

Good news bad news

Economists predict an upturn on capital markets this year. Still, pension plan sponsors face rising costs and the possibility of a war on Iraq.

By Caroline Cakebread

THE UNITED STATES IS PUTTING PRESSURE ON IRAQ TO reveal its arsenal of weapons—or else. At press time, the United Nations' head weapons inspector, Hans Blix, said he was "not satisfied" with Iraq's

12,000-page weapons declaration. There is a real possibility of war in the Gulf, perhaps as soon as the next few months.

That scenario, and its potential impact on capital markets, comes during what is already a challenging time for pension plan sponsors in Canada. Despite a relatively rosy outlook for the Canadian economy, a new survey of economists predicts that pension expenses will continue to rise this year.

Watson Wyatt Worldwide's Annual Survey of Economic Expectations documents the views of leading economists for 2003 and the long term. The survey is sent out to economists at major financial institutions and manufacturers. Participants are asked to respond to questions, forecasting macro-economic activity and financial indicators.

REAL GROWTH

Survey participants see a bright future in 2003 for economic growth in Canada and the U.S. "We're talking about 3% real growth in Canada and, in the States, 2.9%," says John Gilfoyle, national practice director of investment consulting for Watson Wyatt Canada in Toronto. But that's not going to be enough to stave off major difficulties for companies sponsoring defined benefit pension plans.

The long-term return forecast for funds with 60% equities and 40% fixed income is 6.9%. Gilfoyle points out that last year's survey incorrectly predicted long-term returns at 7.5%, "so we're down another half point." At that rate, he says, sponsors of defined benefit pension plans can expect funding liabilities to increase between 5% and 12%. That means more contributions for plan sponsors.

"We recommend that contributions and pension expenses be reviewed very strongly over the next

three to five years," says Gilfoyle. "We're talking about serious increases in contribution levels."

He says surpluses have been drained and they won't be there to borrow from in the near future. "There will be no surplus in the vast majority of cases, which means that they don't have any leeway and they're going to have to start increasing contributions."

Gilfoyle's recommendation for plan sponsors is clear. "Even though you might not need to do an evaluation of contribution levels right now, do one in order to find out what sort of contributions might be recommended."

TWELVE PER CENT

Looking back at 2002, economists surveyed by Watson Wyatt missed the mark on a number of short-term levels. They forecast 9% to 12% returns on equity markets for last year. That obviously wasn't realized. The Standard & Poor's/Toronto Stock Exchange composite index fell 13.9% during 2002. The Canadian dollar didn't fare any better, despite the fact that last year's survey participants expected it to rise.

Last year's predictions were of course complicated by the terrorism question. Surveyed not long after the Sept. 11, 2001 attacks on New York and Washington, the possibility of further terrorism hung over those economists asked to make calls on the global economy and capital markets. Their positive predictions suggest they discounted that possibility almost completely.

This year, with a second war with Iraq looming on the horizon, the environment is similar. Gilfoyle explains that the surveys were returned in mid-December. So while participants weren't asked about war specifically, "it will have been incorporated in their responses." Their healthy predictions for both the U.S. and Canada leads him to conclude that there will likely be no impact if war is declared. "If there's going to be an impact, it will be short-term," says Gilfoyle. **BC**

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