BETTER FINANCE ALERT

European savers are set to lose hundreds of billions of euros in purchasing power in 2022 alone

2 May 2022 | Financial repression poses a major problem for the protection of savers: policymakers must act and stop using savers' cognitive biases to their detriment.

Facts | On average, over the last 30 years, annual increases in consumer prices ("inflation") have averaged +2% for the euro area[i], a historically very low level. Nonetheless, this means that the real value (purchasing power) of all long-term or pension savings has almost halved since 1992.

Since last year (2021) it is getting much worse, with a sharp rise in inflation, and with real interest rates (= nominal minus inflation) even deeper in negative territory.

For example, French retail investors in capital-guaranteed life insurance contracts lost about €43 billion in purchasing power (real return) in 2021 alone. [ii] However, French annual inflation was +3.4% in 2021, but +5.1% at the end of March 2022.

Similarly, in Belgium, savers in bank savings accounts lost an estimated 22 billion euros in purchasing power in 2021 alone. [iii] However, Belgian annual inflation was +6.6% in 2021, but +9.3% at the end of March 2022. [iv]

BETTER FINANCE estimates that the losses in real terms will be well over 100 billion euros for French savers alone in 2022.

… But not disclosed to EU savers | Providers, distributors and even public authorities very rarely disclose the returns of long-term savings products in real terms (net of inflation).[v] This is hardly surprising since none of the existing investor protection rules require the disclosure of real performances, i.e., "net of inflation".

Regulatory requirements do not take inflation into account and thus exacerbate the damage suffered by pension savers | Furthermore, existing rules of conduct do not require taking into account the risk of inflation and its exponential negative impact in the long-term on the real value of savings, nor warning people about this risk either.

This is particularly detrimental to savers since behavioural finance has clearly shown that savers suffer from cognitive biases such as "money illusion" and "exponential growth bias". Due to the *money illusion*, people tend to view their wealth and income in nominal terms, rather than recognising their actual purchasing power, i.e., their real value, adjusted for inflation. [vi] *Exponential growth bias* is the tendency of people to underestimate the effects of compound interest. For savings and investments, this means that people tend to overestimate their purchasing power. [vii]

As Guillaume Prache, Managing Director of BETTER FINANCE, said: *"For a decade (even in an environment of historically low inflation), BETTER FINANCE has been warning about the very negative impact of inflation on retirement savings, compounded by the lack of any mandatory disclosures or warnings.*

With inflation soaring dramatically since 2021, it is high time that Public Authorities at least require disclosure of real returns on long-term savings alongside "nominal" (and therefore largely fictitious) ones, and lead by example in their own public reports. Member States should also stop de facto taxing the loss of purchasing power of their long-term savers."

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[i] https://tradingeconomics.com/euro-area/inflation-cpi
[ii] https://www.faider.org/communiques
[iii] https://www.lecho.be/monargent/epargne-et-placements/epargne/les-epargnants-belges-perdent-22-milliards-d-euros-de-pouvoir-d-achat/10356967.html.
[iv] https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=prc_hicp_manr&lang=en
[v] There are some exceptions, such as the OECD (see for example pp. 28-29 of https://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-2021.pdf) and BETTER FINANCE (see for example https://betterfinance.eu/publication/real-return-of-long-term-and-pension-savings-report-2021-edition/).
[vi] Darriet, E., Guille, M., Vergnaud, J. C., & Shimizu, M. (2020). "Money illusion, financial literacy and numeracy: Experimental evidence." *Journal of Economic Psychology 76*, 102211; Cohen, R. B., Polk, C., & Vuolteenaho, T. (2005). "Money illusion in the stock market: The Modigliani-Cohn hypothesis." *The Quarterly Journal of Economics*, 120 (2), 639-668; Shafir, E., Diamond, P., & Tversky, A. (1997). "Money illusion." *The Quarterly Journal of Economics* 112 (2), 341-374.
[vii] Levy, M., and Tasoff, J. (2016) "Exponential-Growth Bias and Lifecycle Consumption", *Journal of the European Economic Association*, 14 (3), 545–583, https://doi.org/10.1111/jeea.12149; Stango, V. and Zinman, J. (2009), "Exponential Growth Bias and Household Finance",. *The Journal of Finance*, 64: 2807-2849. https://doi.org/10.1111/j.1540-6261.2009.01518.x; Almenberg, J., and Gerdes C. (2012), "Exponential growth bias and financial literacy", *Applied Economics Letters*, 19 (17), 1693-1696, DOI: 10.1080/13504851.2011.652772