Lower salary increases mean less retirement savings
But working longer can help

Wage freezes have and will continue to be a reality for many people as South Africa battles the COVID-19 pandemic and its destructive impact on the local and global economies.

Salary increases have been trending downwards for several years. Gone are the days before the Great Financial Recession when top performers could achieve double digit increases. Now, increases in line with inflation are more likely – if you are lucky.

According to a salary trends report from PEC Corporate Services, over five years to the end of 2019 salary increases have, on average, only beat inflation by 1.4%, including increases for promotions.

What effect can a zero percent increase have on your retirement savings? As contributions to employer pension or provident schemes are based on a percentage of your salary, the answer is clear. The lower your increases, the lower your contributions to your retirement fund will be, as well as the amount of your employer's contribution. And the less money you have invested to capitalise on any investment growth.

When you consider that most South Africans retire without sufficient savings, a lack of decent increases will exacerbate the problem, says Twané Wessels, Product Actuary at retirement income specialist, Just.

One way to help address this is to work for longer, providing your employer allows this. Wessels looked at the impact of working up to five years longer to boost your retirement savings. She began with a retirement age of 65 and looked at the impact of adding savings between 0% to 20% of your annual salary over the following five years. She considered different rates of real (after inflation) returns on these savings, from 1% to 7%.

If you continue to make contributions to your retirement fund for a further five years after age 65, your replacement ratio will improve substantially, particularly if you have not saved enough. Replacement ratio is a rule of thumb that estimates what percentage of a person's pre-retirement income can be achieved in retirement.

If, for example, you have only saved the equivalent of one year of your current salary and make no further contributions and receive no further salary increases, deferring your retirement by five years can improve your replacement ratio from 10% to between 12% and 16%. The range depends on whether your savings earns between 1% and 7% real investment returns. If, instead, you save 10% of your monthly salary during the five years of deferment, you can further improve your replacement ratio to between 18% and 23%. And if you are lucky enough to be able to save 20% of your salary, you can improve your replacement ratio to between 24% and 30%.

If, on the other hand, you have accumulated 5 times annual salary and you continue with a 20% contribution rate during the five years of deferment the replacement ratio can be improved from 50% to between 73 and 95%.

"Working longer can help with your retirement readiness, and continuing to save as much as you can while deferring your retirement date is very important."

A 'side hustle' or some consulting work in the years leading up to your retirement can also boost your retirement savings pot, as the same benefits apply to any additional money saved.

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