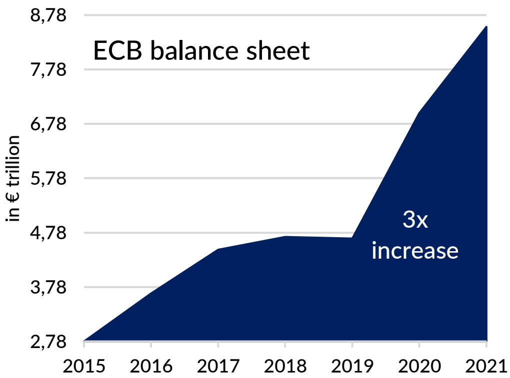
EU Pensions seem doomed with 'Financial Repression' as the only game in town

Eurozone inflation mushroomed from 3.4% to 10% in one year,[1] further deepening Europe's cost-of-living crisis, yet the best the European Central Bank (ECB) could muster is a late and timid hike of interest rate from 0 to 0.75%. Financial repression policies in place since the crises of 2008 and 2009 are being tightened further in an effort by governments and central banks to address the ballooning debts of the Eurozone economies, with seemingly no consideration for European citizens and the destruction of the purchasing power of their pension savings. So, why does 'Financial Repression' remain the only game in town?

INFLATION MYTHBUSTERS

Smoke & Mirrors | More than a reaction to short-term economic and political triggers, inflation is a monetary phenomenon, currently enabled by the unprecedented increase of the money supply by the ECB: its balance sheet tripled between 2015-2021 to reach €8.6 trillion.



From risk to reality | Inflation is generally presented as a *risk*, although its long-term and persistent presence proves it to be a **reality**: except for 2014 and 2017, the last three decades have seen inflation eroding the real value of income and savings year after year.

Not a negligible amount | Maybe we generally don't notice it, but over the last 30 years inflation halved the purchasing power of money. In other words, it's not a phenomenon we can easily ignore of absorb.

No fair play | National fiscal policies levy tax on nominal investment profits, which in many cases are fictitious given that, in real terms, these are negative, and thus shouldn't be taxed. This phenomenon intensifies the negative effects of inflation on savings.

Unknown & invisible enemy | Non-professional savers and investors are **fully unaware** of the effects inflation has on savings and investments, mostly because inflation is swept under the carpet and veiled behind cognitive biases.

Reporting requirements, especially those mandated by EU law, do not require any kind of disclosure or warning that factor in inflation. The obligatory risk indicators do not take inflation risk into account, nor do the prominent warnings on investment products include inflation, and past performance reporting (if this will even remain a thing) never disclosed **real returns**.

At the same time, households are subject to two biases: money illusion - the tendency to think of currency in nominal terms, as if its value will never decrease - and exponential growth.

FROM INFLATION TO FINANCIAL REPRESSION

What is financial repression | This is how economists call the public policies channelling savings to government coffers and ensuring that nominal interest rates are kept below or much below inflation rates.

Financial repression is not a new game | It has been used to inflate away debt on several occasions in the post-war era and has become a cherished tool among politicians and policymakers, thanks to its covert capacity to reduce debt and pass it on to future generations, whilst supporting high levels of spending.

[1] The 3.36% represents September 2020 – September 2021, and the 10% is the estimate for September 2022.

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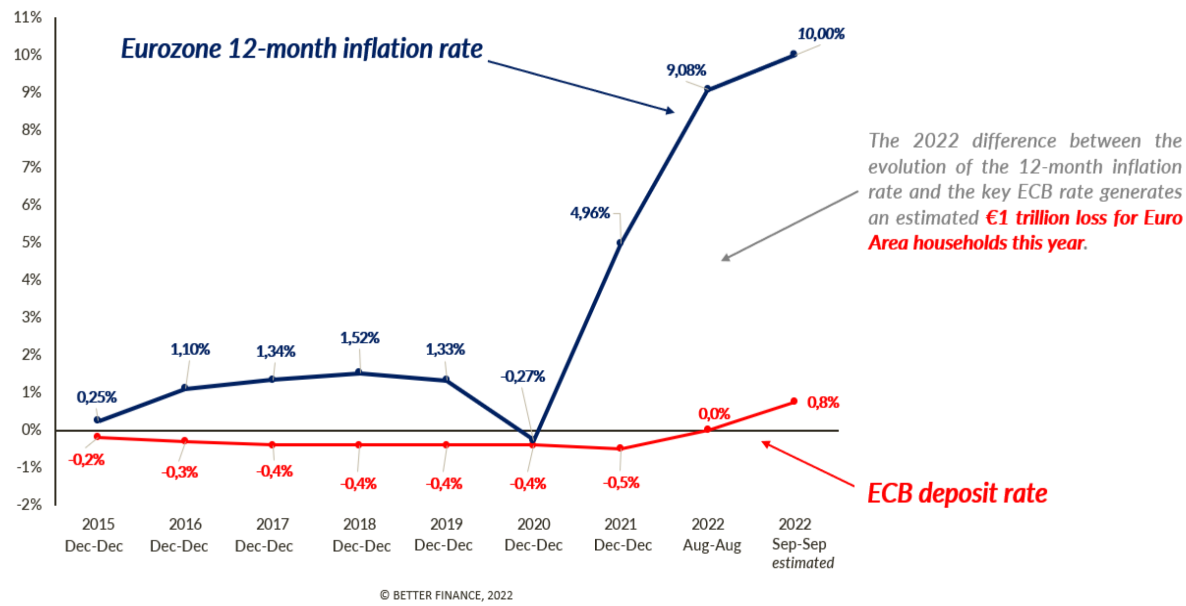
Financial repression 2.0 | We have been living through a new era of financial repression since more than a decade now. Working its magic through quantitative easing, key policy rates, inflation and the forced inclusion of sovereign bonds in households' long-term portfolios, financial repression is beating record after record, with the latest peak recorded in 2022. A conservative estimate by BETTER FINANCE puts losses for Eurozone savers at more than €1 trillion (that's €1,000,000,000,000), since the majority of their savings are linked to nominal interest rates.

2022 "FINANCIAL REPRESSION" of Euro Area financial savers



Source: BETTER FINANCE, 2022

WHAT TO DO?

Start with fair disclosures | Inflation risk must feature in the mandatory "risk" indicators for retail investment products and a prominent warning should be included in pre-contractual disclosures for consumers. At the same time, actual cost and past performance must be re-introduced so that savers can compare nominal net and real net return, waking savers up to the hugely damaging impact inflation has on their savings.

Distribution rules | Whether advisers or sellers of financial products, distributors in general should inform and educate their non-professional clients about inflation. Furthermore, when advisers undertake a suitability assessment (same for sellers and appropriateness evaluations), the knowledge and experience of the client should also cover the understanding of the exponential impact of inflation on returns.

ESAs to lead by example | The annual cost and past performance reports of the products supervised by the European financial supervisory authorities (EIOPA and ESMA) should take into account the risk and negative impact of inflation by increasing awareness and education, and provide, where relevant, both the nominal return of long-term saving and investment products, as well as the actual return in real terms (net of inflation).

THE REAL RETURN

Every year BETTER FINANCE compiles the returns of private long-term and pension savings. This year, in its 10th edition, the impact of inflation and financial repression is addressed at length. [You can find the report here.]

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