Retirement of Baby Boomers in Korea and Its Impact on the Financial Market

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Abstract: The Korea's stock market continues to be depressed amid the aftermath of the global financial crisis and the eurozone debt crisis, and a growing number of baby boomers has begun to retire since 2010. Combined with aging population, this trend is expected to have a considerable impact on the financial market. Specifically, a wave of baby boomer generation's retirement would undermine savings, investment, and growth potential of the economy. The ratio of households' financial debts would rise as elderly people earn less income, widening social polarization. This would incur greater fiscal burden to bolster social safety nets to protect financially vulnerable elderly population. Similarly, in the U.S., studies have shown that the price of financial assets would fall due to aging baby boomers, and that the intense sales of financial assets by the public pension funds could severely hit the financial market. Given this, the Korean government should design preemptive measures to minimize negative impact of baby boomers' retirement on the asset markets including the stock market, and overall social safety nets. To this end, timing of the house sales should be better distributed by promoting the reverse mortgage schemes, which gives the elderly people an incentive to own a house longer, and the supply of new houses should be kept at a manageable level. In addition, securities industry should be reformed to be more competitive and the stock market should be opened up further and globalized. It would be equally important to seek new sources of profit by diversifying business activities of securities firms. Lastly, the government should redouble efforts to enhance fiscal soundness to establish and maintain strong social safety nets.

Introduction

The Korean stock market has been shrinking since 2007, and has not recovered fully from the aftermath of the global financial crisis. In particular, retailers' trading contracted sharply, and their investment share dropped from over 70% in the early 2000s to nearly 50% by the late 2000s. Adding to the pressure is a massive retirement of baby boomers that started in 2010, and the domestic financial market is undergoing changes akin to those in advanced economies. Against this background, this paper examines the impact of baby boomers' retirement on the financial market in Korea and draws policy implications.

Aging Population and Baby Boomer Generation in Korea

In Korea, population aging is swiftly on the way amid falling fertility rate and lengthening life expectancy. According to the national statistical office, Korea has entered an aging society in 2000 as the share of population aged 65 and over exceeded 7%. The same indicator is expected to rise over 14% by 2017, ushering in the era of an aged society. After that, population aging will gain even greater traction as baby boomers become 65 years old in 2020, pushing Korea into a super-aged society with more than one-fifth of the population aged 65 and older.

Baby boomers are those born between 1955 and 1963 in Korea, accounting for 14.6% of the population, or some 7.12 million people. Until now, they have made immense contributions to the national economy, pushing up income, savings and investment, as a backbone of the economy. As they retire in a large number, the pool of labor force will decline, and the economy would slow down with greater welfare burden.

According to a report by the national statistical office, Korean households' financial assets and liabilities peak at the age of 50 through 59, and both begin to decline afterwards. As the share of elderly population rises, the income level goes down and debts grow faster than assets. In other words, it is increasingly more likely that Korean households' savings and net assets will shrink while debts expand as baby boomers leave the labor market.

Unfortunately, in many cases, Korean households are poorly prepared for post-retirement living, and the social safety nets are often not strong enough to support low-income elderly people. The 2011 survey by the Korea Insurance Research Institute (KIRI) showed that people needed 60% of the pre-retirement income to maintain the standard of living after retirement, but in reality, they had savings capacity to keep the income level at merely 40% of the pre-retirement level.

Meanwhile, the growing income inequality would threaten the livelihood of retirees. The coffer of the national pension is expected to be deplete by 2060, and the government's fiscal burden will rise to manage social safety nets of public pension, medical expenditure and so forth.

The Impact of Baby Boomers on the Economy and Financial Market in Korea

Researchers have come up with methods to analyze the impact of baby boomers' emergence and retirement on the financial market and overall economy, notably, with the life-cycle investment hypothesis and the life-cycle risk aversion hypothesis. According to the former, a person's needs for property and financial assets change over time. Specifically, people in their 20s and 30s form a family and invest most of their income into buying a house, affecting property prices. By comparison, the elderly generally prefers more liquid assets, thus affecting price of financial assets. The life-cycle investment hypothesis associates the housing price rise in 1965-80 and the stock market boom in the 1990s in the U.S. with the emergence of baby boomer generation. Baby boomers that were born in the post WWII-era began to form families and heavily invested in purchasing homes, causing a price spike in subsequent years. As the baby boomers became middle-aged and their income peaked, the stock market boom ensued in the 1990s. Also during the 1990s, the number of population aged 65 and over increased, which led to less housing needs and more investment in financial assets.

Meanwhile, according to the life-cycle risk aversion hypothesis, people become more risk-averse as they age.[1)] But, at the same time, their expectations for a higher return on risky assets rise. In other words, as population aging advances, risks inherent in risky assets will be overestimated, and accordingly, investors will demand higher returns, leading to a price fall of risky assets.
The growing preference for safe assets can be explained by changes in income. A person's income is largely divided into labor income and asset income, to be spent, saved or invested. Investment in financial assets usually yields a relatively high return, but it harbors risks of loss. Once a person retires, labor income drops sharply, and the total amount of expected labor income declines with time. Thus, in case of financial loss, it becomes harder to recover and regain resources to maintain the standards of living.

Earlier studies show that the savings rate in the U.S. has steadily decreased since 2000, and the savings rate in 2030 is estimated to be half the level in 2000. After retirement, baby boomers would sell stocks and bonds to cover living expenses. If the market fails to absorb the massive sales of financial assets, their price might take a nosedive.

In the U.S., for now, welfare schemes have greater revenue flow than disbursement, but the revenue is likely to sharply fall from 2020. Moreover, if pension funds sell off assets to pay for pension benefits, the financial market might be hit hard. In the mean time, financial assets are heavily owned by the wealthy people. In the U.S., the richest 10% of the population held 90% of stocks and 70% of financial assets in the 1990s. Since they have sufficient money to cover post-retirement living expenses, they have less incentive to sell their assets right after retirement. In this regard, some argue that baby boomers' retirement would not swamp the financial market with sales of assets. However, at some point, they should dispose of their assets in one way or another, and the price of financial assets will be affected accordingly.

Massive Retirement of Baby Boomers in Korea and Changes in Financial Market

Since the 2008 global financial crisis, Korea's housing market and financial market have not made a full recovery. The recovery is being further de-

1) Poterba, J. M. Population Age Structure and Asset Returns: An Empirical Investigation, NBER Working Paper No. 6774, October 1998.

layed by the recent downward adjustment of economic outlook. Additionally, baby boomers began to retire in a large number from 2010, and the trend is likely to last for the

time being. Under this circumstance, it is critical to formulate policies to minimize a negative impact of the baby boomers' retirement on the housing market, stock market, and social safety nets.

The first task is to stabilize the housing market. As the working-age population shrinks, economic growth would be dragged down, and as people sell houses, housing price is unlikely to rise in the near future. In terms of y.o.y housing price change, the rate dropped from 11.6% in December 2006 to a zero six years later. In March 2013, the rate recorded a negative figure of –0.7%, reflecting the downward movement of house price.

The housing demand is likely to further shrink, while the supply increases. In the long run, it will be necessary to further promote reverse mortgage schemes to better distribute the timing of house sales and keep a supply of new houses at a manageable level.

The second task is to revitalize the stock market. Stock transactions have markedly fallen since 2007, mainly led by retail investors. In securities market, the growth rate of stock transactions recorded 37.2% between 2003 and 2007, but the rate fell to 6.2% between 2007 and 2011. Similarly, the amount of stock transactions slid by 29.7% between 2011 and 2012 from KRW1,702 trillion to KRW1,196 trillion. Furthermore, in the first three months of 2013, the amount recorded KRW244 trillion, a drop of 33.2% from the same period last year.

According to a 2012 survey on Korean households' finance and welfare, a baby boomer household had assets worth KRW394.1 million on average, with KRW54.1 million in financial assets, accounting for 13.7% of the entire wealth. Among the baby boomers, 42.7% dispose of their financial assets to cover living expenses, and from this, it can be estimated that assuming 7.12 million baby boomers form two-member families, the 3.56 million households can sell as much as KRW82 trillion of financial assets to cover living expenses.[2)]

A study by Miles[3)] showed that a massive retirement of baby boomers would cut investment in financial assets and lower interest rate, and estimated that the effective interest rate in Europe in 2030 would be approximately 10% lower than in 1990. In comparison, Korea's sovereign bond yields fell from the 5%-range in 2008 to the 2%-range lately. After the global financial crisis, low interest rate environment has become prevalent around the world to stimulate the economy, and with the retirement of baby boomers, the trend is unlikely to turn around anytime soon.

A combination of these factors—shrinking savings and investment by baby boomers, sales of financial assets, persistent low interest rate environment—would delay recovery of the stock market and hinder further development of financial markets. In the long term, it would be critical to sharpen competitive edge of securities industry through restructuring and globalize the securities market, and securities firms will have to diversify businesses to seek new sources of profit.

Lastly, measures should be sought to maintain social safety nets. As the population ages fast, income divide and social polarization would deepen. As the revenue of social insurance, national pension and tax declines and public expenditure increases, there will be greater fiscal burden to uphold social safety nets for the low-income elderly population. The Ministry of Health and Welfare reported that the funds of the national pension would steadily expand and peak at KRW2,561 trillion in 2043, but begin to shrink fast afterwards, and possibly depleted by 2060. Given this, it will be essential to take a preemptive measure to maintain financial soundness of the social safety nets.

2) If 42.7% of the 3.56 million households, or 1.52 million households, dispose average KRW54.17 million of financial assets, the total amount reaches KRW82.3 trillion.
3) Miles, D., "Modelling the Impact of Demographic Change upon the Economy", *Economic Journal*, 1999.