



Policymakers are like ostriches with their heads in the sand over the impact of demographics

Plan for a volatile world

While policymakers argue about the impact of stimulus measures and when to adjust them, they ignore the demographic trends that are really driving economies

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We are living in an increasingly volatile and uncertain world – as Unilever CEO Paul Polman has described – where complexity and ambiguity are rising all the time. Last year’s Outlook was titled “Global economy faces tough 2013” (7-13 January 2013), and today, most people would now accept this as a fair summary of the outcome. But a year ago, most policymakers were remarkably upbeat and convinced full recovery was “just around the corner”.

This followed the pattern seen since September 2009. Then the G20 group, comprised of the world’s richest nations, met in the US and is-

sued a statement congratulating themselves on having delivered “the largest and most coordinated fiscal and monetary stimulus ever undertaken” – and claiming that “it worked”.

Today, life is therefore becoming increasingly difficult for company boards and business managers. Policymakers continue to believe that a lack of liquidity is at the heart of today’s problems. They argue that the 2008 crisis broke some of the key plumbing in the financial system. And it needed a power hose filled with \$33 trillion (€23 trillion) of global liquidity to flush through it and unblock the problem areas.

They admit they underestimated the scale of the problem back in 2009, but now they believe they have finally resolved it through

their own version of “shock and awe”. Thus central banks in all the major Western countries are lining up to tell us that recovery is really now underway. Investors certainly want to believe them and have taken stock prices to record levels in many major markets, including the US.

Of course, not every stock market collapse leads to a recession. But neither does every market peak lead to economic recovery. So while companies clearly have to take account of policymakers’ optimism, experience tells us to be cautious about believing they can deliver everything they say. This is the problem that Polman has identified, that we are living in what he has named a “VUCA” world, where volatility, uncertainty, complexity and ambiguity dominate.

SCENARIO PLANNING IS VITAL

Scenario planning has thus become an essential tool for survival. The range of outcomes is now so vast and the consequences of each so different, that it would be foolish to wait until we know with confidence what is going to happen. Boards need to accept that the world has likely changed. They need to focus on the new opportunities that are developing, and plan ahead to mitigate the major challenges that may be emerging.

We would therefore like to propose one highly-relevant scenario for boards to consider – the Demographic Scenario – alongside their current Recovery Scenario. This was first summarised in our ICIS-published eBook “Boom, Gloom and the New Normal: How Ageing Populations are Changing Demand Patterns,

Again” in 2011. Its core argument is now receiving more and more attention as business managers come to the conclusion that continued blind faith in policymakers’ Recovery Scenario is misplaced.

Today we would argue that the world has arrived at a critical T-junction. As PIMCO, the world’s largest bond fund managers describe it, we are approaching a moment “where markets realise that the policy Kings/Queens have no clothes... and that monetary and fiscal policies cannot produce the real growth that markets are priced for”. It leads PIMCO to the sombre conclusion that “global economies and their artificially priced markets are increasingly at risk”.

What would your business do if this analysis proves correct? Are you prepared for further disappointment, of the type that has become routine over the past few years?

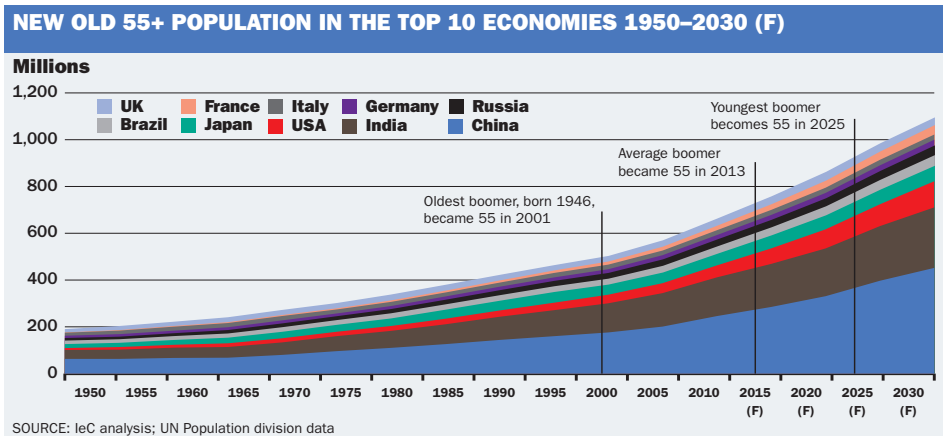
PIMCO, with \$2 trillion of assets under management, cannot be easily dismissed as just a lunatic fringe.

We would argue the businesses need to see the Recovery Scenario as just one potential outcome among many. We also believe it is critical they take account of the Demographic Scenario, and the challenges and opportunities that it presents. It is based on the common-sense idea that demographics are the fundamental driver for demand. This is quite different from policymakers’ assumption that fiscal and monetary policy can always deliver constant growth.

DO NOT IGNORE DEMOGRAPHICS

The Demographic Scenario focuses on the rapid population-ageing now underway in all major economies. Consumer spending is key for economic growth, accounting for between 60-70% of GDP in Western countries. And the plain fact is, as government statistics confirm, that household spending peaks by the age of 55 years and then declines. Thus we argue that today’s ageing populations cannot possibly sustain the SuperCycle levels of demand seen when the Baby Boomers were younger and in their prime wealth creation mode.

The chart shows the dramatic change now underway in the age profiles of the adult pop-



ulation (over 20 years old). It focuses on the world’s 10 largest economies, which between them represent two-thirds of global GDP.

The forecasts have to be accurate, as only those already born can possibly join this age group by 2030. It highlights how:

- The numbers of those in the New Old 55+ generation rose slowly between 1950-2000
- But since then, those numbers have been rising sharply, and will have doubled to 1.1bn by 2030
- Japan shows the largest increase, from 38% of the adult population to 54%; the US rises from 29% to 41%; even India rises from 17% to 25%
- China will see the most dramatic rise, doubling to 41%, as its fertility rate averages 1.1 babies per woman

The reason is the ageing of the Baby Boomers, those born in the world’s great fertility boom between 1946-1970. The oldest Boomer turned 55 in 2001, and the average Boomer followed them in 2013. Now the rest are joining the New Old; the youngest Boomer turns 55 in 2025.

The Demographic Scenario thus provides conclusive evidence to explain why growth is now slowing sharply. It also explains why inflation has largely disappeared despite all the monetary stimulus. Deflation is far more likely to occur when a population is ageing, as older people already own most of what they need and so represent a replacement economy.

Deflation makes it sensible to pay down

debt, because the real value of borrowing increases. It also makes sense to delay purchases for as long as possible when prices are falling. This postponement will anyway be essential for the New Old because their incomes will decline as they approach retirement.

Worryingly also, deflation will make it very hard to repay the vast debts built up in many countries by policymakers’ efforts to create their Recovery Scenario.

Oil prices are another key area likely to see major change under a Demographic Scenario. They have been at record-high annual levels since 2011, supported by the liquidity flow created by the central banks.

But this means they are well above their true value versus natural gas. Oil’s energy value is six times that of gas, so its price would normally be around \$30/bbl with US gas prices at today’s \$4/MMBTU.

Consumers are thus busy switching away from oil to gas wherever they can, accelerating the existing secular trend in this direction. Further volatility is now almost inevitable as today’s mispricing is creating an oil supply glut in the US.

Production is back at 1989 levels, while inventories are well above historical levels. World markets are already feeling the pressure, as US producers argue for a repeal of the 1975 export ban, while Iran, Iraq and Russia are lining up to increase their exports.

Boards may naturally want to believe that this time the Recovery Scenario will deliver on its promise. But today’s VUCA world may well continue to upset conventional wisdom. Those who have prepared in advance for the Demographic Scenario will then prove to be the winners. ■

Paul Hodges is chairman of International eChem (IeC), trusted advisers to the chemical industry and its investment community. With John Richardson, he authored “Boom, Gloom and the New Normal”, published by ICIS over the past year. Board-level strategy workshops are available to help companies exploit today’s new opportunities. Visit www.iec.eu.com/strategy-development



ECONOMY

FUTURE TRENDS IN AUTOS

THE AUTO Industry will see major disruptive change under the Demographic Scenario. This creates four key questions for boards to consider.

What happens if:
 ■ New Olders decide not to bother owning a car, given they will use it even less than

the general average of just one hour per day?
 ■ The “design to cost” model for suppliers – pioneered by Renault’s Dacia range – proves equally successful in Nissan’s launch of its \$3,000 Datsun range?
 ■ The percentage of young

Western men taking the driving test continues to steadily reduce due to their lack of interest in car ownership?
 ■ Car-sharing and the concept of “pay to use” continue to grow exponentially, as seems likely with the support of companies such as Mercedes and BMW?