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Update of wage inflation assumption in ASIC Instrument 2022/603 and RG 276: Submission by Super Consumers Australia

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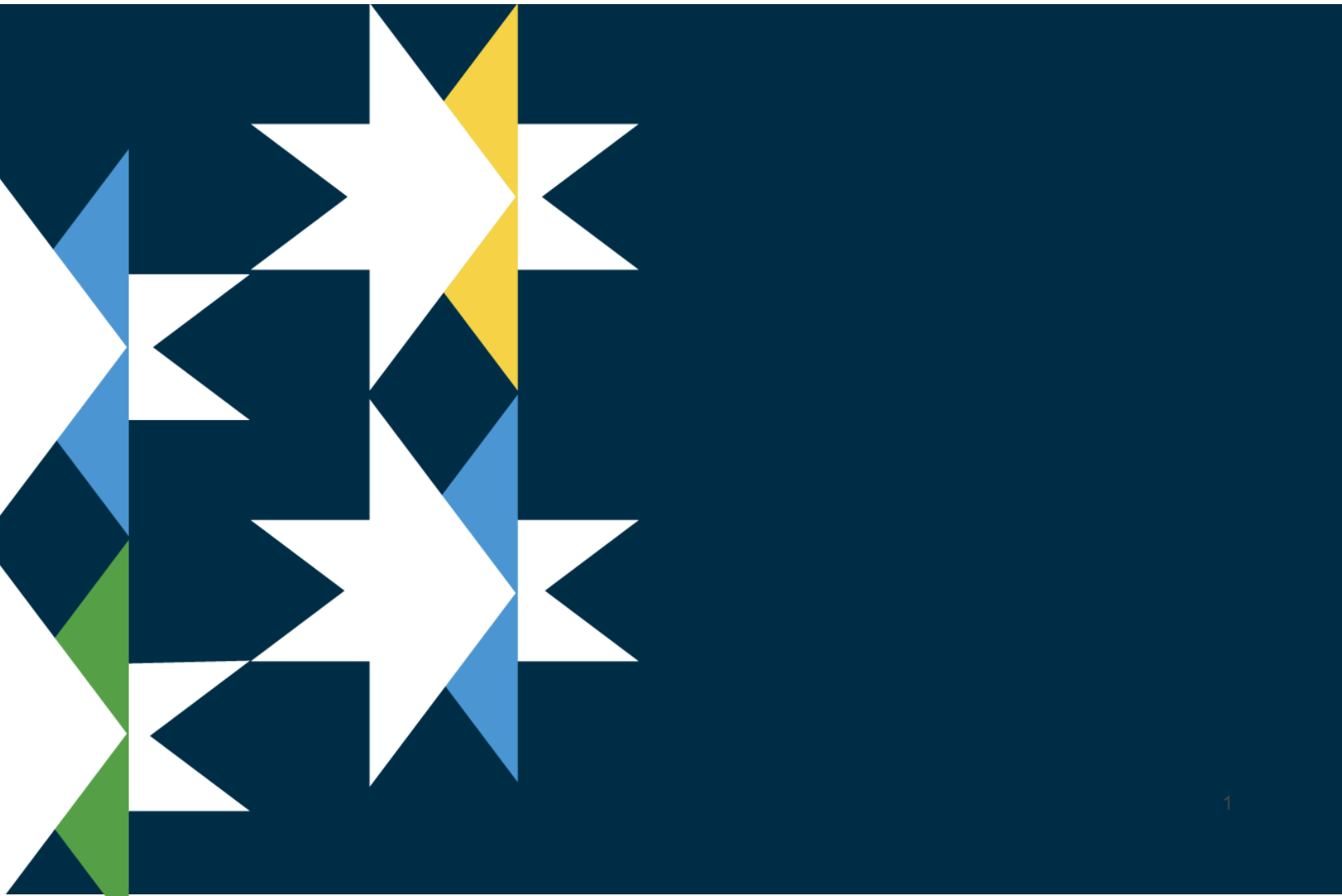
Super Consumers Australia is the people's advocate in the superannuation sector.
Our purpose is to advance the interests of people on low and middle incomes in Australia's superannuation system. Our vision is for an accountable and fair super system that delivers great service and great financial outcomes in retirement.



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Introduction

Superannuation forecasts are an invaluable tool in helping Australians plan for their retirement. Both ASIC Instrument 2022/603 and Regulatory Guide 276 give industry confidence in making those forecasts in terms of relief from requirements relating to financial product advice in the Corporations Act.

Super Consumers Australia publishes superannuation targets. Our superannuation targets estimate how different expenditure levels for singles and couples (low, medium, and high expenditures) map to a retirement balance which will last until age 90, with a confidence level of 90%.

In 2023, our savings target model used the RBA mid-point 2.5% p.a. for the CPI inflation forecast, and a wage growth assumption of 4% p.a. from the 2021 Intergenerational report[1] for the purpose of indexing the age pension. This means we matched the real wage growth forecast assumption in the previous ASIC guidance of 1.5% p.a.

Discussion

Wage growth assumption

We are supportive of ASIC's proposed change in the real wage growth assumption to 1.2% from 1.5% p.a.

Real wage growth is closely related to labour productivity growth in the long-run, both in theory and empirically.[2] It is then normal practice when estimating real wages to use the forecast for productivity growth for the economy. We consider it is sensible for ASIC to match the real wage growth assumption to the long-run productivity forecast, which was released in the 2023 Intergenerational Report (IGR).

Indexing the age pension

Super Consumers Australia is concerned that Moneysmart and other retirement calculators that use 2022/63 and RG 276 are overestimating forecasts of age pension benefits. This overestimate is the result of the age pension being assumed to grow at the real wage growth rate, which has not been the case in practice. As an example, for a single person 25 years into retirement, these calculators can overestimate the income received by approximately $60,000.

According to legislation,[3] the age pension maximum rate periodically increases by the higher of:

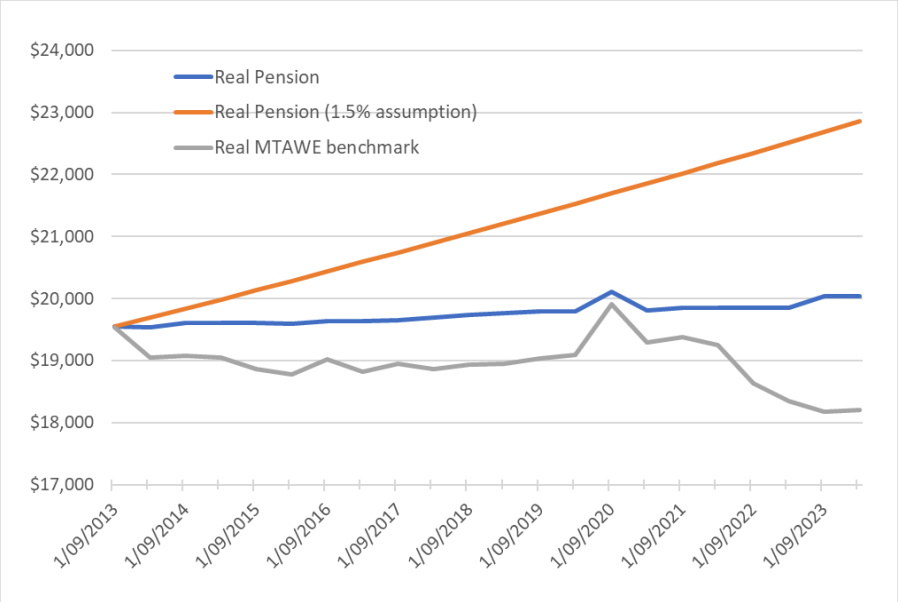
[1] Consultative report: Retirement Spending Levels and Savings Targets (SCA, March 2022, pg. 25).
[2] Real wages match productivity growth in the long-run. See: 5-Year Productivity Inquiry: Advancing Prosperity (Productivity Commission, February 2023, Section 1.3).
[3] See: DSS 5.1.8.50 Common provisions affecting indexation of pensions. Act references: Social Security Act (1991); section 1190, section 1191, 1195(2B), section 1196, and section 1198A.

- the higher of CPI or LCI for Pensioner and Beneficiaries 6-month inflation, or
- a benchmark based on the Male Total Average Weekly Earnings (MTAWE).[4]

Since September 2013 the age pension has grown by CPI/LCI inflation, as these rates have outstripped the MTAWE wage benchmark (see Table A1). We calculate the current single pension maximum rate based on the MTAWE benchmark would be only $24,093, whereas the actual maximum pension for a single person is currently $26,536. Because the actual pension is now 10.1% more than the MTAWE benchmark, it will take the MTAWE benchmark pension a forecast 7 years to overtake the pension again using real wage growth of 1.5% p.a. and 9 years to overtake the pension again using real wage growth of 1.2% p.a.[5] [6]

The fact that the MTAWE wage benchmark is not currently determining age pension rates and will likely not for a long time should be a concern for all retirement income estimates.

Figure 1. Single maximum basic rate age pension (September 2013 dollars)



Source: DSS, ABS, and own calculations

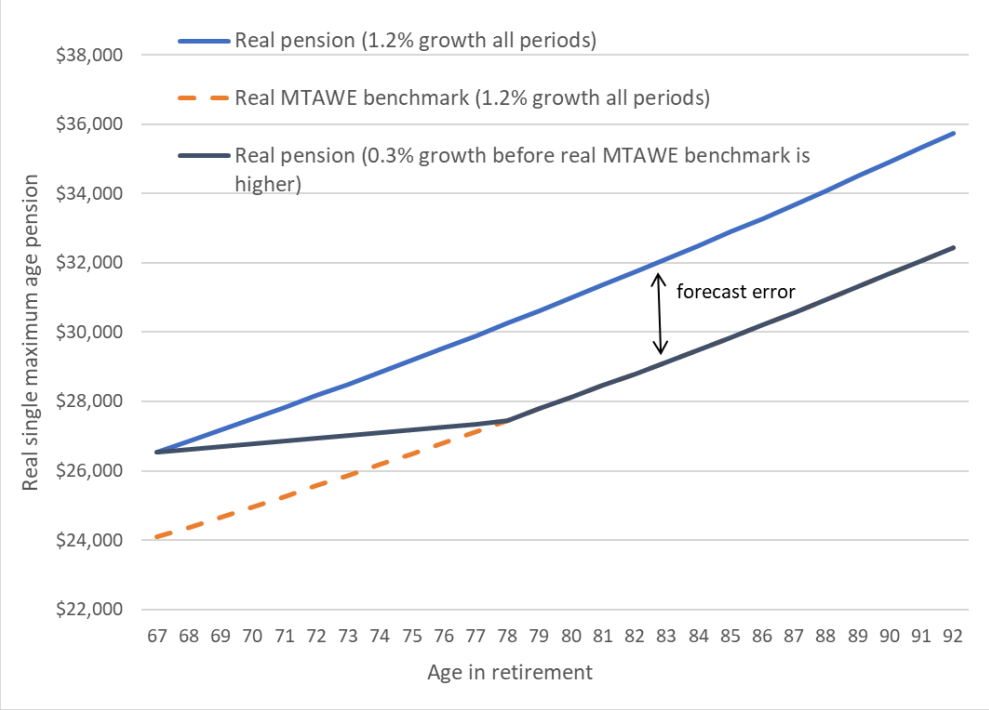
Figure 1 shows the rate of growth of the real pension, the real MTAWE benchmark, and a hypothetical real pension growing at 1.5% p.a. since September 2013.[7] This shows because the MTAWE benchmark has been below the CPI/LCI adjusted age pension, the real age pension has grown only through indexing the greater of CPI semi-annual growth and LCI semi-annual growth. We calculate the real pension has averaged an annual growth of 0.34% p.a., not the 1.5% p.a. currently assumed in forecasting models.

[4] The couple rate is equal to 0.4176 times the Male Total Average Weekly Earnings (MTAWE). The single rate is 0.6633 the couple rate.
[5] Rounded up to the nearest year, as calculators are all estimated annually.
[6] Assuming LCI and CPI semi-annual price changes are identical in the future.
[7] All discounted to September 2013 dollars using the CPI index.

We see the need to introduce better guidance over age pension projections to improve the quality of forecasts being used by consumers for retirement planning.

Figure 2 shows diagrammatically when the real MTAWE benchmark will overtake the CPI/LCI indexed pension using the revised wage assumption. Assuming the real CPI/LCI pension increases by 0.3% p.a.[8] in the period before the MTAWE benchmark overtakes CPI/LCI based pension, it takes 11 years before the real pension grows at the assumed 1.2% p.a. This is almost halfway through the assumed 25-year forecast period.

Figure 2. Real age pension forecast error - single maximum basic rate



Source: DSS and own calculations

The impact in current dollar pensions over the 25 year retirement period is large.

Using 1.2% real wage growth assumption, 11 years of compounding of the age pension means an increase from $26,536 to $30,256 for a single and $40,003 to $45,613 for a couple. This will be a significant overestimate. If real pensions increase by a predicted 0.3% p.a. then the real pension should be $27,460 for a single and $41,398 for a couple in 11 years time.

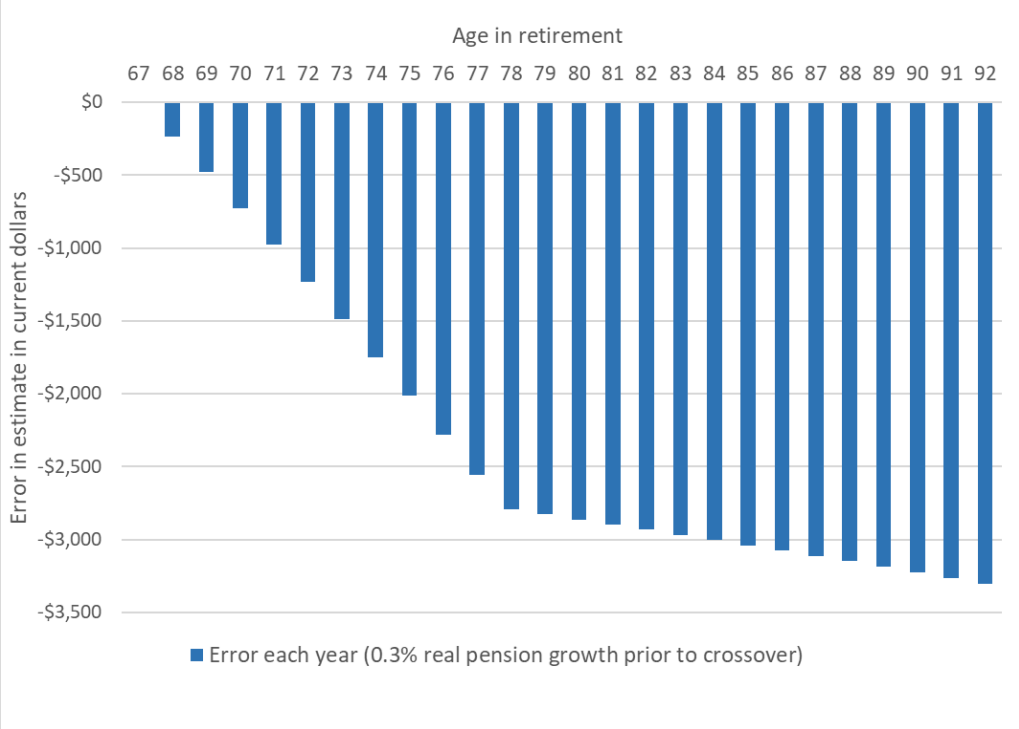
Figure 3 shows the annual error in real pension forecasts over the assumed 25 years of retirement, using the 0.3% p.a. real growth assumption for the pension prior to MTAWE pension overtaking the CPI/LCI pension. The accumulated gap between correctly modelled real pension

[8] This is the historical increase in the real age pension from increasing the age pension by the higher of CPI or LCI 6-month inflation.

income and real pensions assumed to grow by 1.2% p.a. from the start of the forecast period is $59,400.

The end result is a person would likely need additional savings in conjunction with the age pension to deliver the same level of retirement income.

Figure 3. Annual error in real age pension forecasts from early application of real wage growth assumption - single maximum basic rate.



Source: DSS and own calculations

Super Consumers Australia has recently reviewed 23 retirement calculators including the Moneysmart retirement calculator. We found that 22 calculators currently forecast growth in the real age pension from the start of the retirement period, with 21 using a 1.5% p.a. growth rate and one using a 1.0% p.a. growth rate. We found one calculator kept the real age pension constant over the retirement period. This means that 21 of 23 calculators we analysed followed the exact assumptions and methodology for growing the age pension described in ASIC RG 276.[9]

For SCA's own published 2023 retirement targets, our 2023 model also grew the real age pension by 1.5% p.a. from the start of the retirement period.

[9] ASIC RG 276.170 and RG 276.199 recommend the pension payment rate increase by 4% p.a. wage inflation over both accumulation and retirement phase. In the retirement phase the payment is deflated by 2.5% p.a. to give the result in current dollars, resulting in real growth of 1.5% p.a..

In following ASIC RG 276 for forecasting the age pension payment, almost all the industry's retirement calculators and SCA's 2023 retirement targets overestimate the real age pension over the forecast horizon. In SCA's case, we have since revised our retirement savings target model so that future published targets will accurately reflect the legislated age pension indexing methodology.

SCA however remains concerned about the accuracy of retirement calculators using the methodology in RG 276 to forecast the age pension, since RG 276 ignores a key element of the age pension indexation. By not comparing the actual age pension maximum basic rate to the MTAWE benchmark as in the legislation, the current RG 276 approach materially incorrectly forecasts the age pension payments. As a result, we recommend ASIC revise RG 276 to reflect the legislated age pension indexing methodology as soon as possible.

Recommendations

Recommendation 1: Super Consumers agrees with ASIC's proposed change in the nominal wage growth assumption from 4% to 3.7% to match both Treasury's forecasts and the 2023 IGR report.

Recommendation 2: ASIC consults on amending RG 276.170 and RG 276.199 to add guidance on age pension forecasting to ensure alignment with legislated age pension indexing methodology.

Appendix

Table A1: Maximum Basic Rate Age Pension

Maximum basic rate						Benchmark	
	Single	Couple		MTAWE	MTAWE Annual	Couple	Single
20/03/2010	$16,749	$25,251	15/11/2009	$1,163	$60,460	$25,248	$16,747
20/09/2010	$17,118	$25,808	15/05/2010	$1,183	$61,537	$25,698	$17,045
20/03/2011	$17,443	$26,296	15/11/2010	$1,211	$62,967	$26,295	$17,441
20/09/2011	$17,914	$27,009	15/05/2011	$1,237	$64,298	$26,851	$17,810
20/03/2012	$18,078	$27,253	15/11/2011	$1,255	$65,260	$27,253	$18,077
20/09/2012	$18,512	$27,908	15/05/2012	$1,285	$66,825	$27,906	$18,510
20/03/2013	$19,076	$28,761	15/11/2012	$1,324	$68,864	$28,757	$19,075
20/09/2013	$19,544	$29,463	15/05/2013	$1,357	$70,548	$29,461	$19,541
20/03/2014	$19,916	$30,025	15/11/2013	$1,348	$70,091	$29,270	$19,415
20/09/2014	$20,194	$30,446	15/05/2014	$1,365	$70,959	$29,633	$19,655
20/03/2015	$20,337	$30,659	15/11/2014	$1,372	$71,318	$29,782	$19,755
20/09/2015	$20,498	$30,904	15/05/2015	$1,370	$71,214	$29,739	$19,726
20/03/2016	$20,665	$31,153	15/11/2015	$1,375	$71,490	$29,854	$19,802
20/09/2016	$20,745	$31,278	15/05/2016	$1,395	$72,545	$30,295	$20,095
20/03/2017	$21,016	$31,684	15/11/2016	$1,398	$72,691	$30,356	$20,135
20/09/2017	$21,164	$31,907	15/05/2017	$1,417	$73,694	$30,775	$20,413
20/03/2018	$21,481	$32,386	15/11/2017	$1,428	$74,246	$31,005	$20,566
20/09/2018	$21,694	$32,708	15/05/2018	$1,445	$75,156	$31,385	$20,818
20/03/2019	$21,934	$33,067	15/11/2018	$1,461	$75,946	$31,715	$21,037
20/09/2019	$22,110	$33,332	15/05/2019	$1,476	$76,731	$32,043	$21,254
20/03/2020	$22,376	$33,732	15/11/2019	$1,498	$77,906	$32,534	$21,580
20/09/2020	$22,376	$33,732	15/05/2020	$1,538	$79,960	$33,391	$22,149
20/03/2021	$22,576	$34,034	15/11/2020	$1,527	$79,383	$33,150	$21,989
20/09/2021	$22,937	$34,580	15/05/2021	$1,555	$80,876	$33,774	$22,402
20/03/2022	$23,421	$35,308	15/11/2021	$1,577	$82,009	$34,247	$22,716
20/09/2022	$24,357	$36,722	15/05/2022	$1,587	$82,524	$34,462	$22,859
20/03/2023	$25,259	$38,080	15/11/2022	$1,621	$84,302	$35,205	$23,351
20/09/2023	$26,065	$39,296	15/05/2023	$1,641	$85,327	$35,632	$23,635
20/03/2024	$26,536	$40,004	15/11/2023	$1,673	$86,980	$36,323	$24,093

Source: DSS, ABS