Ageing and financial stability

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Abstract: Although the precise details are subject to major uncertainty, it seems likely that the process of population ageing will involve major shifts in financing, which may give rise to financial turbulence and systemic risk. The locus and scale of these effects will also depend on the predominant approach to retirement income provision. It is argued that the financial-stability risks arising from continuing with unsustainable pay-as-you-go systems would be more threatening than those arising from funding. Fiscal crises can have incalculable consequences for private financial markets, while pension funding involves more an adaptation by regulatory authorities to a more securitised and institutionalised financial system, that is likely to develop in any case. Concerning policy, for social security, the key issue is reform, so that the fiscal difficulties and their consequences for financial stability foreshadowed above do not arise. For institutional investors involved in funding, policy issues arising include the need for prudent person asset regulation, absence of guarantees generating moral hazard and international diversification of institutional portfolios, so that they are less dependent on the performance of the domestic economy than would otherwise be the case. Banks would not be immune to the side-effects of the various patterns ageing will generate, and an awareness of such risks as well as firm prudential supervision is essential to both institutions and supervisors.