Flash Economics

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Property prices, stock market indices and demographics

In this text, we examine the following thesis: countries with unfavorable demographics (aging population, declining fertility rate) are affected by a chronic decline in their asset prices (real estate, equities). Indeed, these countries are characterized by a declining ratio of young people and adults to the elderly. Since the elderly are sellers of assets (real estate and financial assets) and the young and adults are buyers of assets, these countries are also characterized by a situation of insufficient demand for assets, hence the decline in asset prices. We compare the demographic structure of the population, real estate prices and stock market indices in the USA, the Euro zone, India, China and Japan.

We can see that demographic ageing (the increase in the weight of the elderly relative to that of young people and adults) is indeed associated with weak property prices and stock market indices.

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Why, in principle, does demographic ageing cause asset prices to fall?

Demographic ageing means that **the number of young people and adults is falling relative to the number of elderly people**. It is the consequence, on the one hand, of **longer life expectancy** (we look at the situation in the **United States, the Euro zone, India, China and Japan, Chart 1**), and on the other hand, of a **falling fertility rate** (number of births per woman, **Chart 2**); only the United States is not benefiting from longer life expectancy, due to the deteriorating health of part of its population.

Chart 1
Life Expectancy at Birth (years)

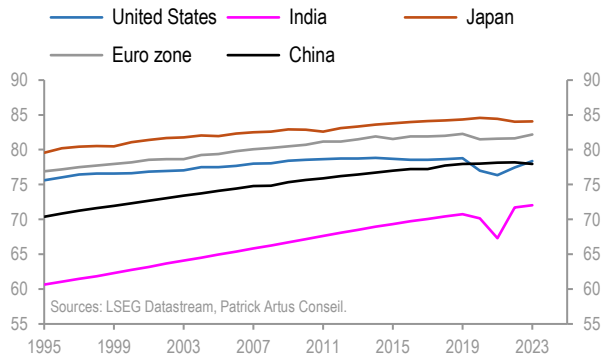
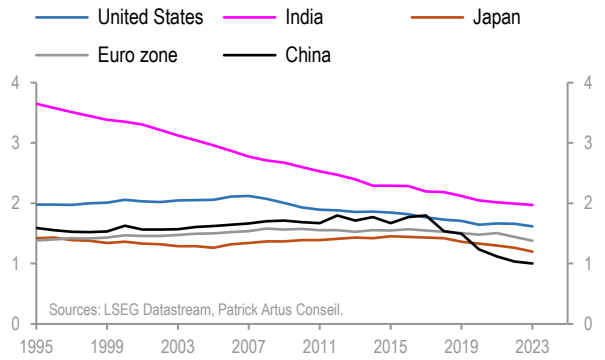


Chart 2
Fertility rate (births per woman)



Indeed, in all five countries (or regions: USA, Euro zone, India, China and Japan), **the weight of the elderly has grown, and will continue to grow in the future, relative to that of young people and adults** (**Charts 3A/3B**). But demographic ageing is lower in the USA and India than in China, Japan or the Euro zone.

Chart 3A
Population aged 65 and over as a percentage of the population aged 15 to 64

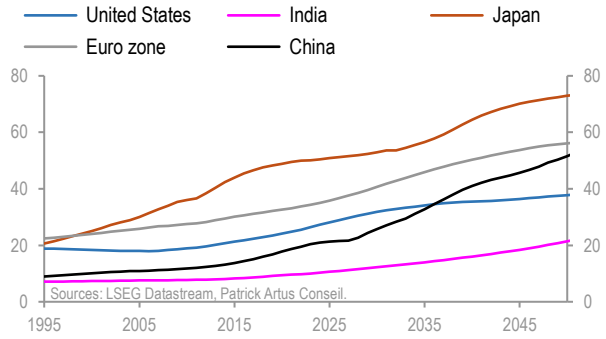
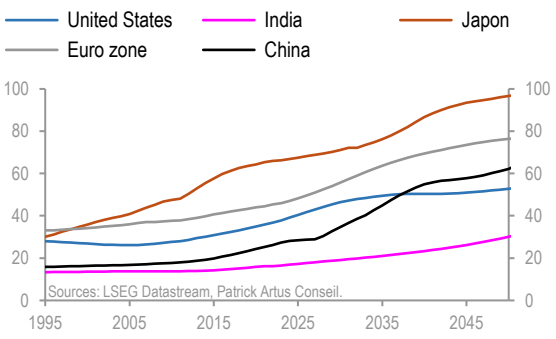


Chart 3B
Population aged 65 and over as a percentage of the population aged 30 to 64



Retired people sell real estate and financial assets; young people and adults buy assets.

This explains why, in theory, demographic ageing creates **a situation of excess supply of assets (financial or real estate) in relation to demand,** which in principle leads to a fall in asset prices.

Is demographic ageing actually associated with low asset prices?

We continue to examine the situation in the United States, the Euro zone, India, China and Japan.

First, let's look at the evolution of real estate prices (**Charts 4A/4B**).

Chart 4A
Residential property prices (1995.Q1 = 100)

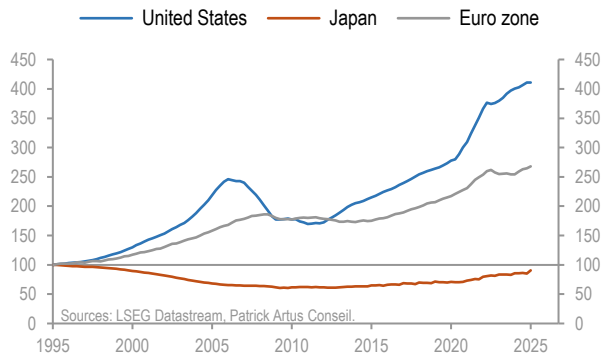
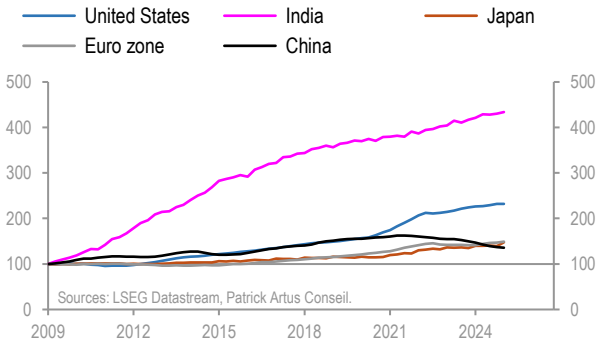


Chart 4B
Residential property prices (2009.Q1 = 100)

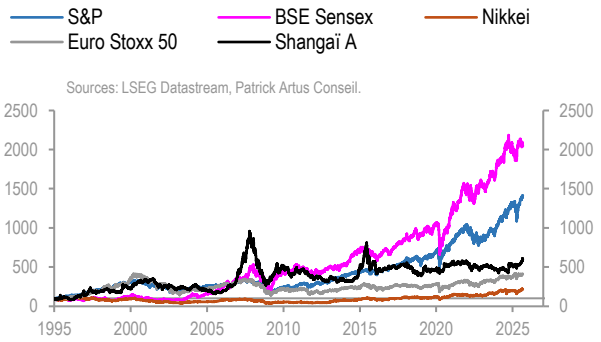


We see :

- A slight rise in property prices since 2008 in the Euro zone, Japan (where property prices have been stagnating since the 1990s) and China;
- Property prices are still rising strongly in the United States and India.

Let's now take a look at the stock market indices (**Chart 5**).

Chart 5
Stock market indices (01.01.1995 = 100)



We can see that the stock market index is growing much faster in India and the United States than in the Euro zone, China and Japan.

It seems that **demographic ageing is associated with weakness in property prices and stock market indices**, as illustrated by the situation in the USA and India (moderate demographic ageing) compared to the Euro zone, China and Japan (significant demographic ageing).

Of course, a number of mechanisms can disrupt this relationship between ageing and asset prices, in particular:

- A structural housing shortage;
- Share purchases by non-residents.

Summary: be careful not to extrapolate the performance of investments in real estate or equities

We often tend to extrapolate past performance of real estate or equity investments into the future.

However, it appears that demographic ageing has the predicted effect on asset prices: as the number of sellers (the elderly) increases relative to the number of buyers (young people and adults), ageing creates a situation of excess supply of assets relative to demand, thus weakening asset prices.

In countries characterized by significant aging (Europe, China, Japan), past performance of real estate or equity investments should not be extrapolated.

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