The world is aging. Across the globe – and especially in the United States, Japan, and Western Europe, the triad where most of the world’s wealth is created and held – falling birth rates and lengthening lifespans are causing populations to age rapidly. Over the next two decades, the median age will rise from 43 to 50 in Japan and from 42 to 51 in Italy. Across the triad, the working population will stagnate or shrink, while the number of retirees will explode.

Aging and its implications are emerging as major social, political, and economic issues. Social Security reform is making headlines in the United States, and the long-term solvency of pension plans – both public and private – is a growing concern across the triad countries. Policy-makers are wrestling with the fiscal consequences of aging and seeking solutions. Business leaders and investors are seeking to understand how aging will affect global markets for goods, capital and labor.

In this report, we seek to shed light on an important and difficult question around aging: How will aging affect future levels of household wealth and economic well-being? To address this question, we focus on five triad countries – the United States, Japan, the United Kingdom, Germany, and Italy – which together account for two-thirds of global financial assets.¹ For each country, we leverage microeconomic data and insights on household financial behavior to project aging’s impact on future levels of household wealth – particularly the liquid financial wealth that fuels global investment and growth. Our "micro-to-macro"

¹ Data from McKinsey Global Institute’s Global Financial Stock Database.
approach, combined with our global coverage, offers a distinctive new window onto the impact of aging on global wealth, and what can be done to counteract this impact.

Our key finding is that over the next two decades, in the absence of dramatic changes in population trends, saving behavior, or returns on financial assets:

- Growth in household financial wealth will slow by more than two-thirds, from 4.5 percent historically to 1.3 percent.

- This slowing growth will cause the level of household financial wealth to fall some 36 percent, or by approximately $31 trillion,\(^2\) below what it would have been had the higher historical growth rates persisted. (Exhibit 1).

**Exhibit 1**

**AGING WILL CAUSE A GLOBAL WEALTH SHORTFALL**

Household financial wealth

$ Trillions, 2000

<table>
<thead>
<tr>
<th></th>
<th>Extrapolation of historical growth(^*)</th>
<th>2003-2024 projection based on demographic trends</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>51</td>
<td>32</td>
</tr>
<tr>
<td>Japan</td>
<td>17</td>
<td>9</td>
</tr>
<tr>
<td>UK</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>Italy</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Germany</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>85</td>
<td>54</td>
</tr>
</tbody>
</table>

| Projected shortfall (%) | -37 | -47 | -34 | -39 | -25 | -36 |


Source: McKinsey Global Institute Household Financial Wealth Model; xe.com exchange rates

This shortfall, left unchecked, could significantly reduce future economic well-being and exacerbate the challenge of funding the retirement and health care needs of an aging population.

\(^2\) Unless otherwise noted, all growth rates and rates of asset appreciation/depreciation are expressed in real terms. All values are expressed in 2000 US dollars.
Our analysis suggests no easy answers. In order meaningfully to counterbalance this demographic impact, households and governments must increase savings and seek higher returns on those savings. These goals will be difficult to achieve. We also find that many measures commonly discussed as "solutions," such as raising birth rates or increasing immigration in fact do little or nothing to counteract the financial wealth shortfall we project (Exhibit 2).

**Exhibit 2**

**ADDRESSING THE WEALTH SHORTFALL**

<table>
<thead>
<tr>
<th>Sensitivities</th>
<th>% of shortfall closed</th>
<th>High and low countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher returns on savings*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher savings by young cohorts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased retirement age**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher birth rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher immigration</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Impact of a 1% increase in rate of financial asset appreciation  
** Estimated by prolonging peak saving years by 5-10 years  
Source: McKinsey Global Institute Household Financial Wealth Model; MGI analysis

We outline additional findings below. Readers interested in our detailed findings and analysis at the national level are directed to the chapters dedicated to each of the five countries. Those interested in our analytic approach and sources are directed to the technical note, glossary and bibliography at the end of this report.

* * *
AGING WILL EXERT SEVERE DOWNWARD PRESSURE ON GLOBAL FINANCIAL WEALTH

- Aging will cause growth in household financial wealth to slow by more than two-thirds across the countries we studied, from 4.5 percent historically to 1.3 percent going forward. This slowing growth will cause the level of household financial wealth in 2024 to fall some 36 percent, or by approximately $31 trillion, below what it would have been had the higher historical growth rates persisted. Like all projections, these numbers must be treated with caution, but they strongly suggest that global aging will exert severe downward pressure on global financial wealth over the next two decades – with important implications for the sustainability of investment, economic growth, and living standards going forward.

- Across the triad, the United States is by far the largest source of the global shortfall ($19 trillion), because of the US’s dominant share of global financial wealth (Exhibit 3). After the US, Japan stands out as the second-largest source ($8 trillion) of the global shortfall, because its demographic trends are so severe. We project that Japan’s household financial wealth will stop growing and enter an absolute decline over the next two decades, driving a 47 percent wealth shortfall – by far the largest among the countries we studied (Exhibit 4).

TRIAD NATIONS CANNOT RELY UPON CROSS-BORDER SAVINGS FLOWS TO MAKE UP DOMESTIC SHORTFALLS

- The prime saver ratio – the ratio of households in their peak earning and saving years to those who are entering retirement and therefore saving less - will be low or falling over the next two decades in every country where we studied this trend. This synchronization is new and significant. Until 2000, the US prime saver ratio moved upward, counteracting the downward trend in Japan and Europe. The year 2000, however, represented an important inflection point: in 2000, the US prime saver ratio peaked, and for the next two decades the prime saver ratio will be low or falling across the triad (Exhibit 5).
Exhibit 3
IN THE US, AGING WILL DRIVE A $19 TRILLION (37%) WEALTH SHORTFALL BY 2024
Household financial wealth
$ Trillions, 2000

Exhibit 4
IN JAPAN, AGING WILL CAUSE A $8 TRILLION (47%) WEALTH SHORTFALL BY 2024
Household financial wealth
¥ Trillions, 2000

Source: BLS Consumer Expenditure Survey; Diary Survey; Federal Reserve Flow of Funds (June 2004); McKinsey Global Institute Household Financial Wealth Model
There is no country outside the aging triad that can generate enough new financial wealth over the next two decades to meaningfully address the global wealth shortfall we project. China’s stock of financial assets has been growing at a remarkable 14.5 percent compounded annual rate over the past decade, but its share of global financial assets remains just 4 percent – less than one-third that of Japan. Other fast-growing economies have yet to accumulate enough financial assets to make a difference: India’s financial assets have grown at 11.9 percent per annum over the past decade but account for less than 1 percent of the global total. Similarly, Eastern Europe’s financial assets have grown at 19.3 percent per annum since 1993 but remain less than 1 percent of the global total.3

Given the global scenario, the triad countries will find it increasingly difficult to rely on cross-border saving flows to make up domestic shortfalls in financial capital. This presents a particular challenge for the US, which has in recent years absorbed more than half of the world’s cross-border savings flows while running a current account deficit.

3 Data from McKinsey Global Institute’s Global Financial Stock Database.
deficit expected to exceed 6 percent of GDP in 2004. Most of this cross-border savings has come from Japan and Europe, where, as we’ve seen, aging will exert increasing downward pressure on financial wealth – and thus pressure on the US to reduce its current account deficit. The need for action is all the more urgent because the current account deficit will be hard to reduce: recent MGI research\(^4\) has shown, for instance, that the cross-border activities of US-based multinationals, while creating enormous new wealth, tend to increase the US current account deficit – and are likely to have an increasing impact going forward.

**HIGHER RETURNS ON SAVINGS CAN HELP ADDRESS THE WEALTH SHORTFALL BUT WILL BE HARD TO ACHIEVE**

- Returns on savings vary widely across the countries we studied: US and UK assets have returned nearly 1 percent per annum since 1975, while the other countries we studied have experienced negative real returns. This variation is an important driver of differential outcomes across triad countries: the US and UK leverage high returns to accumulate wealth despite low savings, while Japan and continental Europe save at higher rates but accumulate less wealth because of low returns on savings.

- Returns are a critical driver of household wealth in some countries, but not in others. From 1975 to 2003, asset appreciation was responsible for almost 30 percent of the increase in the value of household financial assets in the U.S. – but was actually a net negative for Japan (Exhibit 6). European countries fall between the US and Japanese cases: both returns and savings are important drivers of wealth accumulation.

- Returns are also becoming an increasingly important driver of savings, through "wealth effects." When households experience increases in their wealth – when their equity or home values rise – they respond by consuming more and therefore saving less. In the US, for instance, these

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"wealth effects" are estimated to increase spending by 3 to 5 cents for every dollar increase in financial asset values, and by 5 to 8 cents for every dollar increase in home values. These effects can be significant; the $2.7 trillion rise in home values from 1995 to 2002, for example, implies a decline in savings of between $135 billion and $243 billion.

- Higher returns can help address the wealth shortfall. In Germany, for instance, an increase in unrealized capital gains of approximately one percentage point, above the historical average of -1.1 percent to 0 percent over the next two decades, would fully address the wealth shortfall. Returns would need to more than double to eliminate the US' wealth shortfall. Japan and Italy would require an even larger shift in returns to achieve the same results.

- However, higher returns will be difficult to achieve, requiring a broad, sustained effort by the public and private sector. Raising returns will require progress in three challenging arenas: 1) economy-wide capital efficiency, 2) the efficiency of financial intermediation, and 3) household asset allocation.
HIGHER SAVING IS A PARTIAL SOLUTION

- Younger generations are earning far more but saving far less than their elders across many triad countries. Our research shows that this dissaving by the young is an important source of the wealth shortfall in both the US and, more surprisingly, in Japan. What if younger generations could be made to save at the same rate as their elders, through policies to encourage saving and discourage consumption? We find that such a dramatic change would at best be a partial solution to the wealth shortfall. In Japan, for instance, this change would increase the growth rate of financial wealth from -0.2 percent to 0.8 percent, closing one-quarter of the 2024 wealth shortfall. In the US, the impact would be more meaningful, increasing growth in household financial wealth from 1.6 percent to 2.4 percent, thereby closing nearly a third of the wealth shortfall.

- Life spans have lengthened, but the average retirement age has not increased correspondingly: workers who could continue to earn and save for several more years are instead retiring earlier. What if this trend could be reversed, and workers delayed retirement, prolonging their peak savings for an additional 5 years? We find that this change would help address the wealth shortfall in some countries but not in others – the impact is greatest in those countries where saving falls off sharply in retirement. In Japan, for instance, we find that this change would raise the growth of household financial wealth from -0.2 percent to 0.7 percent – a substantial improvement that would close one quarter of the wealth shortfall we project. In Italy, by contrast, because saving behavior changes little in retirement, this change would have a negligible impact.

- Household liabilities are growing faster than assets across the countries we studied: since 1982 liabilities have grown 5.5 percent per annum, versus 4.8 percent for assets. At least three interrelated factors are at work: 1) real estate markets have appreciated dramatically in many countries, causing home owners to borrow more; 2) credit markets have developed, widening access to credit; and 3) younger cohorts are more comfortable with debt than their elders. What if liability growth could be held to the same
rate as asset growth going forward? We find that this change would make only a modest impact, increasing household wealth by $2.3 trillion in 2024 and closing just 7.5 percent of the total wealth shortfall across the countries we studied.

OTHER MUCH-DISCUSSED SOLUTIONS OFFER LITTLE OR NO RELIEF

- Raising fertility rates in the triad countries will not help address the wealth shortfall over the next two decades, because 30 years are needed for new babies to become prime savers. Indeed, in the near term, a new baby boom would probably reduce saving by increasing household spending on children.

- Similarly, increasing immigration will do little to address the wealth shortfall over the next two decades. In Germany we found that even if immigration were 50 percent higher than the government’s "base case" projection, 2024 household wealth would thereby increase by only 0.7 percent over the base case. Immigration’s impact is negligible for two main reasons: 1) even under aggressive immigration scenarios, immigration adds only a modest increment to overall household growth; demographic trends within the nonimmigrant population therefore remain the dominant force shaping the rate of household growth; and 2) immigrant households tend to start with lower levels of household assets, so their contribution to the country’s total household wealth is relatively modest.

- Finally, our analysis shows that the triad countries cannot grow their way out of the problem by simply boosting the overall rate of economic growth. As incomes rise, consumption tends to follow. As a result, higher growth – without an accompanying increase in the saving rate – will do little to address the coming global wealth shortfall.