PERSONALLY SPEAKING

Special Issue *February 15, 2014*

RETIRED SENIORS:
HAMMERED BY FEDERAL RESERVE LOW-INTEREST POLICY

Edward J. O'Boyle, Ph.D.
Mayo Research Institute

Thoughtful seniors who for years set aside and invested funds for their retirement have been hammered by the Federal Reserve's deliberate policy of maintaining low interest rates to stimulate economic activity and lift the U.S. economy out of the Great Recession.

While it is painfully clear that over the last six years those who have lost their jobs have shouldered much hardship, the retired especially the ones who have not re-entered the labor force have taken a beating too. The latest data from the Census Bureau indicate that the net worth of the typical household with a head who is 65 years of age or older is less than $175,000. Taking into account home equity, net worth drops below $28,000. Thus the appeal of the reverse mortgage so widely promoted in advertising that targets seniors.

For seniors who have been more fortunate than their peers and have accumulated a retirement portfolio of $250,000 invested in CDs at current rates interest payments amount to less than $50 per week. If the typical household with a head who is at least 65 years old were to sell the family home and retrieve all of their equity then invest it with returns of 3 percent and an inflation rate of 3 percent that pays out $2000 every month, those monies would be exhausted in six years. If that household were to invest and take out enough for two persons to live at the official poverty threshold, those monies would last ten years. Thus the incentive to work beyond age 65.

At her first appearance before the House Financial Services Committee as Federal Reserve chair, Janet Yellen was asked about the problem of the low interest rates for retirees dependent on interest income. She replied "low interest rates are a tough one for retirees looking to earn income on investments like CDs and bank deposits." Beyond that she had nothing to offer retirees but the promise that with economic growth interest rates would rise.

In order to stimulate economic growth, the Federal Reserve has inflated its balance sheet with asset holdings that at present total more than $4 trillion, including about $1.5 trillion

in mortgage-backed securities, thereby ballooning private bank excess reserves. It continues to purchase assets at a monthly rate of $65 billion to hold down interest rates. Those excess reserves are the stuff out of which private banks make loans provided the returns earned by banks produce enough incentive to cover the risk of default on those loans. Any first-year student of finance should be able to figure out that low interest rates that are favorable to borrowers are not favorable to lenders. As long as the Federal Reserve deliberately depresses interest rates, banks are less likely to make loans, and economic growth stalls.

Yellen gave no assurances that these asset purchases would end soon except to offer the tired reply that they would continue until normal economic activity is restored. In the meantime, seniors can expect no relief from low interests and no safe way to invest in equities because they have only a few years to recover from any serious correction in equity values.

Here's the ditch the economy is stuck in. Economic growth rests squarely on business and consumer spending that in turn depends on business and consumer borrowing for big ticket items like plant expansion and modernization along with housing and durables such as appliances and motor vehicles. At low interest rates borrowing becomes less costly but lending becomes less attractive. Those inflated excess reserves sit idle, waiting for higher rates to make lending more attractive. The Federal Reserve policy of adding billions to excess reserves every month is not working and persistent low interest rates are hurting retirees. The major beneficiaries of this policy are big-time investors who switch from bonds to equities because the return on bonds is too low to justify keeping them in their portfolios.

What are retired seniors to do? Move into the household of an adult child? Fall back on Social Security retirement even though its trust fund will be depleted of assets by 2033? Live off the money that comes from a reverse mortgage and then hope that Medicaid or Medicare – the Medicare trust fund reserves will be depleted by 2016 -- will be available when severe old-age infirmities set in? Ezekiel Emanuel, one of the principal architects of Obamacare, advocates the "complete lives" system for allocating scare medical resources in which persons 15 to 40 years of age have a substantially *better* chance of getting treated than younger or older persons. Or should retirees turn to more deadly schemes?

Edward J. O'Boyle is Senior Research Associate with Mayo Research Institute

Offices in New Orleans, Lake Charles, and West Monroe

www.mayoresearch.org 318-381-4002 edoboyle737@gmail.com
