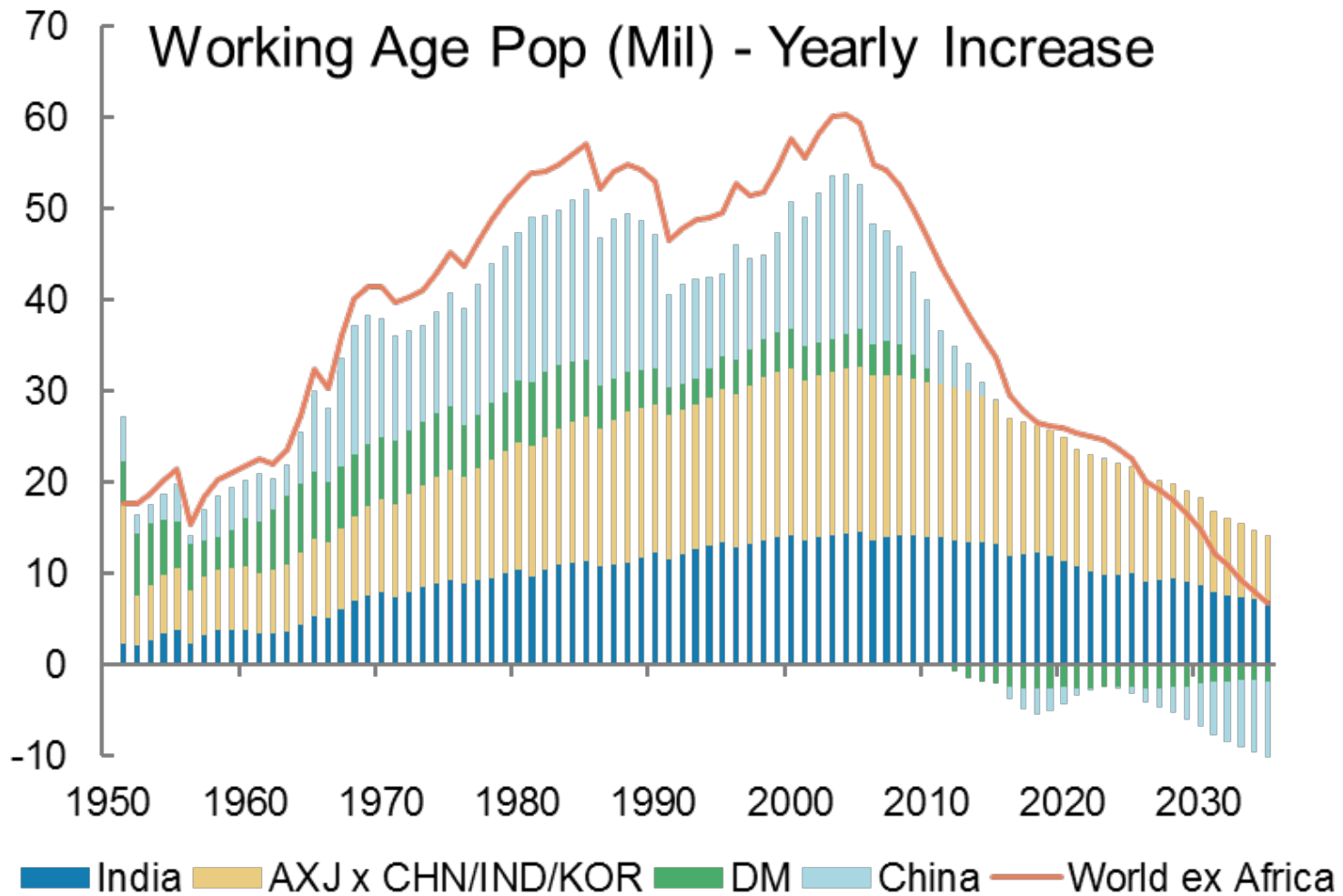
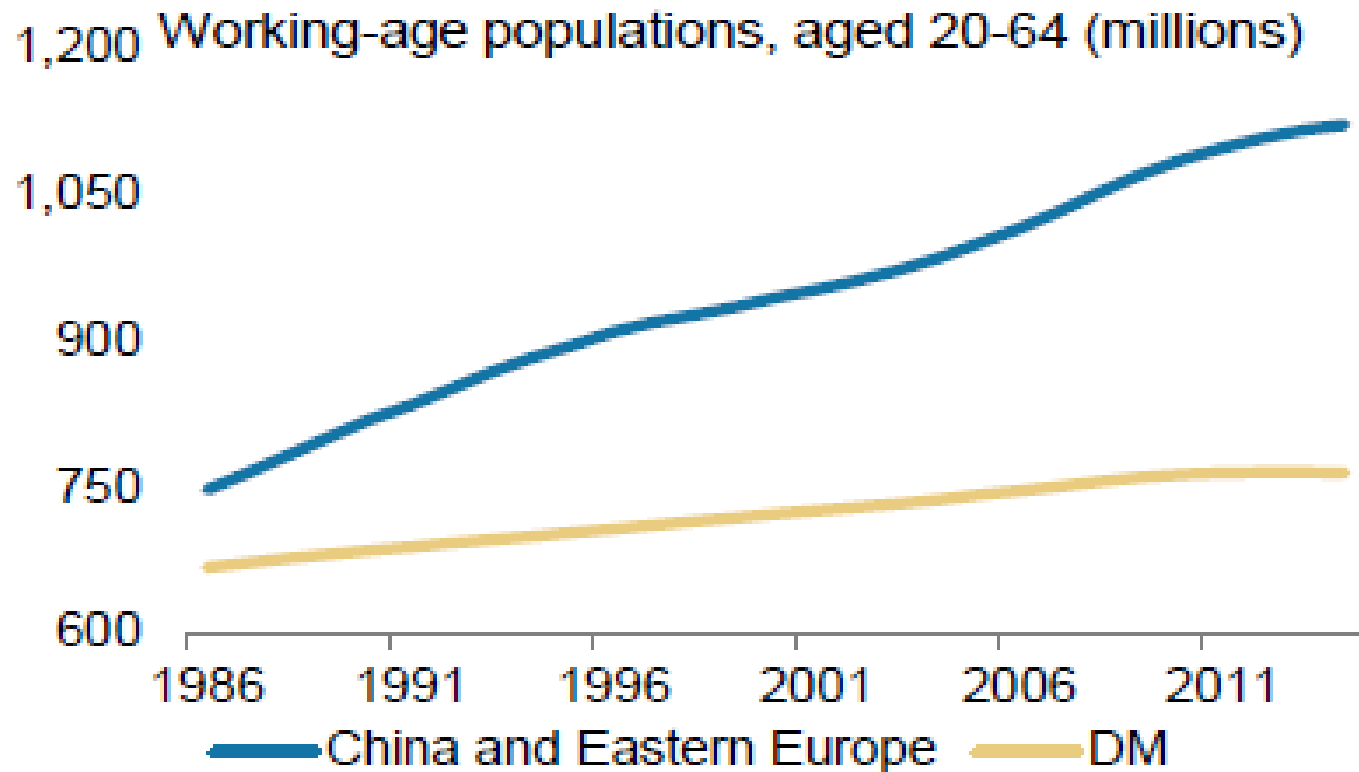


Demography versus Debt

By Charles Goodhart and Manoj Pradhan

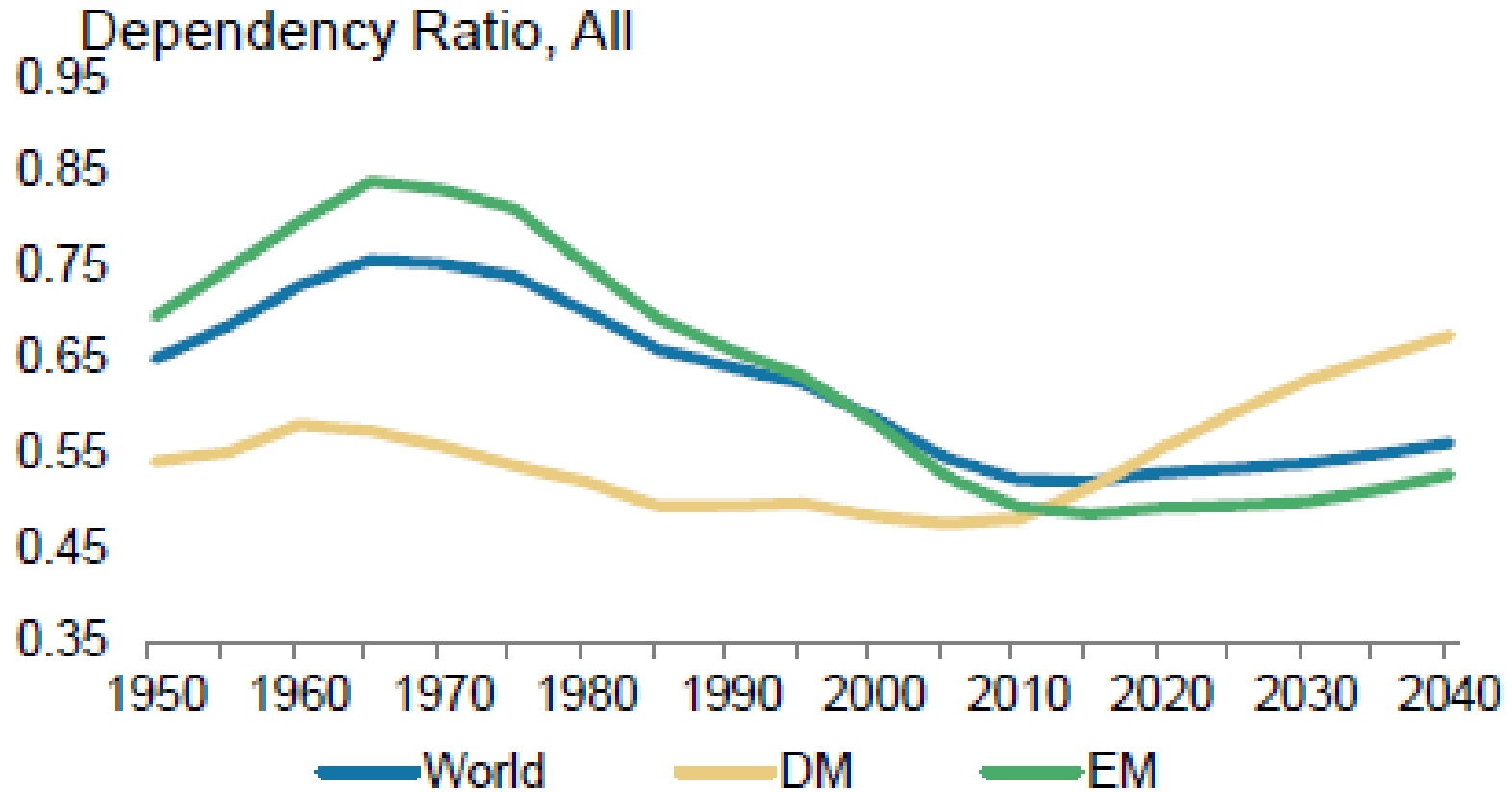


The Positive Labour Supply Shock from China and Eastern Europe



Source: UN Population Database, Morgan Stanley Research. Note: Industrial regions refers to DM economies

Dependency Ratios Were Falling, Should Now Rise



Source: UN Population Database, Morgan Stanley Research

Effects of Positive Labour Supply Shock

- 1) Shift of moveable production, notably manufacturing, to Asia, especially to China.
- 2) Collapse of power of private sector trade unions.
- 3) Stagnation of real wages.
- 4) More inequality within countries, less between countries.
- 5) Weakness of demand, deflationary pressures and savings glut.
- 6) Trend decrease in (nominal and real) interest rates.
Increasing public sector deficits.

Demographic trends now reversing

- Growth of working population slowing rapidly, (except India/Africa).
- Dependency ratio rising, armies of the old.

Results:

- 1) Slower growth.
- 2) Need to shift resources to succour old, so higher taxes on workers.
- 3) Rebalancing of power between workers and capitalists/managers.
- 4) More inflationary pressures.
- 5) Higher interest rates.

Mitigants

- 1) India/Africa.
- 2) Less generosity to old, (retirement, pensions, health).
- 3) Robotics.

- But are we now stuck in a debt trap?
- Despite GFC being ascribed to excessive debt/leverage, most DM debt ratios have risen since 2007, and EM debt ratios have, become high especially in China.

Mitigants, so far:-

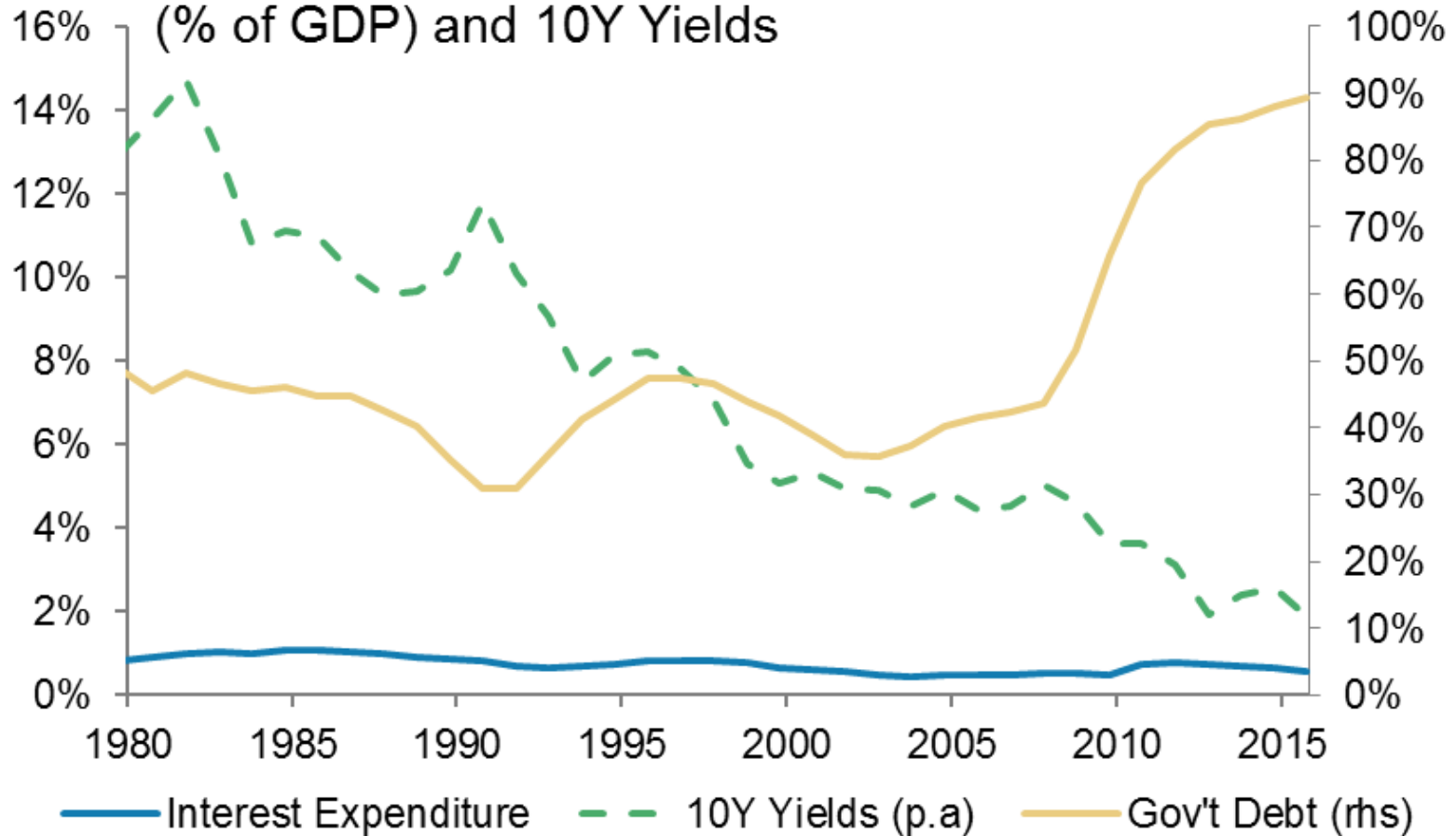
- 1) Rise in debt ratios offset by falling interest rates, so debt service ratios mostly stable, or even declining.
- 2) Bank leverage in DM brought down.
- 3) China under State control.

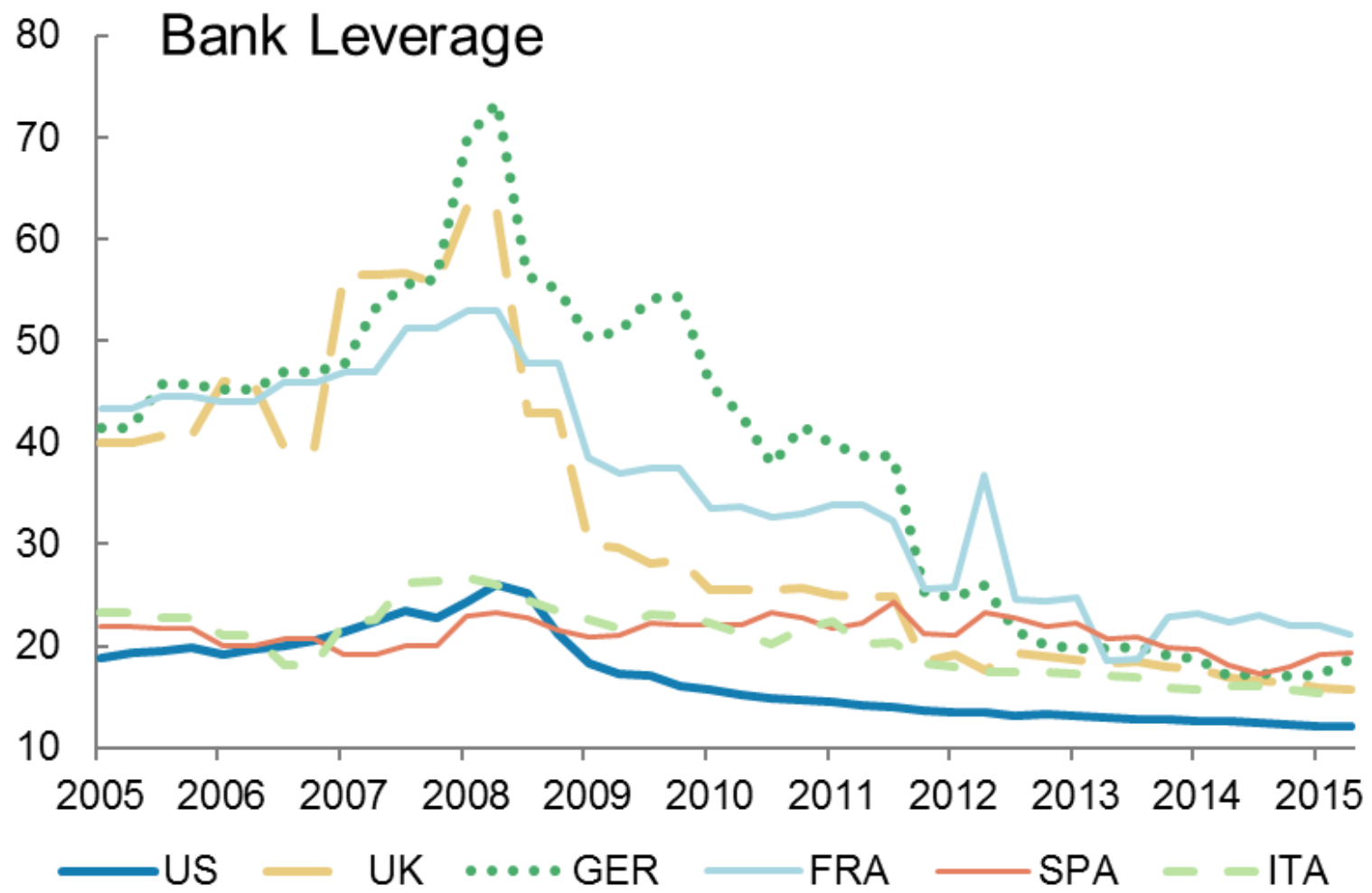
Change since 4Q'07

	HH	NFC	PSC	Gov't	Total
US	-19	1	-18	43	24
EA	1	8	8	38	47
JPN	0	2	2	66	67
UK	-10	-16	-26	46	20
AUS	16	2	18	29	45
CAN	17	22	40	25	64
SWE	19	26	45	5	51
GER	-7	-2	-9	5	-1
FRA	10	21	31	34	63
ITA	-4	-25	-29	69	40
SPA	-13	-17	-30	64	34

EM Debt (% of GDP, latest)					
	HH	NFC	PSC	Gov't	Total
CHN	39	166	205	47	249
KOR	87	106	193	37	229
IND	10	50	60	66	127
IDN	17	24	41	28	68
MAL	70	68	139	56	196
THL	71	52	123	44	166
RUS	18	60	79	18	97
POL	37	47	84	52	135
CZE	31	57	88	41	129
HUN	23	87	109	75	185
TUR	21	59	80	31	113
SAF	37	36	73	51	123
BRA	25	50	75	76	149
MEX	16	25	40	55	94
ARG	6	12	18	61	75

UK Gov't Debt, Interest Expenditure
 (% of GDP) and 10Y Yields





But:

- 1) Interest rates have hit ZLB.
- 2) Growth has slowed, and will remain slow. Japan is good performer on output per worker.
- 3) Politics has gone populist.
 - The balance between growth and real interest rates is worsening.
 - Debt sustainability likely to become more of a problem.
 - Debt trap:
 - Debt overhang → low interest rates
 - low interest rates → more debt issuance

Possible responses:-

Default

No, please

Unexpected inflation

No, please

Supply side reform

You wish

Negative interest rates

Politics and practicality

More equity finance

Politics and practicality