

FUNDAMENTALS

Asia demographics: from ageing champions to young challengers



Veeral Gandhi joined LGIM in 2015 and is a fund manager for the Asian Income portfolios. Most recently Veeral was a research analyst at Amiya Capital, an emerging markets hedge fund.



Ben Bennett is the Head of Credit Strategy, focusing on allocation within the fixed income funds and providing the credit input to macro strategies.

Driven by positive demographic trends, Asia has been a critical engine of the global economy, contributing around 30% of world GDP growth since 1980. But the countries behind this growth are now changing. In the coming years, the ageing champions will pass the baton to the young challengers. Understanding this transformation will be crucial for investors.

By focusing on their future demographic trends, we are defining two broad groups of countries in Asia. These are the ‘ageing champions’: Japan, China, South Korea, Taiwan, Malaysia, Thailand and Singapore, and the ‘young challengers’: Indonesia, Philippines, Vietnam, India, Pakistan, Bangladesh, Cambodia, Laos and Myanmar.

SIMILAR POPULATION, DIFFERENT PROSPECTS

The ageing champions, with 1.7 billion people in total are outnumbered by the young challengers’ population of 2.2

billion. But fast economic growth in the past means that the ageing champions’ collective GDP is four times larger than that of the young challengers. The difference between the demographics of these two groups is extreme. Pakistan is expected to continue to have favourable demographics for the next 30 years, while Japan’s population pyramid in 30 years is completely the opposite (Figure 2 overleaf).

The young challengers have an excellent opportunity to follow in the footsteps of the ageing champions and embark on rapid

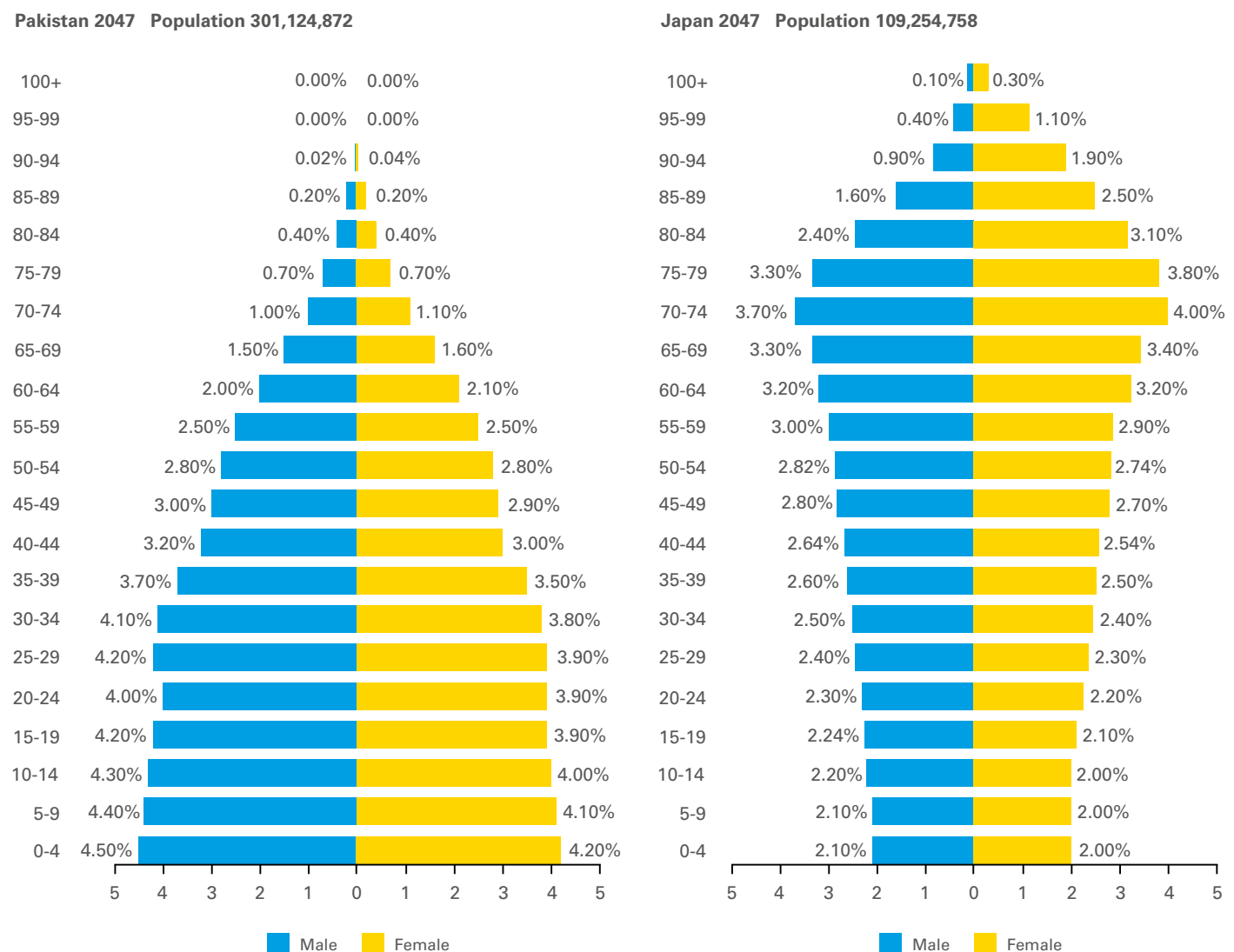
capital expenditure enabled growth. Wages are markedly lower among the young challengers, and we would expect manufacturing capacity to migrate to these countries over time. The intense, manufacturing-based growth we saw in cities like Shenzhen, Taipei and Seoul in recent decades should now be expected in cities like Manila, Jakarta and Mumbai.

Figure 1: Asian country statistics

	Population (m)	Population growth 2016	% of population aged 65 and above	GDP 2016 (USD tn)	GDP per capita (USD)
Ageing champions					
China	1,374	0.5%	10%	11.2	8,153
Japan	127	-0.1%	27%	4.9	38,984
South Korea	51	0.5%	14%	1.4	27,713
Taiwan	23	0.2%	13%	0.5	22,525
Thailand	68	0.3%	11%	0.4	5,965
Singapore	6	1.3%	12%	0.3	51,363
Malaysia	31	1.5%	6%	0.3	9,575
Young challengers					
India	1,267	1.1%	6%	2.3	1,787
Indonesia	258	1.1%	5%	0.9	3,609
Philippines	103	1.6%	5%	0.3	2,971
Pakistan	202	2.0%	4%	0.3	1,404
Bangladesh	156	1.1%	5%	0.2	1,418
Vietnam	95	1.1%	7%	0.2	2,127
Myanmar	57	0.9%	5%	0.1	1,185
Cambodia	16	1.6%	4%	0.02	1,254
Laos	7	1.4%	4%	0.02	2,266

Source: World Bank, IMF, Taiwan National Statistics, Focus Taiwan, CIA World Factbook

Figure 2: Asia has highly heterogeneous demographics



Source: PopulationPyramid.net

LIVING UPTO POTENTIAL

The incremental return on capital in an economy with large amounts of labour is high. These high returns can be reinvested in more capital, creating a virtuous circle.

For example, Foxconn, one of the contract manufacturers of the iPhone, recently announced its intention to invest \$5 billion in India to establish a manufacturing hub¹. One of the reasons behind this is that India’s wages for skilled workers are around one half to two thirds below the levels paid in China (Figure 3).

However, for the young challengers to live up to their potential there needs to be the right institutional framework. In particular, the young challengers need to build public infrastructure, stamp out corruption, ensure labour markets operate efficiently and maintain macroeconomic stability. Without these conditions in place, investors may deem it too risky to invest in large scale projects that are needed to create the jobs to harness the growing working age population.

1. Infrastructure

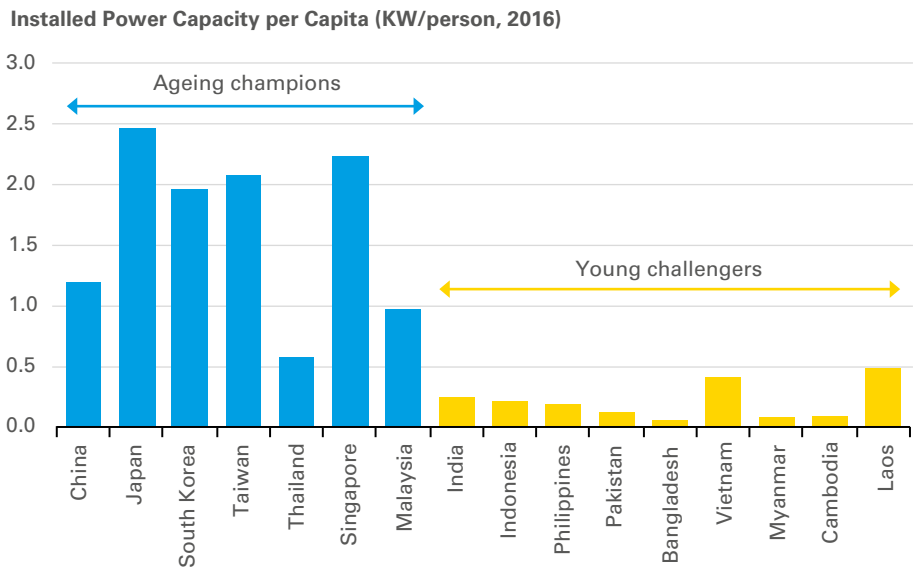
The young challengers lack sufficient infrastructure in areas such as power generation capacity, transport networks, water and sewage facilities and internet connectivity (Figure 4). Better infrastructure requires coordinated policy and public planning. It also requires that politicians prevent

Figure 3: Wages for Indian skilled workers are 1/2 to 1/3 of Chinese levels

Gross Annual Income of Skilled Workers	
City	Annual Income (US\$)
New York	79,100
Shanghai	9,200
Beijing	6,200
Delhi	4,800
Mumbai	3,100

Source: UBS survey, 2010

Figure 4: Infrastructure needs to improve among young challengers



Source: CIA World Factbook

red tape and bureaucracy from delaying projects. India has tried to make progress on this front by granting single window clearance for infrastructure projects, reducing the amount of time it takes to secure environmental and other consents.

India’s ruling party also attempted to implement a land acquisition bill to speed up the process of acquiring land for infrastructure and industrial projects, but the bill was blocked by the opposition.

1. <http://timesofindia.indiatimes.com/business/india-business/foxconn-plans-to-invest-up-to-rs-32000-crore/articleshow/59433253.cms>

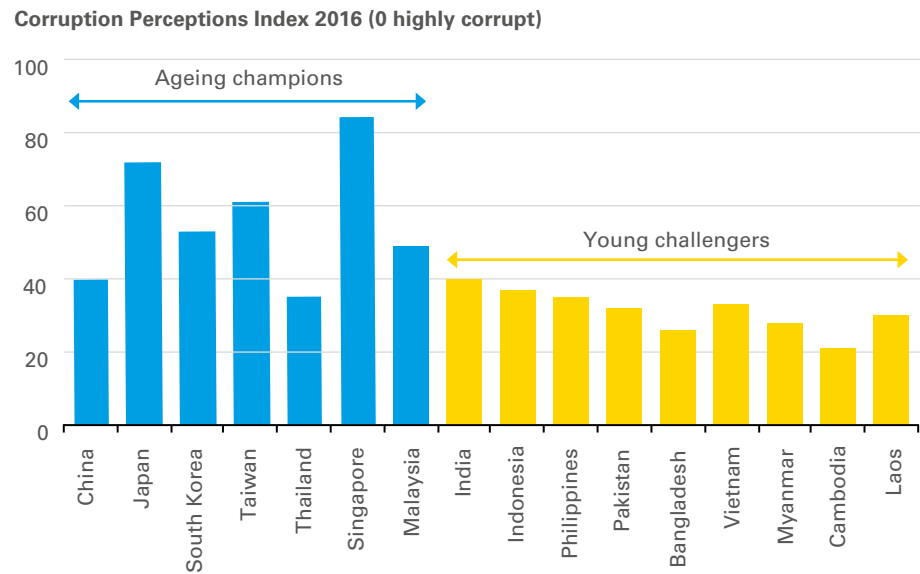
2. Corruption

Corruption is an impediment to investment in the young challengers (Figure 5). It results in an uncertain and arbitrary political environment, where politicians do not make decisions in the national interest. This creates uncertainty and raises the risk associated with investing in countries with high degrees of corruption. The young challengers are often perceived to be more corrupt than the ageing champions, although interestingly some of the ageing champions may actually have similar levels of corruption to the young challengers – in particular China and Thailand. It is likely that the economic growth that has been achieved in these countries has been despite the corruption prevalent, rather than as a consequence of its removal.

3. Labour market efficiency

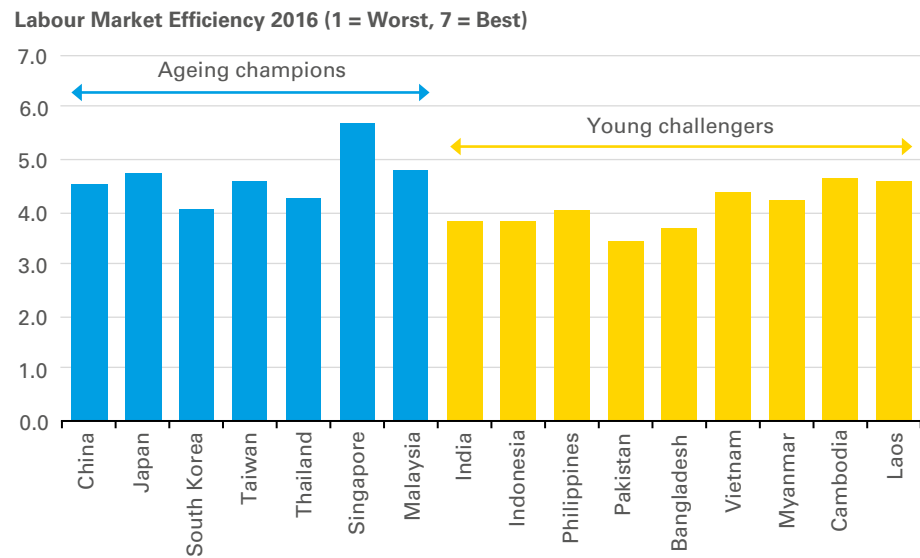
Efficient labour markets are important to permit firms to use the large labour pools available in the young challenger countries. Employment protection policies that diminish the employer’s flexibility reduce the willingness of firms to hire in the first place. The young challengers actually score quite well on this front, only slightly worse than the ageing champions. Within the group, Vietnam, Cambodia and Laos score particularly highly (Figure 6). India is attempting to improve its labour market flexibility with the government’s plan to merge 44 labour laws (some from the time of British rule) into four major

Figure 5: Corruption holds back growth among the young challengers



Source: Transparency International

Figure 6: Vietnam, Cambodia and Laos have particularly flexible labour markets



Source: World Economic Forum

bills covering minimum wages and industrial relations. These bills are likely to face opposition in

parliament, but their tabling is a move in the right direction.

4. Macroeconomic stability

Macroeconomic stability is a prerequisite for the investment necessary to absorb the large labour force in the young challenger nations. After the Asian financial crisis in 1997, investors are wary of investing in Asian countries vulnerable to debt crises and severe currency depreciation. On this point, the young challengers have performed reasonably well. Many have fairly low rates of inflation and manageable public debt (Figure 7).

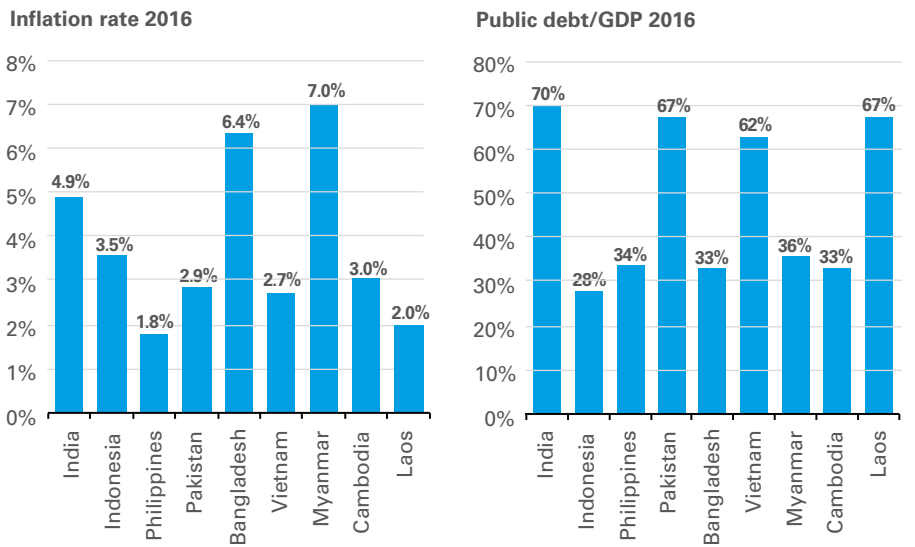
LOOKING REGIONALLY, NOT GLOBALLY

The ageing champions were able to grow rapidly through exports to the developed world. For example, Taiwan’s export to the US as a percentage of its total exports increased from about 12% in 1960 to 42% in the 1980s. In the current period of slower economic growth in western countries, the young challengers may find it more difficult to find demand in export markets (Figure 8).

However, the young challengers could still be able to grow their export industries through displacing the ageing champions in world trade. The young challengers also have the opportunity to export to the ageing champions, who, owing to previous rapid economic growth, now have a large wealthy, consumer class.

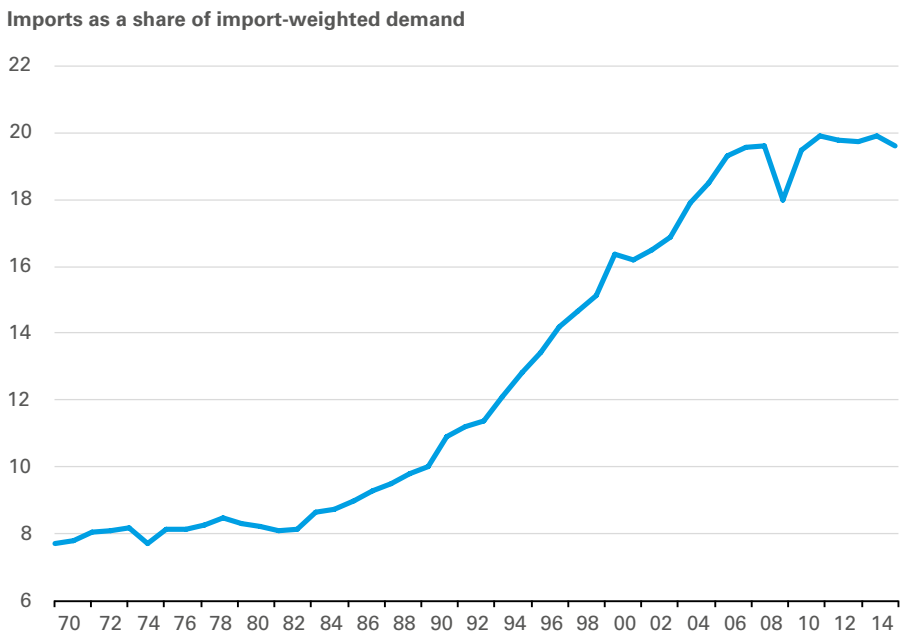
Indeed, both the ageing champions and the young challengers stand to benefit from deeper intraregional integration. For example, the young challengers could provide young migrant workers to the ageing champions, to offset declines in their working age population.

Figure 7: Many young challengers have fairly low inflation and manageable public debt



Source: Macrobond, IMF

Figure 8: Export growth has been subdued in recent years



Source: World Bank, LGIM estimates

The more developed, yet ageing countries, are able to export capital and expertise to the young challengers. This could give them better returns on investment than are available in their domestic markets, which could then be used to mitigate the financial

strain of providing pensions and healthcare for their growing elderly populations. Japan has been particularly active in investing in the young challenger nations, with significant investments in India, Thailand and Myanmar in recent years. China’s ‘One Belt, One

Road' initiative could also be seen through this lens, as many of the countries chosen for investment have favourable demographics.

Greater integration within Asia is even more critical now, as western countries appear more protectionist and less favourably disposed to free trade. In the past, Asian countries were helped by trade and capital flows from western economies. In the next era of economic expansion for the region, Asia may have to help itself.

POTENTIAL INSTABILITY

The final point to make on the young challengers is that their favourable demographics could potentially become a liability if not harnessed productively. Demographic researchers find a strong correlation between high unemployment among young men and insurgency². India, Pakistan, Philippines and Indonesia already suffer instances of domestic insurgency, and these problems are likely to get worse if they do

not create sufficient jobs to employ their large populations of young people.

INVESTMENT IMPLICATIONS

Our investment strategy within the ageing champions is cautious regarding exposure to countries that have the most challenging demographics with few options to mitigate their negative effects. Japan looks particularly poorly positioned on this basis given its very high amount of public debt and aversion to immigration. The winners could be those that can mitigate the negative impacts of their deteriorating demographics, while enhancing productivity through innovation. Those that use internal and international migration to revitalise their work forces, adapt work places to permit working to an older age and encourage innovation by investing in research and development and promoting entrepreneurship are likely to be the best positioned. Here, Singapore is a good example.

Given the faster economic growth we expect among the young challengers, we would generally look to raise investment exposure to these countries over the medium term. The key is to seek out favourable institutional factors for capital expenditure. Vietnam, Cambodia and Laos appear well positioned due to their good labour market efficiency, relatively benign inflation, moderate corruption and more advanced infrastructure. India has made progress on improving its institutions, but we note asset valuations in the country have already moved up significantly on the advent of the Modi government.

Given the weak global trend, positive demographic investments are few and far between. But with a patient approach and a keen eye on valuations, the Asian young challengers should provide plenty of opportunities.

2. LaGraffe, D. (2012) The Youth Bulge in Egypt: An Intersection of Demographics, Security, and the Arab Spring. *Journal of Strategic Security*, 5 (2): 65-80.

Important Notice

This document is designed for our corporate clients and for the use of professional advisers and agents of Legal & General. No responsibility can be accepted by Legal & General Investment Management or contributors as a result of articles contained in this publication. Specific advice should be taken when dealing with specific situations. The views expressed in this article by any contributor are not necessarily those of Legal & General Investment Management and Legal & General Investment Management may or may not have acted upon them and past performance is not a guide to future performance. This document may not be used for the purposes of an offer or solicitation to anyone in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

© 2017 Legal & General Investment Management Limited. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording, without the written permission of the publishers.

Legal & General Investment Management Ltd, One Coleman Street, London, EC2R 5AA www.lgim.com

Authorised and regulated by the Financial Conduct Authority.

M1485