TALKING HEADS | MACRO
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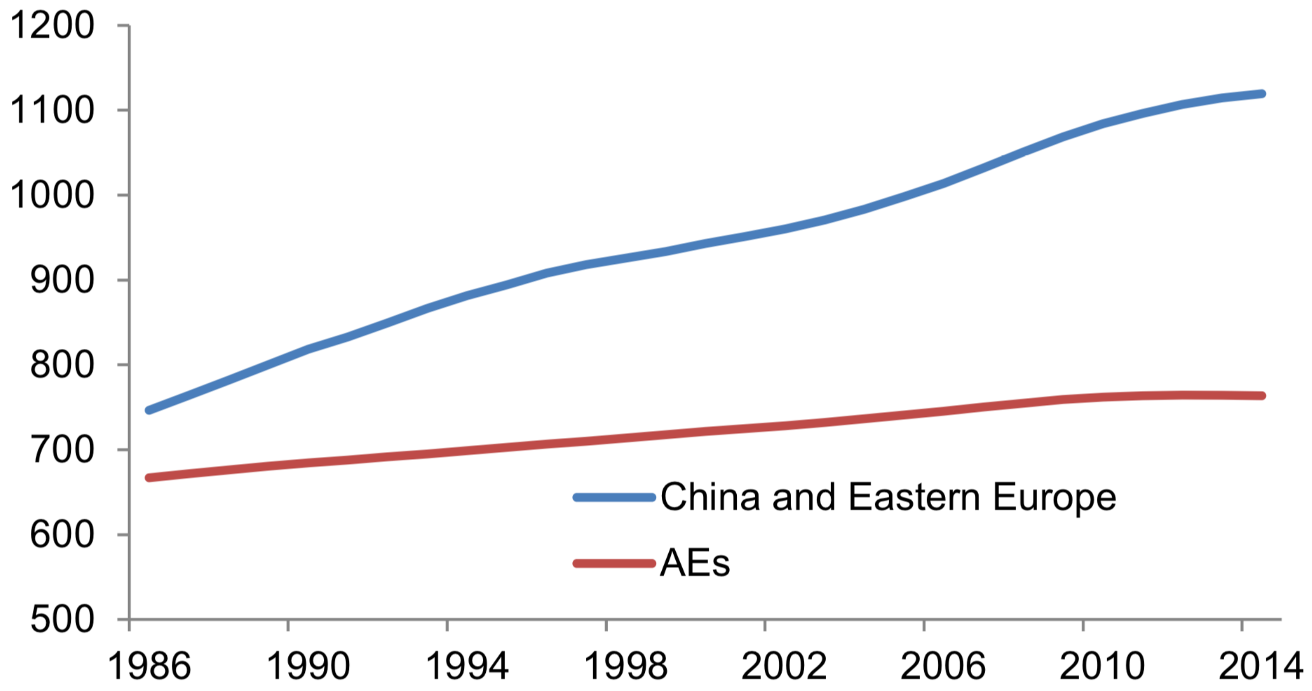
July 2019

Demographic Inflation, Tantrum-led Rebalancing

Sweet Spot: The Rise of China, the Collapse of the USSR

China + Eastern Europe = A historic, 120% Increase in the Labour Force of the AEs

Working age populations (20–64), millions

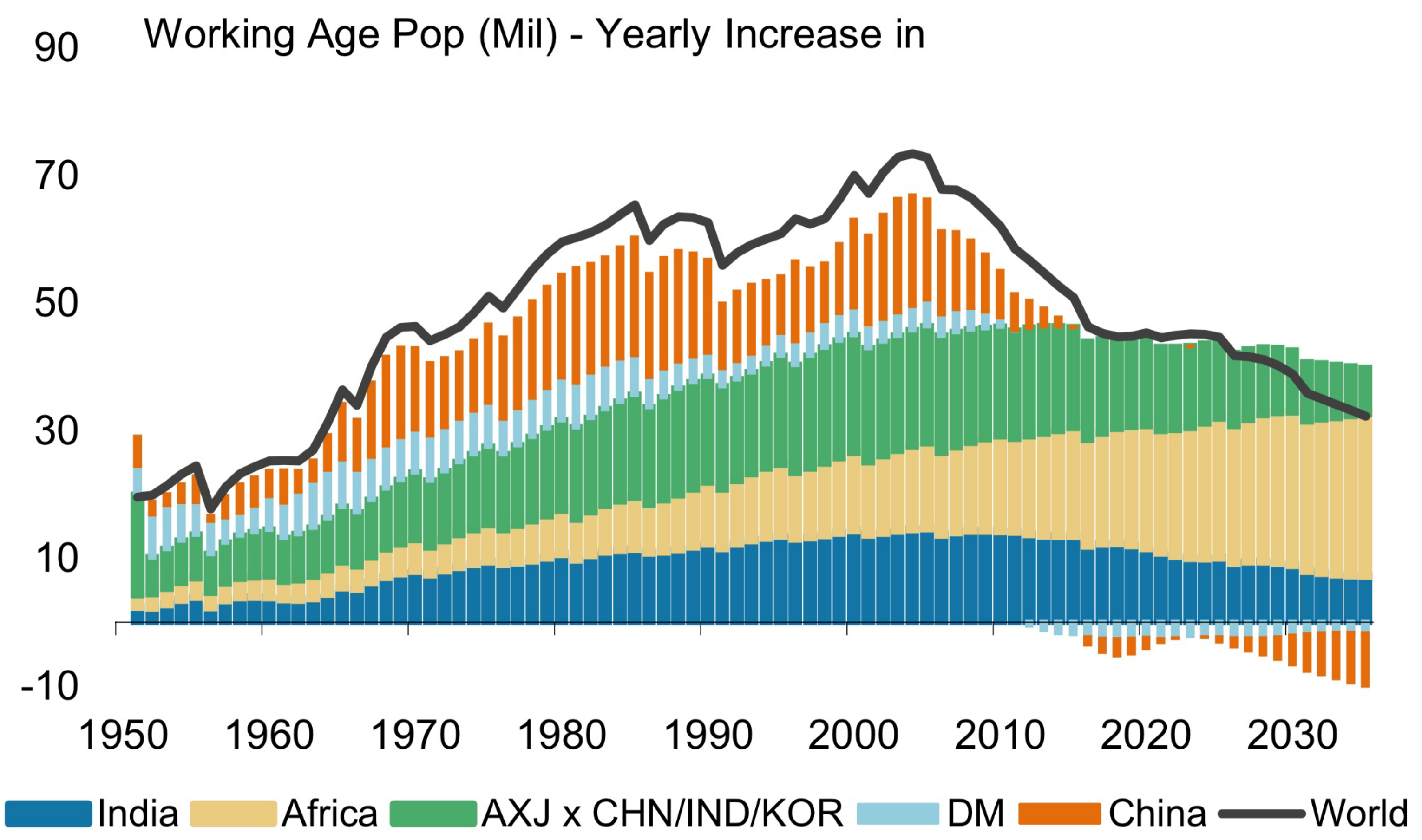


Source: UN World Population Database.

Three Global Trends

- **Real Wages Stagnant + Global Disinflation**
- **Real interest rates fell** – China invested so AEs didn't, but AEs set global interest rates
- **Inequality within economies rose, between AEs and EMEs fell**

The Great Reversal



Source: National sources, IMF, Haver Analytics, Talking Heads Macro

The Great Reversal: Five Implications

- **Inflation will rise + Resurgent labour** (wages will have to rise to offset public health/pension spending)
- **Real interest rates could rise** as saving falls faster than investment (capex and productivity to rise, elderly unwilling to move)
- **Nominal interest rates will rise**
- **Inequality falls: Piketty is History, Not the Future**
- **Central Banks caught in their own debt trap = Political Pressure rises:** Too much weight to inflation targeting regimes and too little to demography?

Source: Talking Heads Macro

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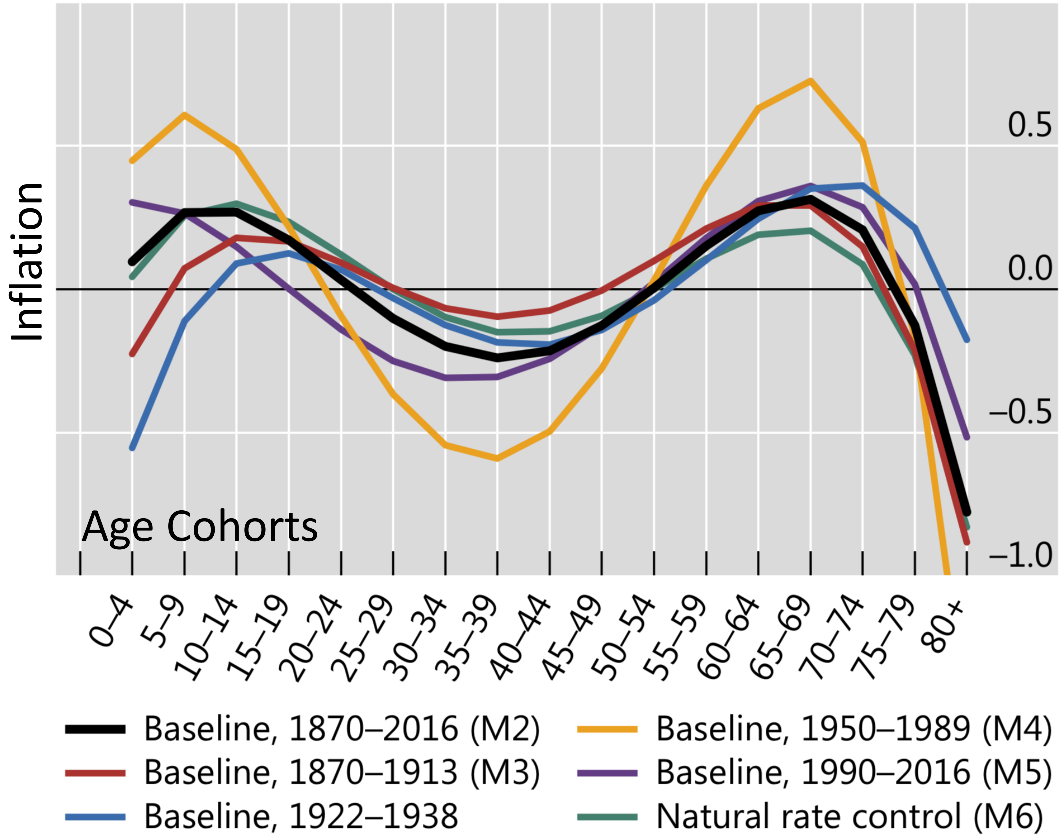
Inflation Will Rise

Juselius and Takats: The enduring link between demography and inflation (BIS, 2018)

Inflationary effect of ageing (except for the very old) is robust across countries and time spans

Age-cohort effect in different time periods



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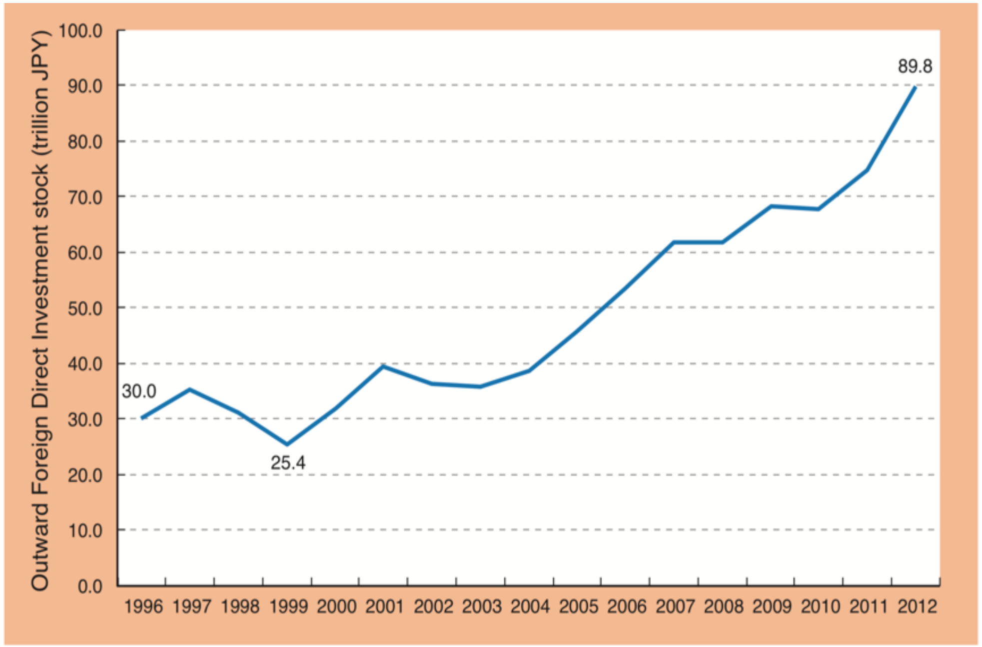
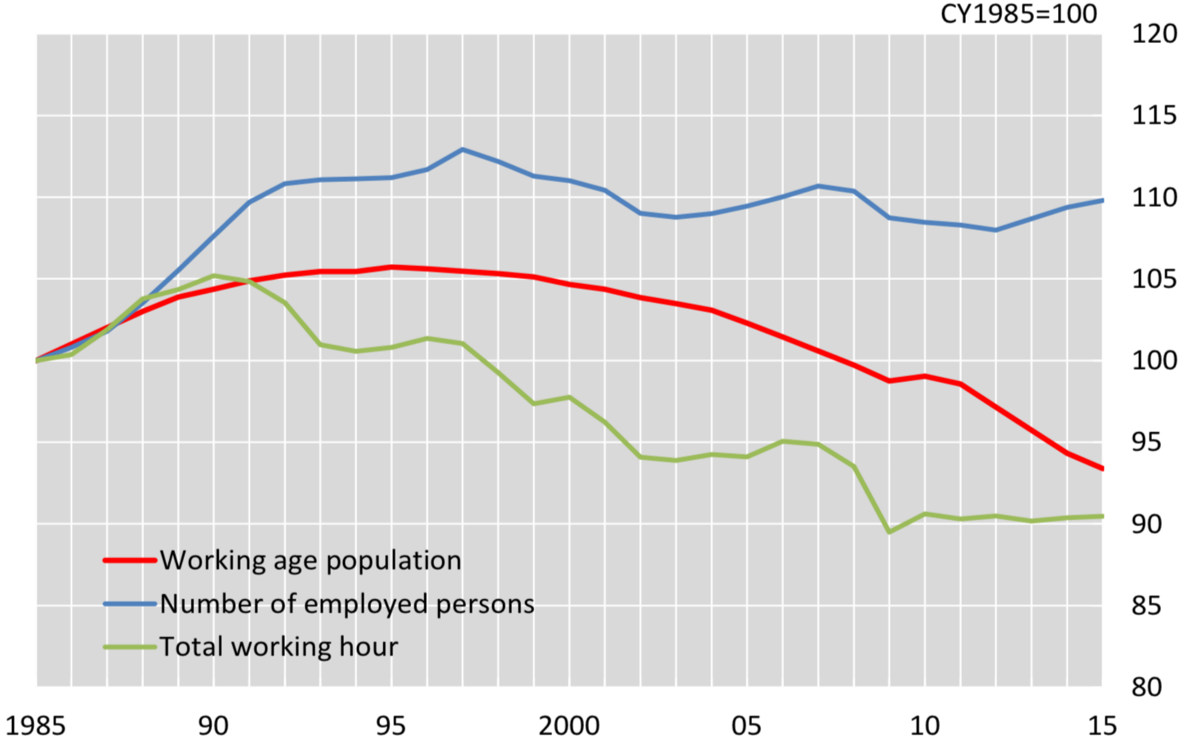
Critique: Why Didn’t it Happen in Japan?

Outbound FDI Was an Escape Value for Japanese Corporates



Note: FDI stock is the international investment position as of the end of the year.
Source: Bank of Japan (2013) Direct Investment Position, Breakdown by Region and Industry,

Within Japan, the adjustments were made through wages and not employment



Source: Talking Heads Macro

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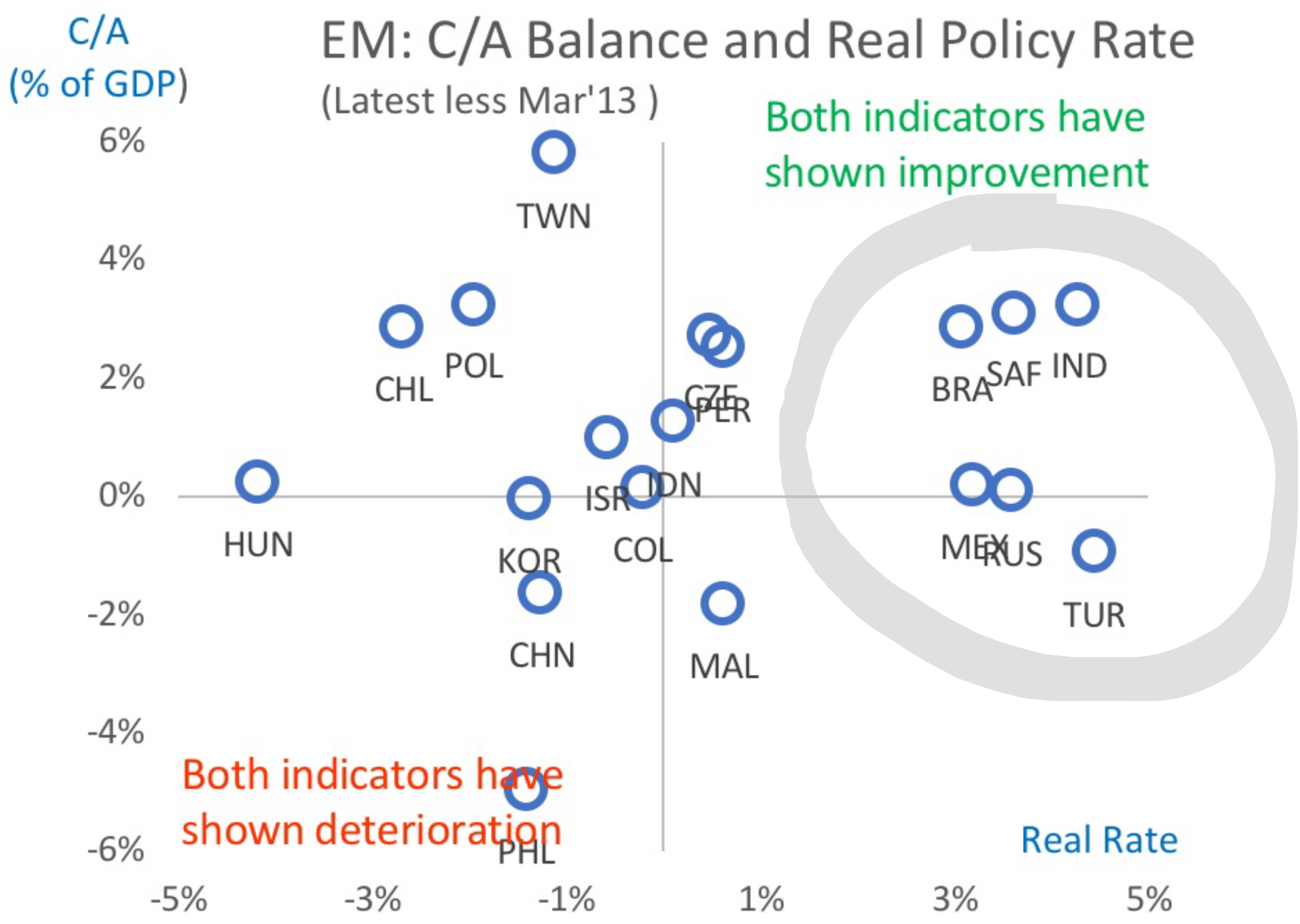
Cyclically: From the Fragile 5 to the Fragile 0.5



The Role of Tantrums is to Prolong the Global Expansion

How? By making the global and US economy out-of-sync = move away from overheating

1. **Tantrums start with absolute or relative US exceptionalism (and China weakness)**

2. **Tantrums end when the US economy becomes out-of-sync and the global economy feeds back into the US** (via imported disinflation and lower investment due to lower oil prices)

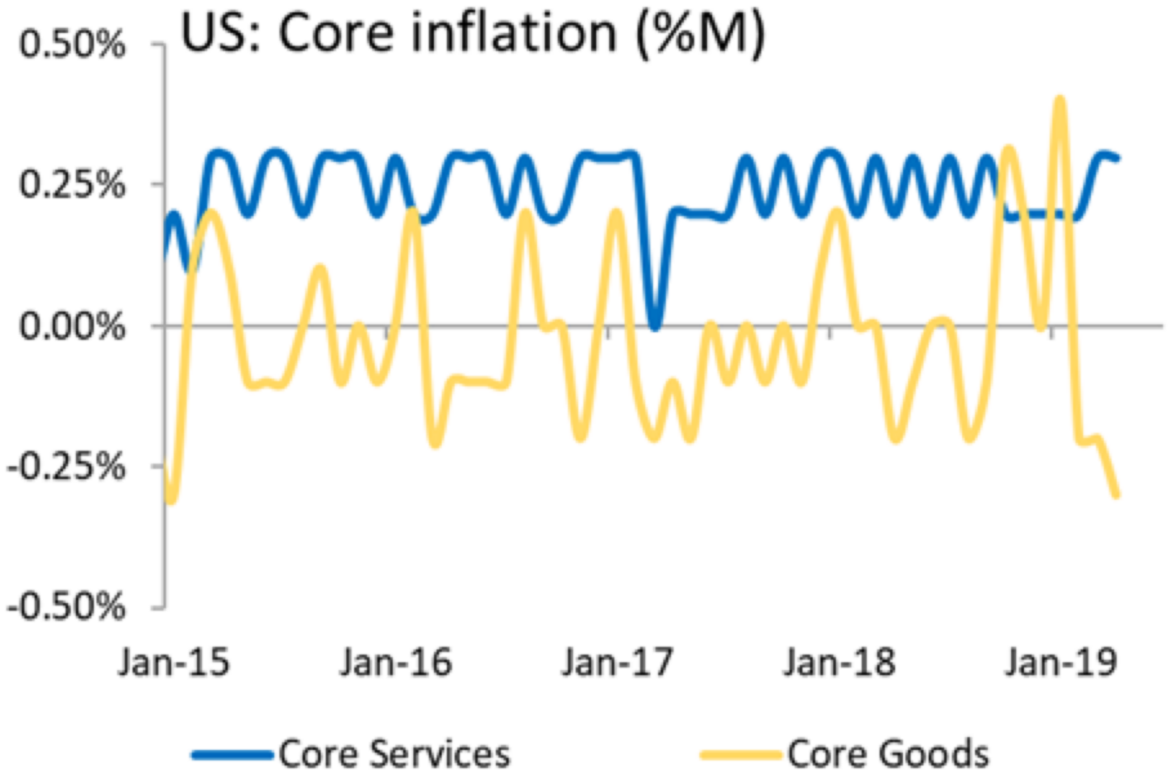
3. **Tantrums reduce imbalances** by hurting growth that depends on excessively loose monetary conditions

Source: Talking Heads Macro

US Inflation/Disinflation is a Global, Not Local, Story

Core services inflation: generated at home, flat when Fed Funds rate is 0%, rising by 200bps, and after the rise

Core goods inflation: Negative when USD is strong and global growth is weak (and vice versa)



Source: Talking Heads Macro

Fewer Imbalances, Broken Growth Model Discarded

	Taper Tantrum	China/Dollar Tantrum	Fiscal Tantrum
US Strength	Absolute	Relative	Absolute
China	Weak: SHIBOR spike	Manufacturing + Property collapse	PBoC crushes Shadow Bkg (2017-18)
Tantrum ends when	US housing slows	US inflation falls, real rates rise	US housing, capex and inflation fall
EM Adjustment	India, Indo	Russia, Brazil + commodity producers (AEs and EMEs)	Argentina, Turkey

Source: National sources, IMF, Haver Analytics, Talking Heads Macro

Problem is that Many Don't Have a New Growth Model

1. **China: No longer a driver of growth:**
   - Manufacturing/Property = post-crisis behavior;
   - Consumption growth will structurally slow down to 2%

2. Ageing EMEs need to get rich before they get old (China included)

3. Commodity producers have gotten rid of the Dutch Disease but where's the new model of growth? Reforms are not easy.
   - **Brazil reforms:** Pension reforms will lead *lower* growth, tax/others must come

4. Younger economies with very low capital-labour ratios will do very well (India, Indonesia, Sub-Saharan Africa) but they are a small part of EME

Disclosure: