



Daily Note

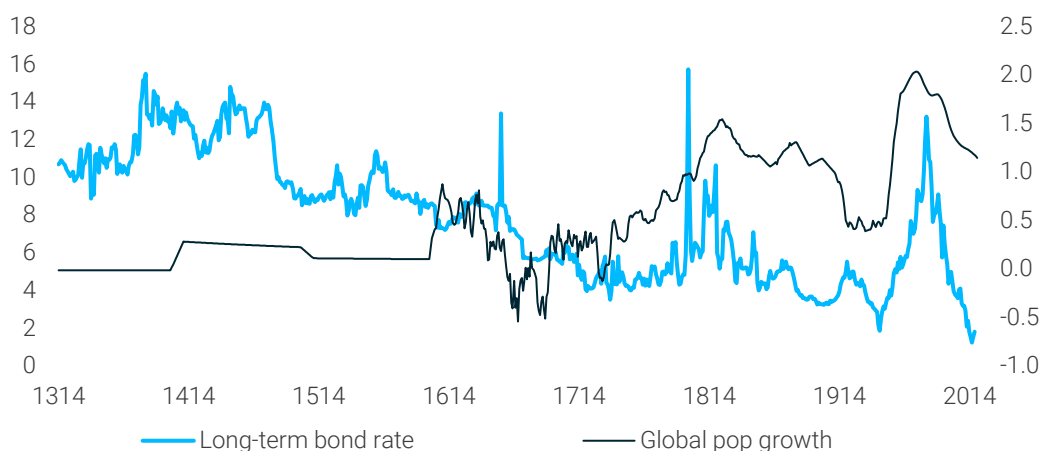
BOOMERS AND MACRO DOOMERS

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- The baby-boom generation has contributed to long-term macro trends
- Consensus wrong to assume population aging means endless disinflation
- Structural labour shortages could overturn the trends of the last 40 years

There is no doubt the baby-boom generation has had an important influence on macroeconomic outcomes since WW2. When they were young, they needed homes and public infrastructure, which contributed to the strong economic surge of the 1950s and 1960s. When they hit their 20s, they needed jobs, which encouraged governments to prioritize full employment and high wages. And in the 1960s and 1970s, they became more militant and – as part of powerful trade unions – contributed to the wage-prices spirals that defined the era. Some say the Great Inflation was, in effect, the baby boomers' mid-life crisis, though that is probably going too far. But it is clear that, as the baby boomers' preferences shifted from the mid-1980s onwards, they were a big part of the neoliberal order that delivered secular disinflation. On entering middle age, they needed to save for retirement – especially with life expectancy rising – which meant they wanted to prioritize low inflation over full employment. Ultimately, inflation is about power, not just monetary policy. And there is no doubt that demographics – and the role of the baby boomers, in particular – has had a material influence on politics and the balance of power in the economy over time. **Now, with the baby boomers retiring en masse, the obvious question is: what happens next?**

Chart 1: Demographics and interest rates – long-term trends

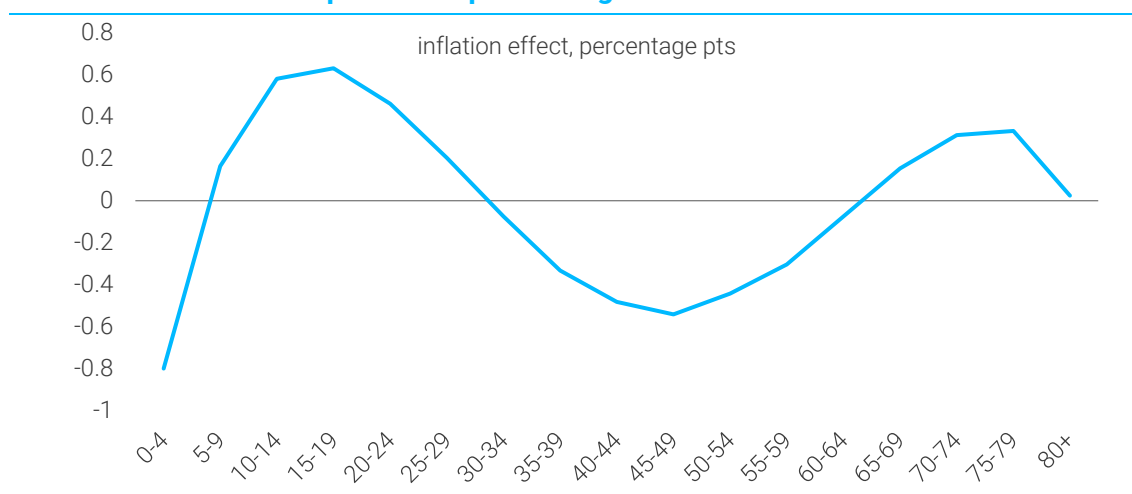


Source: Bank of England, TS Lombard

Most investors have a fixed idea about what aging demographics means for the future. They invariably point to Japan's experience, assuming that the whole world is, in effect, "turning Japanese". In the minds of many, the momentous events of the last three years are just a brief

disruption in the era of perma lowflation and zero rates. And, in terms of simple accounting, it seems obvious that slower population growth means lower trend GDP estimates. When the population is growing slowly, there is less investment demand – particularly in areas like housing – which brings a range of broader deflationary spillovers. But the impact of demographics is more complicated than just GDP accounting. **Changes in population affect not only investment but also the desire to save.** And it is this balance between desired savings and investment that ultimately determines equilibrium interest rates (the level of rates that is consistent with stable inflation and full employment): if savings decline more than investment, equilibrium interest rates rise, which shifts the prevailing tendency of inflation. Thinking in terms of equilibrium interest rates means central banks retain some ability to influence inflation, but only if they are sensitive to these deeper structural changes (and have the policy space to so – unlike in the 2010s).

Chart 2: Inflation consequences depend on age structure



Source: [BIS study](#)

In principle, demographics can influence the economy through several channels:

- 1 **Population growth** – a rapidly growing population needs more investment.
- 2 **Compositional effects** – consumption patterns follow a “life cycle” profile. People borrow while they are young, save during middle age, and spend down those savings after they retire. All else being equal, a population in which everyone is middle-aged will be far more disinflationary than a population stacked with younger or older groups.
- 3 **Longevity** – as life expectancy increases, people will need to save more for their retirement, particularly if retirement ages do not keep up with longevity. Life expectancy trended higher for decades, although progress has stalled recently (even before the pandemic).
- 4 **Politics** – a large cohort of a specific demographic group can tilt political outcomes.

Based on these transmission channels, it should be clear that the prevailing tendency of demographics shifted from inflation to disinflation during the 1980s. The baby-boom generation, which required big increases in investment after WW2, were entering middle age – which raised desired savings, just at the point when overall population growth had slumped (reducing investment demand) and longevity had increased (providing an additional boost to savings). Equilibrium interest rates collapsed. This was the start of a multi-decade bull market for bonds – and of a period that [central banks would affectionately label the Great Moderation](#). Unfortunately for policymakers, it is unlikely these trends will continue. In fact, the world seems to have recently passed another demographic inflection point, which could [turn the Great Moderation on its head](#).

With the baby boomers retiring, savings rates will plunge, equilibrium interest rates will rise, and the prevailing tendency of inflation could shift higher – particularly if central banks fail to respond. This is a point that [Charles Goodhart and Manoj Pradhan](#) have made repeatedly in recent years.

While Goodhart and Pradhan are the names most readily linked to the inflationary impact of future demographics, their ideas are consistent with several recent empirical studies, the most important of which is a [BIS paper from 2019](#). The BIS estimated the effects of the demographic structure—not just aging—on inflation using data from 22 advanced economies from between 1955 and 2014 and found a robust relationship. In particular, the researchers identified a stable U-shaped pattern: the young (aged 5-29) and the old (65+) are inflationary, whereas the prime working-age cohorts are disinflationary. This U-shaped pattern is robust and did not disappear when other variables that are often associated with inflation – such as output gaps, oil prices, real interest rates, population growth, and fiscal policy – were included. Moreover, the relationship survives different time periods and alternative country samples. The BIS believes age structure can explain the bulk of what they call “trend inflation” and about a third of the overall variation in OECD CPIs. **Looking ahead, they predict a sustained inflationary impulse over the next 20 years – as the share of people in middle age continuously dwindles.**

Chart 3: The population age structure is turning inflationary



Source: [BIS study](#)

After some initial scepticism, I am increasingly coming around to the Goodhart and BIS view that future demographic trends will be mildly inflationary, not disinflationary. The COVID experience was the game changer, because it showed how accelerated demographics can lead to severe labour shortages, which increases the wages of younger people. Overlay that with the other secular changes that have emerged during the last three years – namely, deglobalization and an appetite for activist fiscal policy – and there is a good chance that current labour shortages will become structural. And as labour becomes scarce, many of the big macro trends of the past 40 years will reverse, meaning faster wages, higher interest rates, reduced inequality and a trend decline in the profit share. Naturally, many investors will look at this scenario with trepidation. It will provide [a radically different backdrop for financial markets](#). But, at least for the real economy, it isn't as gloomy as it seems. **Contrary to what the consensus assumes, this new macro regime could even mean higher growth**, especially if the higher-pressure economy that emerges boosts tech diffusion and raises productivity. Far from worrying about robots and AI replacing jobs, labour shortages could be the very catalyst that finally delivers the gains from these technologies.