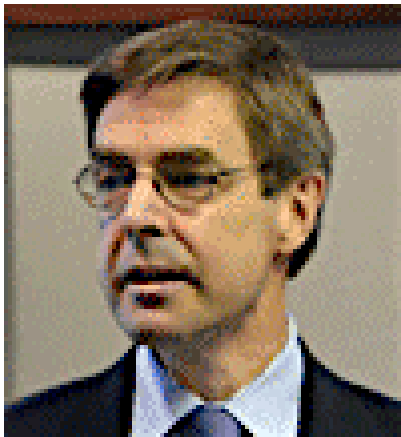


A Recession's Threat to Retirees and Near Retirees

By George A. (Sandy) Mackenzie Thu, Jun 30, 2022

A recession today could reduce a new retiree's ability to pay for assisted living or nursing care services or long-term care 20 years from now, among other effects, writes our guest columnist.



Inflation is running at close to 9%, its highest annual rate in four decades, and the Federal Reserve has increased its short-term lending rate by 0.75 basis points, the largest hike in two decades. This has already led to increases in long-term rates, like rates on mortgages.

GDP growth and the labor market remain strong, but the Fed's efforts to dampen inflation may precipitate a recession, possibly even a severe one, with a drop in GDP and an increase in unemployment.

These developments and uncertainty over the conflict in Ukraine may have serious implications for both retirees and households near retirement. That uncertainty and fears that the Fed would indeed raise interest rates contributed to the severe decline in the stock market in the first half of 2022.

Impact on households) approaching retirement

Most households preparing for retirement, with heads in the 55 to 65 age range, still rely on income from work. A severe recession could cost them their jobs at a time when households should be building up their retirement nest egg.

Wage and salary earners who had lost their jobs after age 62 might feel compelled to draw on Social Security earlier than would otherwise be ideal, particularly if another job is not found. Doing so would leave them less well prepared for retirement, particularly if they were counting on Social Security for most of their retirement income. They might also be compelled to take on additional debt.

A home equity loan, for instance, might make sense. However, declines in house prices, which are quite likely given the increase in mortgage interest rates, could reduce the collateral value of a house. In any case, increases in debt would eat into retirement savings. Unemployed people who manage to find another job might suffer a cut in pay and a loss of

fringe benefits.

Households with secure jobs could nonetheless be hurt by declines in stock and housing prices, particularly if they were relying on the sale of a house or stock to finance current or future expenditure.

The uncertain economic and financial environment would lead many households, even those with secure jobs, to rein in their expenditure on discretionary items like dining out or entertainment. This cautionary approach to spending would aggravate the recession and would

reduce employment in sectors of the economy that have not fully recovered from the effects of the pandemic.

Impact on retired households

Retired households rely for their income on a blend of Social Security, income from old-fashioned defined benefit pensions (which public sector workers are most likely to have), and 401(k) plans and other savings. Most retired households do not own significant quantities of stock, nor do they rely on the labor market for income.

However, most of them do own a home. Declines in house prices could conceivably affect their ability to pay for current expenditure, but also to afford a place on an assisted living facility, a continuing care retirement community (CCRC) or a private nursing home. The impact of a decline in house prices would hurt older retirees who can't age in place and who need services provided in assisted living facilities or nursing homes.

One of the curious effects of high inflation is that it can reduce the purchasing power even of an indexed benefit. Social Security, for example, is adjusted once a year, based on the increase in consumer prices over a period ending a few months before the adjustment.

However, the price of groceries and those of other goods and services increase continuously through the year. Consequently, the adjustment of Social Security is always trying to catch up. For example, if a load of groceries costs \$100 at the beginning of the year, it will cost about \$109 at the end of the year at the current rate of inflation. By June it will cost \$104, but the Social Security benefit will not yet have been adjusted. Consequently, its purchasing power will have declined during the year, dragging on the economy.

Retired households who do hold substantial amounts of stock might find their ability to

finance current expenditure impaired if they were planning to finance this expenditure by capital decumulation. Similarly, stock market declines would impair a move to an assisted living facility or a CCRC. They would also find their ability to pay off student debt compromised, and likewise their ability to make *inter vivos* transfers to support younger family members who had been thrown out of work.

Conclusions

The effect of the recent surge in inflation on retirees and near-retirees will depend largely on the Federal Reserve's success in curbing inflation without inducing a severe recession. Among households who are in the run-up to retirement, the most severely affected will be those who lose their jobs. They will be forced to deplete their savings rather than build them up, possibly reducing their standard of living in retirement. The more protracted any recession, the greater the likelihood of job loss and hardship for the affected households.

Retired households who are particularly vulnerable are those relying on the sale of securities to finance current expenditures, as well as older retirees who were hoping to use the equity in their homes to help pay for long-term care or accommodations at an assisted living facility or a CCRC. It bears noting that a high share of retired households will require some long-term care at the end of their lives. A protracted decline in financial markets could have grave consequences for them.

In general, most retirees can afford routine and foreseeable expenses like groceries and mortgage or rental payments. Many will be less prepared for high out-of-pocket health care expenditure or the cost of long-term care.

Mr. Mackenzie is a past editor of the Journal of Retirement and a former economist in the Fiscal Affairs Department of the International Monetary Fund.

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