

The Bump and Grind of Demographics

Forces of change seem to come in one of two varieties: bumps and grinds. Bumps are generally an event contained in a short term that produces profound effects. Think about 9/11 or an earthquake. Grinds are slow, almost imperceptible events, which produce significant change over longer time periods. Think climate change or the peak oil story.

Demographic changes are often thought to be a grind factor for obvious reasons. However, with the ebbing of the financial and economic crisis, countries contemplate fiscal reform: the dramatic shifts in demographic influence will likely shape policy in powerful ways and may be experienced as a bump and a grind.

Consider the fact that by the end of next year Japan will have roughly three million fewer workers than it did in 2005. Obviously this has significant implications for macro-economic performance and policy. The demographic changes taking place around the world are simply profound. High sounding references to a balanced global economy without taking into account the shifting sands of demography is like talking about health care reform in the United States without talking about what people are eating.

Fertility 2.1

In order for a population to grow, females need to have more than 2.1 children. The United Nations estimate that last year the world fertility rate stood near 2.8, up from 2.65 between 2000 and 2005 period. The United States is the only advanced industrialized country that matches the replacement rate and then just barely. The data suggests the U.S. fertility rate has increased to 2.1 in 2008 from 2.04 in 2000-2005.

Japan is the least fertile of the major industrialized countries at 1.22, slipping further from the 1.29 rate that prevailed in the earlier period. Italy and Spain are at 1.3. Russia, Germany and Switzerland are around 1.4. Both Canada and the UK are both around 1.6.

China's fertility rate in 2008 was 1.77 and seems to be stabilizing in recent years. India's fertility rate continues to fall. In 2000-2005, it stood a little above 3.1 and last year was at 2.76. Brazil's rate is also slipping. In 2008 it was 2.22 compared with 2.35 in the 2000-2005 period.

Surprise!

As one could imagine, long-term demographic projections are notoriously volatile. In 1998, the UN estimated that the world's population in 2050 would be 8.9 billion. Two years later they revised this projection upwards by 400 million people, which is roughly the population US and Mexico combined. Now its estimate is at 9.1 billion. Different assumptions and models generate different projections, with most estimates seeming to fall between 8 and 10.5 billion.

Although Germany reported that its number of births increased for the past two years, UN projections suggest that by 2050 both France and the UK will surpass it in population. Unbeknownst to many, UK births have been rising for several years and its fertility rate was near its highest in more than quarter of a century in 2007, as the age of parenthood appeared to increase. Since the middle of the decade, Scotland's birth rate has increased by almost 5%.

Immigrants have played an important part. In Scotland, immigrants from Eastern Europe account for about a third of the baby boom. However, it is not just about immigrants. France has surpassed Ireland as the more fertile west European country, but the French government traces only 5% increase in the birthrate to immigrants. Birthrates of immigrants tend to take 1-2 generations to gravitate toward the statistical norms of their new homes.

The UN projects the U.S. population will rise toward 438 million by 2050 from a little more than 300 million today. Pew Research estimates that more than three-quarters of this will come from new immigrants and their descendants. China's population is projected to rise slowly for another 20 years and then fall sharply. The UN figures suggest that the U.S. and China may have the same number of births in 2050.

Today, roughly 10% of China's population is over the age of 65, by the middle of the century this will increase to 25%. It makes sense to ask if China will get old before it gets rich.

Where Did Everyone Go?

There are two other regions that are having significant demographic shifts that will influence geopolitics and patterns of investment. Southern and Eastern Europe are experiencing significant falls in fertility rates. The population of Ukraine is expected to shrink in half by 2050. Italy, Spain, Czech, and Poland are likely to see almost as sharp a decline in their populations.

The combination of falling fertility rates, disease, alcoholism and deteriorating health care means that the mortality rate of the average Russian man is 3 to 5 times higher than men in countries with roughly the same GDP per capita. The mortality rate for Russian woman is twice as high as their counterparts. Within a decade, the working age population of Russia is expected to begin shrinking by one million per year.

While many Middle East countries have a large share of their population below 25, fertility rates are falling dramatically in many of them. Yemen, Palestine, Syria, and Saudi Arabia are noteworthy exceptions to this generalization. Turkey, Lebanon, Algeria, Tunisia, and Iran have experienced fertility rates which have reached European levels.

Iran's demographics are particularly interesting. It is experiencing one of the largest population shifts ever recorded. In 1980, as the Council of the Islamic Revolution took over, the Iranian fertility rate stood at 6.5. By 2000, it had fallen to 2.2 and today is near 1.7. The population surge of recent decades is slowing: the median age today is about 26.5 years. By 2050 it will be near 40. While the population will be about a third larger than the 75 million today, it will have fewer working people and may be nearly out of oil.

The Real New Normal

The median age of a country's population is important for social programs, savings, investment, and consumption. In 2050, the UN estimates the median age of Japan and Germany will be 53 and 52 respectively. The average Italian will be 51. The average French and Chinese person will be 45, while the average U.S. citizen will be just shy of 42.

Some economists have traced a good part of the current global imbalances to demographic differences. The demographic developments that are projected will likely assist in the reduction of the U.S. current account deficit, for example, the surpluses of Germany, Japan, and China.

The combination of lower fertility rates and expanding longevity translates into fewer wage earners per pensioner. There are several solutions outside of higher taxes that countries will likely adopt. This new norm will include later retirements. The retirement age may creep up toward 65 in the coming years and could be as high as 70 in a couple of decades.

Many countries will also have to increase their work force participation rate. In the U.S., roughly seventy percent of working age people are in the labor market compared with 64% in the EU. To meaningfully boost the labor force participation rate, women are going to have to be integrated to a greater extent. In the U.S. a little more than 2/3 of working age women are including in labor force measurements. By contrast, less than half of Japanese women are counted in the labor force and roughly 51% of German women. In the UK, 55% of the working age women are in the labor force and only 45% of Spanish women. About a third of Indian women are part of the labor force. In China, female participation is twice as high as in India.

The greater participation of women in the labor market will have reverberations throughout society, including division of labor within the family, different demands on education institutions, consumption and saving patterns, leisure time activities, etc. etc.

Just as light has both wave and particle characteristics, we are experiencing demographics shifts as both bump and grind. Businesses, investors and policy makers can no longer ignore demographic changes. These changes may very well have the most profound impact on society, the international political economy, and the distribution of power. The U.S. is in a relatively favorable position to cope with the demographic changes that are already underway.

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