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Pension assets EUR 199.9 billion at the end of December 2017

The increase in Finns' pension assets in 2017 came widely from all asset categories. The recent rise in investment assets has been fuelled, in particular, by the acceleration of global economic growth and 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. The year 2017 was the first time when pension contributions in the municipal sector were lower than the pensions paid. In the private sector, in the state's pensions and 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.

1. Pension assets increased by EUR 11.3 billion during 2017

- Pension assets in total: EUR 199.9 billion.
  - Pension assets in the private sector: EUR 125.2 billion.
  - Pension assets in the public sector: roughly EUR 74.7 billion.
- Growth during the year 2017: EUR 11.3 billion, and during the quarter: EUR +1.0 billion.
- Investments in equities and equity-like instruments accounted for EUR 105.9 billion, or 53.0 per cent of all investment assets.
- Fixed-income investments: EUR 77.5 billion, share 38.7 per cent.
- Real estate investments: EUR 16.5 billion, share 8.3 per cent.
- Returns on investments for the whole year 2017: 7.4 per cent nominally and 6.8 per cent in real terms.

Pension assets increased during every quarter of 2017. The start of the year was especially strong: during the first quarter, assets increased by about six billion euros. In total, assets increased by EUR 11.3 billion during the year. The increase in assets was the result of positive returns for all investment types: fixed-income investments, equities, real estate and other investments. Stock markets, in particular, showed a positive trend, mainly because of higher expectations in terms of global economic growth and the financial performance of businesses. This was also reflected in rising raw material prices. The stimulating monetary policy of the major central banks has had a great impact on the current positive trend of the economy.

During the year, the share of equities and equity-like investments rose from 50.6 per cent to 53 per cent of all investment assets, thanks to factors such as good returns. In contrast, the share of fixed-income investments declined from 41.2 per cent to 38.7 per cent. The share of real estate investments remained virtually unchanged.

During the year, the shares of investments in the various regions remained practically the same as before. At the end of 2017, investment assets were broken down as follows: Finland 25.5 per cent; the rest of the euro area 19.3 per cent; and countries outside the euro area 55.2 per cent. The euro amounts for all regions rose while the relative shares remained unchanged. You can read more about investments in Finland in my blog.

Returns by investment category for the entire earnings-related pension sector in 2017:

- Average returns on equity investments 12.3 per cent in nominal terms and 11.7 per cent in real terms;
- Corresponding average returns on fixed-income investments 1.8 and 1.3 per cent, respectively;
- Average returns on real estate investments 6.5 and 5.9 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:

- 2013–2017 (5 years): 6.8 per cent in nominal terms and 6.0 per cent in real terms
- 2008–2017 (10 years): 4.7 per cent in nominal terms and 3.2 per cent in real terms
- 1997–2017 (21 years): 6.0 per cent in nominal terms and 4.4 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 for the past few years, 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 2016, the entire pension sector collected EUR 2.4 billion of pension contributions into funds, while the sum taken out for pensions paid totalled EUR 3.6 billion. In other words, the net sum used for pensions from the funds and their returns totalled EUR 1.2 billion.

In the coming years, pension funds will be used in a controlled manner increasingly often to finance pensions, 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 (increase) by half a percentage point, there will be pressure to raise (reduce) the pension contribution by one percentage point. 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 solid. The solvency ratios of the five largest pension insurance companies ranged between 116.4 and 133.5 per cent at the end of December. Correspondingly, the solvency position ranged between 1.6 and 2.2. 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 share of equities on the rise, the share of fixed-income investments on the decline, no major changes in the share of real estate investments during the year

Euro-denominated and relative changes by investment category, for the entire investment portfolio, when compared against the situation a year ago:

- investments in equities and equity-like instruments[1]: an increase of EUR 10.7 billion, and an increase of about 2.5 percentage points in their relative share;
- the comparable figures for fixed-income investments[2]: about EUR -0.3 billion and a corresponding decrease of around 2.5 percentage points in the relative share owing to the rise in the entire investment portfolio;
- real estate investments: an upswing of about EUR 1 billion while the relative share remained almost unchanged.

The increase in investments in equities and equity-like instruments is explained by two factors. The first reason is a positive value trend of about five billion euros. Secondly, the rise in shares is due to a positive net flow, which was over EUR 5 billion during the year. A positive net flow refers to a situation where purchases exceed sales. About EUR 3.0 billion of this sum came from quoted shares. Thus, pension insurers have increased the share of risky investments in their portfolios – especially during the last quarter of the year. The strategy worked well during 2017 thanks to the positive stock market trend. However, risk taking is limited by every player's own solvency. The more solvent the pension insurer is, the more risk it can take.

The stability of fixed-income investments during the year is explained by the rather small positive net flow of about one billion euros and moderate investment returns. A positive net flow in fixed-income investments means that purchases exceed sales and maturities. However, for its part, the cash collateral associated with derivatives (EUR -1.7 billion during the quarter) contributed to a marked downturn in investment loans, a subcategory of fixed-income investments. This is discussed in more detail in the last chapter.

Among fixed-income investments, especially the amount of money market investments rose during the year by over EUR 3 billion. In this way, pension insurers provided for some potential disturbances on the financial markets. It is also interesting that, during the last quarter of 2017, the amount of money market investments declined by about EUR 2.5 billion. Nearly all of this is explained by the fact that sales exceeded purchases. The proceeds from the sale of money market investments were mainly channelled into equity investments.

Real estate investments showed no major difference between purchases and sales.

3. Economic situation and the financial market

Underlying the good returns in 2017 was market actors' optimistic view of the future. This optimism was visible, for instance, as the rising values of equities. One reason for the positive atmosphere has been the fact that the major central banks – headed by the Fed of the United States and the

[1] When the analysis refers to investments in equities and equity-like instruments, this means the following categories of investment figures: quoted shares (including funds); hedge funds; and other investments in equities, which include, for instance, equity investments and investments in unquoted shares.
[2] When the analysis refers to fixed-income investments, this means the following categories of investment figures: money market investments; investment loans; TyEL relending; and bonds.

European Central Bank ECB –so far have proceeded cautiously when taking measures to tighten their monetary policy.

Market actors have feverishly speculated on the pace at which central banks tighten their monetary policy in a situation where economic growth is strong and inflation is beginning to raise its head, for example in the United States. Rising inflation is visible as higher interest rates, which have a negative impact on the value of fixed-income investments already owned. On the other hand, as interest rates rise, the yield expectations for new fixed-income investments to be acquired for the portfolio rise as well. Fixed-income investments play an important role in the investment strategy of a long-term investor who values stable returns.

The figures for the real economy have also been positive. The broad revival of economic growth, positive employment statistics, the solid performance of businesses globally and economic players' strong belief in the future are good examples of this. The upswing in global economic growth was also reflected in rising raw material prices and in the fact that many forecasting agencies, such as the IMF, raised their economic growth forecasts as the year progressed.

However, during 2017, the financial markets had some very typical, occasional market turbulence. In particular, this stemmed from political risks, such as uncertainty factors associated with the French presidential election and the new administration in the United States. Geopolitical risks were also experienced on the Korean Peninsula. Market actors also pondered feverishly whether the central banks will tighten their monetary policy more rapidly than had been anticipated earlier. However, this and many other fears were assuaged towards the end of the year.

The high level of indebtedness in the world economy is a long-term risk worth mentioning. Will the various actors have enough capacity to stimulate the economy when a new crisis arises in the future? How will those burdened by debt cope with a potential rise in interest rates?

4. 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 pensions managed by industry-wide pension funds and company pension funds, which totalled approximately EUR 4.3 billion at the end of 2017.

Since 2016, the data have been collected using the new report model for earnings-related pension assets devised by Statistics Finland. In consequence, we now use the data collected by Statistics Finland. Previously the data were collected using a report model maintained by the Financial Supervisory Authority. The report model had been devised more than ten years ago, primarily to meet the European Central Bank's needs at the time. Following this change, certain sections in the reporting have become more precise when compared against the old data collection model. For instance, cash collateral given and received in connection with derivatives, and purchase price claims and liabilities associated with investments, are considered at their net value in the new reports. The changes are described in more detail in the Investment Analysis 2016Q1 on pages 3-4.