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COLUMBIA THREADNEEDLE INVESTMENTS

Thematic Insights

If demographics are destiny, investors should brace for change

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At a glance

- Many major economies are in the midst of the most rapid demographic change since the second world war – with business leaders and politicians warning of the potential consequences
- These population shifts will have profound and far-reaching implications for global economies and government fiscal policy, with consumption patterns, dependency ratios and the jobs market changing fundamentally
- At the macro level it could reconfigure the international balance of power, further igniting geopolitical tensions; at the individual company level it will have a material impact on investments we make at Columbia Threadneedle Investments
- With markets experiencing these demographic shifts at different paces, we look at how three major economies are reacting to demographic shifts and highlight the potential implications

The demographic tortoise has its skates on

Demographic change is perceived to be slow moving and therefore irrelevant to investment decision making, particularly in a world grappling with faster moving geopolitical tensions, changing governments and technological advancements. However, many of the world's major economies are experiencing the most rapid demographic changes since the second world war, with general and working populations – and birth rates – falling at a record pace[1].

Changing demographics will alter consumption patterns and affect the sustainability of the revenues and cashflows of firms in which we invest. It will lead to profound changes to the job market – creating labour shortages, skills gaps and reduced innovation. This will impact businesses growth trajectories and their competitive positioning. It will also challenge government policy by shrinking tax bases and pressurising budgets, due to increased expenditure on pensions and healthcare.

Population changes can also affect economic growth, unemployment levels, the equilibrium interest rate, the housing market and the price of other financial assets. Collectively, these could have consequences for the sovereign debt market.

At the macro level, demographic change will refigure the global economy and the international balance of power, much as China and India's population growth has done over the past few decades. This could ignite both geopolitical and intergenerational issues.

However, companies which manage to adapt their product profiles to ageing demographics or growing middle classes in emerging markets could profit from these changes. Firms who can support infrastructure development in emerging markets or offer tools and technology to improve productivity within ageing populations will also have an advantage.

All of which has the potential to have a material impact on investments we make at Columbia Threadneedle Investments.

> Changing demographics will alter consumption patterns and affect the sustainability of the revenues and cashflows of firms in which we invest

[1] HSBC, Demographics – A Key Driver of Everything, May 2024

Here and now: global demographic trends

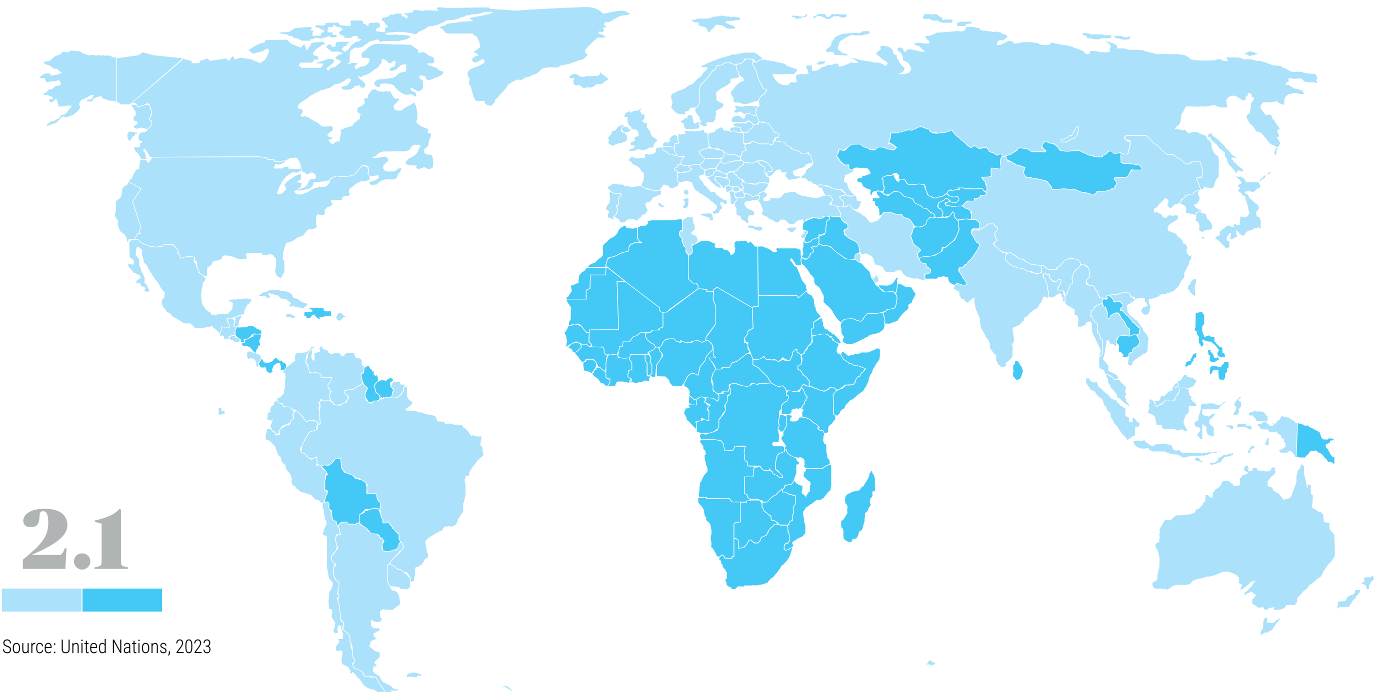
Fertility rates

Fertility rates are collapsing. This is a function of female participation in the workforce, better access to healthcare in emerging markets and the high cost of living and childcare in many developed markets.

What is truly remarkable is the speed of decline. For example, in 1960 South Korea's fertility rate was six[2]; now it is 0.72[3]. The only continent with a fertility rate above the replacement rate of 2.1, whereby the population remains stable without the need for immigration, is sub-Saharan Africa (Figure 1).

Around 68% of the world's population live in a country with fertility rates below the replacement rate[4]. What is concerning is these low birth rate countries account for 90% of global GDP.[5]

Figure 1: UN total fertility rate by country (2023)



Source: United Nations, 2023

Peak population

The United Nations predicts the world population will peak at **10.3** billion people in **2084**[6]

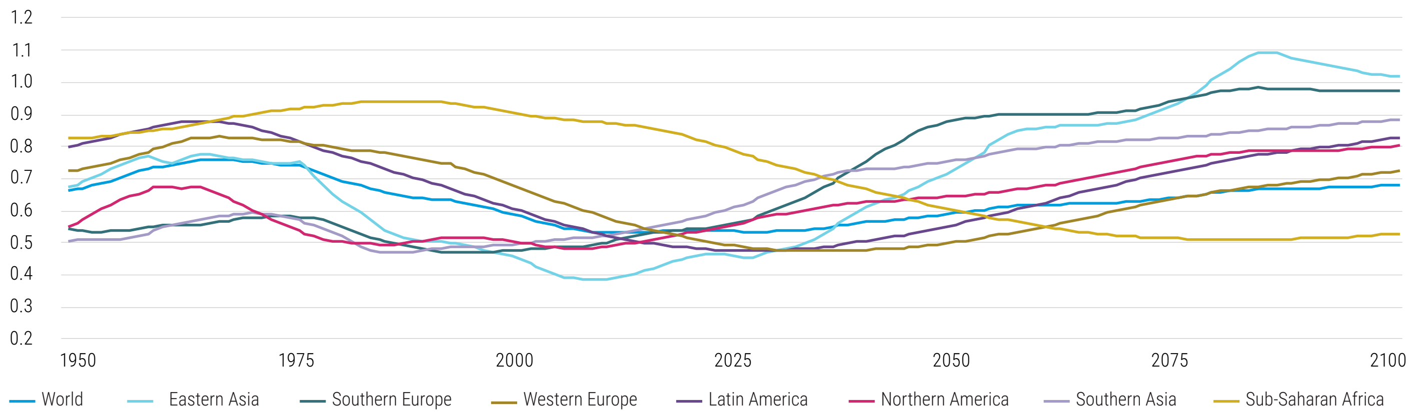
However, if birth rates continue their current trajectory, it could peak as early as the 2040s[7], which could result in the average developed market population halving by the end of this century[8].

[2] The Guardian, Monday briefing: From the UK to South Korea, why people are having fewer babies, 12 February 2024
[3] BBC News, Why South Korean women aren't having babies, 28 February 2024
[4] Columbia Threadneedle Investments' analysis of UN WPP 2022 data, May 2024
[5] Birth Gauge analysis of country-released data, July 2024
[6] United Nations, World Population Prospects 2024: Summary of Results, July 2024
[7] HSBC Global Research, The baby bust intensifies, 21 January 2024
[8] HSBC Global Research, The baby bust intensifies, 21 January 2024

Dependency ratios

This is one of the best measures of changing population density. It measures the proportion of working population to non-working population – typically defined as below 15 and above 65. In most developed markets the ratio is rising to unprecedented levels (Figure 2) – ie there are increasingly more non-workers than workers, which will have implications for future productivity and economic activity.

Figure 2: global dependency ratios



Source: United Nations World Population Prospects 2023 (2022 revision)

Changing destinies

"Demography is destiny" is a quote often attributed to Auguste Comte, a French philosopher who argued that the size and structure of a population will influence its future. Many of the most significant markets in which Columbia Threadneedle invests are experiencing seismic demographic shifts. However, not all markets are at the same point. Some are still benefiting from population growth (the demographic dividend); others still have the benefit of immigration supporting underlying populations (demographic transition); while others are at the forefront of ageing populations and falling birth rates (demographic tax).

Here we highlight how three major economies are reacting to demographic shifts and highlight the potential implications for Columba Threadneedle Investments.

Demographic tax – Japan

Japan is at the forefront of demographic change in developed markets and acts as a test case for how a government and capital markets respond to population change.

Latest data suggests the number of Japanese nationals is falling by 100 per hour – the largest amount since comparable records began in the 1950s[9]. At that point the over-65s accounted for just 5% of the population; now they account for more than 30%. In a country in which more adult nappies are sold to incontinent elderly people than nappies for babies, this figure will increase to more than 40% of the population over the next 20-25 years[10].

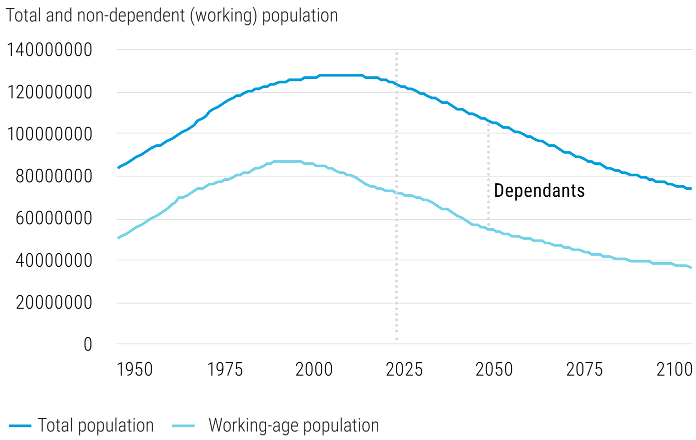
Japan's working population started to decline in the mid-1990s and was accompanied by three decades of economic stagnation[11]. Worryingly its working population is forecast to fall a further 35%[12] by 2065 as the population ages and leaves the workforce (Figure 3).

As a result of demographic trends, rigid labour markets, and little investment in training employees", Japan's labour productivity is the lowest in the G7[13].

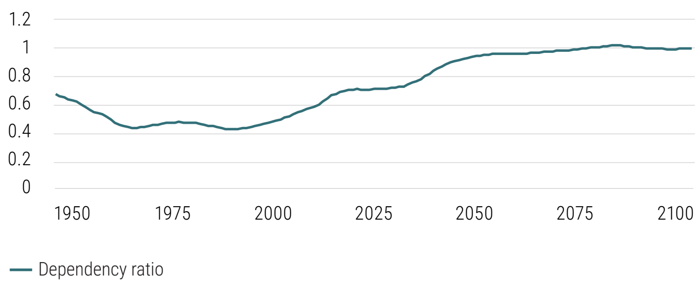
Firms have had to look to technology such as artificial intelligence (AI) to improve efficiencies and reduce the required "'human" component of production. Capital has been committed to providing solutions to demographic issues, which has led to Japan being the world's largest industrial robot manufacturer, delivering 45% of global supply. Japanese exports of industrial robots have experienced a compound annual growth rate of 6% over the past five years as countries like China (Japan's number one market) look to technology to solve their own population and productivity issues.[14]

All of this has offered investment opportunities for Columbia Threadneedle across a range of stocks and sectors. For example, in industrial robotics manufacturers, in firms who can support the facilitation of factory automation, and in those who are addressing their labour challenges through substituting labour for technology[15].

Figure 3: Japan is at the forefront of a demographic shift



Population peak	2010
Working population peak	1994
Dependency ratio - 2022	0.71
Dependency ratio - 2050	0.95



Source: UN World Population Prospects, 2023

[9] FT.com, Japan's native population declines at a record rate as births plunge, 12 April 2024
[10] Columbia Threadneedle Investments' calculations using UN WPP 2022 data
[11] NHK World – Japan, Reviving Japan's Economy: Breaking Free of 3 Decades of Stagnation, 12 August 2023
[12] Columbia Threadneedle Investments' calculation using UN WPP 2022 data
[13] Nippon.com, Japan's Productivity Ranks Lowest Among G7 Nations for 50 Straight Years, 6 January 2022
[14] International Federation of Robotics: Japan is World´s number one Robot Maker, 10 March 2022
[15] Columbia Threadneedle Investments, The substitution effect: AI and the labour market, January 2024

Demographic transition – US

The United States is part of a group of countries, like the UK and France, which although experiencing falling birth rates and increased longevity is not as exposed to demographic shifts relative to regional peers. This is due to historic immigration, and in the case of the US is driven by Latin America, which typically has a younger age profile than the American population. Historically higher fertility rates within this immigrant population will single-handedly support overall US population growth from the mid-2040s (Figure 4)[16].

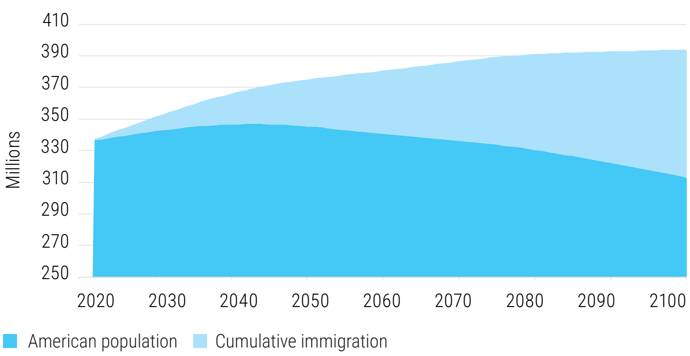
Generally, as people retire their spending falls[17] and spending patterns change – more on household bills and services, less on holidays and motoring[18]. However, an interesting feature of the US (and indeed the UK) economy is the unprecedented wealth concentration of the baby boomer generation (1946-1964). While they make up 20% of the US population, they own 52% of its net wealth – around $76 trillion[19]. Over the next decade the younger cohort of this age group will join their older peers and retire, with companies already highlighting that this will lead to a skills and labour shortage. What they do with this wealth will have significant implications for economies and the firms we invest in.

If they sell assets to help younger family members buy property, this will support the housing market as well as property-associated purchases, for example large durable goods[20]. Ultimately this could be inflationary.

If they release assets to support their own "active ageing"[21], this could create opportunities for the companies that make products or offer services that appeal to this age group. Businesses in sectors such as beauty, leisure, health and social care could see their total addressable markets (TAMs) increase. Conversely, sectors exposed to the consumption habits of younger people may see their TAMs decline as the size of this cohort falls – unless, of course, their older, wealthier family member has passed on early inheritances. We are yet to see this phenomenon occur – in fact if anything savings rates have risen[22] – but at some point this wealth transfer will likely occur.

The ultimate effect will have far reaching outcomes on the economy, government policy and to the companies in which Columbia Threadneedle invests.

Figure 4: US forecast population



Source: UN WPP, 2023

Demographic dividend – India

Just nine countries will contribute half of the world's population growth between now and 2050: India, Nigeria, Pakistan, the Democratic Republic of the Congo, Ethiopia, Tanzania, Indonesia, Egypt and the USA (in descending order of contribution)[23]. India has already supplanted China as the world's most populous country with 1.4 billion inhabitants.[24]

Generally, as populations grow, individuals move to urban areas in search of employment, education and healthcare. A billion more people are forecast to live in cities within the next 10 years[25]. Urbanisation creates a consumer class, which provides investment opportunities for Columbia Threadneedle – for example, both Hindustan Unilever and Colgate-Palmolive India have benefited from India's growing middle class. It also creates opportunities for global firms, such as Columbia Threadneedle, to outsource jobs to the country to take advantage of larger pools of talent.

However, many emerging markets have a shortfall of both physical and digital infrastructure, which limits economic growth and job creation. Indeed, one of the biggest risks to emerging markets benefitting fully from the demographic dividend is insufficient jobs for a growing working population. This can result in high youth unemployment and a rise in populism[26]. India, whose population isn't expected to peak until 2064, has struggled to provide enough jobs for its working population, which will continue to grow for nearly a quarter of a century.

16 Columbia Threadneedle Investments' calculations based on 2022 United Nations World Population Prospects data
17 FT Lex, Defined Contribution pensions: the lifestyle you ordered is currently out of stock, 29 October 2023
18 IFS, How does spending change through retirement? 19 May 2022
19 The Economist, Baby-boomers are loaded. Why are they so stingy? 26 May 2024
20 Bank of England, How does the housing market affect the economy?
21 WHO terminology: the process of optimising opportunities for health, participation and security in order to enhance quality of life as people age.
22 The Economist, Baby-boomers are loaded. Why are they so stingy? 26th May 2024
23 United Nations, Shifting Demographics, 24 October 2019
24 UN DESA Policy Brief No. 153: India overtakes China as the world's most populous country, 24 April 2023
25 HSBC Global Research, Making a success of cities, 30 April 2024
26 ECPS: Crisis of Democratic Political Legitimacy & Emerging Populism in Africa, 24th May 2024

However, the Indian government has allocated 3.3% of GDP[27] towards the infrastructure sector in 2024, seeking to create jobs and capitalise on the rejigging of global supply chains away from China following Covid-19 and rising geopolitical tensions. In addition, the Indian government has launched the National Infrastructure Pipeline (NIP) under which $1.4 trillion[28] of infrastructure projects including transportation, energy, communications and social infrastructure are expected to be completed by 2025 – of which the private sector is expected to contribute 21%.

Global firms across a range of sectors – from financial services, building materials, industrials and utilities – will benefit from increased focus on infrastructure spending.

Columbia Threadneedle has invested in firms exposed to the positive demographic trend of urbanisation and essential infrastructure development. With India accounting for around 5% of global private participation in infrastructure projects, compared with 40% in China[29], it suggests there are further opportunities for capital markets to support India's future economic growth.

India, whose population isn't expected to peak until 2064, has struggled to provide enough jobs for its working population

Conclusion

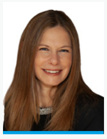
Historically low birth rates and rising life expectancy are transforming the global population. This has implications for the businesses and markets Columbia Threadneedle invest in, affecting revenue opportunities, company cost bases and, as labour becomes more scarce, productivity and ultimately the sustainability of cash flows.

It will also affect the macro environment as governments come under the strain of lower tax receipts and increased expenditure, notably on pensions and healthcare. However, demographic changes also offer opportunities. Sectors exposed to wealth management, automation, technology and healthcare, and supporting infrastructure in emerging markets, are likely to benefit.

At Columbia Threadneedle, we believe that firms who acknowledge such changes and manage their business in response will achieve a competitive advantage and outperform in the long term.

[27] EY: Building the future: Infrastructure investment opportunities in India, December 2023
[28] EY: Building the future: Infrastructure investment opportunities in India, December 2023
[29] EY: Building the future: Infrastructure investment opportunities in India, December 2023

Get to know the author



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Sally joined Columbia Threadneedle Investments in 2023. As part of the global research team she undertakes thematic research, engages with companies, and collaborates with investment teams on the risks and opportunities arising from the transition in human capital. She previously worked as an equity research analyst and an industry policy lead for responsible investment regulation and legislation. Sally studied at the University of Warwick (BSc Economics) and gained the CFA charter in 2003.

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James joined Columbia Threadneedle Investments in 2017. As a part of the research advanced analytics team he supports the investment process by conducting data-driven research, collaborating with teams that make fixed income and equity investment decisions. James studied aeronautical engineering (BEng) at Brunel University London.

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