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

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**

Source: UN World Population Database.
The Great Reversal

Working Age Pop (Mil) - Yearly Increase in

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?
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

Source: Talking Heads Macro
Critique: Why Didn’t it Happen in Japan?

Outbound FDI Was an Escape Value for Japanese Corporates

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

Note: FDI stock is the international investment position as of the end of the year.

Source: Talking Heads Macro
Cyclically: From the Fragile 5 to the Fragile 0.5

EM: C/A Balance and Real Policy Rate
(Latest less Mar'13)

Both indicators have shown improvement

Both indicators have shown deterioration
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

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

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:

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