added up to EUR3.9trn, which corresponds to 6% of total assets, just ahead of South Korea, where they amounted to EUR3.6trn. Of the remaining countries, only India (EUR2.7trn) and Singapore (EUR1.0trn) reported gross financial assets above the EUR 1trn threshold. In the other countries, gross financial assets ranged from EUR702.4bn in Thailand to EUR24.7bn in Cambodia.

However, taking into account the population size highlights the wealth disparities within the region. In Singapore, gross financial assets per capita amounted to EUR173,610. In Taiwan, they reached EUR164,610 and in Japan EUR127,190. In South Korea, the fourth of region's mature markets, gross financial assets per capita were EUR70,280, or about 40% of the value in Singapore. China, Malaysia and Thailand make up the midfield in this ranking, with gross financial assets per capita amounting to EUR22,280, or merely 13% of the average financial wealth of a Singaporean in China; EUR18,680 in neighboring Malaysia and EUR9,810 in Thailand. In the remaining Asian countries, gross financial assets per capita were markedly below the EUR5,000 threshold. That means that even though the gap between the richest and the poorest in terms of gross financial assets per capita has almost halved since 2010, individuals in Singapore have 265 times the average financial assets per inhabitant in Pakistan. Moreover, convergence has slowed since 2019 and even reversed in 2021 (see Figure 1).

Figure 1: Gross financial assets per capita

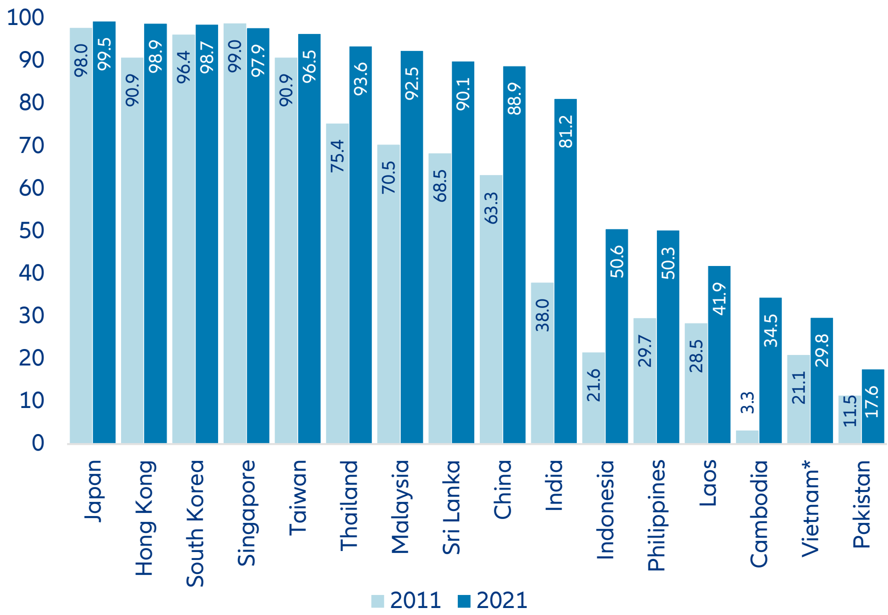


Sources: National central banks, financial supervisory authorities, finance associations and statistical offices, Refinitiv Eikon, UN population division and Allianz Research.

These marked differences in financial assets per capita explain why Asia is a region of two speeds: on one side are emerging markets, with double-digit growth in financial assets driven by backlog demand, and on the other are mature markets with less dynamic growth. In 2021, Sri Lanka and Cambodia recorded the highest growth rates, with gross financial assets increasing by +23.0% and +17.6%, respectively. China (+12.2%), India (+11.6%) and the Philippines (+10.4%) also recorded double-digit growth. In Taiwan and Thailand, gross financial assets increased by +9.5% and +9.4%, respectively, while in South Korea and Indonesia they rose by +8.6% and in Pakistan by +8.2%. In Singapore and Japan, growth was weaker at +7.3% and +4.2%, respectively. Malaysia took Japan's place and brought up the rear with +2.4%. However, while 2021 growth was still below the 10-year compound annual rate in many emerging markets, such as Cambodia, China, India, Pakistan and Malaysia, it was markedly higher in Taiwan, South Korea or Japan.

What is driving the boost in financial assets? Ongoing efforts to improve access to financial services and financial literature, which are essential for building up a capital stock, helped to boost financial asset growth in many emerging markets. Ten years ago, only the mature markets Japan, Hong Kong, South Korea, Singapore and Taiwan could boast of over 90% of the population aged 25 and older holding a financial institution account and thus having access to financial services. In 2021, Thailand, Malaysia and Sri Lanka joined the list; these countries had shares ranging between 69% and 75% ten years ago. The two most populous countries in the world, China and India, have almost closed this gap, with the share of adults that have an account at a financial institution increasing from 63% to 89% in China and from just 38% to 81% in India since 2011. In the remaining countries, the distance from the advanced economies of the region remains high despite impressive improvements: In the Philippines and Indonesia, only around half of the population aged 25 and older had access to financial services in 2021; in Cambodia, the share increased from 3.3% in 2011 to 35.5% while in Vietnam it was merely around a third. The lowest share was recorded in Pakistan, where only 18% of the adult population had access to financial services (see Figure 2).

Figure 2: Share of adults aged 25 and older having a financial institution account (in %)

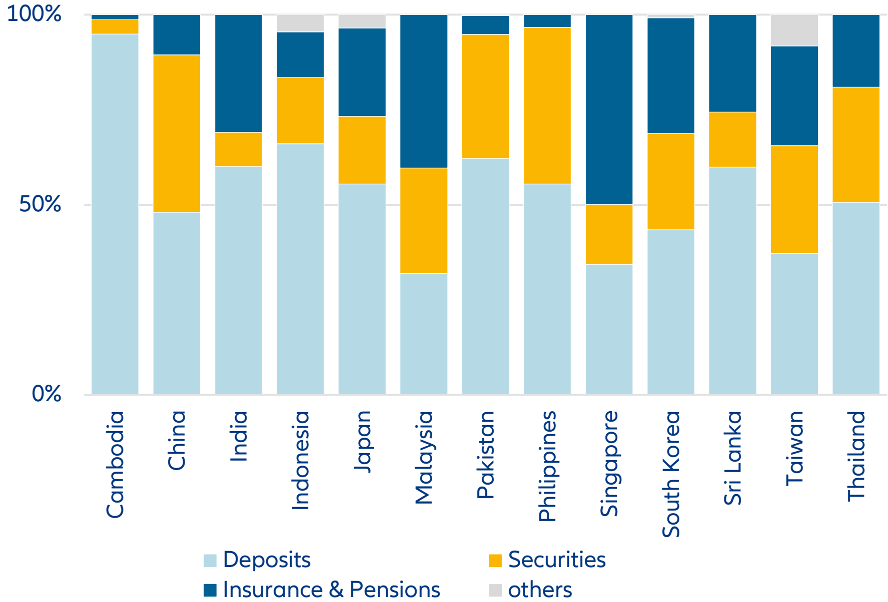


**Data refers to 2017.*
Sources: World Bank, Allianz Research.

Bank deposits are still the most significant asset class in Asia, reflecting the accessibility of financial services, the overall development state of the financial system, savings motives and the importance of capital-funded old-age provision. In Cambodia, bank deposits accounted for more than 90% of total assets, while the share was above 50% for India, Indonesia, Pakistan, the Philippines, Sri Lanka and Thailand. However, the same held true for Japan, despite its mature financial system, given its low interest rates and the weak performance of the Japanese stock market since 1990. The Nikkei only stabilized above its 2000 level in 2013 and remains below its all-time high of 1989. As a result, Japanese households have been rather reluctant to invest in life insurance and stocks over the last three decades. Only recently, have they begun to return to the stock market.[1] In South Korea and Taiwan, private households held only around 40% of their financial assets in deposits, while the lowest shares of deposits were reported in Malaysia and Singapore, which also stand out by having the highest share of insurance and pension assets. In both countries, capital-funded provident funds are the major vehicle for old-age provision (see Figure 3).

[1] *Flows into securities reached EUR42bn in 2021, which was the highest amount since 2007. Nevertheless, the bulk of the total EUR326bn financial flows, namely EUR262bn, went into bank deposits like in the past. Source: Bank of Japan.*

Figure 3: Asset structure reflects development state of financial system and accessibility of financial services

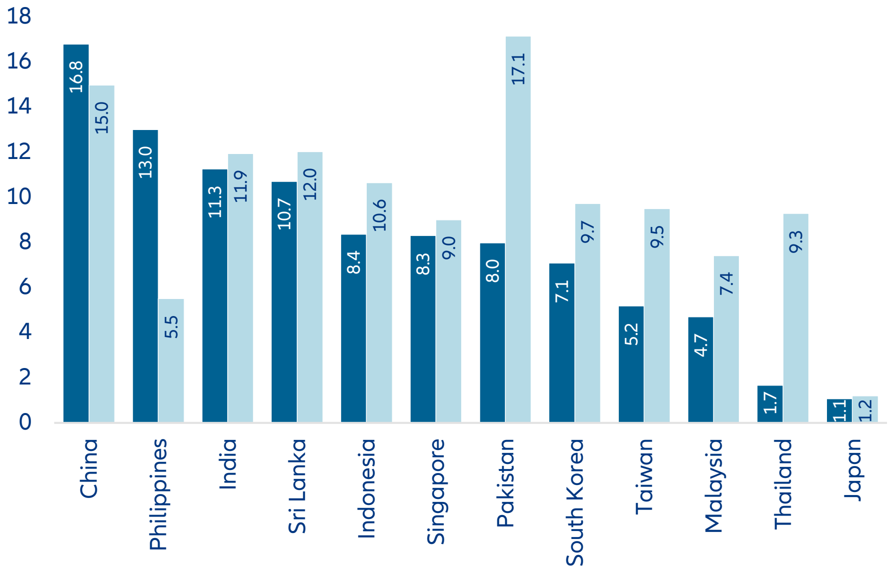


Sources: National central banks, financial supervisory authorities, finance associations and statistical offices, Refinitiv Eikon and Allianz Research.

However, in most countries, with the exception of China and the Philippines, the annual growth rates of insurance and pension assets in 2021 was below the ten-year annual compound growth rate. In fact, the share of insurance and pension assets in the portfolios of Asia's private households declined from 23.2% in 2008 to 18.4% in 2021. The Covid-19 pandemic reinforced this trend, not only because deposits were the asset class of choice as households focused on precautionary saving, but also because of state measures to ease the financial burden of the pandemic: The Covid-19 pandemic had put pension system reforms on hold – or even into reverse – in many countries. These measures included the temporary lowering of contribution rates to pension funds and public pension systems, as seen in Malaysia or China, the postponement of already agreed upon increases of contributions as in Singapore and also even the allowance of early withdrawals, as seen in Malaysia or India. As a result, the ripple effects of the Covid-19 pandemic will still be felt in decades from now, albeit to varying degrees, as it has slowed the build-up of pension assets and entitlements; poorer households will be particularly hard hit (see Figures 4 and 5).[2]

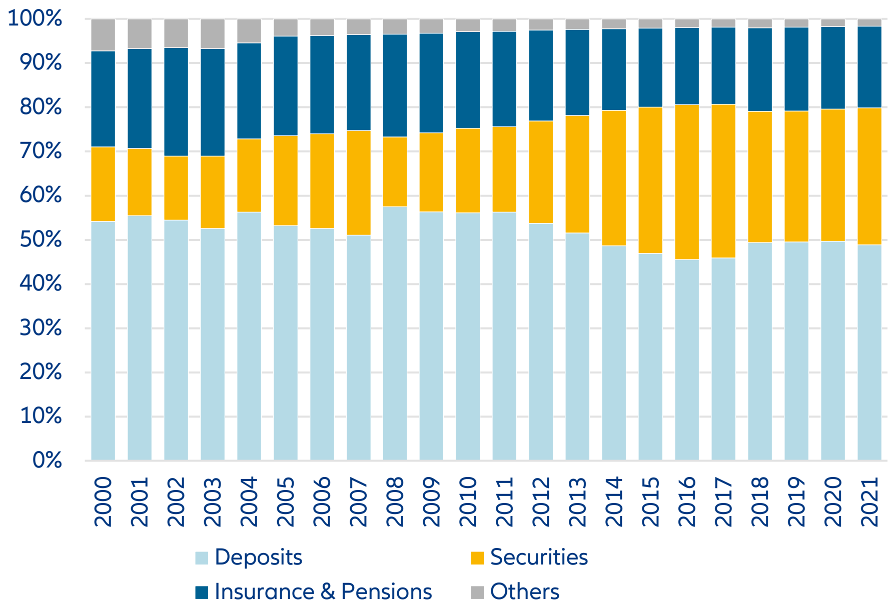
[2] *The Provident Fund Scheme was amended to allow for a Covid-19 non-refundable advance of up to 75% of members' total PF contributions or a sum of three months of their wages, whichever was less. Employees Provident Fund Organisation (2021): Response to Covid-2.0. Delivering social security through the pandemic, p. 4.*

Figure 4: Growth in insurance and pension assets slowed during pandemic



Sources: National central banks, financial supervisory authorities, finance associations and statistical offices, Refinitiv Eikon and Allianz Research.

Figure 5: Insurance and pensions lost attractiveness

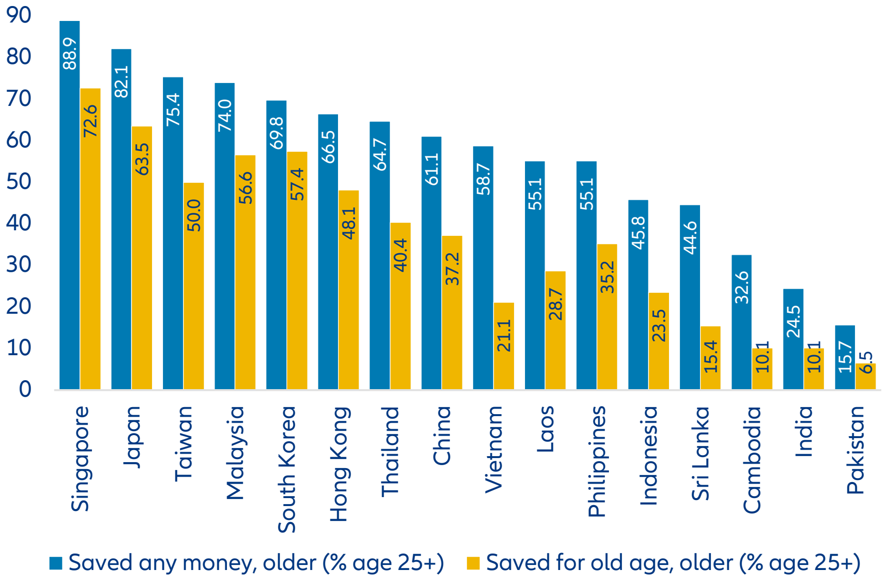


Sources: National central banks, financial supervisory authorities, finance associations and statistical offices, Refinitiv Eikon and Allianz Research.

In India, 12.1mn employment provident fund members took the offer and early withdrawals summed up to around EUR3.2bn in autumn 2021. In Malaysia, the statutory EPF contribution rate for employees was lowered from 11% to 7% from April to December 2020, and early withdrawals were allowed in 2020 and 2021; 7.4mn members made use of the offer. The withdrawals summed up to EUR21bn at the end of 2021, leaving 6.1mn EPF members[3] with savings of less than EUR2,100 in their accounts, and 3.6mn with less than EUR210. The savings of the bottom 40% of EPF members dropped by 38% and those of the middle 40% declined by 18%, while those of the top 20% of members aged below 55 increased. The EPF estimates that it will take an additional four to six years to rebuild the retirement savings that have been withdrawn during the pandemic.[4] In Singapore, the introduction of higher contribution rates for higher ages was postponed and the build-up of pension assets slowed due to increases in unemployment and lower wages. As a result, it is not only the withdrawals that will lower future pension payouts but also the lowered contribution rates that will result in lower pension entitlements.

This matters because in most countries, private households have also become less capable of saving than in the past. Compared to previous years, the share of savers was lower in 2021 in almost all markets, with the exception of Singapore, Japan, Taiwan and Hong Kong. There were also differences with respect to savings behavior and motives between the countries. In most countries, more than half of all adults aged 25 and older said they saved any money. The highest share was reported in Singapore, where close to 90% did so. In Indonesia and Sri Lanka, 45% of the adult population said they saved money, while it was merely a third in Cambodia. The lowest value was recorded in Pakistan with only 16% (see Figure 6).

Figure 6: Share of savers among adults aged 25 and older (in %)



Sources: World Bank and Allianz Research.

Asked about their savings motives, more than 70% of Singaporeans aged 25 and older said old age. This hold also true for 63.5% of the Japanese population in this age group and more than or 50% of their peers in Malaysia, South Korea and Taiwan. However, in the other countries, 40%

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[3] At the end of June 2022, this number had increased to 6.62mn members. Sooi, Cheah Chor (2022): Dire straits: 2.58m Bumiputera EPF members have less than RM1k savings, https://focusmalaysia.my/dire-straits-2-58m-bumiputera-epf-members-have-less-than-rm1k-savings/

[4] EPF (2021): EPF focused on rebuilding members' retirement savings following exceptional withdrawal facilities, https://www.kwsp.gov.my/en/web/guest/w/epf-focused-on-rebuilding-members-retirement-savings-following-exceptional-withdrawal-facilities

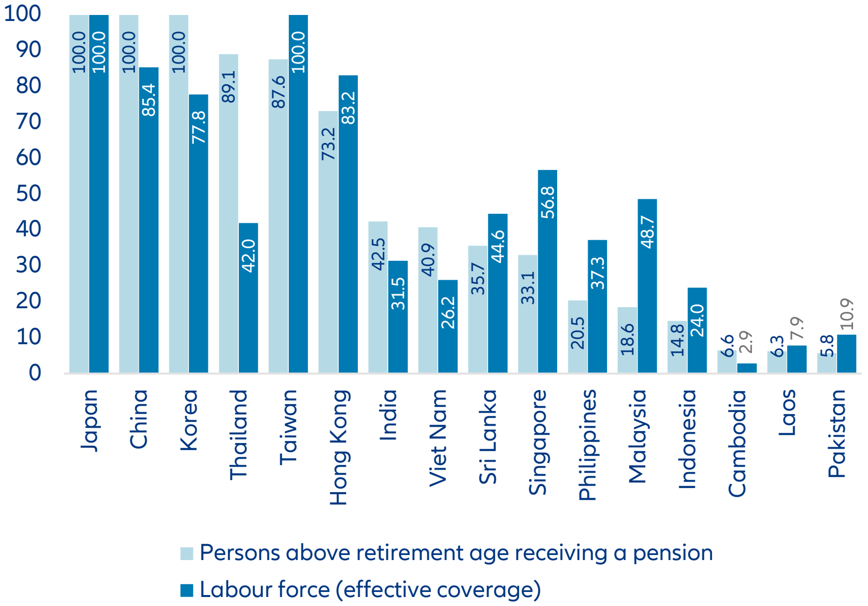
or less considered saving for old age as a savings motive. Only 10.1% in Cambodia and India, and 6.5% in Pakistan, gave it as a reason for saving.

In the context of dwindling old-age savings and rapid aging, pension reforms are urgent.

In many emerging markets, pension-system coverage is still low and the elderly depend on family support and scarce private savings in their old age. In this context, the declining popularity of life insurance and pension funds is a cause for concern, especially as Asian economies face rapidly aging populations.

According to latest available ILO figures, around three out of four persons in retirement age received a state pension in the countries we include in our analysis[5]. However, there were marked differences with regards to the coverage between the countries. While in Japan, China and South Korea, 100% were covered, and the ratio in Thailand and Taiwan was close to 90%, this held true for only a third of their peers in the other countries. Here the shares ranged from around 6% in Laos and Pakistan to just over 40% in India.[6] The coverage of the labor force population ranged between 3% in Cambodia to 100% in Japan and Taiwan. However, in October 2022, Cambodia introduced a mandatory pension system with the employer and employee sharing the current 4.0% contribution to the pension system equally, which should markedly improve coverage[7] (see Figure 7).

Figure 7: Low pension system coverage in emerging Asia (in %)



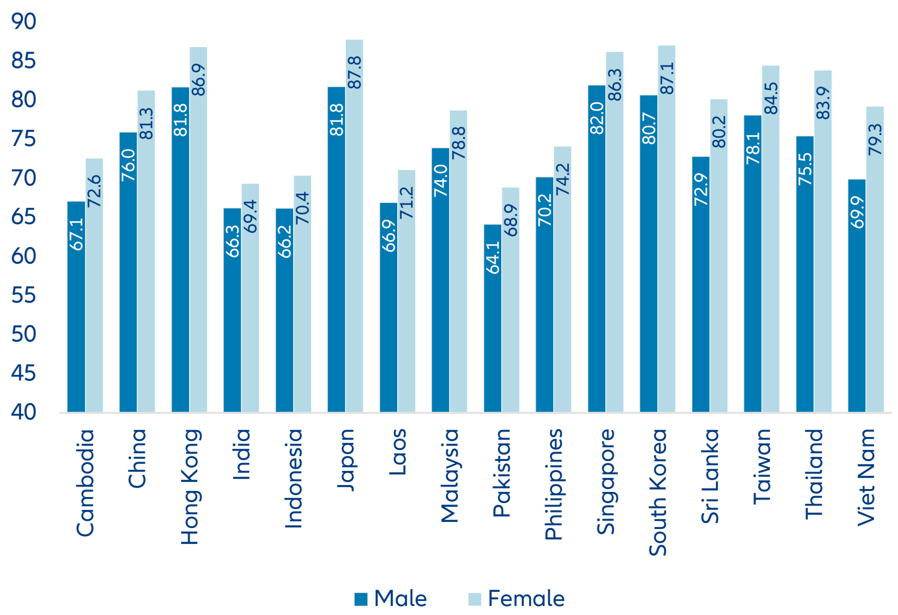
Source: ILO.

[5] *There was no data available about the development of private households' gross financial assets in Hong Kong, Laos and Vietnam.*
[6] *In Malaysia and Singapore, the Employee Provident Fund and the Central Provident Fund are the main sources of retirement income.*
[7] *Every company with one or more employees is obliged to register with the National Social Security Fund, non-registered employees must be registered within three days after the start of employment. Pensions can be withdrawn at the earliest at age 60; the necessary precondition is at least 12 months of contributions. Voluntary contributions are possible after reaching the age of 60, which can increase future pension benefits.*

The old-age dependency ratio, which expresses the number of people aged 65 and older per 100 people in working age between 15 and 64, is expected to more than double from 14.4% today to 29.9% in 2050. This demographic shift that is set to happen within one generation in Asia took almost 60 years in Europe. The double-ageing of Asia's population is the consequence of the steep decline of the average fertility rate per woman from 6.3 in 1963 to 1.9 children today on the one hand and the improvements in life expectancy on the other. The latter increased from 42.0 years in 1950 to 72.5 years in 2022 and is expected to rise further to 79.5 years in 2050, even though the Covid-19 pandemic wiped out almost a decade of life-expectancy gains. During the same period, the average life expectancy of a 65-year-old rose from around 10 years to 16.4 years in 2022 and is expected to increase further to 19.8 years in 2050. As a result, without a trend reversal in fertility, the total number of people aged between 15 and 64 years is expected to peak at 3,391mn in 2046 up from 3,173mn today, while the number of people aged 65 and older is set to more than double from 455mn to 1,004mn.

Of course, there are marked differences between the countries with respect to population dynamics as demographic change reflects medical advancements, the overall economic level and population policies of a country. The higher the overall prosperity level, the higher the life expectancy and the lower the fertility rates. In 2022, the differences in life expectancy between the countries covered in our report amounted to more than 15 years. In Pakistan, the life expectancy of a newborn boy is around 64.1 years, while that of his peer in Singapore is 82.0 years. The average newborn girl in Pakistan has a life expectance of 68.9 years, while a girl born in Japan has a life expectancy of 87.8. In fact, India is the only country besides Pakistan where the life expectancy at birth for both sexes was still below 70 years (see Figure 8).

Figure 8: Marked differences in life expectancy at birth (in years)



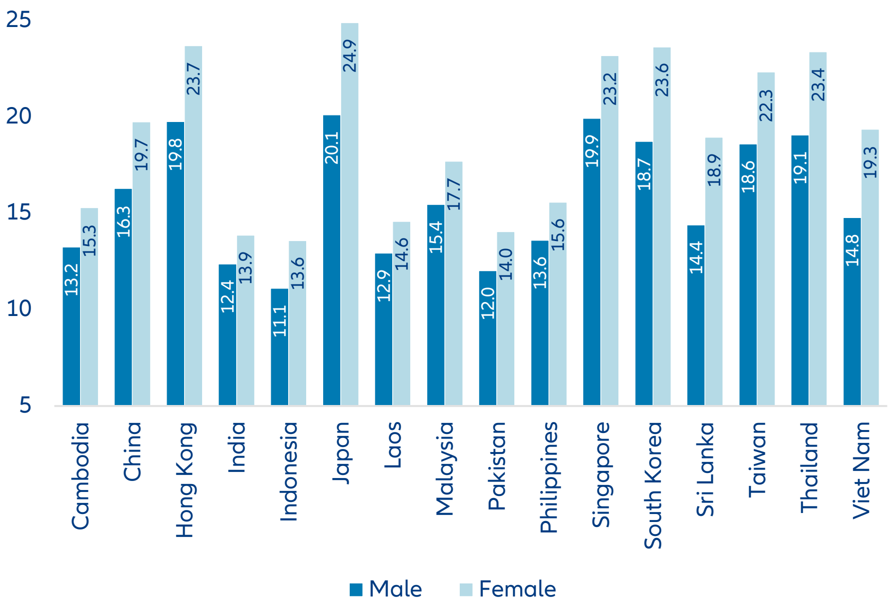
Sources: UN Population Division (2022) and Allianz Research.

The differences in the further life expectancy at the age of 65 were smaller, with Indonesia and Japan marking the lower and upper ranges. The average life expectancy of a 65-year-old male in Indonesia was 11.1 years, while that of his Japanese peer was 20.1 years. That of woman of this age was 13.6 years in Indonesia compared to 24.9 years in Japan. In Hong Kong and Singapore, an average 65-year-old man could expect to spend 19.8 and 19.9 years in retirement, while the average further life expectancy of female peers was 23.7 and 23.2 years.

At the lower end were Pakistan and India, where the average further life expectancy of a 65-year-old man was 12.0 and 12.4 years, respectively, while that of woman of this age was 14.0 and 13.9 years. The further life expectancy is also set to increase until 2050, with the upper and lower ranges then set by Pakistan and Hong Kong, where the further life expectancy of a 65-year-old man is expected to reach 13.3 years and 23.5 years and that of 65-year-old woman 15.4 and 28.1 years, respectively (see Figure 9).

All in all, in many markets, retirement ages will need to be adjusted in line with the development of further life expectancy to ease the financial burden on pension systems.

Figure 9: Marked differences in further life expectancy

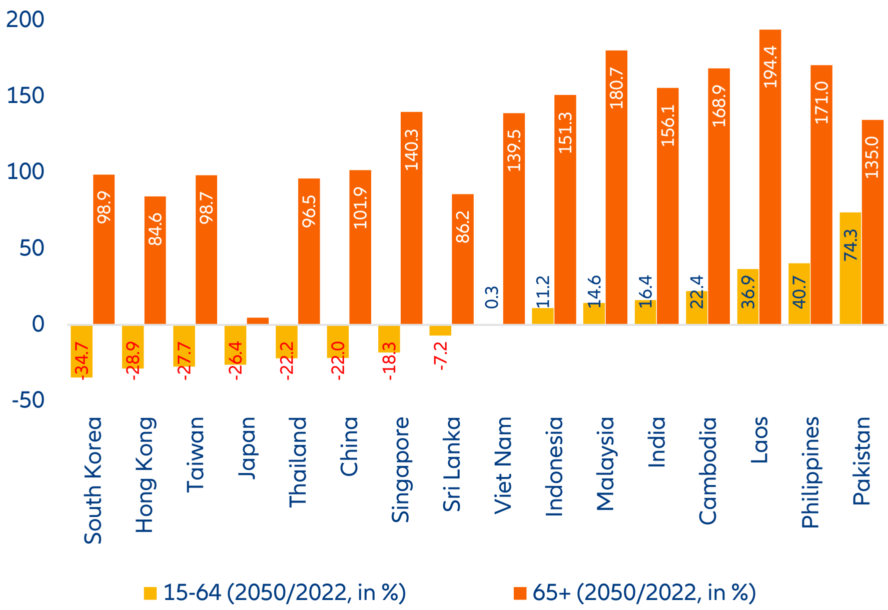


Sources: UN Population Division (2022), Allianz Research.

In Cambodia, India, Indonesia, Laos, Malaysia and the Philippines, the number of people aged 65 and older is expected to almost treble until 2050, while in almost all other countries it is set to "only" double. The exception is Japan, which has today the oldest population worldwide. In Japan, this age group is expected to grow by only around +5%. However, during the same period, the working-age population is expected to shrink by -26%. This decline will only be topped by that of South Korea, where this age group is set to shrink by almost -35%, Hong Kong (-29%) and Taiwan (-28%). Due to the decline in fertility rates below the replacement fertility level of 2.1 children per woman, Thailand and China will also have to cope with an absolute decline of their working-age population by -22%. The same holds true for Singapore, where it is expected to shrink by 18%, and Sri Lanka, albeit to a lesser extent with only -7%. In the other countries, where the fertility rates are still above the replacement fertility level or fell below it only within the last 20 years, the number of people in working age is set to increase further between 0.3% in Vietnam and 74% in Pakistan (see Figure 10).

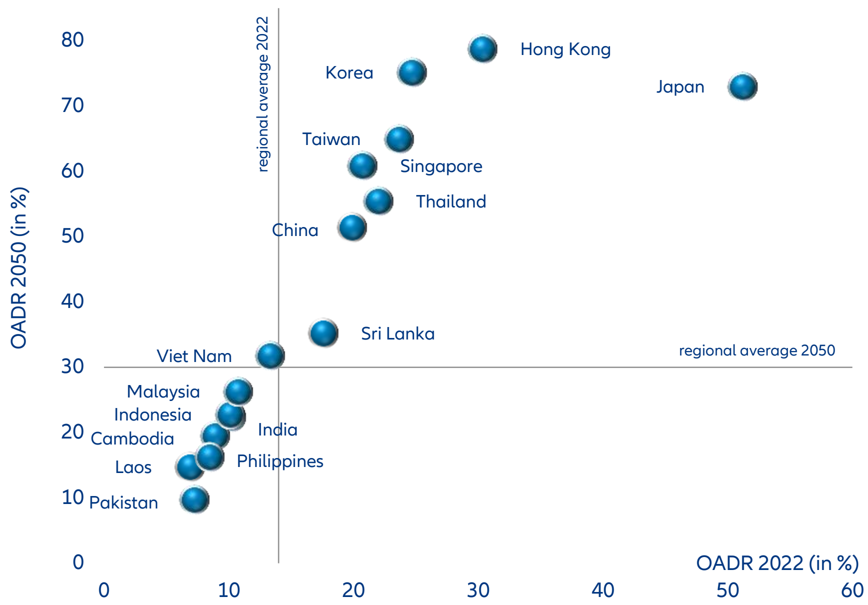
As a result, we expect a marked increase of the old-age dependency ratio (OADR) in most markets. In South Korea, Singapore, Taiwan, Hong Kong, China and Thailand, this ratio is set to treble within the next three decades, with Hong Kong and South Korea expected to overtake Japan as the markets with the highest OADR worldwide. In Hong Kong, there are going to be 79 people aged 65 and older per 100 people aged between 15 and 64; in South Korea, the ratio is expected to reach 75 to 100. In Japan, the OADR is set to increase from 51% today to 73% in 2050. In the remaining four markets in this group, the OADRs are expected to range from 51% in China to 65% in Taiwan. In the other markets, except Pakistan, the OADR is set to double, albeit at varying levels. While in Malaysia it is expected to increase from around 11% today to 26% in 2050, in Indonesia, India, Cambodia, the Philippines and Laos, the OADR will probably remain below the regional average of 29%. It is expected to rise above this level in Vietnam (31%) and Sri Lanka (35%) (see Figure 11).

Figure 10: Differing population dynamics



Sources: UN Population Division (2022), Allianz Research.

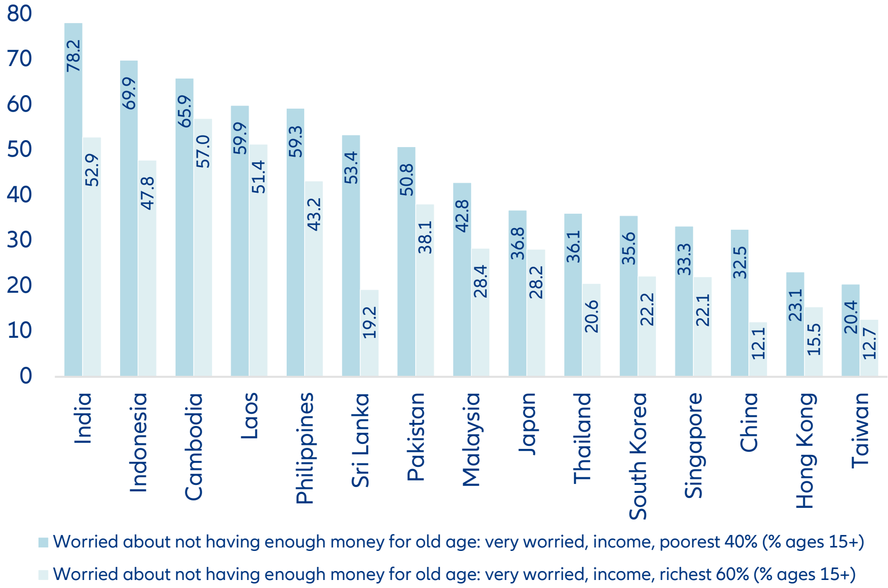
Figure 11: Rapidly aging populations



Sources: UN Population Division (2022), Allianz Research.

Besides further improvements in the accessibility of financial services and financial literacy to support capital-funded pension provision, Asia's emerging markets also need incentives and subsidies to enable lower income groups in particular to save for old age. In a recent World Bank survey, more than two thirds of the poorest 40% of the populations in India, Indonesia and Cambodia were very worried about not having enough money for old age; in Laos, the Philippines, Sri Lanka and Pakistan, the share was above 50% (see Figure 12).

Figure 12: Having enough money for old age is a major cause for concern



Source: World Bank and Allianz Research.

As pay-as-you-go- or tax financed public pension systems are strained by rapidly aging populations, reforms including increasing retirement ages and strengthening the capital-funded pillars will be essential to cushion against the decline of the working-age population and the increase in life expectancy. Against this background, tax incentives and subsidies to reverse the decline in popularity of private, capital-funded pension provision could be an important measure to make pension systems in Asia more sustainable. The launch of a pilot project to introduce supplementary private pension products in 36 cities and regions of China at the end of November 2022 is a clear sign that policy makers understand the need for capital-funded pension provision in adapting the Asian pension systems to rapid demographic change.

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

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