

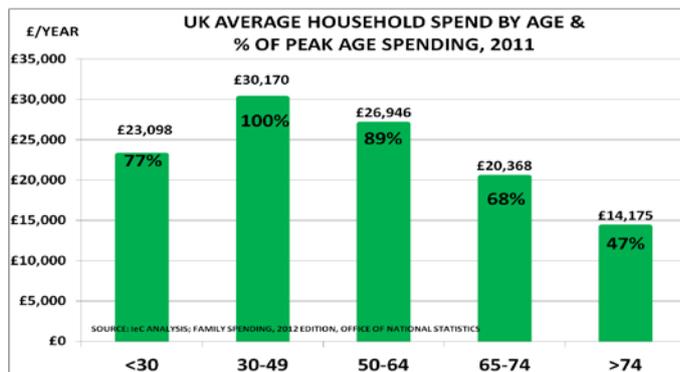
**SUSTAINING ECONOMIC GROWTH AS THE UK ARRIVES AT THE
'DEMOGRAPHIC CLIFF'**

SUMMARY

We welcome the Committee’s decision to question Dr Carney on his views regarding possible alternatives to the inflation targeting that underpins the current work of the Monetary Policy Committee. It is now 6 years since the late Lord George told the Committee in March 2007 that in dealing with the 2001-2 recession, “One had only two alternatives in sustaining demand and keeping the economy moving forward: one was public spending and the other was consumption.” It appears that since then the MPC has continued to follow Lord George’s prescription, notably by reviving the concept of quantitative easing. Yet as the Governor’s Belfast speech on 22 January made clear, the key question remains unanswered, namely “has the process of recovery and rebalancing been derailed or merely delayed?”

Against this background, it is clearly critical to understand whether Dr Carney may bring with him new insights into the current regime of inflation targeting which would make recovery more certain. We are doubtful, however, that such a magic wand exists. As the Governor also noted in his speech, “We are not in a typical post-war business cycle recession”, with the result that “living standards have been squeezed for longer than at any time in living memory”. In our view, a more fundamental review of the situation is essential. This should aim to learn not only from developments in Canada, but also from New Zealand’s successful adoption of a Long-Term Fiscal Model.

DEMOGRAPHICS DRIVE DEMAND



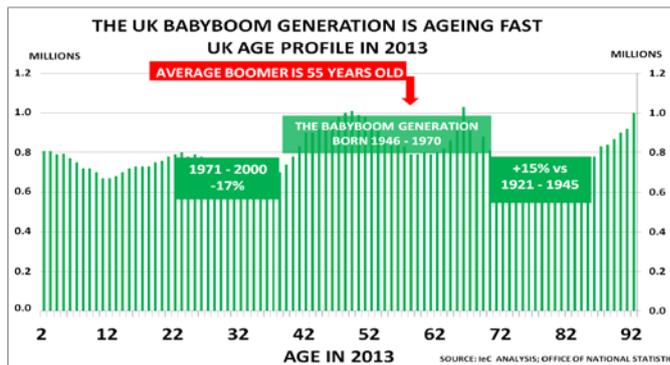
The evidence we have assembled for our new eBook, ‘Boom, Gloom and the New Normal: how the Western Baby Boomers are Changing Demand Patterns, Again’, presents a powerful case for the common sense argument that demographics drive demand.

It is well known that the UK is now an ageing society, with over a third of the population now in the over-50 age group. Less well appreciated, however, is the data from the ONS Family Spending Survey which highlights the dramatic decline that takes place in household spending as people transition into this cohort.

As the chart shows, young people aged between 30-49 years spent an average of £30,170 in 2011, whereas those aged 50-64 years spent only £26,946, and those aged 65-74 years just £20,368. The reason is two-fold: (a) older people already own most of what they need, and so mainly buy replacement rather than new products and (b) they have lower incomes as they enter retirement. Against this background, today’s slowdown in GDP growth appears much less remarkable, given that household expenditure is 60% of the UK economy.

It also seems unlikely that either monetary or economic stimulus can easily reverse the key causes of today's ageing society. The positive impact of greatly improved public health and better lifestyles means that UK life expectancy has risen to around 80 years compared to 69 years in 1950. Equally important is that the average woman has just 1.87 children today, compared to the 2.81 peak of her mother's generation in the 1960s.

1 JANUARY MARKED A KEY DATE IN THE DEMOGRAPHIC TRANSFORMATION



As the second chart shows, 1 January 2013 marked the moment when the average UK BabyBoomer (born in 1958) celebrated their 55th birthday. They joined the 18 million people already in the 55+ cohort.

They can now look forward to another decade or more of active life compared to earlier generations.

This **change in demographic profile is unprecedented** in UK history and means we now have the oldest population in history. In turn, it takes the economy into **uncharted territory**, creating opportunities as well as difficult challenges. It is therefore essential that the MPC under Dr Carney's new leadership confronts these challenges head-on. The scale of the transformation is simply too large for these to be solved by a fine-tuning of existing policies:

- ❖ Between 1946-70, the UK saw a unique boom in the number of babies born each year.
- ❖ Births suddenly and unexpectedly jumped 15% versus the previous 25 year period, averaging 901,000 a year instead of 784,000 a year.
- ❖ This added 3 million babies to the population, equivalent to the population of Wales.
- ❖ The next generation, born between 1971-2000 was 17% smaller, with only 746,000 births each year. So it cannot compensate for their parents' lower spending.

Certainly no Boomer, faced with this bonus of extra life, would dream of describing it as 'lost decades'. This is the paradox at the heart of today's economic debate. Yet at the moment, the MPC is continuing to fight yesterday's battles, rather than focusing on the real challenges that confront us.

A proper national debate on the challenges and opportunities presented by this demographic transformation is now long overdue. New Zealand's successful adoption of a Long-Term Fiscal Model highlights the benefits of such an approach. The Committee's session on 7 February provides the perfect opportunity for this debate to begin.

Paul Hodges
 Chairman, IeC