Retirement Spending

How much are you going to spend in retirement? What once seemed like a simple question has become incredibly complicated in recent years.

Why? First of all, a diminishing number of people actually plan to leave work and embrace leisure on a full-time basis, and those who do seem to be doing it later than people from earlier generations. Of the oldest baby boomers, who are now age 68, only 52% are actually retired. 21% are still working full-time. According to a Gallup survey, 37% of Americans say they plan to work full-time past the age of 65, but that may be underestimating the actual shift in preference. A 2012 survey conducted by Transamerica found that just 19% of workers expect to retire full-time by age 65.

When people DO leave the workplace, it now appears that some of the assumptions about their spending habits will have to be revisited. The default assumption for many retirement plans is that what you spend now for things like food, clothing etc. will remain pretty much the same the day after retirement as they were the day before. Your home mortgage may or may not go away in retirement and the expenses related to commuting to and from work will diminish. When you sort it all out, you end up with a baseline spending plan, which includes a new car every few years, dining out occasionally, making home improvements and other basic necessities. These expenses have traditionally been assumed to increase each year roughly with the inflation rate.

On top of that, it was assumed that in the vigorous early years of retirement, people would spend more on travel and country club memberships than they did when they were working, so their overall expenses would go up the day after they retire and gradually diminish as they found it harder and harder to play 18 holes of golf every day. At some point in the age curve, health expenses would start to rise. The people who study retirement expenditures talked about a "smile" graph of expenses, where it cost more to live and play in the earlier and later years of retirement than in the middle years.

What's wrong with that? For one thing, when you look at the Bureau of Labor Statistics data on what people actually spend in their later years, it contradicts this comfortable smile pattern. People between the ages of 65 and 74 tended, on average, to increase their annual spending levels between 1.11 percentage points and 1.78 percentage points more per year more than the inflation rate. Over that decade of their lives, any assumption that used the inflation rate would undercount their aggregate spending by somewhere between 11% and 19%. People age 75 and older accelerated their actual spending to (again over the course of the next decade) between 13% and 22% more than the inflation statistics would suggest. After that, healthcare costs would start to dominate the spending pattern.

To make things more complicated, the statistics suggest that retirees tend to cut back on their spending whenever the investment markets go down. In 2009, people age 75 and older, on average, spent less than they did the year before, and they actually spent less than that in 2010. That same year, the average spending of people age 65-75 declined a remarkable 3.55%. As your wealth goes down, so too does your spending.

How can we predict these things in advance? We can't. And it's important to remember that these broad statistics don't apply to your individual circumstances; they just suggest things that most of us should watch out for. The only clear conclusion of the research, thus far, is that we should probably make conservative assumptions about spending, and hope we're pleasantly surprised as the years go on.

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