Quartz

Why Low Interest Rates Are Good for Millennials and Bad for Boomers

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Baby Boomers have it pretty good. They came of age during an era of prosperity in much of the West. Economies grew vigorously, as did wages and the stock market. They didn't need a college degree to land a steady, well-paid job.

Meanwhile, Millennials face more uncertain prospects, having entered the labor market laden with student debt in the shadow of a bad recession (which can have long-lasting negative effects). They must navigate a riskier, winner-take-all economy. To top it off, Millennials have to help pay for their parents' retirements, via the national debt the Boomers racked up.

If may seem unfair, but the tide is turning. Bad financial luck has come for the Baby Boomers, in the form of persistently low—and even negative—interest rates.

What low rates mean

Low interest rates pose both costs and benefits. Whether you win or lose depends who you are.

On the one hand, low rates are great if you owe money because borrowing costs fall, in the form of cheaper mortgages and opportunities to refinance student debt. Economists also believe that low rates encourage economic growth by lowering the cost of borrowing, which encourages businesses to take mores risks and expand their operations. Low rates also benefit stock market investors, because share prices are based on projected cash flows that are discounted using current interest rates. If low rates stimulate investment, projected cash flows rise. Also, the lower the discount rate, the more investors value a stock's future cash flows, bidding up valuations.

On the other hand, if you are lending money, keeping your savings in bonds, or just sitting on cash in a bank account, you'll get a lower return when interest rates are low. This hits hardest if you don't have other forms of income to rely on, like if you are retired. Pension funds also value their future benefits using interest rates, so lower rates mean that benefits promised tomorrow are more expensive today. This means firms that offer pensions must put more money aside, leaving less money to invest in other parts of their business.

Boomers own more bonds and have more savings

Younger people tend to borrow more, so low rates are good for them. Older people, especially those nearing retirement, tend to be savers. According to the US Federal Reserve's Survey of Consumer Financesthe leverage ratio (the ratio of debt to assets) for Americans 25 to 40 is 56%; for Americans over 60 it is just 4.5%.

As people age, they are generally advised to shift their investments towards less risky assets. Americans over 55 have about 43% of their retirement assets in stocks, versus 56% of assets for Americans between 25 and 40. With a majority of their money in bonds or cash, lower rates hit Boomer portfolios harder. Granted, the average Boomer stock portfolio is still bigger than the typical Millennial's—they've had years to save and economic good luck—but the Boomer's holdings also face more rate risk.

The other way low rates are bad for Boomers is the cost of retirement. One way to value retirement is it to take all your projected spending and discount it at prevailing interest rates. Lower rates make future spending more expensive in today's prices. This is reflected directly in the prices of annuities. If you wanted to buy an annuity worth $25,000 a year for a 20-year term, at current rates that income results in a $420,000 premium. Twenty years ago, when interest rates were much higher, it only cost $280,000. This means retirement savings today are a third less valuable than 20 years ago. Put another way, retirement is a third more expensive for Boomers than it was for the generation before them.

Generational wealth is not a zero-sum game. If the economy grows, every generation benefits and each lives better than the one before. Certain policies and economic conditions can break this cycle. So far, persistently low rates are the first lucky break for Millennials and stroke of bad fortune for Boomers.