The World Is Running Low on Workers and Why That May Be a Good Thing
Morgan Stanley, October 21, 2015

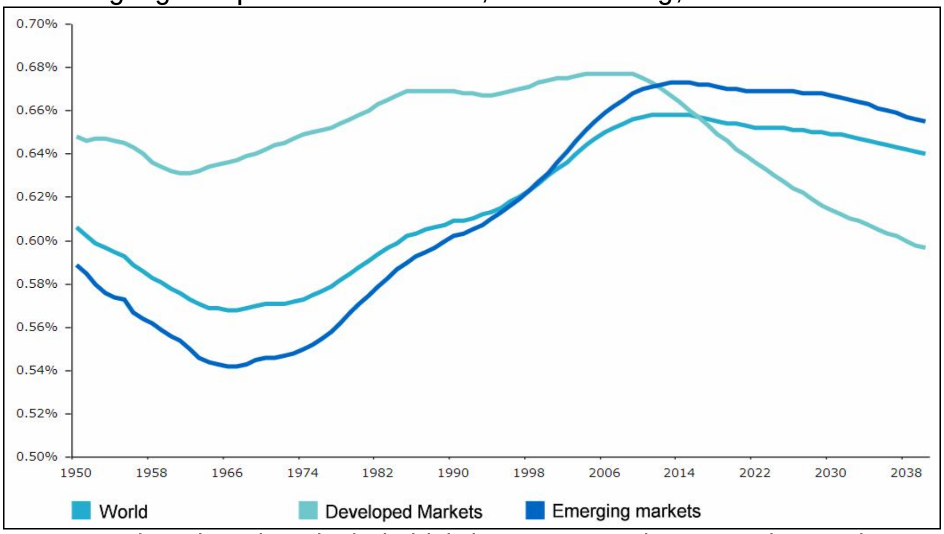
Shift in global demographics promises to reverse decades of falling wages and interest rates—and growing inequality.

For the past several decades, the world has been awash in workers. First came the baby-boomer wave of the 1970s. Then, Eastern Europe and China's economic opening in the 1990s more than doubled the global workforce. Over the same period, wages, inflation and interest rates all fell, and economic inequality climbed. That tide is now receding.

Over the next three decades, as the global workforce shrinks, amid the steady decrease in average fertility rates, labor could ironically find greater strength in its fewer numbers, parlaying growing competition for talent into higher wages; since cost of labor contributes to how companies price goods and services, we can also expect inflation to rebound, followed by higher interest rates.

So argues a recent Morgan Stanley Research report, "Can Demographics Reverse Three Multi-Decade Trends?" The authors—Charles Goodhart, a professor at the London School of Economics and senior consultant to the firm, and Manoj Pradhan, global economist at Morgan Stanley—peer through the lens of demographics and see a monumental shift that could ultimately close the economic gap between the haves and have-nots.

Working Age Population Growth, Once Rising, Should Now Fall



Note: Developed markets include high-income countries, emerging markets include low and middle-income countries
Sources: UN Population Database, Morgan Stanley Research

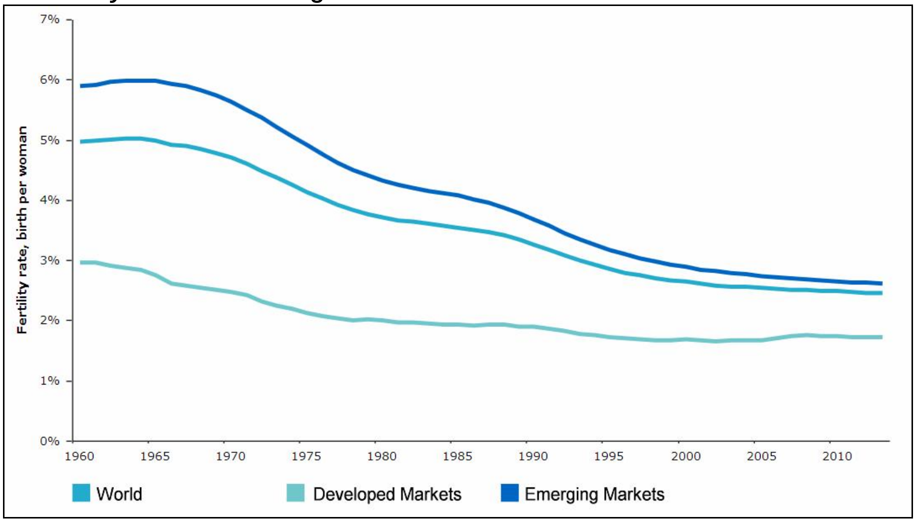
Is Piketty History?

To that end, the report's thesis refutes one of the central tenets of French economist Thomas Piketty's 700-page tome, "Capital in the Twenty-First Century." The unlikely 2013 international bestseller on economic theory held that, because return on investment from capital outstrips labor, the gap between the rich (those most likely to benefit from capital investments) and the poor (laborers with low economic leverage) will continue to worsen without policy or structural intervention.

According to the demographics, however, “Piketty is history,” Goodhart says. Looking at the last 30-odd years, it’s the “demographic sweet spot" of labor oversupply that has kept wages low and allowed competitive pricing to drive down inflation. Meanwhile, excessive savings, particularly in China, facilitated lower real interest rates. “Despite an already-high investment ratio, the savings ratio climbed even higher, creating a savings glut channeled back into the U.S. Treasury bond market,” Pradhan says.

These trends are now played out. “There won't be another China for a long time, if ever," says Pradhan. Baby boomers are retiring. The number of new workers is declining, as are fertility rates, which only promise to exacerbate current demographic trends. The shift, which has been apparent in North America, Europe and Japan for years, is now also playing out across North Asia, particularly China.

Fertility Rates Falling All Over the World



Sources: UN Population Database, Morgan Stanley Research

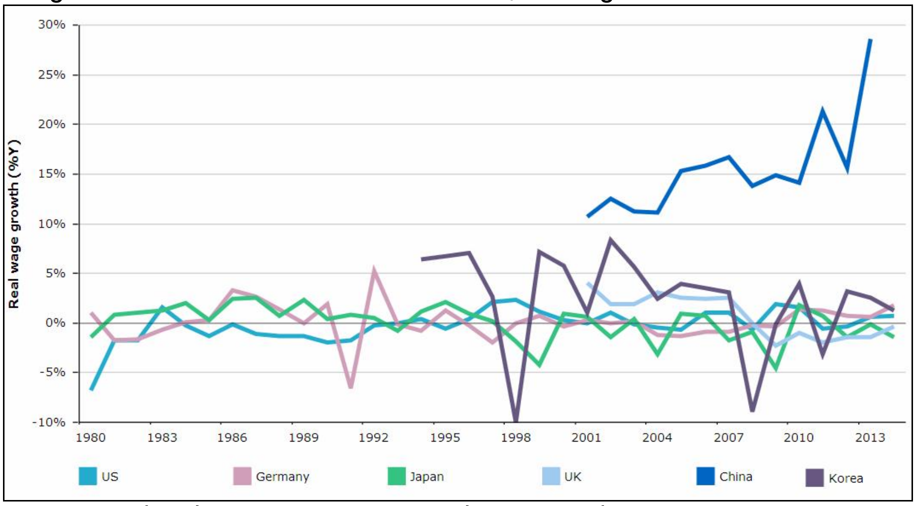
“As the positive labor supply shock of the last decades turns into a negative shock, all three trends [falling wages, lower interest rates and rising inequality] could reverse,” says Goodhart.

Less Is More?

When the supply of labor is plentiful, companies hold the upper hand. As supply tightens, the dynamics shift. This is especially true because the world’s population, around 7.3 billion today, is expected to hit 9.7 billion by 2050, according to the latest UN estimates. The aging population (65 and older) will increasingly make up a larger portion (as much as a quarter of the total population in Europe, Japan and other advanced economies). In fact, Goodhart and Pradhan expect the growing demand for more caretakers for retirees to further shrink the available workforce for other sectors.

Because overall population continues to trend higher, the general demand for goods and services will grow. To support that growth, companies must invest more in a shrinking base of labor. With greater demand for labor comes higher wages. As salaries rise, so will the prices for goods and services, restoring inflation and interest rates to more normative levels.

Wage Growth has Been Flat in DM, Rising in China



Source: National Sources, Morgan Stanley Research

Some mitigating factors could offset these effects, but none of these, even collectively, are likely to “offset the demographic drag that the world will see over the next 10 to 20 years," Goodhart says.

Migration Won’t Be Enough

People are working longer, for example, but that trend has been playing out over the past 20 years. The population of older workers will grow, but incrementally. Adding more women to the workforce would also help, but current patterns suggest that the labor gap between men and women isn't likely to change significantly. Fertility rates could improve, but the effects would take a decade or two to materialize.

Some economies, including India, Indonesia and countries in Africa, still boast a growing working population. However, business conditions would need to improve significantly before these nations could absorb an inflow of capital and put it to work in a meaningful way, Pradhan says.

What about migration? “For all the news that immigration generates, we find that net immigration is pitifully small," according to Pradhan. In fact, net migration into the U.S. and the UK has been around 2% a year—enough to make headlines and stir up political debate, but no match for the demographic reality.

That reality can be sobering. Overall levels of economic growth will fall, even as a more populous world competes for scarcer resources. Yet, higher per capita income will improve the quality of economic growth, and perhaps produce more equitable societies.