FREE chapter

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Boom, gloom and the new normal

How Western baby boomers are changing global chemical demand patterns, again

This chapter is part two of a thirteen part series which will form a free ebook. Chapter two examines the long-term implications of the financial crisis and shows how we are moving to a new normal in terms of the global economy. Since the latest economic downturn, policy makers have pumped billions into mature economies to try and release pent up economic growth. But the policy is destined to fail because changing demographics mean an aging population can no longer be relied upon to sustain high rates of growth.

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The financial crisis and the New Normal

Since the latest recession, policy makers have pumped billions into mature economies to try and release pent-up economic growth, but the policy is failing

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Where's the money going? Over the past 50 years it has been poured into housing

PAUL HODGES INTERNATIONAL ECHEM

Pent-up demand has been the key driver for petrochemical growth over the past 20 years. Since the early 1990s, we have not had to suffer the multiyear downturns that were common in previous decades.

This good fortune may be about to change, however. This is why we have titled our new eBook, *Boom, Gloom and the New Normal: How Western BabyBoomers are Changing Chemical Demand Patterns, Again*.

Last month, in Chapter 1 (*ICIS Chemical Business*, May 23, 2011), we showed how the number of births had risen by 33m between 1946–1970 in the wealthy G7 countries (US, Japan, Germany, France, UK, Italy, Canada). In turn, we argued that this had led to a Golden Age for chemical demand in recent years.

The reason was that by 1995, all of these babies had entered the 25–54 age group. This is when people typically marry, settle down and have children. And so demand for housing, autos and electronics – all key markets for chemicals – had soared.

This month, in Chapter 2, we look at the Boomers' likely impact over the next 20 years. They are now entering the 55+ age group, when people normally save more, and spend less, as their family commitments decline. They are not only the largest and wealthiest generation that the world has ever seen, but they also have the longest life expectancy, a decade more than their parents. So they will have to save more and spend less, to fund these extra years.

We also analyze two critical issues:

- Housing and auto markets;
- Economic policy and interest rates.

HOUSING IS THE KEY DRIVER

Housing has been the biggest single growth market for petrochemicals over the past 50 years. Originally, it spurred demand in the Western economies as more and more Boomers began to marry and settle down. Their arrival also began to push up house prices, as housing demand began to exceed supply. In »

» turn, this allowed Western home owners to extract equity from their homes, boosting sales of autos, electronics and other staples of petrochemical demand.

Housing has also been the main engine behind China's growth, and that of other emerging economies, over the past 20 years. As investment bank UBS noted recently, "real estate and housing construction pervade the entire Chinese growth model. They are the most important determinant of commodity demand."

China's government is not unique in seeing home ownership as being a key route to securing social stability. Western governments have also been keen to promote it with tax benefits to give people a personal stake in the economy. Buying a home is, after all, the largest financial transaction of most people's lives. And it becomes far harder for workers to go on strike when the mortgage still has to be paid at the end of the month.

DEMOGRAPHICS AND DEMAND

But over the past decade, more and more Boomers have been leaving the 25–54 age group. The oldest is now 65, and the typical Boomer will be 55 in 2013. So the concept of pent-up demand for housing and associated products is becoming less and less relevant. It should also be no surprise that we now face a slowdown in growth.

But governments, just like many chemical companies, have shown a considerable reluctance to accept that the world might be changing. "What have demographics to do with growth?" perhaps sums up the general attitude.

Instead, most countries have simply followed Japan's response, from 1990 onwards, to the bursting of its property and asset markets. When I first visited Tokyo in 1987, the land under the Imperial Palace was said to be worth more than all the land in California. This was because Japan's Baby Boom took place a decade earlier than in the West. And its growth model was therefore already beginning to fail, even as my plane touched down at the airport.

Japan's government responded to the slowdown with major stimulus programs, just as we have seen more recently in the West. The only difference is that the scale of the current stimulus has been even larger. This is due to the influence of Ben Bernanke, now chairman of the US Federal Reserve, who argued in a widely reported speech in 2003 that Japan's government had not focused sufficiently on creating "an environment of combined monetary and fiscal ease."

Policymakers around the world have therefore aimed to avoid this mistake since the financial crisis began. US demand, for example, has been artificially inflated via tax credits for house purchases and the "cash for clunkers" programs to boost auto sales. In addition, financial markets have been flooded with two

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Cash just keeps getting squeezed

major waves of liquidity, with the latest $600bn of loan buying just coming to an end.

But if we look at housing and auto demand today, it is clear these policies have failed to deliver the expected results. US housing starts are now down below 600,000, compared with a 2006 peak of 2.2m. They are lower than at any time since records began in 1959. Equally, auto sales have slipped to a 10m–12m/year range, versus a steady 15m–17m during the Golden Age.

"We therefore argue in the eBook that that it is time for a new analysis of the underlying issues"

We therefore argue in the eBook that it is time for a new analysis of the underlying issues. This should start with the demographics, as these drive demand. The key issue in our view is that 38m fewer babies were born in the G7 between 1971–96. This was even fewer than in the years between 1921–45. We believe that today's reliance on the concept of "pent-up demand" is starting to look more like wishful thinking.

PENT-UP DEMAND IS WISHFUL THINKING

Equally, we argue that the aging of the Boomers is not all bad news. It is actually self-balancing in its economic impact. As Japan's example shows, interest rates tend to fall as a population ages because older people spend less and save more. So the large Western economies can expect to see an increase in domestic savings, alongside a slowing of demand growth.

This is the same law of supply and demand that boosted housing and asset market values over the past 20 years, when demand also rose ahead of supply. Only now, the demand is for guaranteed long-term income rather than McMansions and Hummers. So prices for "safe" G7 government bonds are rising, causing long-term interest rates to fall.

Return *of* capital, rather than return *on* capital, is instead becoming the driving force behind investment flows. In turn, the cost of long-term project funding is therefore falling. This is excellent news for those companies who share our views about the predictive power of demographics.

As we will discuss in future chapters of the eBook, there are plenty of new ideas (such as the global megatrends concept), to power the next wave of global growth.

The key issue is that we need a change in mindset. Those companies that continue to expect stimulus measures to deliver a return to the Golden Age are likely to be disappointed. Instead, the winners will focus on understanding how to profit from the changes now underway as we transition to the New Normal. ■

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KEY FACTS

Authors' credentials

Chapter 2 of *Boom, Gloom and the New Normal – How Western Baby Boomers are Changing Global Chemical Demand Patterns, Again* is now available on free download at www.icis.com/NewNormaleBook. It is co-authored by Paul Hodges, chairman of International eChem, who writes the ICIS Chemicals and the Economy blog, and John Richardson, director, ICIS training Asia, who writes the Asian Chemical Connections blog.

ICIS and International eChem have also launched a training course, aiming at helping companies to become a winner in the New Normal. Visit www.icis.com/NewNormalSeminars