

### Aging Dynamics

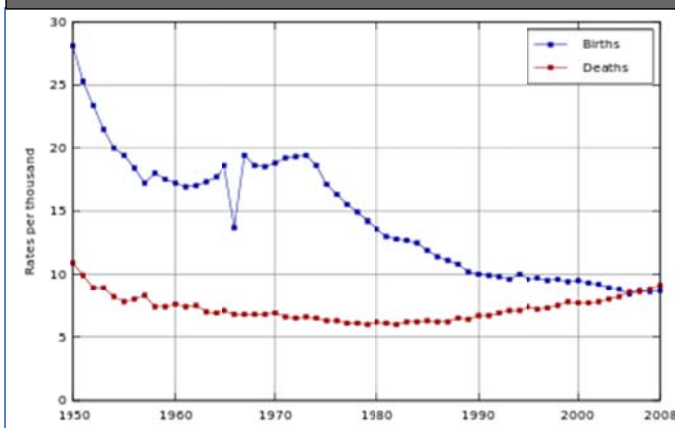
Across the world, the combination of low fertility and high life expectancies is changing both population levels and age distribution. Over the last twenty-five years, countries such as Japan, Germany, Italy, and to a lesser extent the United States have reported nearly a doubling of the percent of the population over age sixty-five. This cohort could reach 25% of the total in Developed Markets (DM) by 2025. In addition, world population growth has slowed over the last thirty years, not just in countries such as Russia, which actually reported a decline, and Japan, which will soon report a decline, but in South America and Africa as well. The United States will see an aging of its population, but given births higher than deaths and net immigration the Census Bureau predicts our population will grow from 321 million to 398 million by 2050. The chart below details the more extreme example of Japan. The impact of these demographic changes could be very significant for economic growth and interest rates: the new normal could be lower growth and interest rates through an economic cycle.

levels to fund pension and health care costs, declining labor force participation, and lower economic growth and inflation. Countries must respond to the rising tensions between two seemingly conflicting priorities --- the need to increase public spending on pension and health care and the need to reduce the growth of government spending and public sector debt. This will be a difficult political quagmire to tackle.

Public finances have been under stress due to higher debt levels associated with government deficits to ameliorate the effects of the 2007-2008 crisis. Weak economic performance has delayed the implementation of new, lower-cost health care and pension reform. The concern is that an aging population will demand more than the approximately 40% of national budgets now being devoted to these programs. In Europe, an EU Aging Work Group has made reform recommendations that are starting to be implemented, but given an aging population and resulting lower growth, these measures can only slow down the increase in debt levels, not reverse them. The charts on the following page detail expected debt and expenditure changes.

Among the nations, a differentiating factor will be the fostering of investment and labor productivity. This will be difficult in countries with aging populations, lower labor force participation, low productivity and net emigration. This is apparent in peripheral European countries now. Emerging Market (EM) economies could be less impacted due to both lower spending on social benefits and younger populations, but at some point social scientists expect a political consensus will emerge for higher benefits and potentially higher debt levels. The United States is not immune from the concern of an aging population and growing deficit-fueled debt increases, but population growth and productivity are important positive considerations.

Japan: Birth and Death Statistics



Source: Wikipedia

### Implications

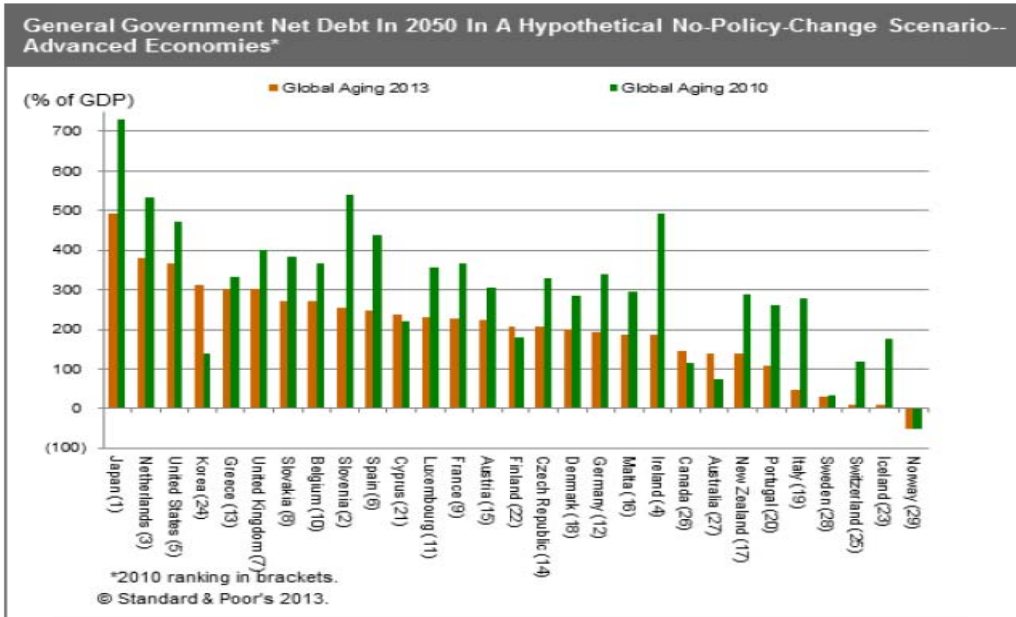
Population aging will also prompt social and economic policy adjustments. There are significant implications for public finances such as higher debt

However, it is not certain these important trends will continue if immigration control is strengthened and the recent dip in productivity growth continues. Policy initiatives are crucial to foster economic growth in an aging society if we are to limit sovereign debt to manageable levels.

fostering low demand growth, including low money demand growth. The government has not been successful in increasing demand by its quantitative easing measures and the result is low to no inflation and the continuation of low bond yields. This outcome is also apparent, to varying degrees, in the EU and United States, where significant increases in

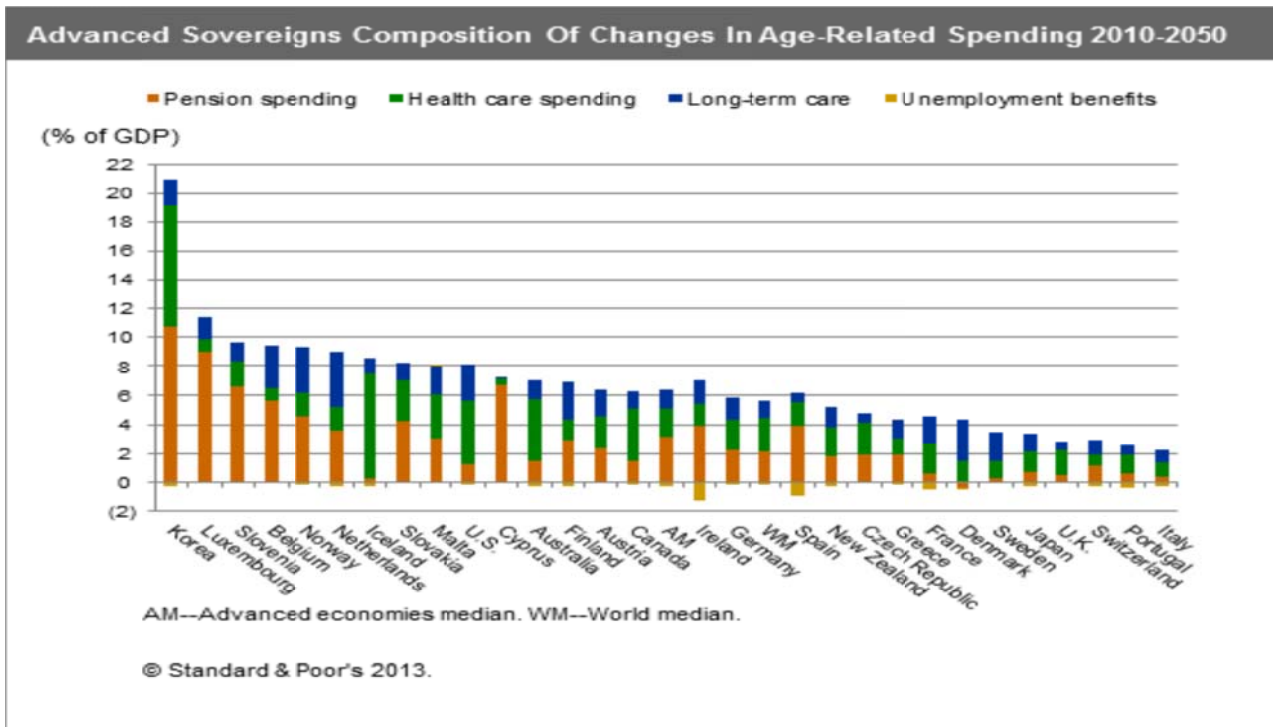
money supply have not yet resulted in the expected growth in economic activity and inflation. We should expect increases in retirement ages, as in France and Italy, and a more concerted effort to increase productivity with targeted government education and tax policies. Observers are pointing to these population dynamics as an important reason why inflation and bond yields are unlikely to increase significantly in this expansionary cycle. *The*

*“new normal” could be continued low bond yields, but at least investment portfolios may not lose value as rapidly as typically feared when the Fed begins a tightening cycle.*



### Inflation and Bond Yields

GDP growth is a function of labor force growth and productivity. In Japan we see these dynamics



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