Global Asset Management

# Emerging Market Demographics

The RBC Emerging Markets Equity team

## China's surprising lead

It is expected that many emerging market (EM) populations will enter a demographic 'sweet spot' over the next decade, while others will experience deteriorating demographics such as an ageing population and increasing dependency ratios. But is the market over-hyping the impact of positive demographic changes in some regions, such as India, due to the sheer size of the country's young population while at the same time overlooking compelling demographics in other EMs like China? We believe the biggest misconception about demographics is the tendency to equate a large young population with 'good demographics', without considering important qualitative variables such as education levels, (female) labour force participation and savings/wealth accumulation, which also determine economic growth and consumption. In this report we look beyond over-simplified headline statistics, such as population size and age, and identify key misconceptions about demographics in the larger EM countries.

## Why are demographics an important theme in EMs?

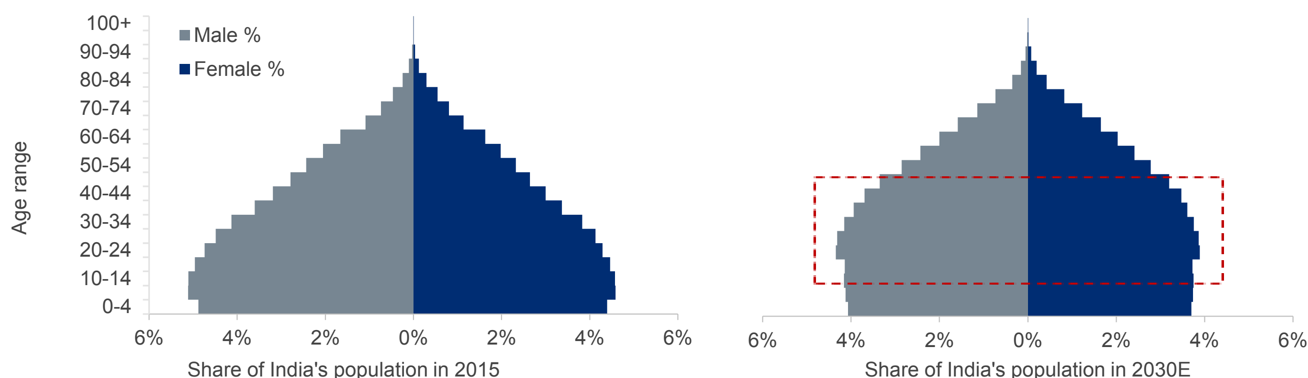
Demographics and population trends in EMs have often occupied centre stage in discussion of the sources of economic growth: a large, well-educated and growing workforce supports poverty eradication, higher savings rates and wealth accumulation, which in turn drives increased investment and economic growth. Consequently, identifying and understanding long-term demographic trends is an important investment theme in EMs, as a key determinant of consumption preferences and a driver of long-term economic growth.

Countries will typically experience two demographic windows of opportunity, termed 'demographic dividends': 1) the benefits of an abundant supply of labour resulting from a rapidly-increasing share of young working-age adults (Exhibit 1); and 2) access to increased capital, stemming from savings and wealth accumulation by an older working-age population preparing for an extended life expectancy (prominent in EMs where state healthcare and pension expenditure is low).

Exploiting these demographic windows of opportunity, and translating them into strong per capita income growth, will depend on effective implementation of policies regarding education, healthcare, wealth investment, family planning and labour participation.

While countries such as India, Indonesia and the Philippines are experiencing their first demographic dividend, China is nearing the end of its first demographic dividend. But can India's burgeoning workforce be used to fuel economic growth, given that the current gaps in education translate to a large pool of unskilled labour? Has the Philippines lost its window of opportunity to capitalise on its youth dividend (high unemployment rates have led to around 10% of Filipinos working abroad)? We analyse these dynamics below.

**Exhibit 1: EMs such as India which are entering their first demographic dividend will benefit from an increased share of working age population**




Source: UNDESA, World Population Prospects: The 2017 Revision, 21 June 2017

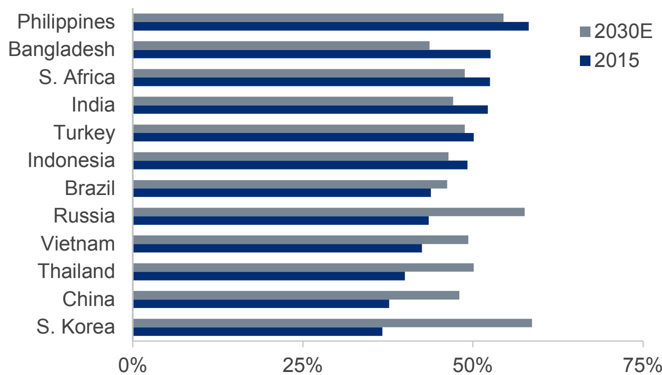
## Household dynamics: looking beyond headline statistics

*Population ageing will negatively impact dependency ratios/labour force size...*

EMs with a large youth population are typically viewed as being in a demographic 'sweet spot', due to lower dependency ratios (a lower proportion of elderly and young dependents relative to the total population). India, the Philippines and Bangladesh are perceived to be the strongest beneficiaries in this respect due to their large youthful populations moving into working age over the next two decades, which is expected to translate into an improvement in dependency ratios and a demographic dividend. In contrast, much has been said about the potential economic and social impact of rapidly-ageing populations in countries such as China, Vietnam and Thailand, in terms of increased elderly dependency ratios, a decline in workforce sizes and an increased burden on state healthcare programmes. In fact, while China's attractive dependency ratio of roughly 38% is expected to deteriorate to 48% by 2030E (due to its ageing population), India's dependency ratio is expected to improve by 5% to 47% by 2030E due to a drop in child dependency ratios amid falling birth rates (Exhibit 2).

*. . . but consumption spending is determined by household discretionary income*

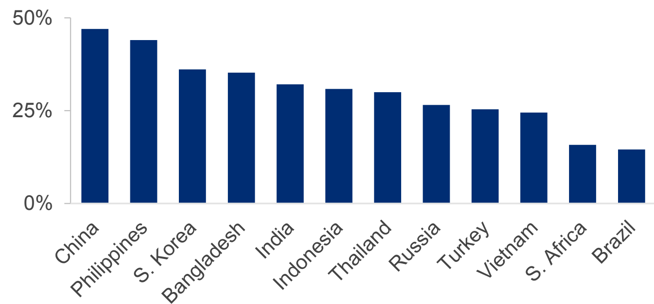
### Exhibit 2: Divergent trends in dependency ratios




Source: UN World Population Prospects 2015, UNDESA, Population Division, 14 November 2018

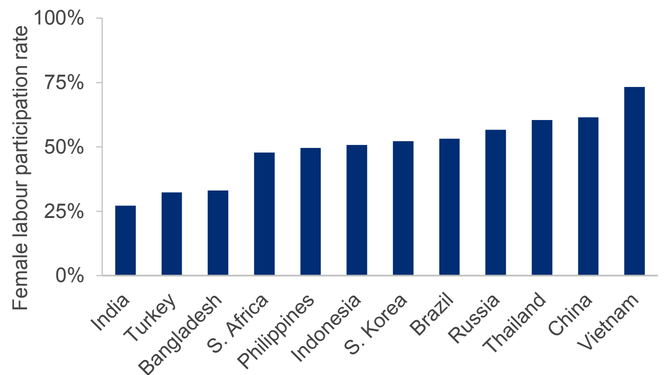
Country-wide dependency ratios can, however, be somewhat misleading in terms of quantifying purchasing power/discretionary income levels. There are many qualitative factors that also need to be considered. For example, while India's dependency ratio is expected to improve over the next decade, low female workforce participation, a sizeable education gap, and larger households with very young children (the average age of young household dependents in India is 5 years old vs 16 in China) are likely to present significant headwinds to consumption and growth for many years to come. China, on the other hand, while facing an ageing population and deteriorating dependency ratios, has the advantage of high female labour participation and small household sizes with a large number of empty nesters (a legacy of the one child policy), which translates to fewer dependents per wage earner and therefore higher discretionary spending power (Exhibits 3, 4 and 5).

### Exhibit 3: China has one of the highest savings rates in the world



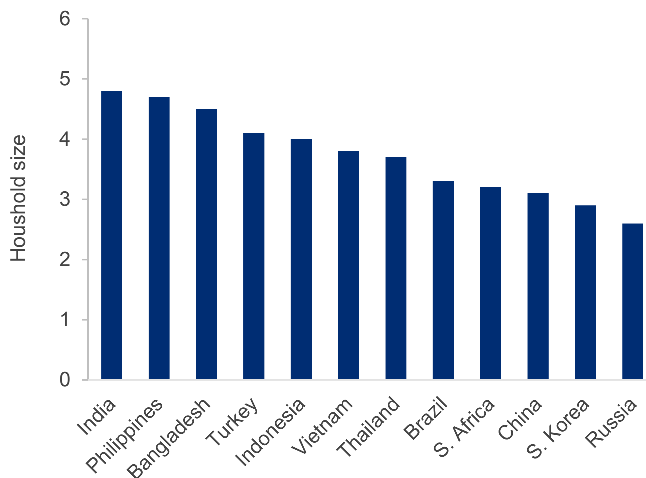

Source: World Bank national accounts data and OECD National Accounts data files, 2017

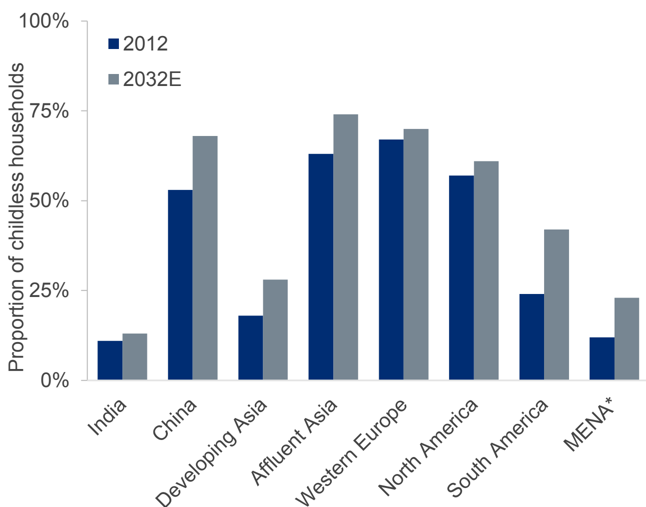
### Exhibit 4: EM Female Labour Participation is low in India relative to other EMs




Source: World Bank national accounts data and OECD National Accounts data files, 2017

**Exhibit 5: Smaller households with older children typically (will) have higher discretionary spending power**




Source: UNDESA, Population Division, 2009-2018, Global Demographics Ltd, 2013

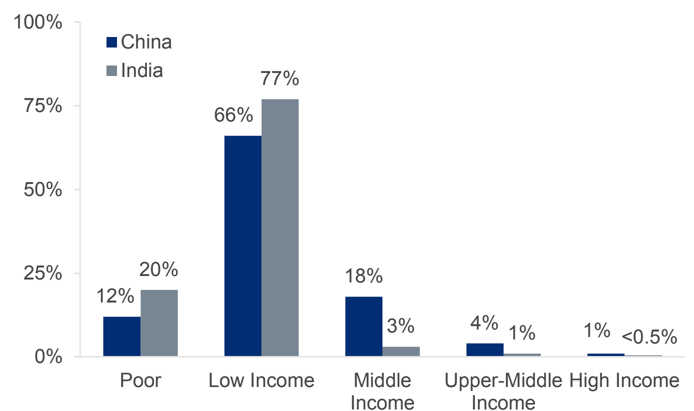
Note: *Middle East and North Africa

## Wealth effects

In our analysis of wealth effects, we looked at the impact of economic growth on two key demographics: 1) an emerging middle class; and 2) the affluent 40-64 age group. Strong economic growth over the next decade is expected to result in an expansion of the middle class population in several EM countries. (Pew Research defines the middle class as the share of the population living on USD 10.01-USD 20.00 per day). Spending on education and healthcare, as well as expenditure on consumer durables (appliances, cars and furniture), recreation activities, transport and fuel, typically increases as EM households move from lower income categories to the middle income class. While EMs such as Thailand and Brazil already have a sizeable middle class (29% and 28% of the population respectively), we expect countries such as China, Indonesia and India to see an expansion in this demographic, supported by GDP per capita growth and increased urbanisation (Exhibit 6).

We believe that over the next decade the most influential demographic, in terms of consumption, will be those in the 40-64 age group. Typically they will have accumulated savings and have already acquired fundamental assets (such as property, cars and household appliances) and will therefore have higher levels of discretionary income. We expect this group to drive consumption spending on travel, personal care, health and wellness, sportswear and private healthcare. China's affluent urban empty nesters within this age bracket also contribute to consumption spending through the process of upgrading to higher quality, more expensive goods driven by aspirational needs. Within our RBC 12 EM universe[1], China in particular scores highly on this metric, with a projected 38% of its population falling into the 40-64 age group by 2030E, up from 21% currently, based on UN population projections[2]. The spending power of this demographic in China should be enhanced by the dominant share of empty nesters.

**Exhibit 6: China and India % of population by income (2011)**




Source: Pew Research Center, 2015

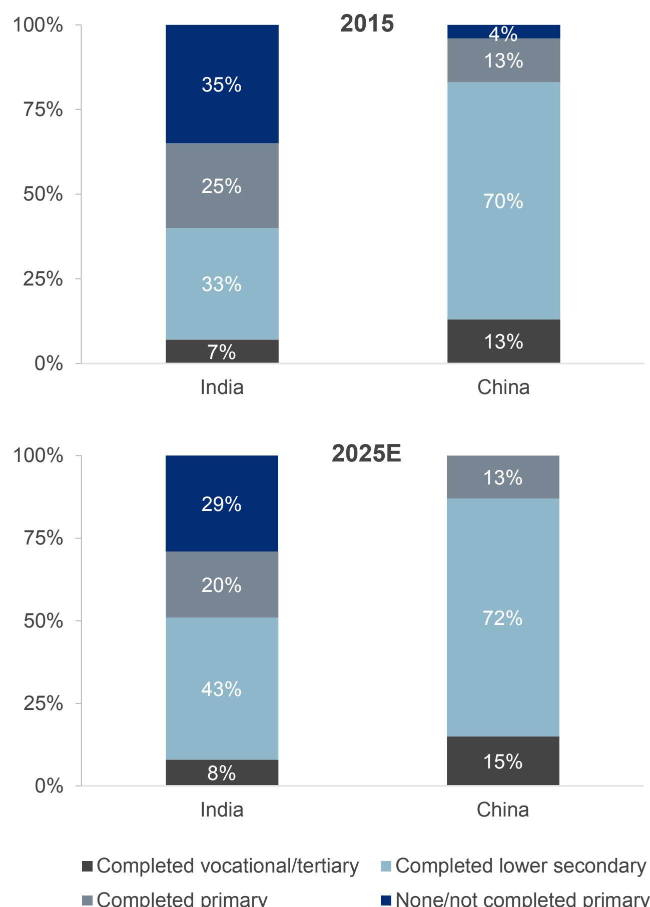
## Lifestyle effects

*Education gaps and headwinds to urbanisation mitigate the demographic dividend of a young population*

We also examined current education levels in each country as a measure of future wealth-generation and spending power for households, as low levels of education typically translate to lower wage levels for largely unskilled workers. We note that countries, such as India, which have large and rapidly-growing working age populations, have poor education profiles compared to countries like China which have older but more educated populations (Exhibit 7). Around 35% of children in India do not finish primary education (compared with 4% of students in China) and are unable to read or write, which makes them unemployable in many industries. Further, many Indian students who do achieve degrees have limited opportunities in the job market due to inadequate English language proficiency and the absence of soft skills. Consequently, the benefits of India's 'demographic dividend' of a growing working-age population could be offset by its education gap. Within EM, Vietnam also scores highly on education, with high primary and secondary

education completion levels, as well as high PISA (Programme for International Student Assessment) scores, in which it ranks ahead of developed countries such as the United States.

**Exhibit 7: India has a sizeable education gap vs. China which mitigates its demographic dividend**




Source: Global Demographics Ltd (as reported by Securities Trust of Scotland, 2018)

Over the past few decades, there has been a substantial shift in population towards urban areas. 57% of the increase in the global urban population is accounted for by 10 countries, nine of which are EMs, and China and India are the key players contributing to this increase. The significant increase expected in India is due to the very low levels of urbanisation currently; in 2016, India's urbanisation level was 33% compared with 57% in China, according to UN estimates. However urbanisation is also highly dependent on education, and the poor level of education level, and the education system, in India has meant that the benefits associated with urbanisation (including improved living standards, resource efficiency, and economic growth) have been slower to unfold there than elsewhere in Asia.

In our assessment, China ranks at number 1, due to attractive consumption-orientated demographics in the form of 1) high labour participation within a large, well-educated work force; and 2) an increasing middle-aged population comprised of a significant number of empty nesters/couple-only households.

While India's large youth-heavy population – with a median age of 27 in 2015 - and the favourable trend of an expanding working-age population, make the country's demographics attractive in the very long term, we think that headline statistics somewhat inflate household purchasing power in India over the medium term. Low labour participation rates, particularly female labour participation (27% compared with 52% for our EM universe based on UN estimates) have led to more dependents per household than suggested by age-wise dependency ratios. India also scores poorly in terms of its education profile, as previously stated, with around 35% of children not finishing primary education and being unable to read or write, which makes them unemployable in many industries.

*South Africa, Bangladesh and Russia have the least attractive demographics*

Despite a young population with a median age of 26, South Africa has not reaped the rewards of a demographic youth dividend, due to high unemployment (around 27%)[3] and the prevalence of HIV/AIDS creating a larger, dependent population than suggested by age-related dependency ratios.

Bangladesh is experiencing a demographic window of opportunity, supported by an increasing share of its working age population over the next decade (reflected in improving dependency ratios). However, the country's ranking in our scorecard is dragged down by its current high dependency ratios and large household sizes which, combined with low female labour participation (33% compared with an average of 52% for our EM universe)[2], translate to lower discretionary household wealth.

Russia also scores low on its demographics due to its sharply deteriorating dependency ratio, arising from its ageing population, and shrinking labour force, We expect that this will negatively impact sectors such as manufacturing, agriculture and the armed forces, as well as placing a strain on state healthcare and pension provision. The UN estimates that by 2030 around 19% of the population will be aged over 65, with an accompanying rise in the Russia's dependency ratio from 43.5% in 2015 to 57.6% by 2030. The country's shrinking population is the result of low fertility rates coupled with relatively high mortality rates (stemming from high levels of alcohol consumption and smoking, the prevalence of HIV/AIDS and high suicide rates). In contrast to other EM countries with ageing populations, such as China and South Korea, Russia's population also has a lower life expectancy. While having a relatively large migrant population, this is unlikely to offset the impact on economic growth as these migrants are typically poorly educated and hold low-paid jobs.

## ABOUT THE AUTHOR

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Guido is Head of Research and a Portfolio Manager for the Emerging Markets Equity team in London.

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Sources: [1]For the purposes of this study, we classify EM as China, Brazil, Indonesia, India, Russia, Malaysia, Mexico, Thailand, Philippines, South Korea, South Africa and Turkey. We refer to this group as the "RBC 12 EM Universe". [2]UNDESA, World Population Prospects: The 2017 Revision, 21 June 2017. [3]Trading Economics, December 2018.

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