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Chris Loewald

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Special OBEN 2402* – June 2024

Likely near-term macroeconomic impact of the implementation of the two-pot retirement saving system

Nkhetheni Nesengani, Riaan Ehlers, Mish Choonoo, Annelie Van Niekerk, Theo Janse van Rensburg

Abstract

This economic note seeks to explore the possible macroeconomic impacts of the recently-introduced two-pot pension system. Using the core model, we find that a moderate two-pot system scenario will add 0.1 and 0.3 percentage points (pp) respectively to GDP growth in 2024 and 2025, whilst reducing the government debt to GDP ratio by 0.5 pp in 2024/25 and by 1.0 pp and by in 2025/26. Under a high withdrawal scenario, we find that GDP growth will increase by 0.3 and 0.7 pp respectively in 2024 and 2025. The Government debt to GDP ratio will improve by 1.1 pp in 2024/25 and by 2.3 in 2025/26. The negative side is that the higher the withdrawal rates the less funds will be available at retirement age. The above impacts are relatively small when compared with pension reforms elsewhere. For instance, in Chile, rule changes allowed much larger withdrawals and pension assets declined by 14% of GDP.

1. Introduction

This economic note assesses the impact of the introduced pension reforms on household consumption, real fixed investment, inflation, government debt, and GDP growth. We postulate that over the short term the partial, pre-retirement withdrawal will boost consumption and growth somewhat, whilst over the long(er) term, the reforms are expected to raise the pool of retirement savings as employees will be unable to withdraw all their pension fund savings on resignation.

The note is structured as follows: In 2) we provide international experience with regards to pension reforms; 3) the need for pension reforms in SA; 4) the two-pot pension system characteristics and potential flows; 5) Pension fund reform scenarios; and finally concluding remarks.

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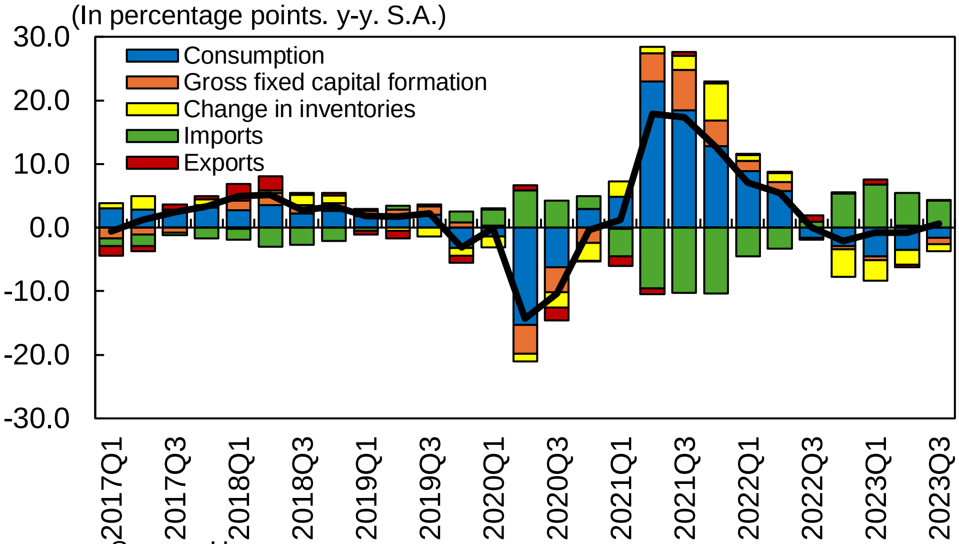
2. International experience with regard to pension reforms

Globally, there have been different models of pension reforms. The reforms include the conditions under which access to funds pre-retirement is allowed, whether the funds need to be repaid or not, and the share of pension savings that an individual will have access to. Examples are listed as: (a) Allowing permanent withdrawal without repayment obligation. (b) Permission to take a loan from pension fund, with repayments required. (c) Hybrid pension savings models.

The impacts of these different models have varied considerably. But in general, when governments responded to financial stress facing households by allowing (multiple) withdrawals from pension funds, it resulted in increased consumption. This boosted demand and output, while governments benefited from increased tax revenues. However, total assets within pension funds were significantly reduced.

Figure 1: Contributions to Chile's real GDP growth

(In percentage points. y-y. S.A.)



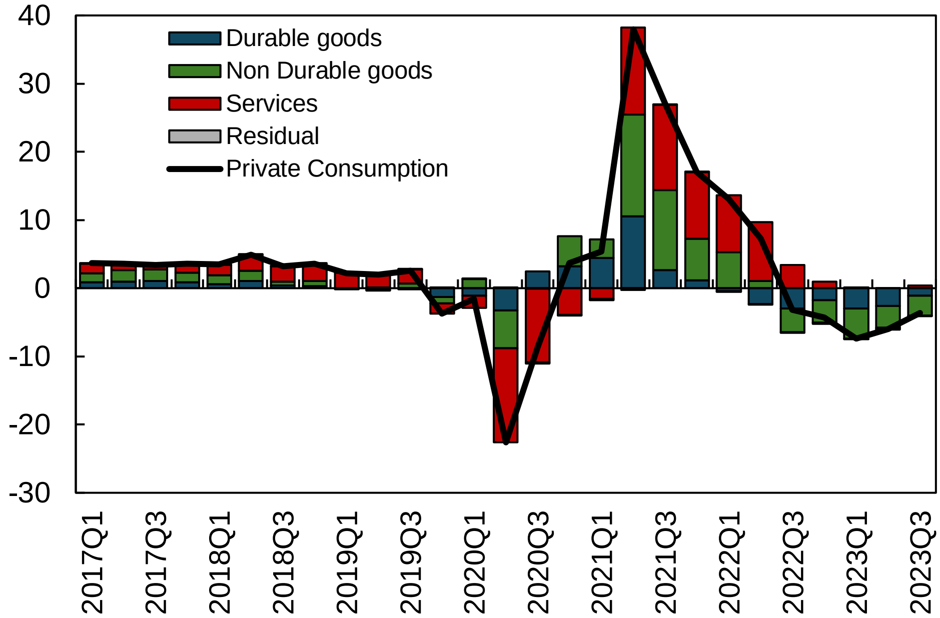
Source: Haver

For example, in the case of Chile, the International Monetary Fund estimated that withdrawals accounted for 14% of GDP, following three pension withdrawal episodes between 2020Q3 and 2021Q1. These withdrawals halted growth in pension assets. Initially net tax revenues increased sharply, rising by 40% and 22% in 2021 and 2022, as spending increased with the opening of the economy from Covid-19 related lockdowns (Figures 1 to 3).

Real GDP growth was 11.7% in 2021, at least partly boosted by pension withdrawals. However, pension funds' assets declined significantly. Hence, government stopped further pension withdrawals. As a result, consumption growth slowed significantly.

Figure 2: Contributions to real consumption in Chile

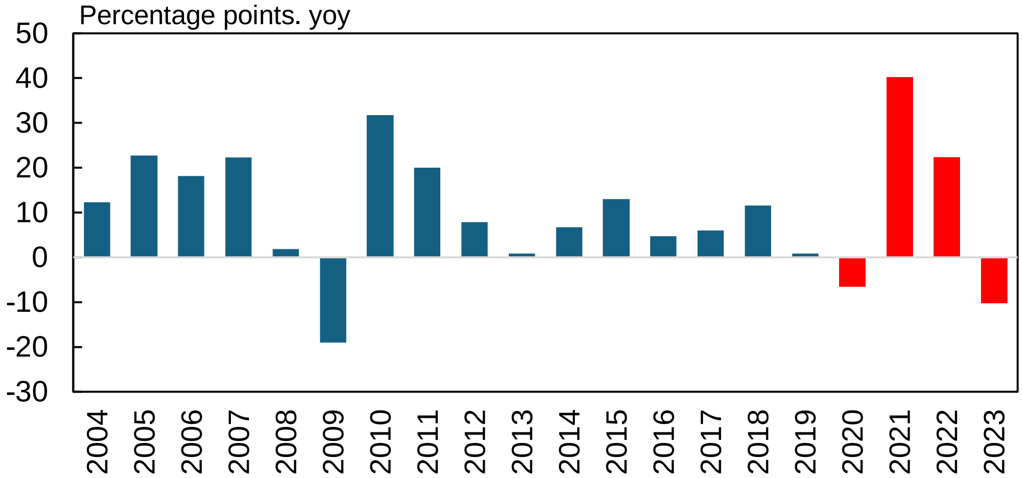
Percentage points, yoy , SA



Source: Haver

Figure 3: Net tax revenue growth in Chile

Percentage points. yoy



Source: Haver

3. The need for pension reform in SA

South Africa's savings rate is very low when compared to Chile. In essence, according to ASISA,[1] only 6% of South Africans that are economically active can retire comfortably.[2]

1 ASISA is the Association for Savings and Investments in South Africa.

2 The 6% statistic illustrates the urgency of the retirement crisis in the country and the need to reform (see www.fanews.co.za). Factors contributing to financial stress among the middle-aged population include: a) inadequate savings on account of low incomes, informal labour market, limited access to formal pension schemes, b) high levels of debt including credit cards and personal loans, c) lack of financial literacy and

SARS data illustrates that for each of the three years (2016-2018), over 700 000 individuals opted to take out the withdrawal lump sum in cash before retirement (National Treasury, 2021). Around R78 billion on average between 2016 and 2018 per annum was taken out of the retirement system through withdrawals made before retirement compared to R246 billion annual pension contribution. On average, taxation on early withdrawals is over R12 billion each year. Higher tax rates are levied as a disincentive to deplete assets before retirement. However, given the large number of withdrawals, the severe tax implications do not appear to be a sufficient consideration in minimising this behaviour.

This large leakage reduces funds available for employees in retirement, contributing to low replacement ratios.[3]

4. The two-pot pension system characteristics and potential flows

It follows from the above that reforms to the South African pension system were urgently needed to allow some access to retirement funds, without having to resign, while simultaneously preserve funds for retirement.

This is addressed in the new (two-pot) retirement system which will be implemented on 1 September 2024, after which all retirement fund contributions made by an individual would be split between three components (or 'pots'):

a) **Vested component:**

- The vested component contains all accumulated retirement fund contributions made until 31 August 2024.
- A once-off seed capital transfer of 10% (capped at R30 000) of an individual's vested funds will be made to their savings 'pot' after the implementation date.
- Remaining funds stay invested, with access to these funds still only permitted after retirement or upon resignation, as per the current legislation.

b) **Savings component:**

- An individual's savings 'pot' will contain 1/3rd of all their net annual retirement contributions made after the implementation date, including the once-off seed capital transfer and future capital growth.
- Individuals will have full access to the available funds in their savings 'pots' before retirement, and without having to resign.

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education on retirement planning leading to poor decision making around savings and investments, d) economic challenges of high unemployment and low economic growth. This depressing position is corroborated by the Schroders Global Investor Study 2018. The greatest disparity between current savings and savings perceived as necessary at a country level is seen in Chile and South Africa, (Appendix 2a) where people are saving, on average, 6% less for retirement than they would need to live comfortably. Also, South Africa, Sweden, and the US (Appendix 2b) fare the worst as locations where non-retired people are at risk of significantly misjudging the proportion of income required by the cost of living in retirement.

3 Replacement ratio = Starting pension after retirement / Final salary before retirement. The ratio should ideally be around or above 75%.

- Restricted to one withdrawal per tax year and be taxed at an individual's marginal tax rate.

c) **Retirement component:**

- An individual's retirement 'pot' will contain the remaining 2/3rd of all their net annual retirement contributions made after the implementation date, including future capital growth.

- Prohibits access to these funds before retirement and requires an individual to buy a pension income after retirement.

The retirement industry is currently in a net outflow position, with annual withdrawals from pension funds exceeding annual contributions to those funds.[4] The reforms seek to minimise the net outflow over time, with the introduction of the two-pot pension system where the pension contributions will be allocated to the 1/3rd and 2/3rd savings/investment pots. Employees will have access to withdraw from the 1/3rd pot once annually, subject to a minimum withdrawal of R2 000.[5]

Gradually, the magnitude of annual net outflow is likely to dwindle and the industry to reach a new steady state. Coronation Fund Managers' view is that it would take roughly 10 years for the vested component to deplete, with the guiding principle being that once the vested component has been accessed (upon retirement/resignation), it cannot be accessed again.

This new steady state is estimated to result in an outflow of roughly R40-50 billion per year in less than 10 years, on the key assumption that there's no additional seeding after year one and that the availability of the savings pot might deter people to quit their jobs to access their vested rights. This is a reduction of around R50 billion compared to the current outflow levels. The withdrawals amount is therefore expected to bottom out, and either reach a flat or net positive cash flow position over time.

The initial drop in the assets of the pension funds due to the reforms will have positive shocks to consumption and GDP in the near-term. Based on the impact seen in other countries, as well as the transmission mechanisms and elasticities in the South African economy, the likely macroeconomic impact of the reforms is discussed in the next section.[6]

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[4] Coronation Fund Managers: Interview on 20 February 2024. We sincerely thank Pieter Koekemoer, Alistair Barge and Rael Bloom for their time and invaluable insights into the reforms and the expected impacts. Under the current system, the withdrawals from the pension fund system are roughly about R360 billion per annum (of which between R100 billion to R120 billion per annum are due to resignations) with total annual contributions of R246 billion into the funds. Taking into consideration asset growth however, the total size of pension funds has remained almost unchanged over the last few years.

[5] When the new system is implemented on 1 September 2024, our estimates suggest an additional R40 – 100 billion of withdrawals in the first year. This is due to the 10% of vested rights or R30 000 (10% of accumulated funds capped at R30k) in seeding capital being transferred to the savings/access pot becoming readily available to members for withdrawal within the 2024/25 tax year. The caveat is that the R80 – R100 billion "normal" outflow per annum is expected to continue but at a declining pace over a decade. This is due to the uncertain transition between the current and new system (assuming that the early resignation trend/behaviour is likely to persist for some time).

[6] The elasticities here refer to the responsiveness of various economic variables from additional income available to households from pension withdrawals and to government's additional tax revenues.

5. Pension fund reform scenarios – possible impact on the economy

Implementation of the new "two-pot" pension fund reforms will lead to several possible economic and fiscal repercussions that are fundamentally linked to how people will react to this new source of income. Outcomes will vary depending on the rate of uptake of the available funds as well as the intended destination of the funds (consumption or debt reduction). Although the reforms will help employees to access funds in the 1/3rd pot for consumption once a year, the 2/3rd pot will boost retirement savings.[7]

Two scenarios are presented (Figures 4&5). First, is the high withdrawal scenario where the majority withdraw large portions (more than 90% of available funds) of all their available funds;[8] Second, the more moderate and more plausible scenario is where fund members realise the taxation penalties as well as the high cost of future compound growth, and only make emergency use of the option. We assume that those in higher income tax brackets, will be less likely to withdraw funds as they face higher tax penalties and should also have better access to other (crisis) funding options such as bank loans and credit cards.[9] The total accumulated vested component pot (R3 - R3.5 trillion) is an estimate based on SARS's different income groups and their historical pension fund contributions. To get an estimate of the withdrawable portion (seed capital) of the total vested pot (R122 billion), these contributions are then scaled by the number of payers per income group combined with the 10% or R30 000 rule.

5.1 The high withdrawal scenario.

In this scenario we assume that in 2024Q4 people will extract an additional R100 billion from the savings portion of their pension funds (this includes seed capital and their 1/3rd savings pot in 2024) due to the new legislation.[10] This will be on top of the historical resignation portion of R110 billion for the whole 2024 calendar year.

For 2025, it is assumed that the usage of the contributions to the one-third pot will drop to R40 billion, spread evenly over the four quarters (where 1/3rd of the total contributions for 2025 is R86.8 billion), leaving R46.8 billion in the savings pot. These withdrawals will increase by

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7 We do not model the long-term benefits of the 2/3rd pot in this economic note.

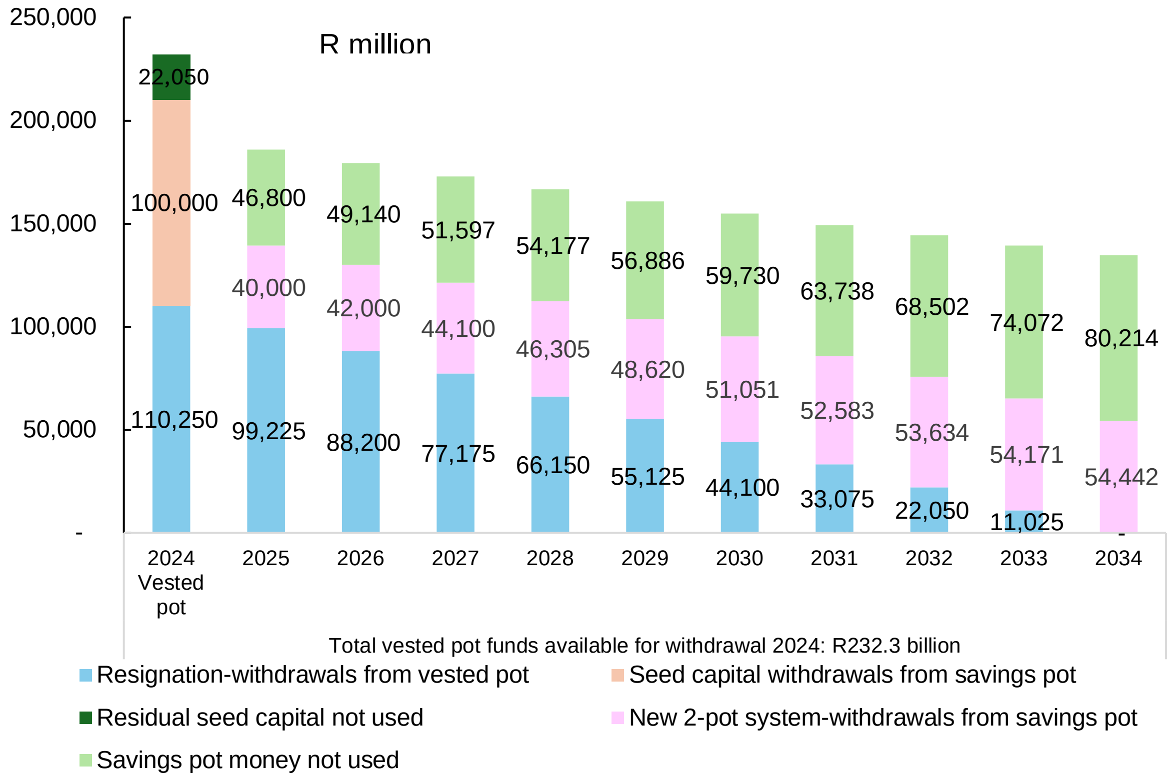
8 Note that this is a "high usage" scenario and not one that simulates the case where all eligible people use all of their available funds in 2024 as well as the following years.

9 Under the current system the withdrawals from the pension fund system are roughly R360 billion per annum, of which between R80 billion to R100 billion per annum are due to resignations. We assume that these annual outflows will continue over the next decade, albeit at a slower pace in each consecutive year, until the transitioning to the new two-pot system is completed. According to Financial Sector Conduct Authority (FSCA) data, there are 6.5 million people contributing to pension funds, of which about 700 000 people reset their pension funds annually, implying that within 9-10 years the system should reach a point where withdrawals will no longer be made from the historical vested pot when they resign and will then only have access to their 1/3rd savings pot.

10 This R100 billion is the upper estimate of the currently available funds within the pension fund system that will be taken by members from their vested pot and is derived from SARS income tax numbers as well as their tax deduction figures. According to SARS, on average, 85% of tax deductions are for retirement contributions.

5% to R42 billion in 2026 due to growth in the funds' underlying investments and as contributions are subject to annual wage increases.

Figure 4: High withdrawal scenario



After accounting for taxes, household disposable income is therefore only expected to be boosted by R79 billion in 2024Q4, by R31.5 billion in 2025 and by R33.1 billion in 2026.[11] Therefore, household consumption expenditure is expected to grow by an additional 0.8 pp in 2024, 1.8 pp in 2025 (as most of the 2024Q4 large withdrawals spill over into the following year) and to remain at an almost unchanged growth rate in 2026.

Initially, the withdrawals and higher interest rates (due to rising inflation related to rising output gap and weaker rand following increased imports) will curtail the positive effects that the higher GDP will have on fixed investment. As fund managers are forced to liquidate assets, thereby decreasing the pool of funds available for investments, growth in private sector fixed capital formation is expected to decline marginally by 0.2 pp in both 2024 and 2025, before increasing by 0.1 pp in 2026 as the benefits of the new system starts to positively affect this sector.

GDP is forecasted to grow by an additional 0.3 pp in 2024, 0.7 pp in 2025. Then GDP outlook returns to the pre- pension reforms growth rate in 2026. Inflation increases by 0.2 pp in 2025 and 0.3 pp in 2026, which along with a more positive output gap, necessitates repo to increase by 60bp in 2025 and by 90bp in 2026 relative to baseline.

[11] By applying a weighted structure to the marginal tax rates per income bracket from the SARS data numbers, all withdrawals from the pension fund will be subject to a proxied tax rate of 21% in the model.

Higher domestic demand results in increased real import volumes with the balance on the current account as percentage of GDP deteriorating by 0.2 pp in 2024, 0.5 pp in 2025 and 0.4 pp in 2026.

Personal income taxes (PIT) revenues increase by R41.0 billion in 2024/25, and by R32.4 billion in the year thereafter. These increases stem from both the pension fund withdrawals (as they contribute to taxable income) as well as the higher expected employment (consumption expenditure increases in direct proportion to the additional disposable income leading to higher GDP, with second round effects leading to increased employment and therefore more taxable income) and higher wage settlements (through inflation expectations). Corporate income taxes (CIT) grow by R2.0 billion in 2024/25 and by R5.3 billion in 2025/26.

Government expenditure is assumed to stay unchanged in this scenario leading to an improvement in both the primary balance to GDP ratios (0.4 pp in 2024/25 and by 0.7 pp in 2025/26) as well as the Government debt to GDP ratios (by 1.1 pp in 2024/25 and by 2.3 pp in 2025/26).

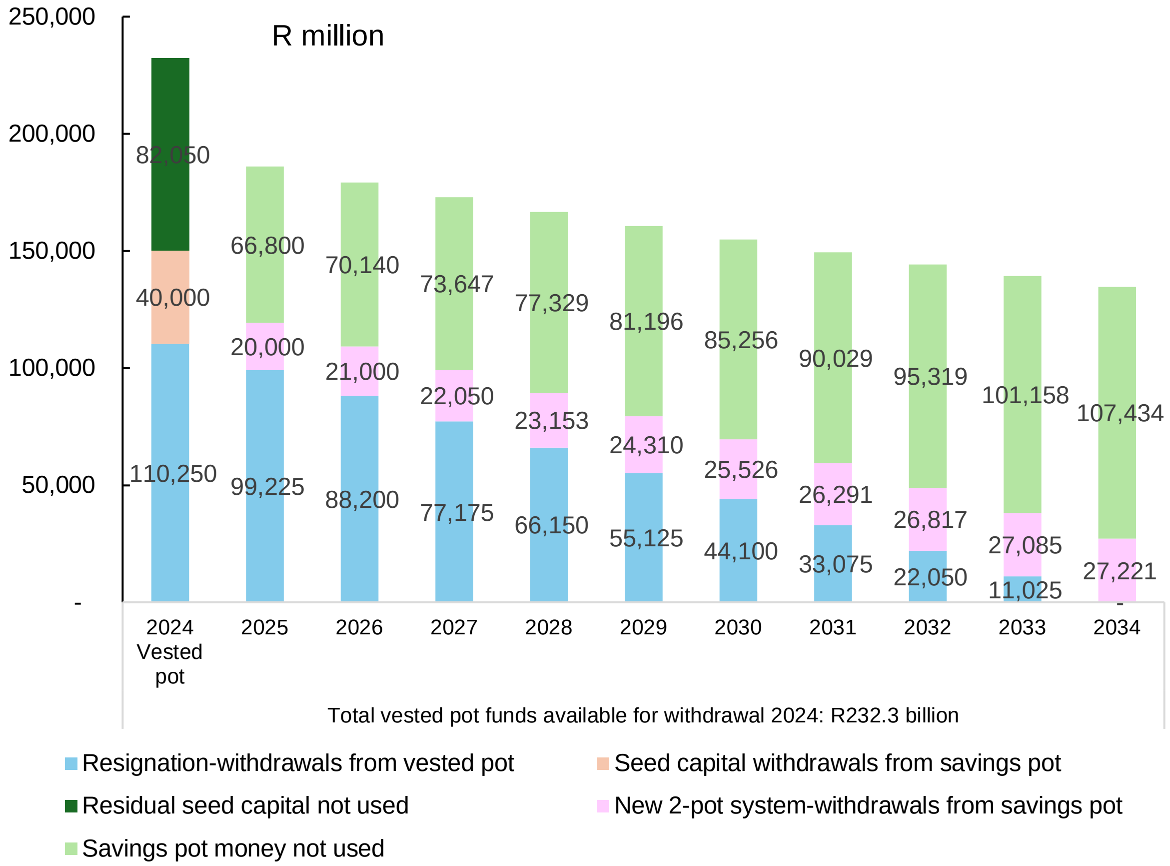
However, there is a likelihood that households will spend a portion of these withdrawals to reduce their existing debts. If this portion is approximately 50%, the effect would be to reduce the impact on consumption by half, so that in this scenario 2024 consumption expenditure by households would increase by 0.4 pp and 2025 0.9 pp. GDP would then increase by 0.2 pp in 2024 and by 0.4 pp in 2025.

5.2 The moderate withdrawal scenario.

This scenario assumes that people will be much more prudent and only extract an additional R40 billion from their pension funds in 2024Q4. For 2025, the usage of the contributions to the 1/3rd pot will drop even more than in the first scenario to only R20 billion, spread evenly over the four quarters. This amount will also then increase by 5% to R21 billion in 2026.

Tax-adjusted household disposable income is expected to be boosted by R31.5 billion in 2024Q4, by R15.8 billion in 2025 and by R16.6 billion in 2026. Household consumption expenditure to grow by an additional 0.3 pp in 2024, 0.7 pp in 2025 (as most of the 2024Q4 large withdrawals spill over into the following year) and to remain at relatively unchanged growth rate in 2026.

Figure 5: Moderate withdrawal scenario



This scenario leads to smaller increases in the growth of domestic demand, resulting in smaller increases in real import volumes, and consequently the balance on the current account as percentage of GDP deteriorates by only 0.1 pp in 2024 and by 0.2 pp in both 2025 and 2026. Growth in private sector fixed capital formation will decline marginally by 0.1 pp in 2024 and by 0.2 pp 2025, before remaining unchanged in 2026.

GDP should grow by an additional 0.1 pp in 2024, 0.3 pp in 2025, but growth should stay unchanged in 2026. Inflation increases by 0.1pp in both 2025 and 2026 resulting in an increase in interest rates of 20bp in 2025 and 40bp in 2026. If it is again assumed that the portion of withdrawals will be split in half between consumption and debt reduction, consumption will only increase by only 0.17 pp in 2024 and by 0.37 pp in 2024. GDP would then increase by only 0.06 pp in 2024 and by 0.15pp in 2025.

PIT will increase by R19.9 billion in 2024/25 and by R16.3 billion in 2025/26. CIT should grow by R0.8 billion in 2024/25 and R2.1 billion in 2025/26.

With government expenditures also assumed to stay unchanged in this scenario the additional revenues lead to an improvement in the primary balance to GDP ratios (0.2 pp in 2024/25 and by 0.4 pp in 2025/26) and the Government debt to GDP ratios (0.5 pp in 2024/25, by 1.0 pp in 2025/26).

6. Conclusion

The international experience indicates that pension fund reforms can result in a substantial boost to economic activity. However, if not well designed, their impacts could be short-lasting and result in a significant decline in pension assets over the long term.

According to our modelling, the two-pot pension funds system strikes a good balance by providing some short-term leeway to distressed consumers whilst over the long(er) term it will most likely result in improved retirement benefits as withdrawals will now be disallowed from the investment pot on resignation. This is also the main reason why government limits the initial withdrawal to the minimum of 10% or R30 000 rather than giving contributors access to the full portion in the vested pot. Whilst we do not model the longer-term benefits to the fund members, as it falls largely outside the forecast horizon, they will be severely impeded if all the available savings component funds are used over the short-term thus leaving members with considerably smaller than needed retirement funds.

More specifically, all current indications are that the net outflow in pension funds should peter out in about eight to ten years, and the pension fund assets would stabilise. Longer term, the economy at large would benefit from employees retiring with a larger pool of retirement savings stemming from the 2/3rd investment pot, which they will only be able to access on retirement.

Under a high withdrawal scenario consumption increases substantially in 2024 and 2025 before reverting to the baseline (pre-two-pot pension impact). However, a more likely scenario is for moderate pension withdrawals where households spending will add between 0.3 and 0.7 pp to real consumption in 2024 and 2025 respectively. Government tax revenue will benefit from these withdrawals, with tax revenues rising by 0.3 percent of GDP in 2025 and by 0.2 in 2026.[12]

[12] This includes tax revenues from CIT, PIT, VAT and Customs revenues.

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Appendix

Table A1: Examples of pension fund models

Types	Criteria and conditions	Countries
Allowing permanent withdrawal without repayment obligation	There are strict conditions where individual pension holders can withdraw funds to address serious financial needs. Rules "allow controlled access in clearly defined cases of disability or terminal illness, [and] severe financial hardship". In these cases, it would typically apply to a small number of employees facing the need to, for example, upgrade their houses or vehicles to suit their disability conditions[13].	Canada Australia
Permission to take a loan from pension fund, with repayments required	Regulations allow for loans from pension funds to finance housing. The loan repayment terms (interest rates and period) would differ amongst pension funds. In the case of Switzerland, the two options of withdrawal and pledging from pension funds are permitted to purchase owner occupied residential property, with repayment. The pledging option allows the funds to remain in the pension fund and used as collateral. Pledging requires less equity, but is subject to higher mortgage interest rates, keeping retirement benefits intact. The Home Equity Access Scheme in Australia allows members of pensionable age to get a non-taxable loan up to 150% of the value of their home. The loan repayment is subject to the inclusion of interest and legal costs.	Switzerland Australia
Hybrid pension savings models	Permitted access to a portion of savings under conditions that are less stringent. Such systems are made possible by allowing for savings vehicles that have both liquid and illiquid components. In these systems part of the pension savings is purposefully placed where it could be easily accessed when the needs arise. But this should be done without disadvantaging the long-term retirement savings that are mostly placed in bigger, illiquid component. There should be a determined limit to the account that can be accessed pre-retirement[14].	United States New Zealand United Kingdom

[13] The Australian Super retirement fund allows early withdrawal on compassionate grounds, terminal medical condition, severe financial hardship, temporary incapacity, or permanent incapacity, see https://accessmysuper.com.au/access-my-super-guides/.

[14] The World Bank Group (2019:7) noted that: "Under this arrangement, contributions paid into the combined account structure would at first be distributed between liquid and illiquid accounts. When the balance in

Table A2: Income Tax brackets

2025 tax year (1 March 2024-28 February 2025) no changes from last year

Taxable income (Rand)	Rate of tax
1-27 500	0% of taxable income
27 501-726 000	18% of taxable income above 27 500
726 001-1 089 000	125 730 + 27% of taxable income above 726 000
1 089 001 and above	223 740 + 36% of taxable income above 1 089 000

2024 tax year (1 March 2023-29 February 2024) changes from last year

Taxable income (Rand)	Rate of tax
1-27 500	0% of taxable income
27 501-726 000	18% of taxable income above 27 500
726 001-1 089 000	125 730 + 27% of taxable income above 726 000
1 089 001 and above	223 740 + 36% of taxable income above 1 089 000

2023 tax year (1 March 2022-28 February 2023) no changes from last year

Taxable income (Rand)	Rate of tax
1-25 000	0% of taxable income
25 001-660 000	18% of taxable income above 25 000
660 001- 990 000	114 300 + 27% of taxable income above 660 000
990 001 and above	203 400 + 36% of taxable income above 990 000

Source: South African Revenue Service 2024.

the liquid account reaches a predetermined threshold level, known as the ‘savings cap’ all contributions thereafter go entirely into the illiquid retirement account.”

Appendix 3a)

Retirement savings deficit

Country	Current income being saved specifically for retirement	Annual income savings needed to live comfortably in retirement	Difference
Chile	13%	19%	6%
South Africa	**13%**	**19%**	**6%**
Hong Kong	11%	15%	4%
Poland	11%	15%	4%
Thailand	14%	18%	4%
Russia	9%	13%	4%
Taiwan	13%	16%	3%
Portugal	11%	14%	3%
Singapore	15%	18%	3%
Brazil	14%	17%	3%
Spain	10%	13%	3%
Italy	10%	13%	3%
UAE	14%	16%	2%
Australia	12%	15%	3%
France	10%	12%	2%

Source: Schroders Global Investor Study 2018.

Appendix 3b)

Proportion of income cost of living

Country	Non-retired: Expected (%)	Retired: Actual (%)	Difference
South Africa	**34**	**59**	**25**
Sweden	34	57	23
US	32	54	22
Australia	39	58	19
South Korea* (n=22)	27	44	17
Portugal	28	45	17
Canada	42	59	17
Belgium	34	50	16
Italy	37	53	16
Spain	35	51	16
France	30	46	16
Singapore	35	50	15
Chile* (n=20)	28	43	15
UK	38	53	15
Netherlands	38	52	14

Source: Schroders Global Investor Study 2018
*Limited Sample

Figure A1: Real household consumption expenditure

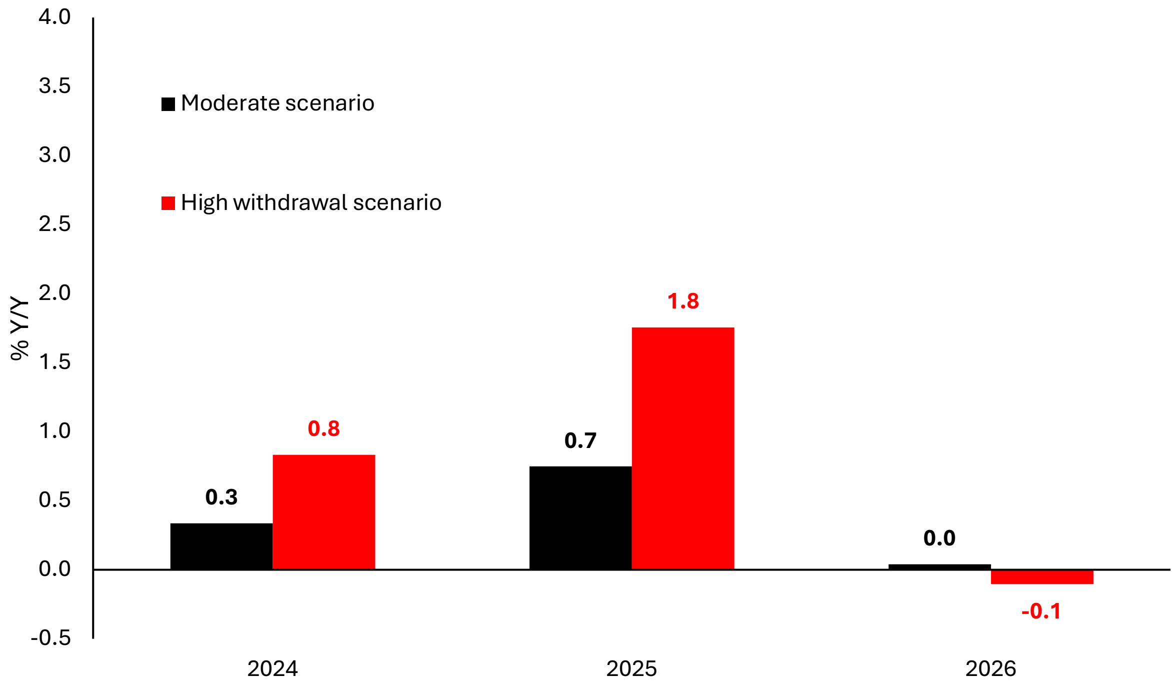

Figure A2: Real private sector investments

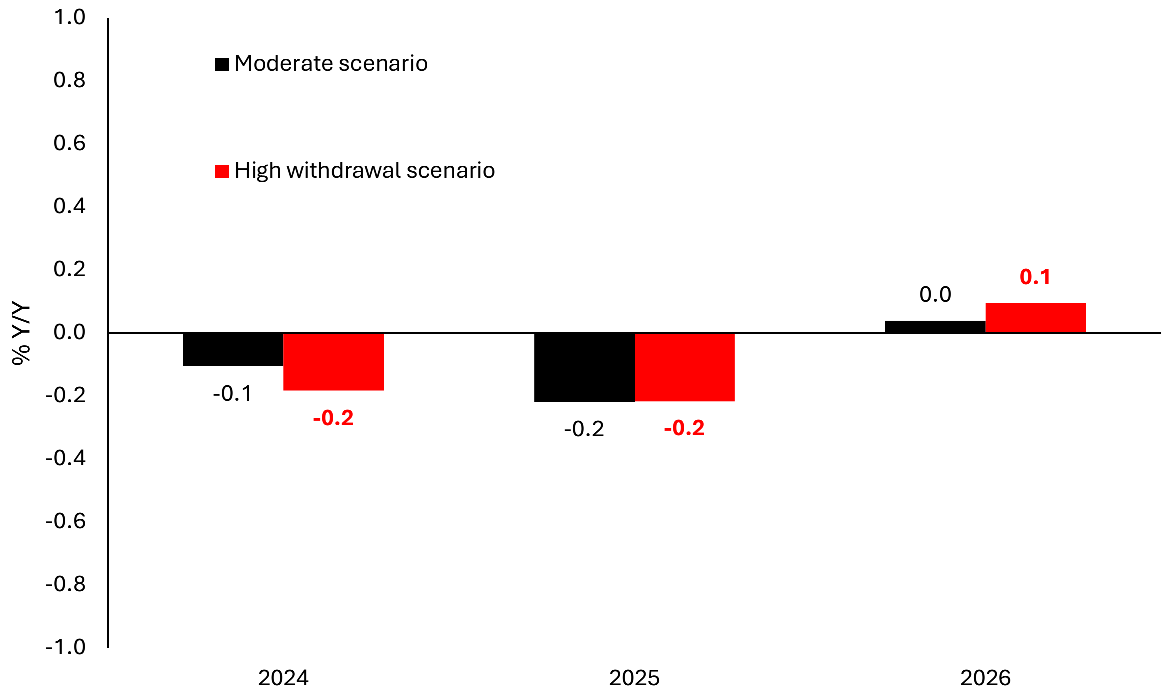

Table1: Impacts of pension fund reforms

Annual % change from baseline		2024	2025	2026
Real HH consumption expenditure	High	0.8	1.8	-0.1
	Moderate	0.3	0.7	0.0
Real Private sector investment	High	-0.2	-0.2	0.1
	Moderate	-0.1	-0.2	0.0
Inflation	High	0.0	0.2	0.3
	Moderate	0.0	0.08	0.1
Repo	High	0.1	0.6	0.9
	Moderate	0.0	0.2	0.4
R/$ exchange rate	High	-0.15	-0.54	-0.73
	Moderate	-0.06	-0.24	-0.32
GDP	High	0.3	0.7	0.0
	Moderate	0.1	0.3	0.0
CA/GDP ratio	High	-0.2	-0.5	-0.4
	Moderate	-0.1	-0.2	-0.2
Personal income tax R billion (2024/25 & 2025/26)	High	41.0	32.4	--
	Moderate	19.9	16.3	--
Corporation income tax R billion (2024/25 & 2025/26)	High	2.0	5.3	--
	Moderate	0.8	2.1	--
Primary balance % of GDP (2024/25 & 2025/26)	High	0.4	0.7	---
	Moderate	0.2	0.4	---
Government debt % of GDP (2024/25 & 2025/26)	High	-1.1	-2.3	--
	Moderate	-0.5	-1.0	--

Figure A3: Real gross domestic product

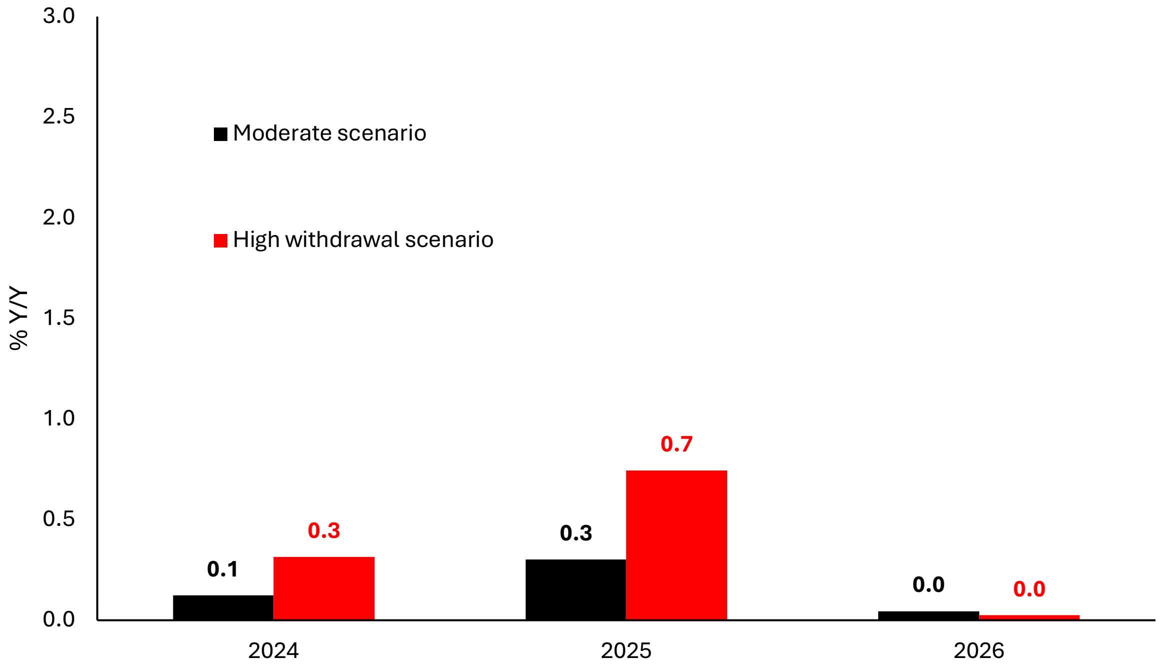

Figure A4: Inflation

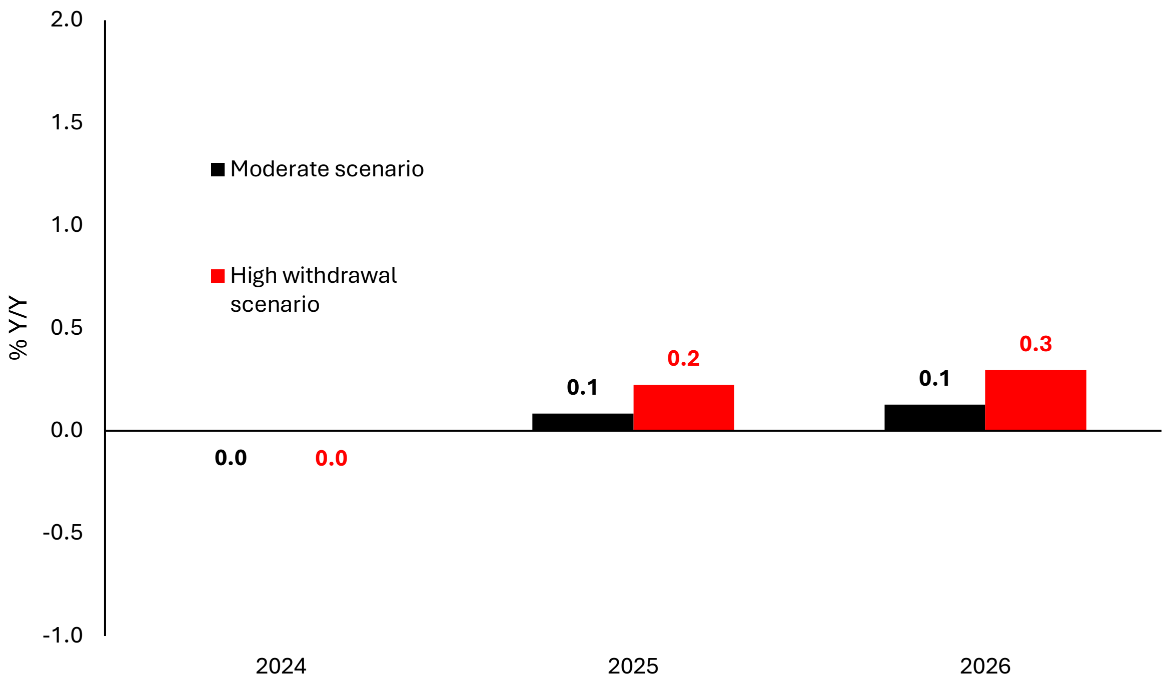

Figure A5: Repurchase rate

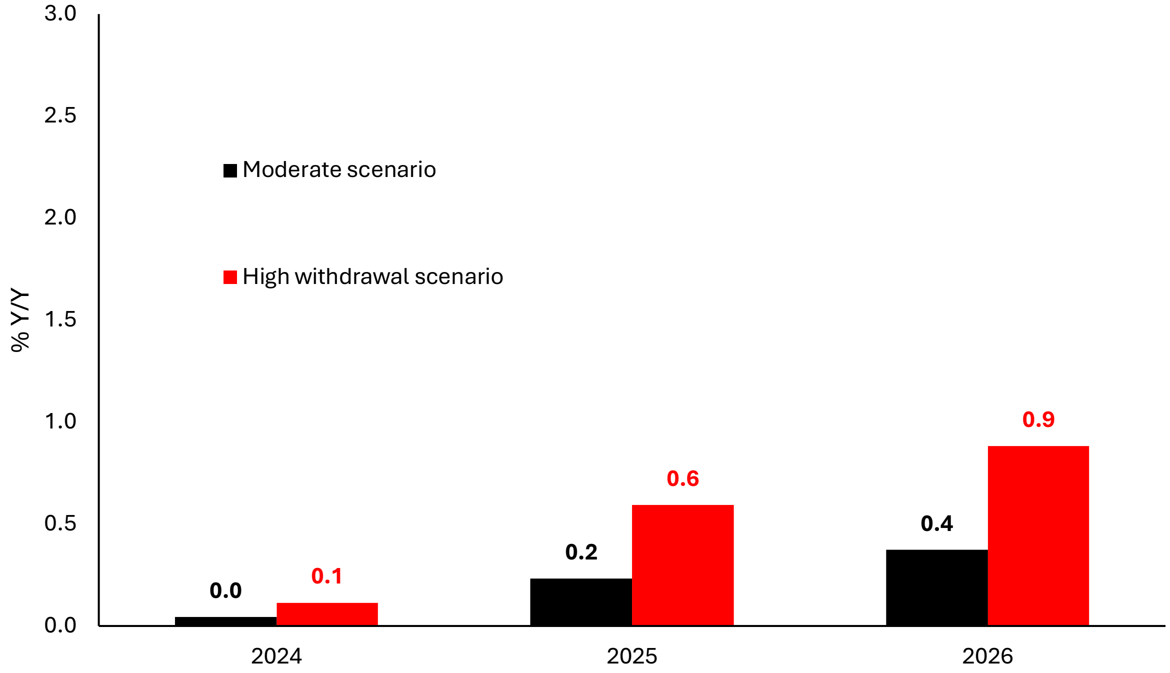

Figure A6: Primary balance

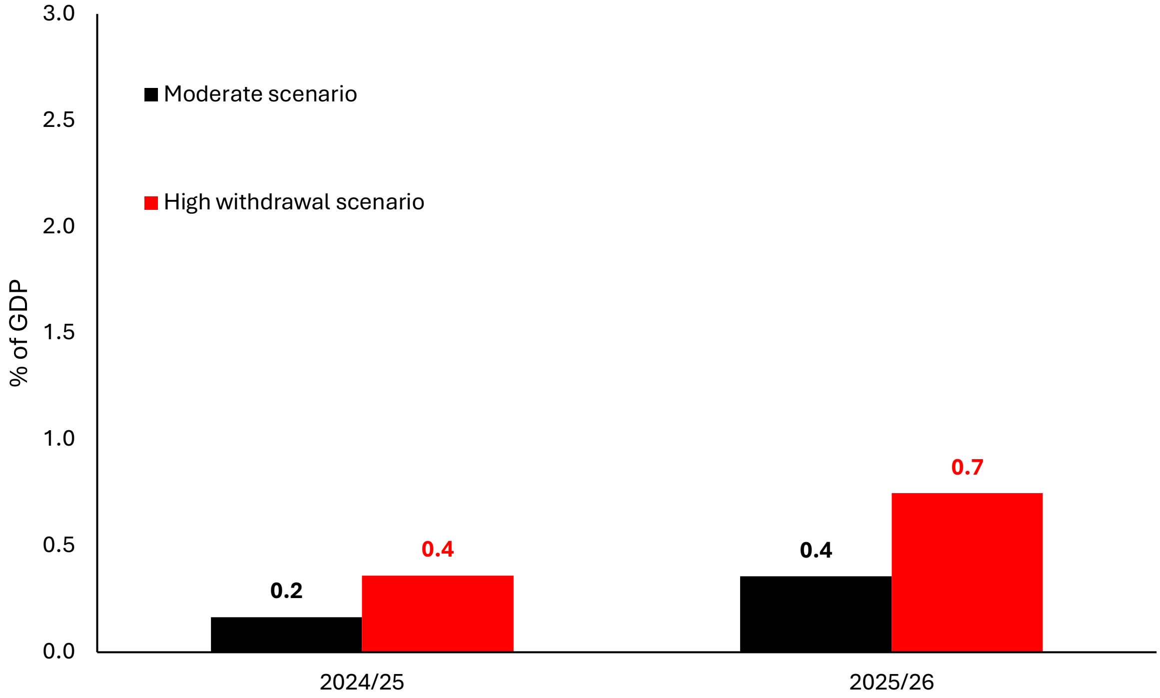

Figure A7: Personal income tax (PIT)

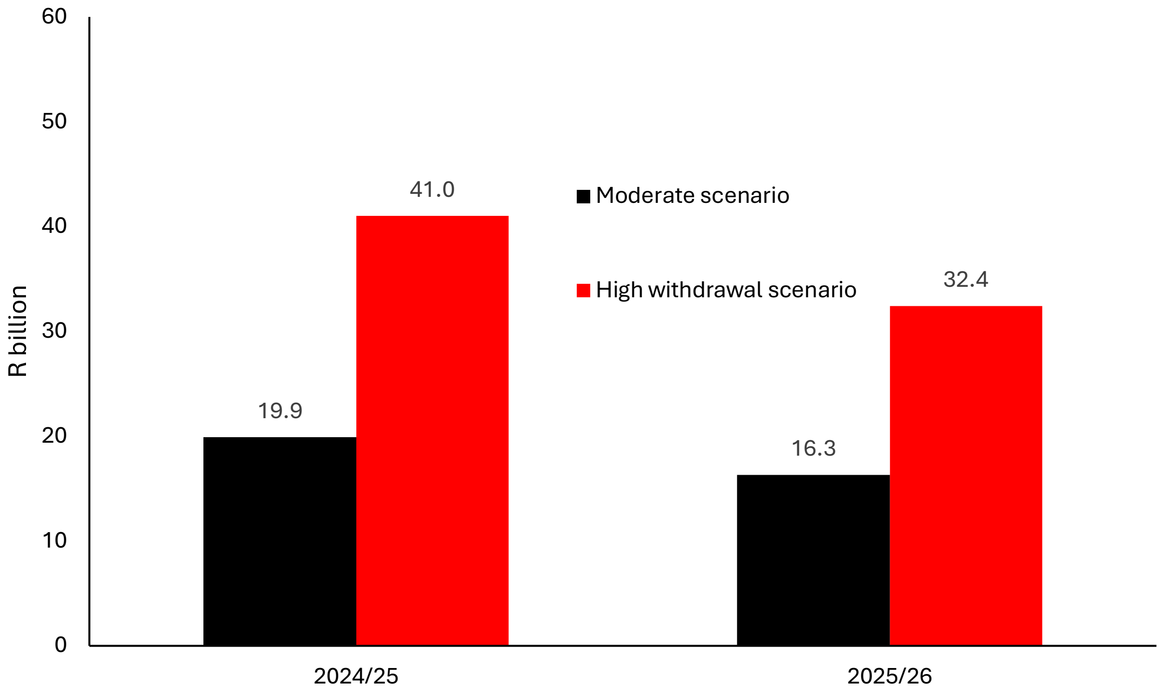

Figure A8: Corporate income tax (CIT)

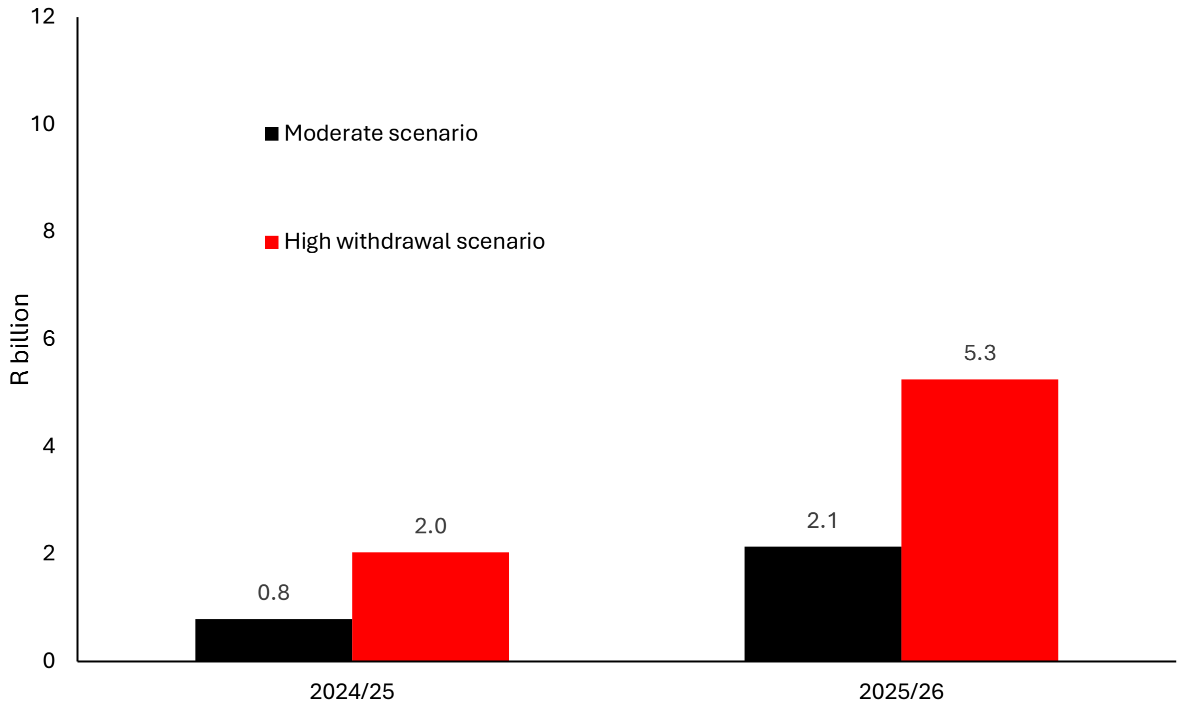

Figure A9: Government debt