Bullish where the babies are

Financial experts say nations with high birth rates usually have economies that are trending up as well, which explains in part why western countries are in decline. However, thanks to automation, ageing exporters such as Japan can still offer plenty even as their populations fall. **Harvey Jones reports**

The Japanese population has stopped replacing itself and the nation is forecast to have a population drop of 38 million by 2055. Yuriko Nakao / Reutersp

Demographics are destiny, they say. Demographics are also data, which mark changes in a population over time. And right now, these data show the world is getting older.

Populations are ageing in Japan, China, Russia, Canada, Australia and most of Europe. There's a youth bulge across the Middle East and North Africa, but that too will pass, and then these countries will start getting older as well. Only sub-Saharan Africa is bucking the trend.

Investors should care about this, because demographics are economics destiny as well. Older people behave differently than younger people. They are less prone to consumer fads and fashions. They stop working and start claiming state pensions. They fall ill more often and need looking after. They are socially conservative. They die.

A youthful population should mean a more healthy and productive economy, says Spencer Lodge, the Dubai-based regional managing director at the financial brokerage PIC deVere. "If properly employed, their earnings, tax payments, innovation, output and spending should offer investors better returns than an older population that needs extensive state support."

This may explain why the West is in relative economic decline, while young, emerging economies such as China and India are blossoming. But is it that simple, and how seriously should investors take demographics?

Nobody wants to invest in a dying country, but unless demographic trends reverse, some countries are in serious danger of fading away altogether. Notably Japan.

The Japanese have stopped replacing themselves. For a country to maintain its population, the average woman must have 2.1 children. Japanese women average just 1.27 children, one of the lowest total fertility rates (TFR) in the world and the figure continues to fall. Japan ranks a lowly 184 out of 195 countries in the UN fertility table.

Japan's population currently stands at 128 million. By 2055, it will have slumped to just 90 million. That's a loss of 38 million people. If demographics really are destiny, the future for Japan is grey – and its financial outlook is even darker.

When people get further into retirement, they do a strange thing. They stop saving and start spending. After all, who would they be saving for? Not their grandchildren – because they might not have any.

This is bad news for Japan. Not only does it have the world's oldest population (the average age is 44), it also has the world's largest public-sector debt at nearly 250 per cent of GDP. So far, this has been serviced by the Japanese savers, who buy 94 per cent of government bonds at miserably low yields of about 1.2 per cent.

Once they start cashing in their savings, who will buy Japanese bonds? Foreign investors will demand much higher yields, which Japan can't afford to pay. At that point, the demographic time bomb may finally explode.

Japan is just a more acute example of what is happening all over the West. Emerging European countries, such as the Czech Republic, Poland, Ukraine and Belarus, all have lower fertility rates than Japan. Portugal, Switzerland, Austria, Spain, Italy, Germany, Greece and Canada all have TFRs of 1.5 or less.

Russia is also doing badly with a TFR of 1.34, and it isn't the only member of the BRICs (Brazil, Russia, India and China) in trouble. The China growth story has dazzled the world, but at some point, it could look like old news. Its one-child policy, implemented 30 years ago, has left the country with a dismal TFR of just 1.54.

Worse, 120 baby boys are born in China for every 100 girls, as the traditional preference for males meets modern clinical procedures such as gender tests and termination. That will leave a surplus of more than 40 million Chinese men by 2020 who will never marry or have children of their own, shrinking the population further.

China is on a deadline, one that it could miss: the country will probably grow old before it grows rich.

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Is this a country you really need to invest in?

Lousy demographics shouldn't totally deter investors. Japan may have to hike taxes to cure its budget deficit, but the economy can survive on its exports, says John Vail, the chief global strategist at Nikko Asset Management in Tokyo.

"Nobody expects the Japanese domestic economy to grow much, if at all. But it is a very successful exporter and its demographic troubles shouldn't affect that. Japanese export industries are highly automated and can keep producing with a much smaller population."

Demographics are important to investors, but they aren't everything. "Having a young population isn't always a good thing. If it was an automatic signifier of success, Africa would be the richest continent in the world," Mr Vail says.

A young population should mean a flexible, competitive and productive workforce, but only if you employ them effectively, Mr Vail says. "Youth isn't everything. They need to be educated, have good job prospects and a strong work ethic. Their country should be relatively free of corruption and it helps to have natural resources. On all these counts, we consider that Chile, Brazil, Mexico, Thailand, Malaysia and Vietnam are good investment prospects."

BRICs are a mixed picture. "China and Russia both have a huge demographic problem due to low birth rates. India, by contrast, faces a surge of youth into the labour market and need to find jobs for them. All four countries should still grow strongly for the next 10 years, but in the long run, Brazil is the best placed demographically," Mr Vail says.

Younger countries typically have more room for development, innovation and growth, says Walid Hayeck, the head of asset management at The National Investor and manager of the Mena Blue Chips Fund. "They need investment in infrastructure such as power, water, transport and real estate. This should raise household income, boost living standards and spur more consumption, which creates a virtuous circle."

This should be good news for investors in the Middle East and North Africa (Mena). "The region has a young, growing population and significant natural resources, primarily hydrocarbons, which could be used to fund investment in infrastructure. That, in turn, could boost GDP and living standards," Mr Hayeck says.

In Turkey, where the average age is 28 and TFR a healthy 2.14, the youth bulge is a boon, says Sonal Pandit, a portfolio manager for the JP Morgan Emerging Middle East Equity Fund. "Turkey has a very positive demographic picture, the economy is booming and there is an abundance of people entering the labour force."

In Egypt, it's a different matter. The average age is just 24. Youth unemployment is estimated at 43 per cent and another half a million Egyptians hit the job market every year. We have all seen the results.

Youth is a turbulent time. Rising food prices, despotism and corruption may have pushed parts of North Africa and the Middle East into revolt, but demographics are arguably the catalyst.

The long-term effect on investors depends on the country, says Nigel Sillitoe, the chief executive at Insight Discovery, a financial services market research company based in the UAE. "With so many young people in the Arab world looking for work, there are threats and opportunities. Investors need to make a distinction between countries that have oil reserves, which includes most within the Gulf region, and those that don't. The main advantage for Gulf countries is that they have a measured plan for diversifying away from hydrocarbon dependence."

Saudi Arabia is working hard to encourage the growth of small businesses, which now account for about 25 per cent of total employment, and is pouring money into education. This should bear long-term results for investors, Mr Sillitoe says.

In the short term, however, anything could happen.

The youth bulge in the Middle East will pass. Fertility rates have fallen sharply in recent years as women become better educated and populations more urban. Fertility rates in Iran and Tunisia are now at sub-replacement levels, while Turkey (2.14), Kuwait (2.18) Lebanon (2.21) Bahrain (2.29), the UAE (2.31) and Algeria (2.38) will soon follow on current trends.

This will leave only sub-Saharan Africa, where women in countries such as Nigeria, Burundi, Liberia, Congo, Sierra Leone, Uganda, Chad and Somalia still average more than six children each. Africa's young population should spare it the crippling demographic crisis facing developed countries, says Nick Price, the manager of Fidelity's EMEA fund, which invests in Europe, and the Mena region.

As China and India struggle to maintain their breakneck growth, Africa could be the next investment frontier. "Many people still associate Africa with poverty, famine and conflict, but the reality is very different. Africa provided six out of the world's 10 fastest-growing economies over the past decade: Angola, Nigeria, Ethiopia, Chad, Mozambique and Rwanda."

Over the next five years, Tanzania, Congo, Ghana and Zambia should also grow strongly, he says, boosted by Chinese investment. "GDP per head across Africa rose from less than US$700 [Dh2,570] in 2002 to over $1,500 in 2008 and could double again by 2013."

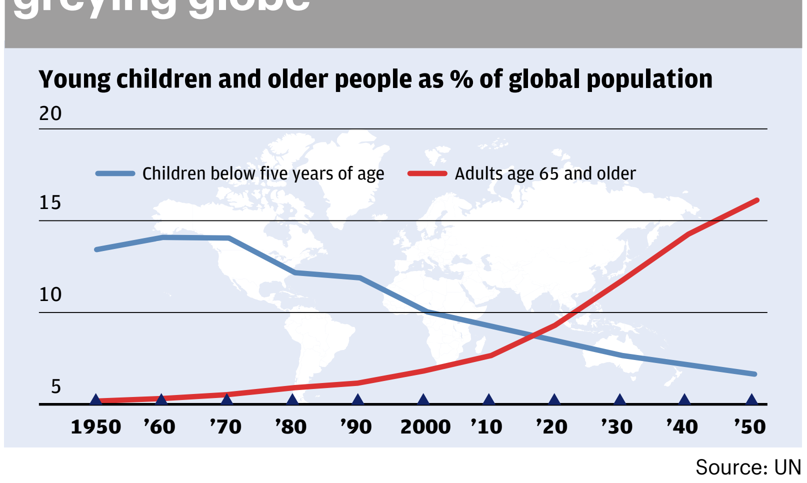
Africa still has huge problems, Mr Price says, but democracy is spreading and corrupt leaders such as Idi Amin, Joseph-Désiré Mobutu and Robert Mugabe are now the exception rather than the norm.

Despite their ageing populations, the West isn't dead yet. Investors could even benefit by plugging into the growing "silver economy". As people get older, they spend more on health and financial services. Investors can play this by targeting private health care and nursing homes, pharmaceutical firms, pensions and investment companies, and even the travel industry, including cruise-liner companies such as Carnival and Royal Caribbean Cruises.

There is one country that bucks the western trend of lower fertility: the US. American exceptionalism strikes again, largely because of higher birth rates among Latin American immigrants, which bodes well for the long-term health of the US economy.

Finally, it is worth remembering that birth rates can quickly reverse. Fertile countries can suddenly become infertile, and vice versa. In 1986, the average Iranian woman had seven children. Now she produces just 1.7. In 2001, the average woman in England and Wales had 1.63 children, but this has since rebounded to 1.96, the highest since the 1970s. That is partly down to more fertile immigrants, but there was also a surprise fertility jump among UK-born women over 40, and no demographer predicted that.

greying globe



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