Pension assets EUR 199.6 billion at the end of March 2018

The net investment assets decreased slightly during the first quarter of 2018. The previous time investment assets fell was exactly two years ago, or the first quarter of 2016. Stock markets experienced occasional turbulence owing to greater inflation expectations and the threat of a trade war between the United States and China. Thanks to extensive diversification among various asset categories, investments were protected against a greater fall. However, in the bigger picture, investment assets have risen fairly steadily for many years in succession, thanks to wide diversification, the central banks' easy monetary policy, the acceleration of global economic growth, improved employment and, consequently, good corporate earnings.

The role of pension funds will grow in the future as pension assets and the returns on their investment will be used increasingly often to finance pensions. At the level of the entire pension system, contributions have been insufficient in recent years to cover pension expenditure. The difference is financed by investment assets and their returns.

1. Pension assets declined by EUR 0.3 billion during the quarter

- Pension assets in total: EUR 199.6 billion.
  - Pension assets in the private sector: EUR 125.8 billion.
  - Pension assets in the public sector: roughly EUR 73.8 billion.
- Decrease during the quarter: EUR 0.3 billion.
- Investments in equities and equity-like instruments accounted for EUR 106.3 billion, or 53.2 per cent of all investment assets.
- Fixed-income investments: EUR 76.7 billion, share 38.5 per cent.
- Real estate investments: EUR 16.5 billion, share 8.3 per cent.
- Returns on investments for the first quarter: -0.4 per cent nominally and -0.6 per cent in real terms.

Pension assets decreased slightly during the first quarter of 2018. The last time the investment assets decreased was exactly two years ago. Occasional market turbulence, as well as fluctuations in the value of investments, are characteristic of the financial markets. The main reason for this – albeit very slight – decline was the turbulence on the stock market. The bond market was also windy at times. Especially the fear of rising protectionism caused uncertainty among investors. This was visible as a decline on the stock market.

The increase in inflation expectations in the United States, stemming from tax cuts, also caused concern for investors. This was seen as a general rise in interest rates, which had a negative effect on the market values of fixed-income investments. As interest rates rise, the value of fixed-income investments falls, and vice versa. The stock market responds to rising interest rates by declining. The higher the interest rates are, the more attractive are the future expected returns on fixed-income investments. This, in turn, encourages investors on certain stock markets to shift their assets to fixed-income investments. Apart from investors, the central banks also follow the development of inflation closely. The higher the rate of inflation is, the more seriously the central banks must consider the tightening of monetary policy. In consequence, the stimulating effect of monetary policy on the economy decreases. Stock markets usually respond negatively to shrinking stimulation – especially in a situation where monetary policy is tightened faster than expected.

During the quarter, the share of equities and equity-like investments rose from 53.0 per cent to 53.2 per cent of all investment assets. In contrast, the share of fixed-income investments declined from 38.7 per cent to 38.5 per cent. The share of real estate investments remained virtually unchanged.

During the quarter, the shares of investments in the various regions remained practically the same as before. However, the share of Finland diminished by about 0.6 percentage points. The assets were broken down as follows: Finland 24.9 per cent; the rest of the euro area 19.6 per cent; and countries outside the euro area 55.5 per cent. Changes in the relative shares of investments are affected by net flows – that is, the difference between purchases, sales and maturities. Value changes also have an impact. More information about investments in Finland is available in the blog *Eläkevarat ovat hyödyttäneet Suomen taloutta kautta aikojen* [in Finnish].

In the first quarter of 2018, the returns of the six largest operators for each investment category were as follows:

- Average returns on equity investments: -1.4 per cent in nominal terms and -1.6 per cent in real terms;
- Corresponding average returns on fixed-income investments: 0.0 and -0.2 per cent, respectively;
- Average returns on real estate investments: 1.0 and 0.8 per cent, respectively.

The trend of returns on pension investments should be examined over the long term; changes occurring during one quarter – or even during one year – are not of major importance to the financial sustainability of the pension system. On the other hand, future returns cannot be predicted on the basis of past returns. Over the long term, in the end, pension assets increase in step with economic growth and inflation.

Selection of the examination period also affects how the returns realized appear in the medium and long term:

- 2013–2018Q1 (about 5 years): 6.3 per cent in nominal terms and 5.6 per cent in real terms
- 2008–2018Q1 (about 10 years): 4.6 per cent in nominal terms and 3.1 per cent in real terms
- 1997–2018Q1 (about 21 years): 5.9 per cent in nominal terms and 4.3 per cent in real terms

Pensions are financed not only by pension contributions but also by investment assets placed into funds and the subsequent returns. Already since 2014, pension assets have been reduced by the fact that the pensions paid out of the funds and their returns have exceeded the sum of pension contributions placed into the funds. For instance in 2017, according to preliminary data, the entire pension sector collected EUR 2.2 billion of pension contributions into funds, while the sum taken out for pensions paid amounted to EUR 4.0 billion. This means that the net sum used for pensions from funds and their returns totalled EUR 1.8 billion.

In the coming years, pension funds will be used in a controlled manner increasingly often to finance pensions, in order to meet the continually rising pension costs as the population ages. Then the pension funds and their returns on investments will help to reduce the pressure to raise pension contributions. The rule of thumb is that a change of half a percentage point in the long-term average returns has an effect of one percentage point on pension contribution income. If the returns decrease by half a percentage point, there will be pressure to raise the pension contribution by one percentage point, and vice versa. This, in turn, affects the pension contributions of companies and wage-earners and, in the end, their income in hand. Ultimately, fiscal sustainability is ensured by the development of employment, the sum of wages and salaries, and fund returns, as well as by the birth rate. More information on this subject is available in the study published by ETLA (ETLA Working Paper 57).

Pension insurers' solvency has remained strong. At the end of March, the solvency ratios of the four largest pension insurance companies ranged between 124.7 and 132.2 per cent. Correspondingly, the solvency position ranged between 1.6 and 2.3. No major changes took place in the solvency ratio or solvency position during the quarter. Thanks to these buffers meant for rainy days, pension insurers are able to withstand occasional worse times on the financial market.

2. The rise in protectionism had a negative effect on pension insurers' investment returns

President of the United States Donald Trump announced in March that import tariffs on steel and aluminium would be raised. This protectionist measure is intended to protect American companies in the raw materials sector from foreign competition. The idea is to increase domestic production in the steel and aluminium industries. Thereafter, especially China began to raise the stakes with the United States by imposing higher tariffs on various imported products. Europe and other countries have also been in the line of fire. Earlier in the year, the United States had already imposed other increments on tariffs, but these were not equally significant. Some emerging signs of protectionist actions have already been visible for a long time. Nor have they only concerned measures taken by the United States.

According to different views, there are many reasons behind the current trade policy pursued by the United States. It has been assumed that President Trump is fulfilling his election promises to his voters, some of whom have suffered from the effects of automation, robotization and globalization, and from the transfer of production to countries with a lower cost level. On the other hand, according to some views, Trump is tired of the situation where China, in particular, has gained extra benefit for its economy by copying American technology, by breaching intellectual property rights (such as patents and copyright) and by keeping its currency at an artificially low level in relation to its trading partners.

Trump and his administration may in fact have deeper motives: the intention may be to destabilize China's role in both trade politics and world politics. The United States and many other countries, such as EU Member States, want China to play with the same free trade rules as other countries. The large trade deficit the United States has with China has also been a pivotal issue in Trump's comments. The United States imports many more goods and services than it exports to China. The relationship between the two world powers is not limited to trade in goods; China is a major buyer of U.S. government bonds.

In the big picture, protectionism – if realized – may have severe adverse effects on the world economy and on the confidence that economic actors, such as companies and consumers, have in the future. In its World Economic Outlook for April, the International Monetary Fund (IMF) made calculations to express its concern over the negative effects of protectionism on the world economy. A rise in uncertainty is always poison to economic growth. In addition, it means that the relative competitive advantage developed by various countries cannot be utilized fully and freely, owing to trade restrictions.

Movements on the market are also reflected in Finnish pension assets, which are invested in a decentralized manner on various continents and in different investment categories. This was seen in the investment returns gained by pension providers during the first quarter. For all major actors, the figure was negative. For instance, quoted shares brought in a result of -1.4 per cent. For a small and open economy, such as Finland, it would also be harmful if the world economy showed signs of a downturn. This is directly reflected in the export earnings and profitability of Finnish companies, and will ultimately be seen in the prices of company stock. The decline in world trade would have a negative impact on both investment assets and Finland's employment figures. The development of employment, in turn, plays a key role in the financial sustainability of the earnings-related pension system. It remains to be seen how far the United States and China are ready to go in their one-upmanship.

3. Basic facts about our investment statistics

Our member organizations are responsible for investing the statutory earnings-related pension assets. The statistics cover the pension insurance companies, the TyEL funds of industry-wide pension funds and company pension funds, as well as the public-sector earnings-related pension providers: Keva, the State Pension Fund (VER), the pension liability fund for employees of the Social Insurance Institution (Kela), the Church Pension Fund (KER) and the Bank of Finland's Pension Fund (SPERA). Also included is the group of specialized pension providers, which comprises the Farmers' Social Insurance Institution (Mela) and the Seafarers' Pension Fund (MEK).

The statistics only cover the statutory earnings-related pension assets put into funds. They do not include the value of the funds for collective supplementary pension provision, managed by industry-wide pension funds and company pension funds. At the end of 2017, these totalled approximately EUR 4.3 billion.