Insights and Observations: Third Quarter 2021

Japan is the world's oldest nation, with more than 29% of the population age 65 or older. The comparative statistic in the U.S. and Europe is 17% and 21%, respectively.

> Efforts to get younger have gone nowhere. The birthrate is still falling and immigration has nearly ground to a halt with Covid-19. Linguistically, however, Japan is at the forefront of change. Millions of people have learned they no longer are old, but merely "pre-old".
>
> Miho Inada – WSJ 9/24/21

The Japan Gerontological Society and the Japan Geriatrics Society now propose that the 65 – 74 age group should be called "pre-old age". Studies suggest people in that age range do not share the traits most often associated with the term elderly:

- Only 6% require care by others.
- Half of those 65-69 hold jobs, as do one-third in their early 70s.
- Women have a life expectancy well into their late 80s. (Men live generally into their early 80s.)

Also, data on walking speed imply that those who are now in their 60s and 70s are (on average) equal in health status to those a decade or so younger a generation ago.

The U.S. population grew by only 0.35% for the year ended July 1, 2020 … the lowest change ever documented. In half of all U.S. states, more people died than were born. The U.S. population grew 7.4% over the past decade, marking the second slowest rate on record for a decennial census.

Generally, about half of total U.S. GDP growth comes from expansion of the working-age population, which includes immigrants.

> **The economy of the developed world for the last two centuries now has been built on demographic expansion. We no longer have this long-term economic and geopolitical advantage.**
>
> **Richard Jackson, Global Aging Institute – WSJ 7/25/21**

The U.S. birthrate, currently at 1.6 births per woman, continues to decline. A decade ago, the birthrate was 2.1 per woman. China, Russia, and nations in the European Union have older populations. In addition, they have had birthrates below replacement level for much longer than the U.S.

> The United States' demographic situation is comparatively favorable. The big wild card is going to be what happens with immigration.
> Nicholas Eberstadt, American Enterprise Institute – WSJ 7/25/21

China had a working age population (people between the ages of 15 – 59) of 894 million last year … or 63% of the total population. In 2010, the working age population measured 939 million … or 70% of the total population. China's workforce is expected to drop by 35 million over the next ten years.

> Labor shortages are materializing across China as young people shun factory jobs and more migrant workers stay home, offering a possible preview of larger challenges ahead as the workforce ages and shrinks.
> Xie/Qi – WSJ 8/25/21

The average Chinese worker's age was 28 a decade ago … now it is about 35. The percentage of migrant workers aged 30 or younger was 46% in 2008 … but it has steadily declined to 23% in 2020. More than half of the migrant workers were at least 41 years old in 2020.

China has long exhausted its demographic dividend.

Shuang Ding, Standard Chartered Bank – WSJ 8/25/21

China's working age population is expected to decline 48% by the end of this century. The U.S. working age population is expected to increase 15% by the end of this century.

Global government debt is at the highest level since World War II, and now is in excess of the world's annual economic output. According to the Institute of International Finance, world-wide government debt increased to 105% of global GDP in 2020 … from 88% before the pandemic.

Like flat screen TVs, the more inexpensive government debt becomes, the bigger it gets.

Walker/Landers – WSJ 7/12/21

Globalization, demographics, and China's emergence have created a world awash in savings. Some economists believe that it makes economic sense to have this excess savings absorbed by government deficits.

> The world had changed. The intellectual frameworks have evolved. We don't need to worry about debt.
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> Paul Sheard, Harvard Kennedy School – WSJ 7/12/21

The current savings glut could actually start reversing. Aging populations in China and other nations will eventually start spending more of their savings, which will put upward pressure on interest rates.

> China's greatest contribution to global growth is now past. This great demographic reversal will lead to a return of inflation.
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> Goodhart/Pradhan, The Great Demographic Reversal – WSJ 7/12/21

If rates rise, governments will be forced to raise taxes and cut spending. Some may even default on their obligations.

> There are still limits to government debt. They are just further out than we use to think.
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> Paul De Grauwe, London School of Economics – WSJ 7/21/21

Over the past 15 years, the U.S. federal debt has grown at 7 times the rate of tax receipts and more than 4 times faster than the overall economy. Federal debt is now 127% of the U.S. gross domestic product … up from 40% in 1966.

The debt burden comes to about $220,000 for every American household … or around three years of median household income.

On the other hand, low interest rates have helped manage the debt explosion. In fact, as Treasury debt rose by over $7 trillion last year, interest expense actually declined by $46 billion.

If you include the *unrecorded liabilities* associated with unfunded entitlement programs, total federal obligations are estimated to be 25 times larger than annual tax receipts. To put that into terms that we can get our arms around, that would be the equivalent of someone making $100,000 annually and having a $2.5 million mortgage.

> No one wants to solve the deficit problem because the cost of fixing it involves short-term financial and economic pain. The hurt is too detrimental to the careers, wallets, and egos of bankers and politicians.
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> Aggressive monetary policies funding immense fiscal spending will only widen the wealth gap and further slow economic growth, as it has done in the past.
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> Michael Lebowitz – Advisor Perspectives 8/27/21

Japan has debt of about $10 trillion, while the government collects about $600 billion in taxes annually. In comparison, the U.S. government collects about $4 trillion annually, and has a *stated* federal debt of around $27 trillion. So, Japan's debt to GDP is roughly 2.5 times higher than the U.S. measure.

> Japan often serves as a tryout venue for policies that later debut on the world economy's biggest stage, the U.S. The Japanese central bank was a pioneer in introducing zero interest rates and buying large quantities of government bonds to stimulate a sluggish economy, tools subsequently used by the Federal Reserve.
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> Peter Landers – WSJ 8/22/21

Half of Japan's debt is owed by the central bank, the Bank of Japan (BOJ). *(Yes, Japan invented quantitative easing.)* While creating too much debt could generate inflation, Japan's inflation rate is basically at zero. In fact, the interest rate on their benchmark 10-year bond is right around zero percent.

> It is 500 trillion yen of borrowed money that in effect carries no interest and never has to be paid back.
>
> Toichi Takahashi, Kaetsu University – WSJ 8/22/21

Japan pays no more in interest now than it did over 30 years ago, when public debt was only two-thirds of GDP. Still, at some point, this potentially could end quite badly.

> If long-term interest rates move sharply higher, compared to other countries, Japan's likelihood of avoiding a fiscal crisis is certainly not high.
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> Ryutaro Kono, BNP Paribas – WSJ 8/22/21

With government influence on the rise, it's a good time to reflect on the two competing ideologies for resource distribution: Capitalism and Socialism. Consider the following synopsis offered by Brian Wesbury and Robert Stein of First Trust Advisors (8/16/21):

Capitalism distributes resources to the most productive use through markets and competition, while at the same time putting brakes on greed and selfishness. In order to accumulate resources in a capitalist system, you must provide goods or services for which someone else is willing to pay. If your cost of production is greater than what the market is willing to pay, you will not create much wealth. Or if a competitor can provide the equivalent or better for a lower price, you will lose market share and therefore your wealth.

As a result, while it may be true that some people in a capitalist system become extremely wealthy, they do it by creating goods and services that people want and in a way that competitors have a difficult time copying.

Under Socialism, on the other hand, politicians distribute resources. They tax individuals who have been able to create income and wealth and then transfer those resources to their favored causes or group, often while shutting down competition. Governments do not create wealth, they spend it.

In the end, because the government doesn't create wealth … the bigger it gets relative to the private sector, the harder it is to create more wealth in an economy.

The bigger the government gets, the slower the economy grows.

As we plan for the future, the key economic issues and influences will most certainly be centered around the three D's … Deficits, Debt, and Demographics.

Demographics are pretty much the only future statistic we can estimate with any confidence. We also know that GDP is simply the product of hours worked and productivity. So, if you're looking for future growth … a strong and stable working age population will be essential.

Endless budget deficits eventually lead to suffocating levels of debt. Maintaining economic growth along with excessive debt is the equivalent of running a marathon with a refrigerator tied to your back.

Providing the proper balance of budget discipline and prudent debt management will continue to be a major challenge … from both an economic and political perspective.

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