Christian Noyer: Demographic shifts – threats or opportunities?

Opening remarks by Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, at the Montreal conference: "Demographic shifts – threats or opportunities?", Montreal, 11 June 2012.

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Ladies and gentlemen,

It is a real pleasure for me to open this session of the Montreal conference on demographic shifts. I am no demographics expert, you know, but I will try to give my opinion of central banker on this extremely important matter.

There is no major uncertainty as to the demographic shifts that are in progress. We already have a clear idea of the likely demographic trends for the coming decades and, even more importantly, of their age and geographical breakdowns.

We must capitalise on this knowledge to analyse the potential impacts of these shifts and determine how they could contribute to decision-making. In that regard, I would like to raise a few points that are relevant to central bankers.

I will focus on the case of developed countries and more particularly on Europe, where demographic developments are mainly driven by the combination of longer life expectancy and a low fertility rate. As regards the latter, it is comforting to note that this rate in France and Canada is less problematic than those in most economies of the same group.

When considering demographic developments, much attention is paid, legitimately, to public debt issues. But demographic shifts can also impact the macroeconomic environment more broadly. I will briefly discuss the impact of demographic shifts on potential growth and monetary policy. Then, I will discuss other likely macroeconomic and financial stability outcomes, via the impact of ageing on savings and investment.

1. Direct impact on potential growth and monetary policy

Ageing can weigh on monetary policy notably through its impact on potential output.

For a central bank, potential output and output gap developments are of major concern. From a more practical point of view, among many other measures, the Eurosystem uses Taylor-like rules to determine its monetary policy stance. According to these rules, the central bank's rate should be close to the natural interest rate, i.e. the rate consistent with output at its potential level and stable inflation. The difficulty lies in how to assess the gap between observed and potential output. You see that potential output matters in our reaction function and since demographic developments are a key parameter for potential output, demographics ultimately directly concern monetary policy as well.

What are the main consequences of demographics for potential output? The decline in the working age population due to ageing should negatively affect potential output in the long run, through the decrease in the labour force contribution and productivity, all other things being equal. I must stress here that France has a specific advantage: its population is expected to keep on growing fast for some decades thanks to a relatively high fertility rate and a dynamic migration policy; while our German neighbours for instance are on a decreasing trend. Overall, based on European Commission projection trends, we estimate that the expected decline of 1.5% in the working age population in the European Union between 2010 and 2020 could take 1 percentage point off its potential output. But there are ways to offset this evolution. A rise in the participation rates of the young, seniors and women is one of them. Pension and labour market reforms implemented in Europe are certainly a step in the right direction and should be further pursued.

Provided that the necessary reforms are implemented and that some changes in working habits are made, we expect that the euro area will be able to cope reasonably well with the expected fall in the population and working age population over the long run, notably in terms of the potential growth rate. Nevertheless, ensuring that public spending dynamics remain sustainable in the face of population ageing will continue to be a challenge, given the current debt situation in Europe.

2. Impact on savings and investment

How are savings likely to evolve, both in terms of levels and structure?

Levels of savings

If we follow the consumption smoothing theory, individual savings behavior is driven by the life-cycle: individuals tend to increase their savings as they earn more and then decrease their savings until they actually become negative when they retire and earn less, thus leading to a hump-shaped pattern for their accumulated wealth. Consequently, as the proportion of the aged population increases, private savings, as a proportion of income, should decrease. However, this decline may be gradual with the negative impact of ageing on the levels of savings prevailing in the longer run.

Structure of savings

In terms of structure, the fact that elderly people account for an increasing share of the population could change savings habits and have an impact on the demand for certain classes of assets. In particular, given that elderly people are more risk adverse, this could increase the already high demand for low-risk assets.

Investment

The standard production function exhibits two productive inputs: labour and capital. If the labour force tends to decrease or decelerate because of demography, then the production process may become more capital intensive, leading to a fall in the productivity of new capital and, in theory, a decline in the rate of capital return. Investment could be less dynamic and negatively impact potential growth. This would in turn have an adverse impact on the real interest rate, so that domestic savings and investments would balance. One danger of such developments is that, in the face of a prolonged period of low interest rates, asset managers might be tempted to chase “tail-risks”. This calls both for more market discipline in the form of better monitoring and disclosure of the risks borne by financial institutions and possibly by investors, and for a close supervision of these institutions.

Demographic shifts are a key factor in the equation of the future world economy. They are key for economic activity, the fiscal stance, and, maybe less obviously, for the monetary policy stance, given their impact on output gap and financial stability. That is why I found the topic of this session particularly appropriate and timely, and I am sure that your discussions will bring very interesting insights.