How Has the Financial Crisis Affected the Incomes of Households Entering and in Retirement?

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Abstract

This paper investigates the impact of declines in stock prices and short-term interest rates on post-retirement consumption. It shows that the wealthy experienced the largest percentage declines in financial assets between October 2007 and 2011, because they held larger proportions of their financial assets in stocks. But the wealthy experienced the smallest declines in investment incomes because they held only modest proportions of their financial assets in short-term deposits, and dividends declined by far less that interest rates on such deposits. However, the wealthy are relatively more dependent on investments to finance post-retirement income, and wealthy retirees experienced the largest declines in total income.

We calculate the amounts that retired households should optimally decumulate from their financial assets, assuming plausible preference parameters. We argue that the decline in stock prices has been partially offset by an increase in expected returns. We calculate that the financial crisis has resulted in, at most, a 18 percent decline in the amounts households can optimally decumulate from financial assets, and a 9 percent decline in optimal consumption, inclusive of the part financed by Social Security and employer pensions.