DEMOGRAPHICS

Shifting population driving economics

Oil market volatility is rising again. Consensus thinking had assumed supply would be on a falling curve by now, while demand would be accelerating due to the success of central bank stimulus policies.

But instead, traders are grappling with the problem of finding storage space for the increasing volume of oil and product inventory. As the International Energy Agency reported in August: "An Organisation for Economic Co-operation and Development inventory overhang continued to shift from crude into products during June, with commercial stocks swelling by 5.7m barrels to a record 3.1bn barrels."

Stockmarket investors similarly risk finding themselves facing in opposite directions at once. The flood of central bank liquidity and the impact of negative interest rates push them into an ever-more frantic search for yield. But they cannot ignore growing concerns over the failure of stimulus policies to create the promised economic recovery.

Annualised oil market volatility (based on the weekly high-low range) is approaching levels not seen since the 1990-91 Gulf War and the sub-prime crisis, yet volatility in the S&P 500 index is near record lows, as investors continue to believe that central banks will never let markets fall.

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The second option, unfortunately, seems far more likely. Common sense suggests it is impossible for central banks to control the economic fortunes of the world's 7.3 billion people simply by adjusting interest rates or printing money.

Our analysis suggests instead that demographics are the critical factor driving the global economy. As the graph suggests, unprecedented change is under way.

Those aged 25-54 have, typically, been the wealth creators within society, dominating the workforce and creating new demand as they settle down, buy homes and cars, and have children.

The 55+ generation, by contrast, have historically been of less economic importance. In 1950, only one in 10 of the world's population was in this age group, and its members would typically die soon after retirement.

But dramatic change has taken place since 1950, due to the rise of the baby boomers, born between 1946 and 1970. They are the largest and wealthiest generation the world has ever seen. They have already caused two major economic upsets, and are now creating a third.

The first was the runaway inflation of the 1960s and 1970s, when their demand simply overwhelmed, creating major shortages in many areas, while causing money supply to rocket. In retrospect, it is clear that Milton Friedman was confusing correlation with causation when concluding that "inflation is always and everywhere a monetary phenomenon". But it is hard to blame him, given that the concept of the baby boom was then unknown.

The second upset came as these babies grew up and became wealth creators. By 1983, the average boomer (born in 1956) was entering this cohort, causing supply to increase at a smart pace. At the same time, the major decline in fertility rates that took place after the baby boom was turbocharging the economy, as women re-entered the workforce after childbirth.

In the US, for example, female participation rates doubled between 1947 and 2000 from 32 per cent to 60 per cent. In turn, they gained greater bargaining power with employers, allowing their wages to rise from 62 per cent of men's wages in 1979 to more than 80 per cent today. This then created the phenomenon of the dual income household for the first time in history.

Now, the third upset is under way. Since 2001, the oldest 'boomers' have been joining the 'new old' 55+ generation. And increasing life expectancy means they no longer die around retirement age. Instead, the average 65 year old can expect to live another 20 years, meaning the new olders will soon be one in five of the global population.

This is good news for them, but bad news for the economy, as new olders already own most of what they need, and their incomes decline as they enter retirement.

It is, therefore, no real surprise that stimulus policies have failed to produce economic recovery, or that oil market volatility is rising. Central banks cannot print babies – and it is babies, when they grow up, that create sustained demand.

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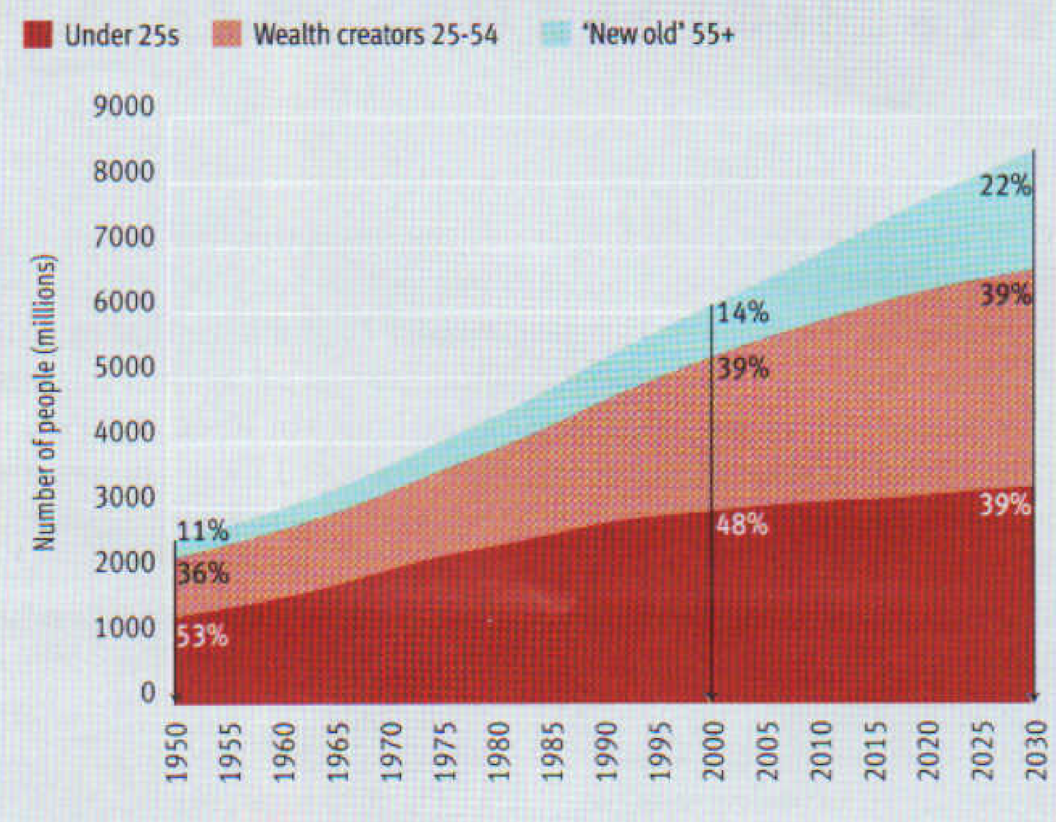
GLOBAL POPULATION SEGMENTS 1950-2030



Source: The pH Report, UN Population Division

EXPERT VIEW SUSTAINABLE INVESTING

Demographics is one of the factors behind the rise of sustainable investing, according to portfolio manager Alex Struc (left) and account manager Kwame Anochie (below) at Pimco. They say:

"Investors globally are becoming more engaged with the environmental, social and governance (ESG) factors that affect the well-being and smooth functioning of the global economy and markets. The widespread endorsement of the United Nations Principles for Responsible Investment initiative, which has more than 1,500 signatories from over 50 countries, is a key example.

"Wealth managers globally are preparing for the great wealth transfer from the baby boomer generation to the millennial generation and female investors. Women are projected to control two-thirds of the world's wealth by 2020 (according to MSCI's issue brief, '2016 ESG Trends to Watch'), and millennials will increasingly become the world's decision-makers. Research also suggests that both millennials and women are increasingly looking to align their investment and financial goals with their values without diminishing their return expectations."