

DEMOGRAPHICS AND FINANCIAL STABILITY

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September 2024



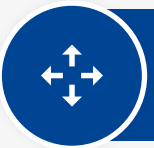
MAIN MESSAGES



Ageing will have profound financial stability implications...



as it affects, growth, savings, future interest rates and asset prices, unless...



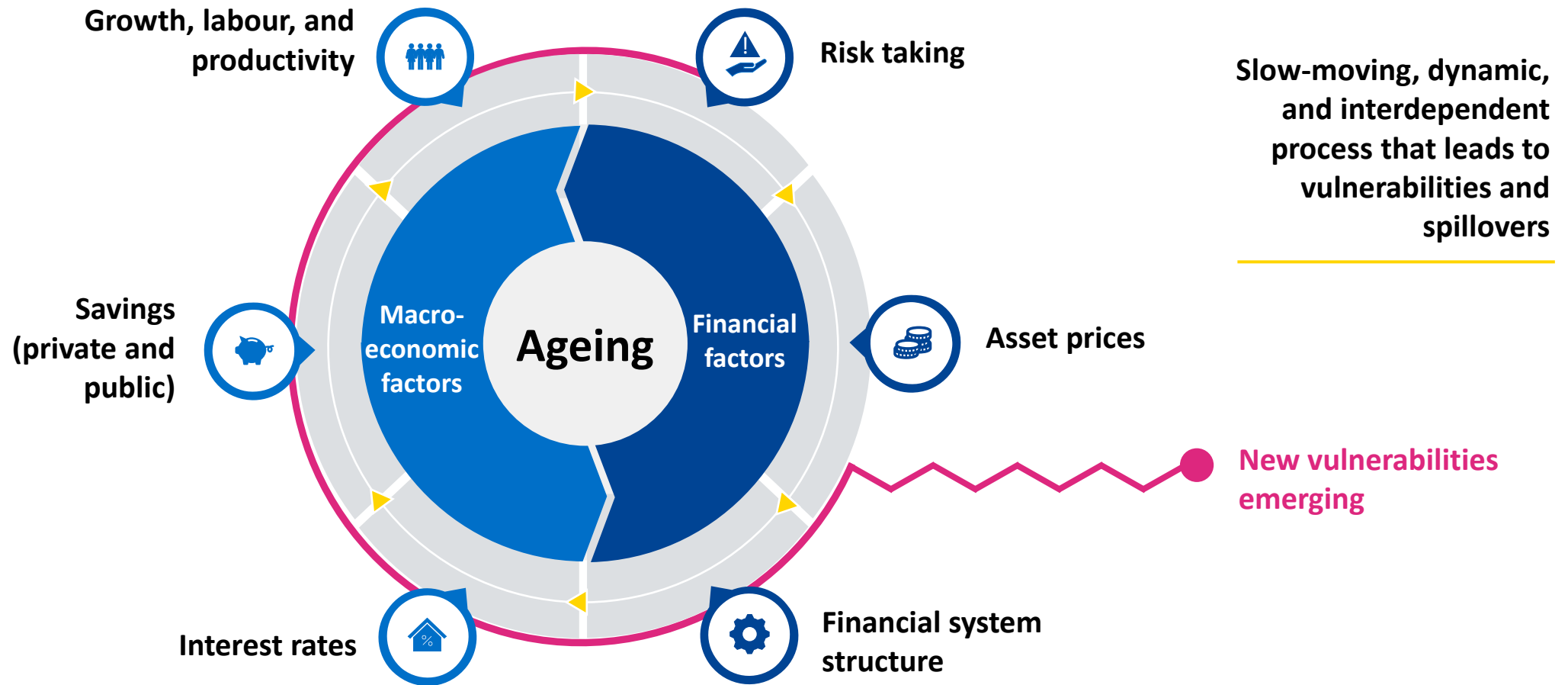
.... we act early and adjust nimbly along the way



The ESM strives to safeguard financial stability by preemptively addressing vulnerabilities arising from ageing



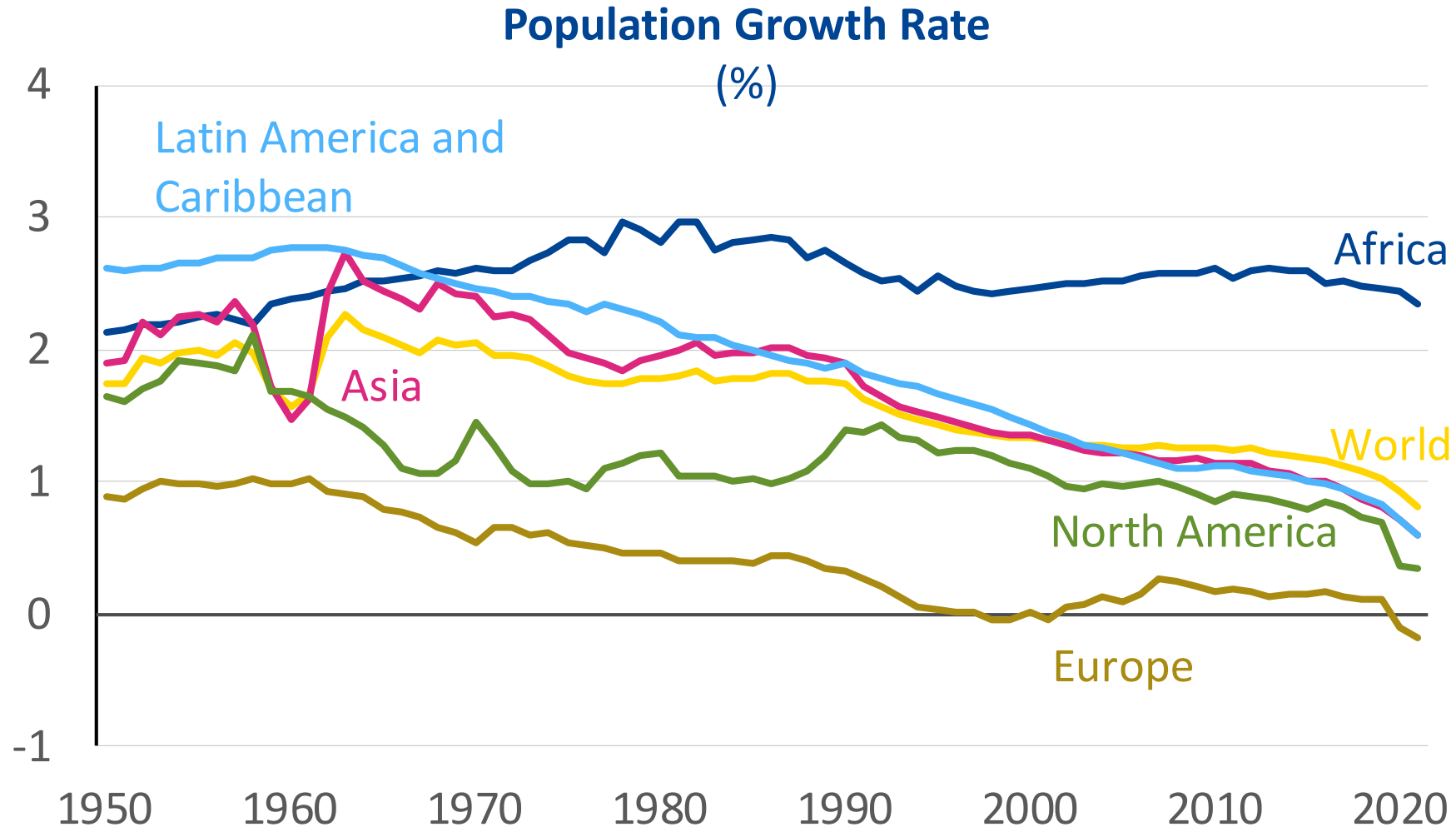
DEMOGRAPHICS AFFECTS FINANCIAL STABILITY DYNAMICALLY



OVERVIEW OF GLOBAL POPULATION DYNAMICS



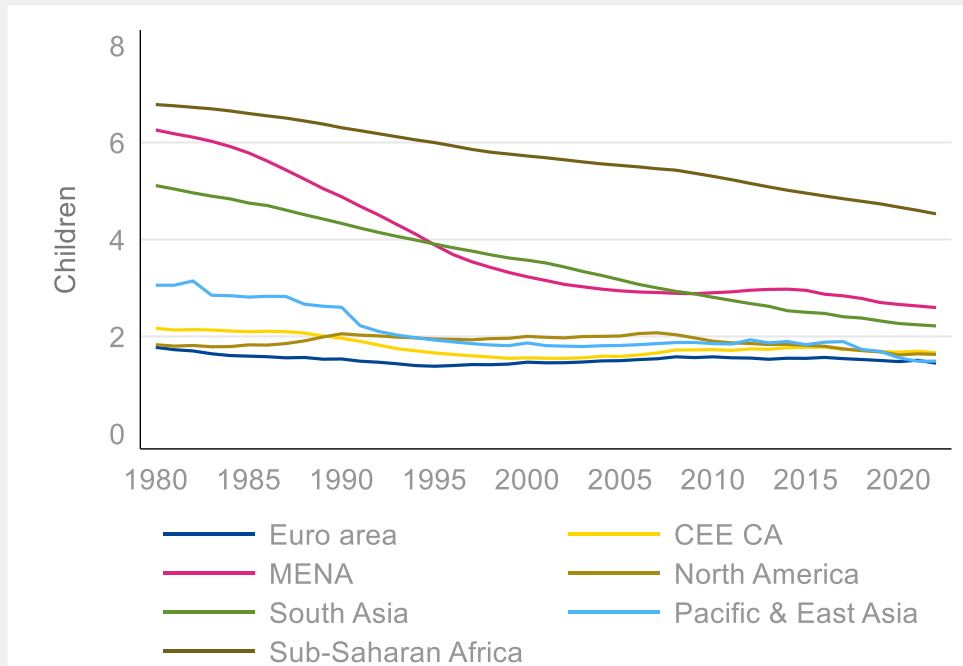
POPULATION GROWTH HAS BEEN FALLING (ALMOST) EVERYWHERE...



Sources: United Nations.

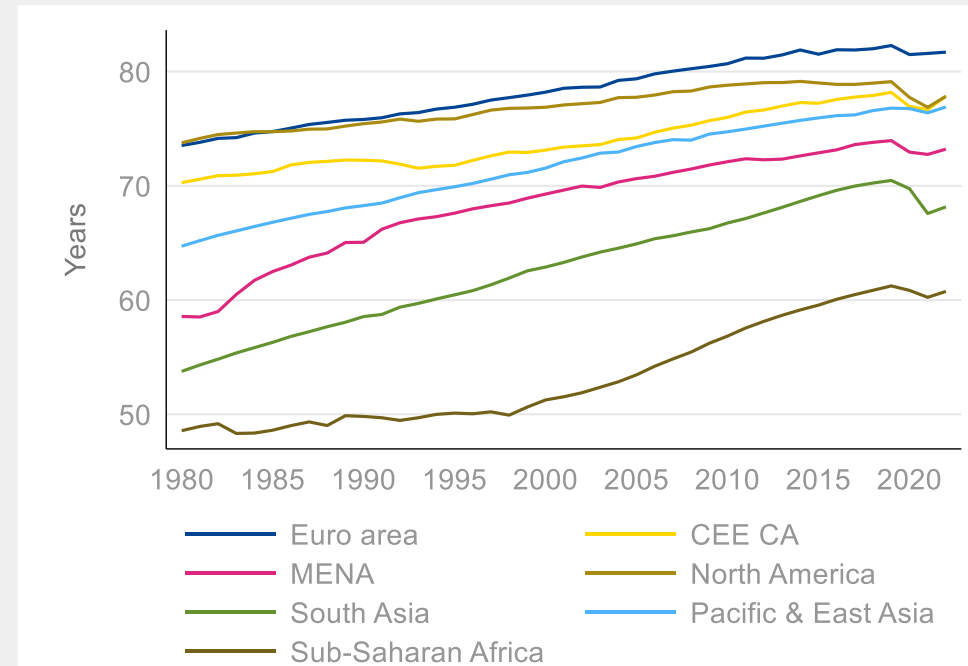
...AMID DECLINING FERTILITY AND LONGER LONGEVITY

Total Fertility Rate (children per woman)



Source: World Bank.

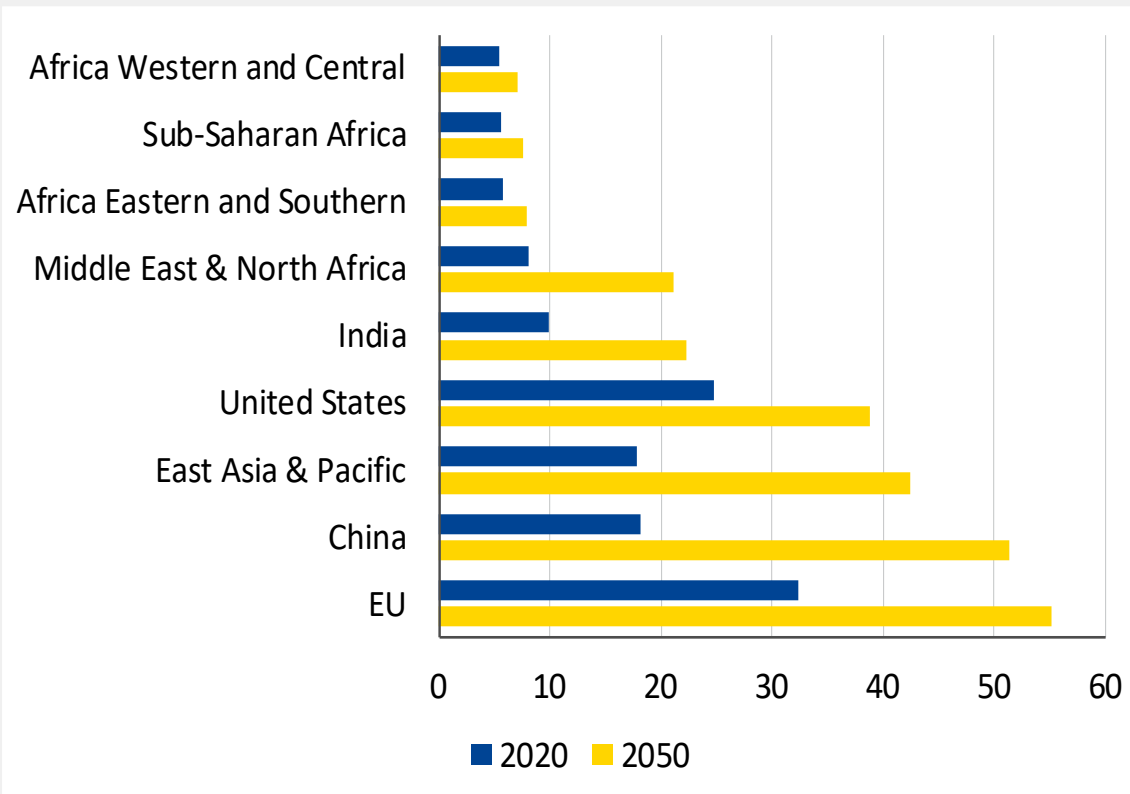
Life Expectancy (years)



Source: World Bank.

IN CONSEQUENCE DEPENDENCY RATIOS ARE SET TO INCREASE

Old-Age Dependency Ratio
(% of working age population)



Source: World Bank.

Labour supply will shrink...

...with profound economic and financial implications.

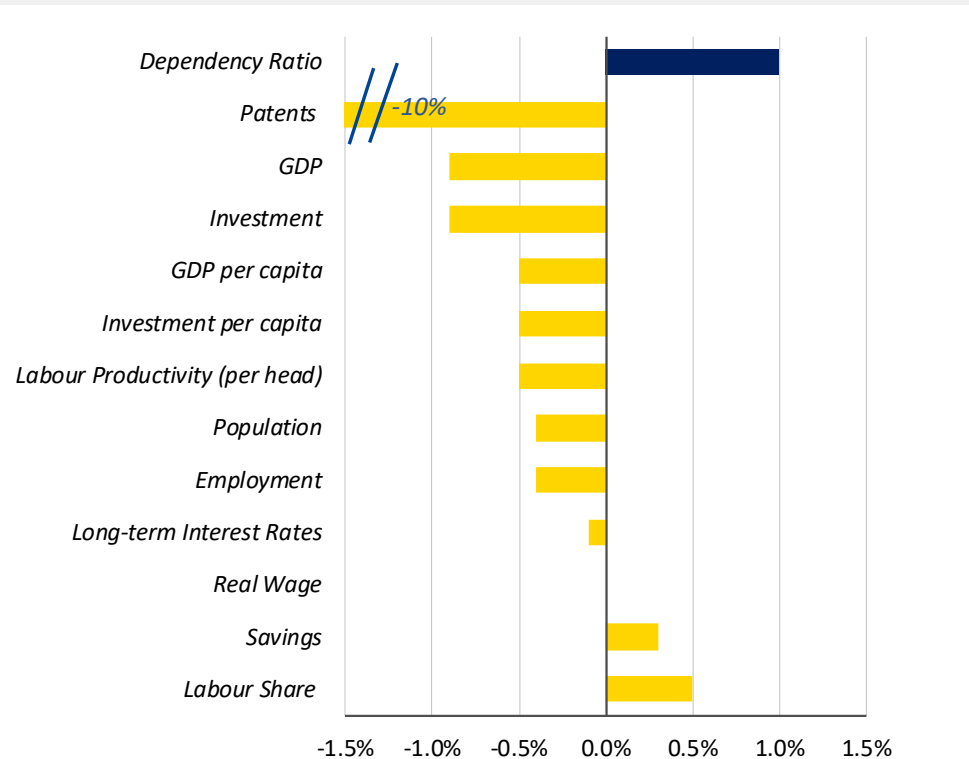
Timing and speed of ageing varies across regions and countries.

TRANSMISSION CHANNELS



AGEING CREATES ECONOMIC HEADWINDS

Long-Term Impact of Demographic Shock in the Euro Area (in ppt and in %)



Source: ESM calculations.

Note: The chart shows the results from a semi-structural (SVAR) model following a one percentage point increase to the dependency ratio in the long run.

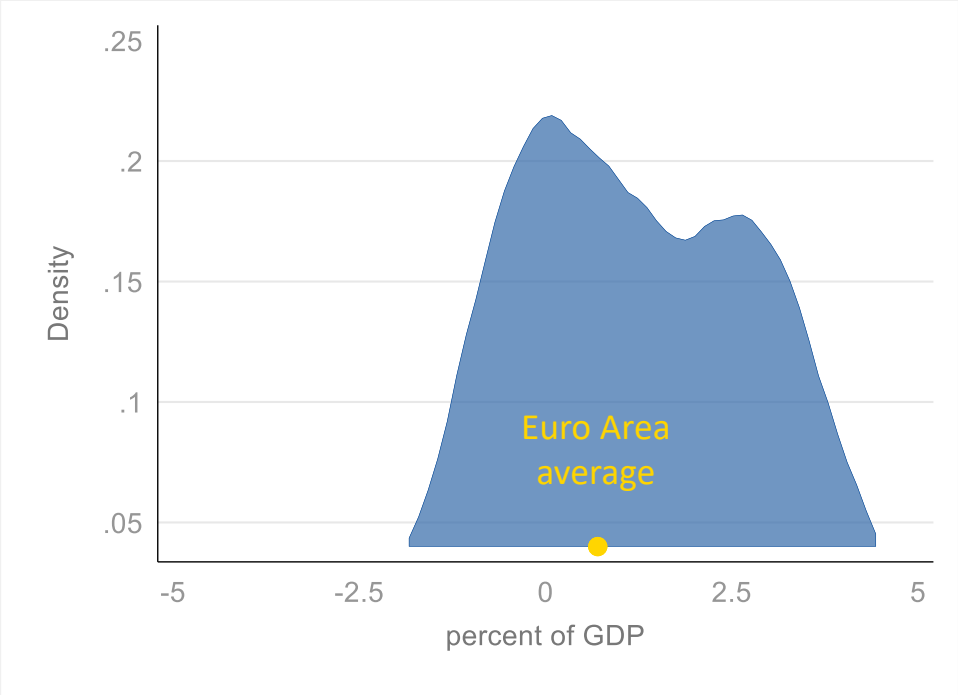
Declining demographics have negative economic effects...

...particularly for growth, innovation, and investment.

Effects will unfold gradually and also depend on the policy response.

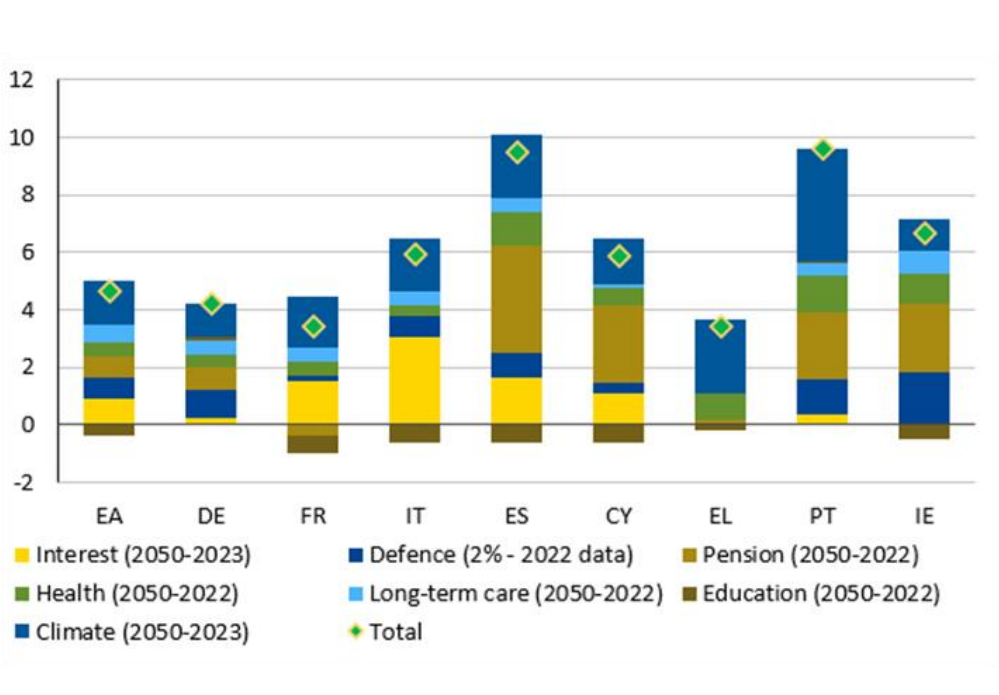
PUBLIC SAVINGS ARE LIKELY TO SHRINK AMID OTHER LARGE SPENDING PRESSURES...

Distribution of Increase in Ageing Expenditure (2023-2050; in % of GDP)



Source: European Commission 2024 Ageing Report and ESM staff calculations.
Note: The plot shows the density distribution of the expected increase in ageing expenditure between 2023-2050 for all EA countries.

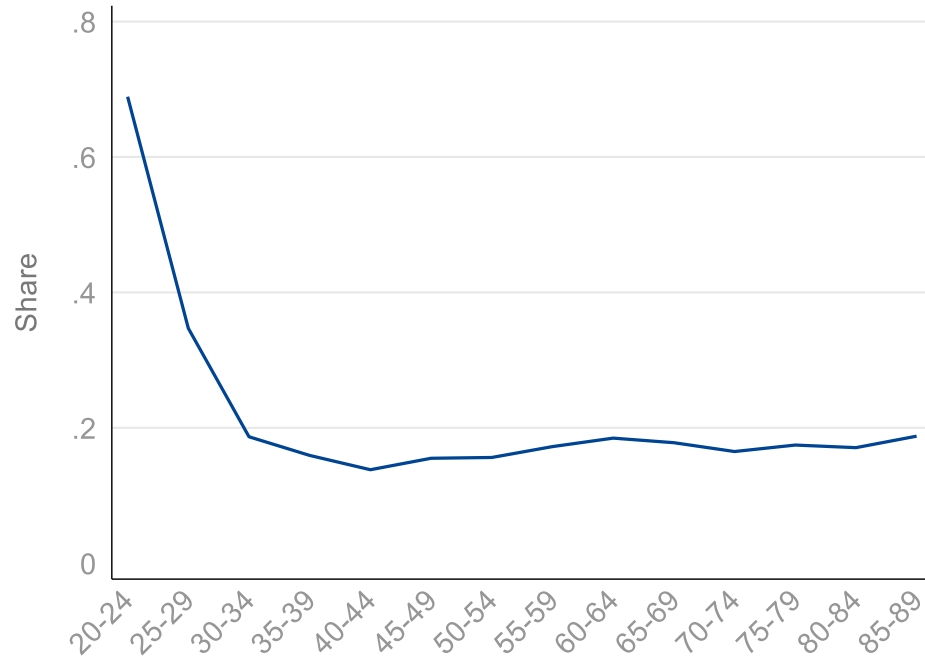
Additional Spending Needs 2023-2050 (in % of GDP)



Source: European Commission (2024 Ageing Report and 2023 Debt Sustainability Monitor), Eurostat, ESM staff calculations.
Note: Pension, health, and long-term care are from the Ageing Report, Defence expenditure is the difference between the 2022 level and the 2% NATO target. Interest spending is from the debt sustainability monitor .

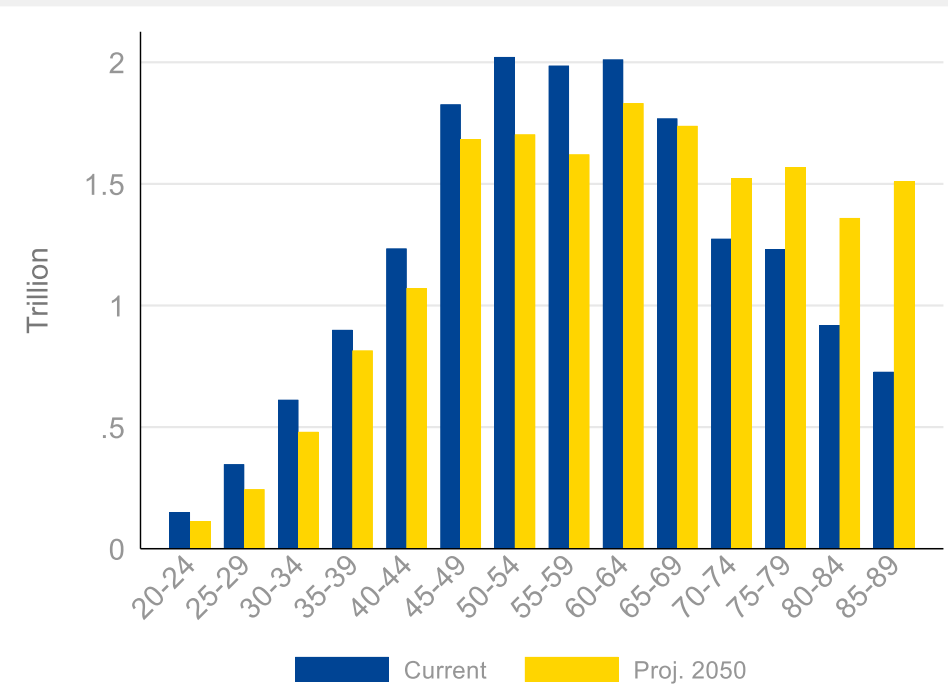
...AND PRIVATE SAVINGS ARE BOUND TO STAY RELATIVELY STABLE...

Safe Asset Share (share of total assets)



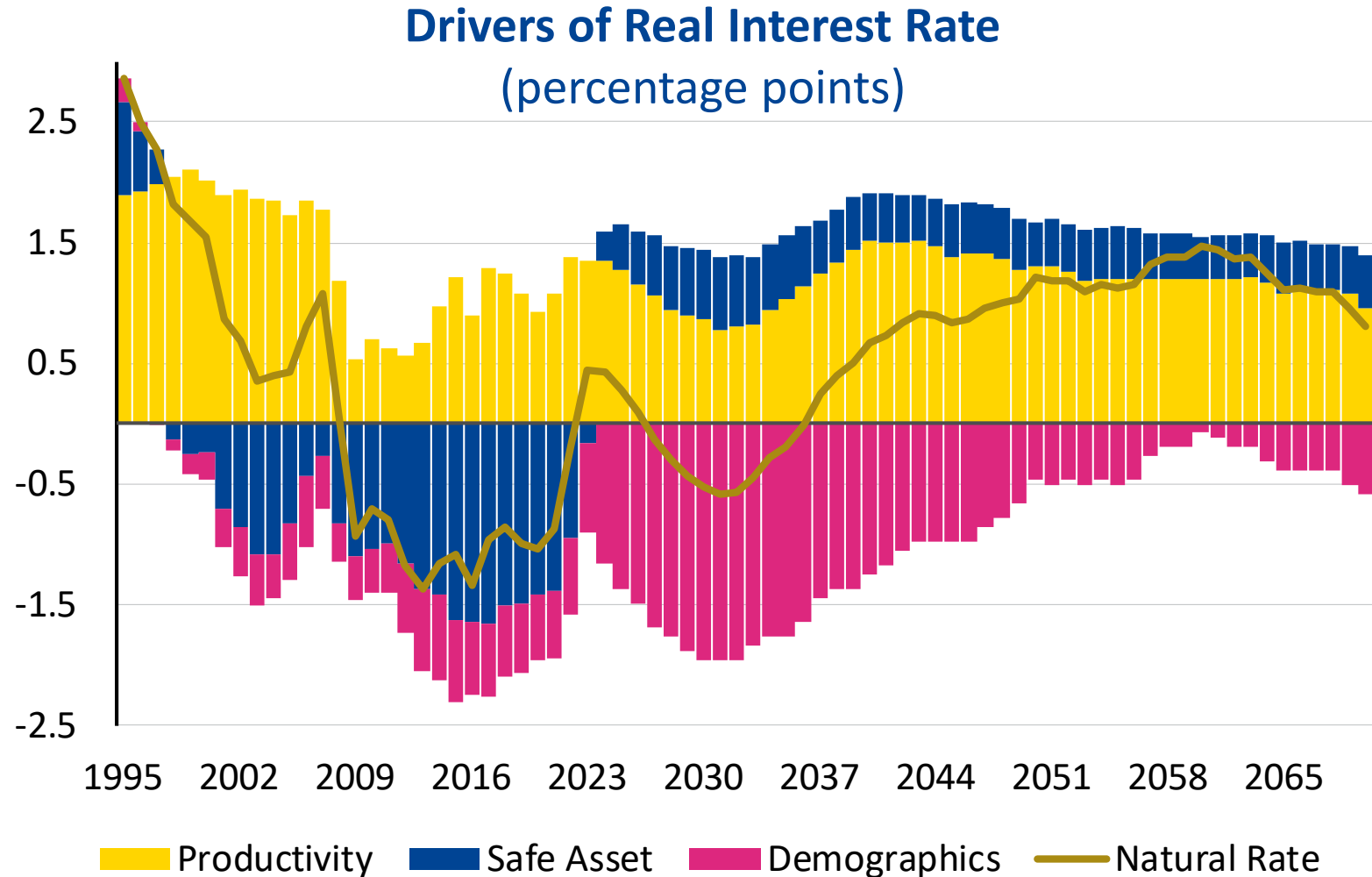
Source: Household Finance and Consumption Survey (2021) and ESM staff calculations
Note: Safe assets include deposits, bonds, and voluntary pensions (life insurance). The sample consists of all 79416 households, selected to be nationally representative.

Safe Asset Holdings by EA Households (in trillion of euros)



Source: Household Finance and Consumption Survey Wave 4 (2023), United Nations, and ESM staff calculations.
Note: Projections combine results from a fractional logit model of the share of safe assets and population projections for the euro area for the year 2050 from the UN.

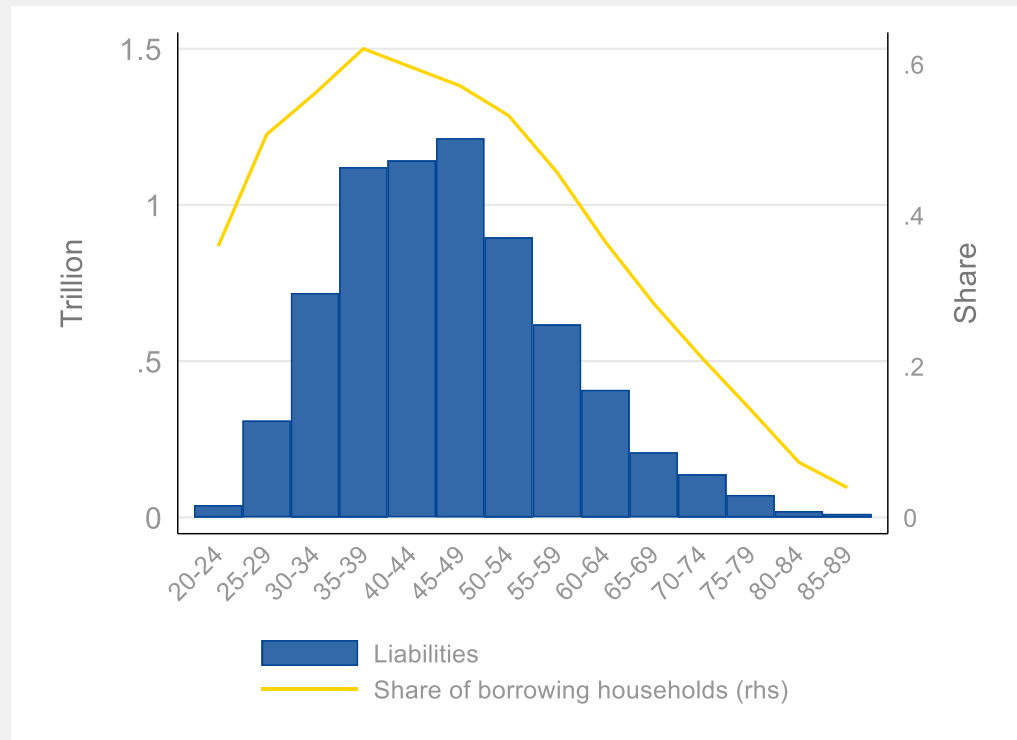
DOWNWARD PRESSURE ON NATIONAL SAVINGS MAY START TO PUSH UP REAL INTEREST RATES IN THE NEXT DECADE



Sources: ESM calculations.

BANKS MAY TAKE MORE RISKS...

Debt and Borrowing
(in thousand euros and in %)



Source: ESM calculations using the HFCS Wave 4 (2023).

Note: Liabilities include all forms of household debt (mortgages, consumer, overdraft, other) and are rescaled to match macroeconomic totals from national accounts.

Older people borrow less...

...which would affect credit demand and bank profitability.

Possible reaction: take on more risk
=> higher NPLs.

...AS THEIR BALANCE SHEETS ARE EXPOSED

Stylised Bank Balance Sheet

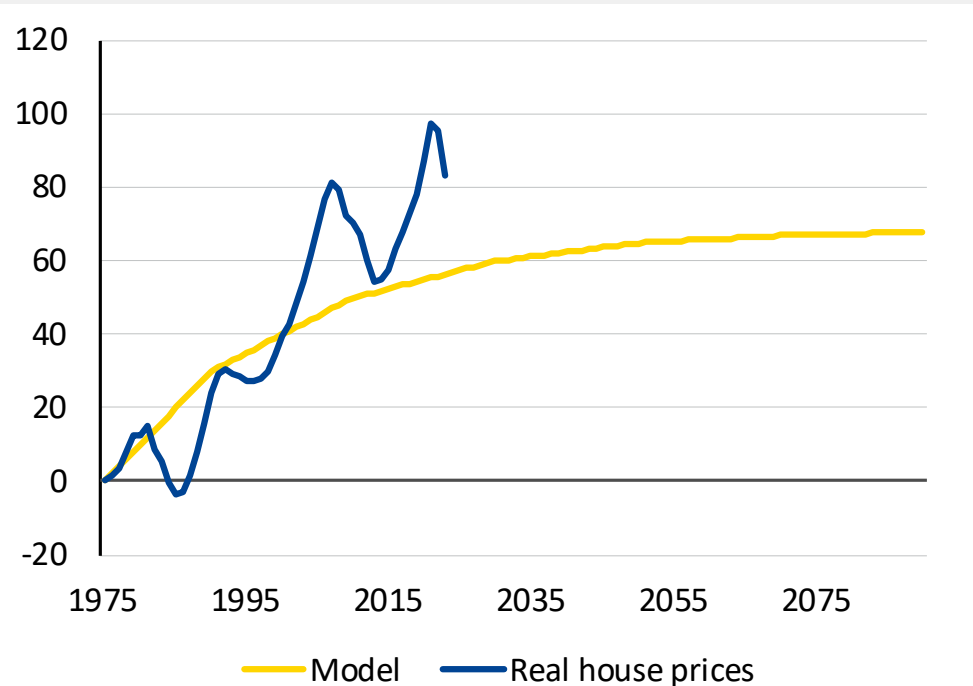
- Search for yield?
- Lower demand from older households?
- Higher credit risk (NPLs)?
- Depressed (financial) asset prices?

Assets	Liabilities & Equity
Cash	Deposits
Loans	Borrowings
Securities	Equity
Other	Other

- ← Lower deposit growth from public and private?
- ← New financial intermediaries?
- ← Lower equity to keep ROE high?

...AND PRICES OF (REAL) ESTATE MAY STAGNATE

Real House Prices
(Deviation from 1975; in %)



Source: BIS and ESM calculations, based on Lisack et al. (2021).

Note: The real house price index is for the euro area.

Older people tend to have lower demand for houses...

...which could become a drag on house prices.

Will older people continue to demand less housing?

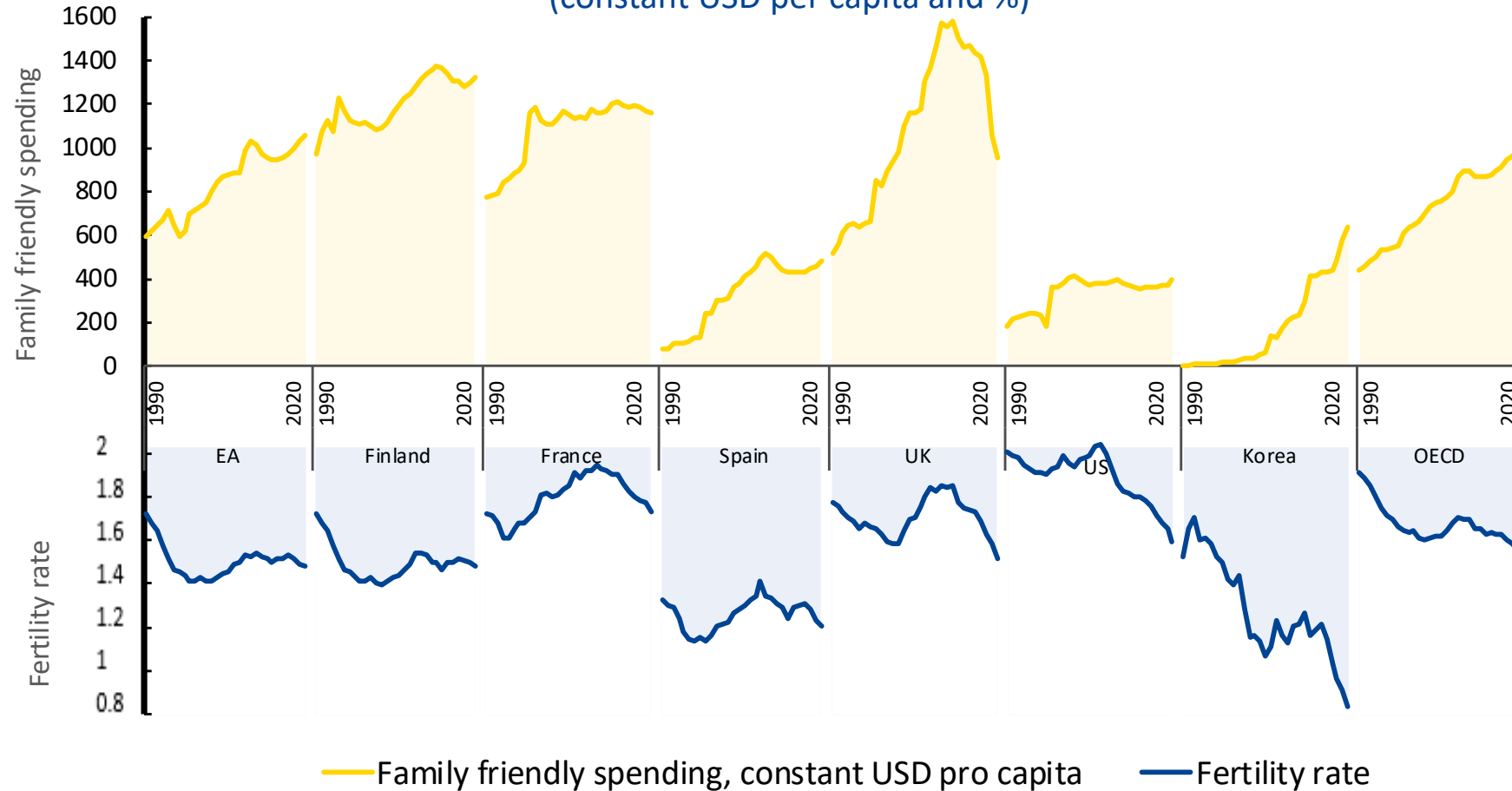
DEALING WITH AGEING – POLICY OPTIONS



REVERSING FERTILITY DECLINE IS INCREDIBLY DIFFICULT ...

Public Spending on Pro-Child Policies versus Fertility Rate

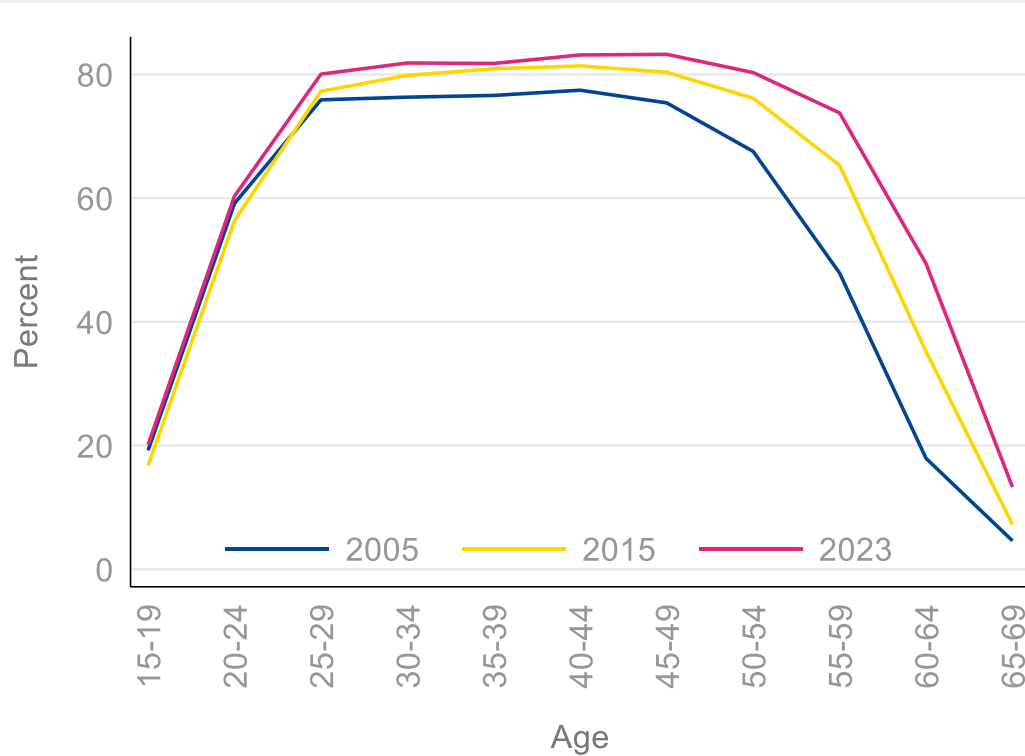
(constant USD per capita and %)



Sources: FT (graphic from John Burn-Murdoch), Eurostat, OECD.

...BUT PARTICIPATION RATES CAN INCREASE SOMEWHAT FURTHER

Female Participation Rates Euro Area
(% of population in age bracket)



Source: Eurostat and ESM calculations.

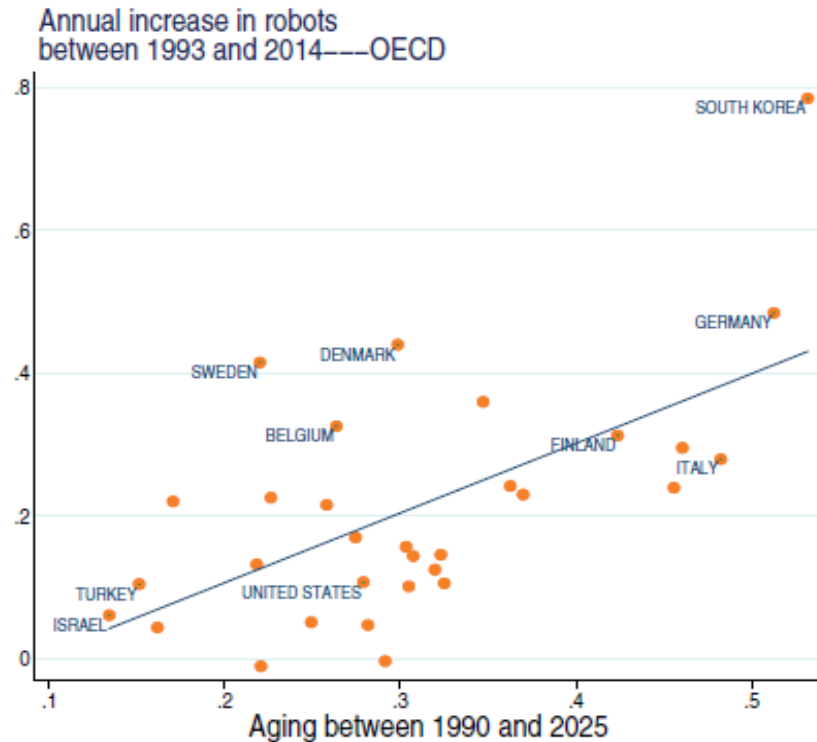
Female employment has risen significantly...

...but participation rates of older female workers remains low.

Investments in skills, health, and childcare are necessary.

ROBOTS CAN REPLACE LABOUR...

Increase in Robots in Manufacturing and Ageing (Industrial robots per thousand workers)



Source: Acemoglu and Restrepo (2022).

Decline in labour supply could lead to greater automation...

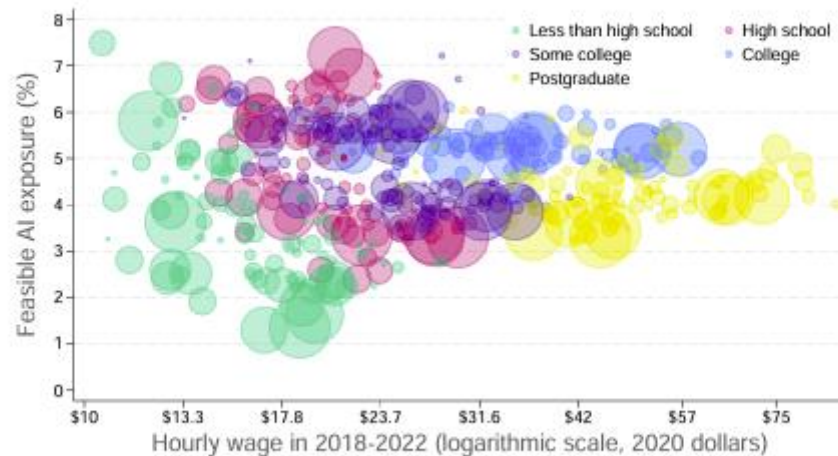
...especially in industries that carry out tasks amenable to automation.

Aggregate productivity and real wages could benefit.

...AND AI ALSO OFFERS GREAT PROMISE (AND RISKS)

Increase in Robots in Manufacturing and Ageing (Industrial robots per thousand workers)

Figure 1: Distribution of AI exposure across the wage distribution



Source: Acemoglu (2024).

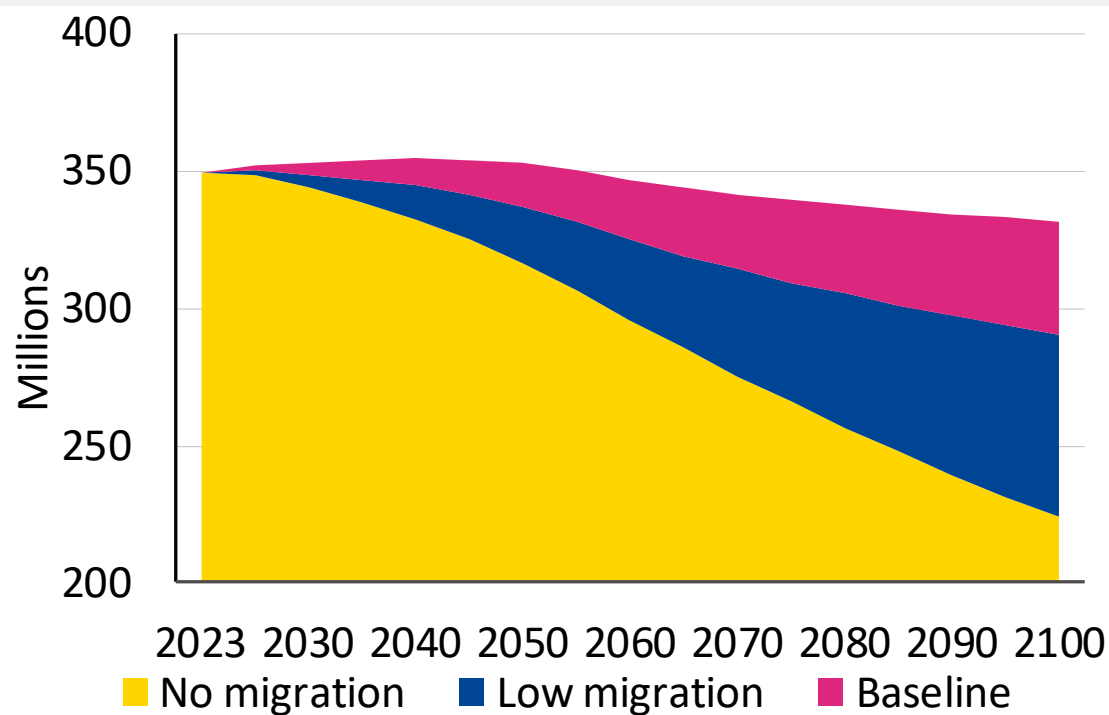
AI will displace and create jobs...

...making some skills obsolete and boosting demand for others.

Focus on skills that complement AI
(flexibility, adaptability, interpersonal)

MORE IMMIGRATION IS NECESSARY...

Population Projection
(people in million)



Source: Eurostat (EUROPOP2023).

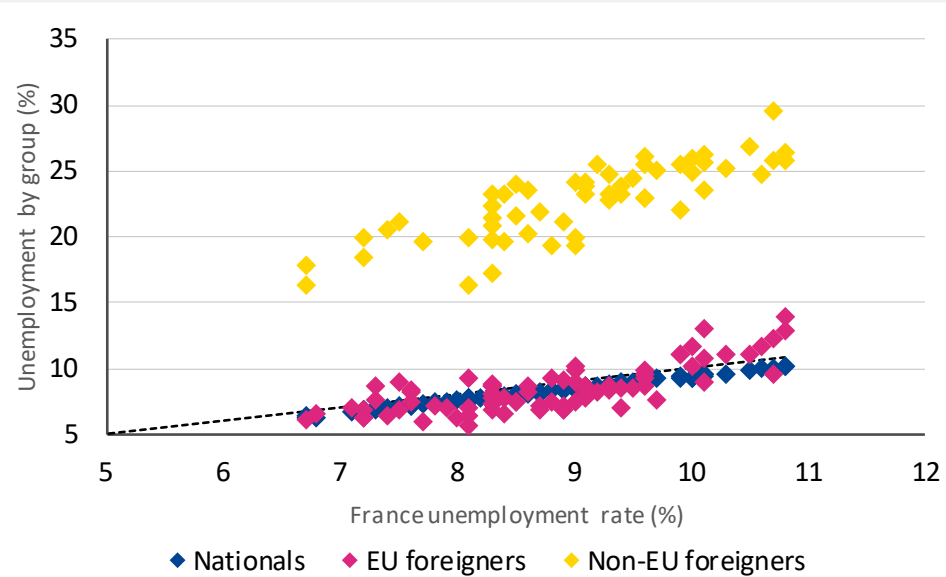
Existing projections already assume substantial immigration...

...which however is insufficient to reverse aggregate ageing.

“Immigration has to be done right.”

...BUT INTEGRATION REQUIRES TARGETED INITIATIVES AND RESOURCES

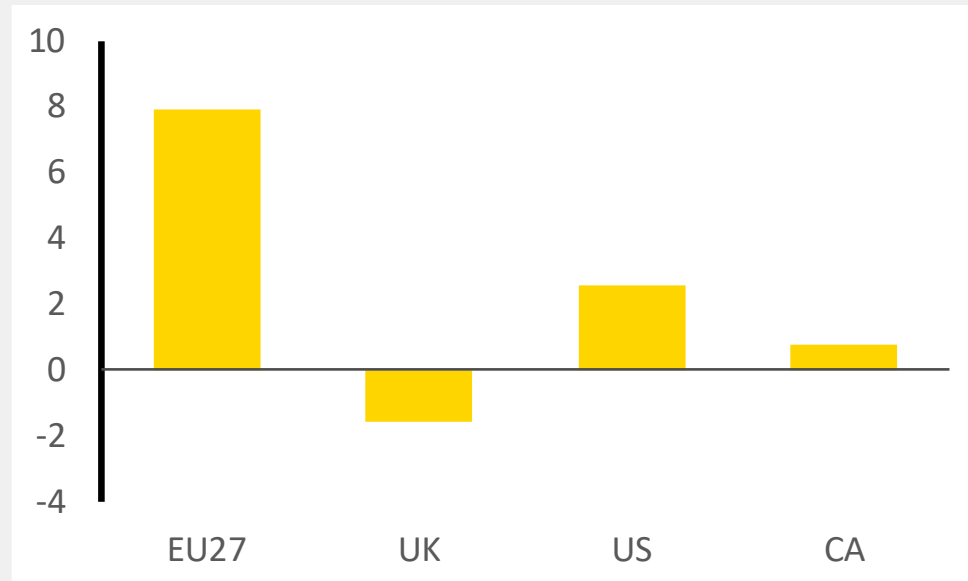
Unemployment Rate by Nationality in France (%)



Source: Eurostat and ESM staff calculations.

Note: The chart shows the reaction of specific groups to changes in the aggregate unemployment rate in France in the period 2003-2023.

Difference between Foreign and Native Young People not in Education, Employment, Training (percentage points)

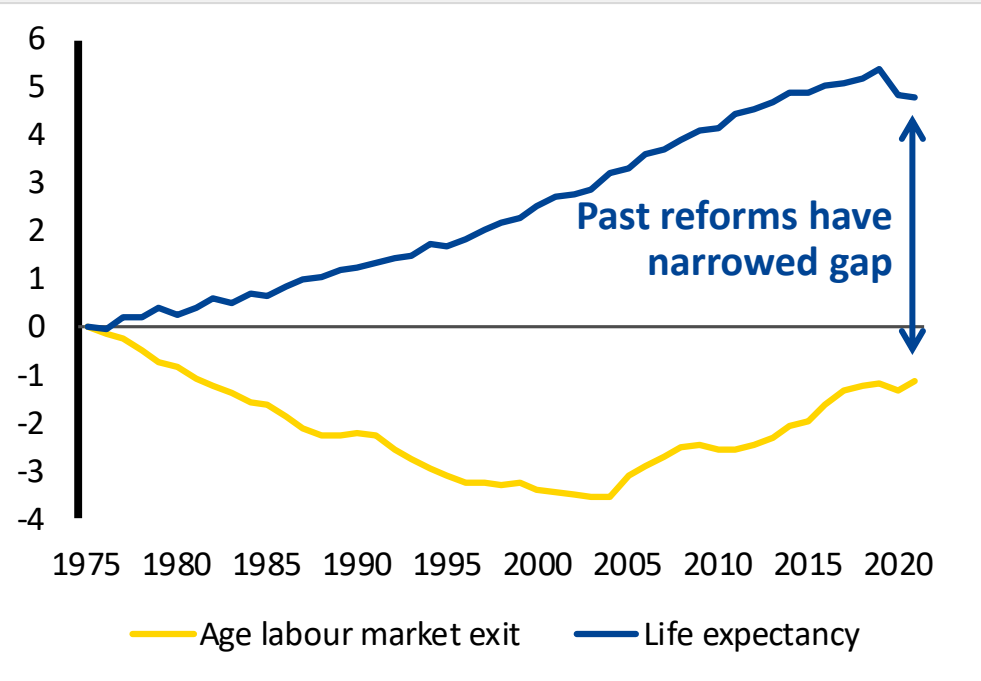


Source: OECD and ESM staff calculations.

Note: The difference refers to the average share of foreign and native-born young people not in education, employment or training in the years 2019-22.

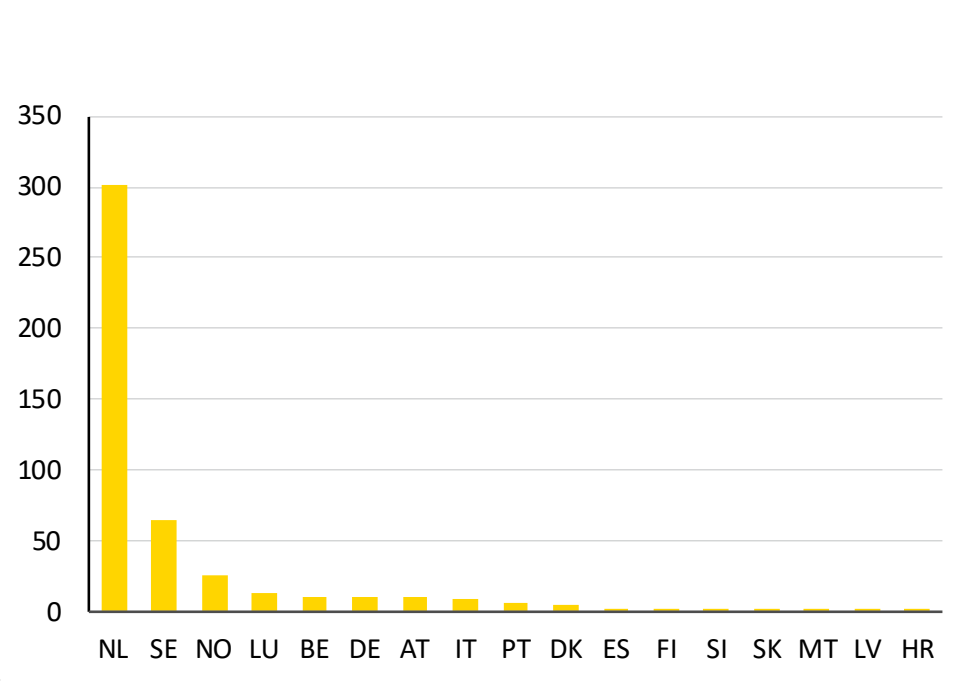
PENSIONS REFORMS NEED TO CONTINUE: FUNDED PENSION SCHEMES HAVE ROOM TO GROW

Average Time in Retirement in OECD Countries
(men; change in years from 1975)



Source: OECD Pension At a Glance 2023.
Note: Average of 25 OECD countries for which data are available.

Occupational Pension Funds' Assets
(per capita, in € thousands)



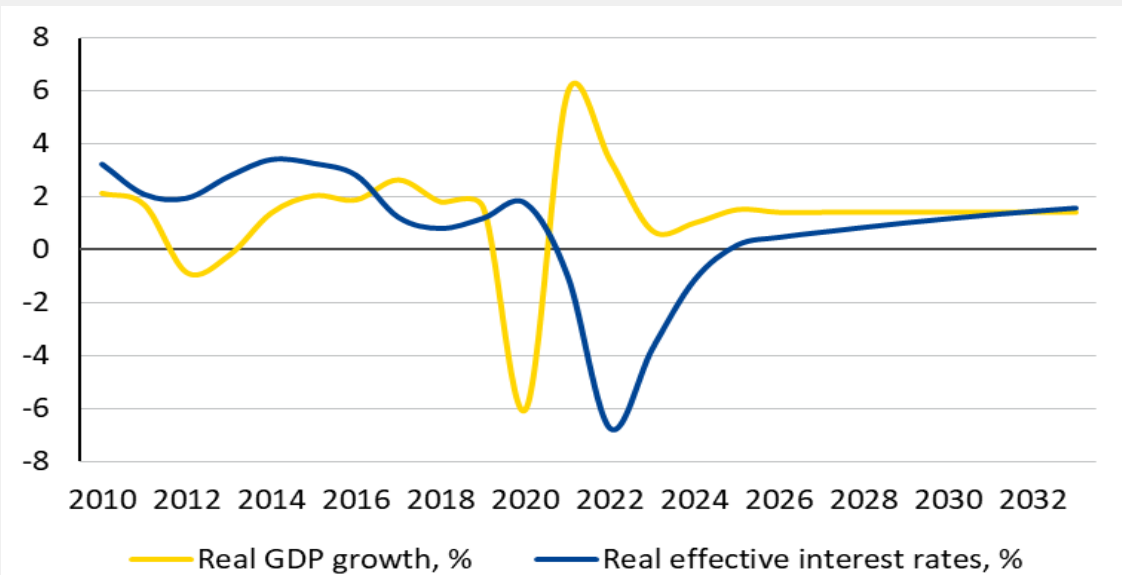
Source: EIOPA's consolidated IORB balance sheet report.

ESM ROLE: PREVENTING FUTURE CRISES



CRISIS PREVENTION: SAFEGUARDING REPAYMENT CAPACITY (FISCAL SUSTAINABILITY)

Real Growth and Interest Rates in the EA
(in %)



Source: EC, ECB, Bloomberg, and ESM staff calculations.

Note: Effective interest rates projections are based on sovereign bond forward curves, deflated with ECB inflation forecast, and potential growth rates are from the European Commission's 2023 AMECO database.

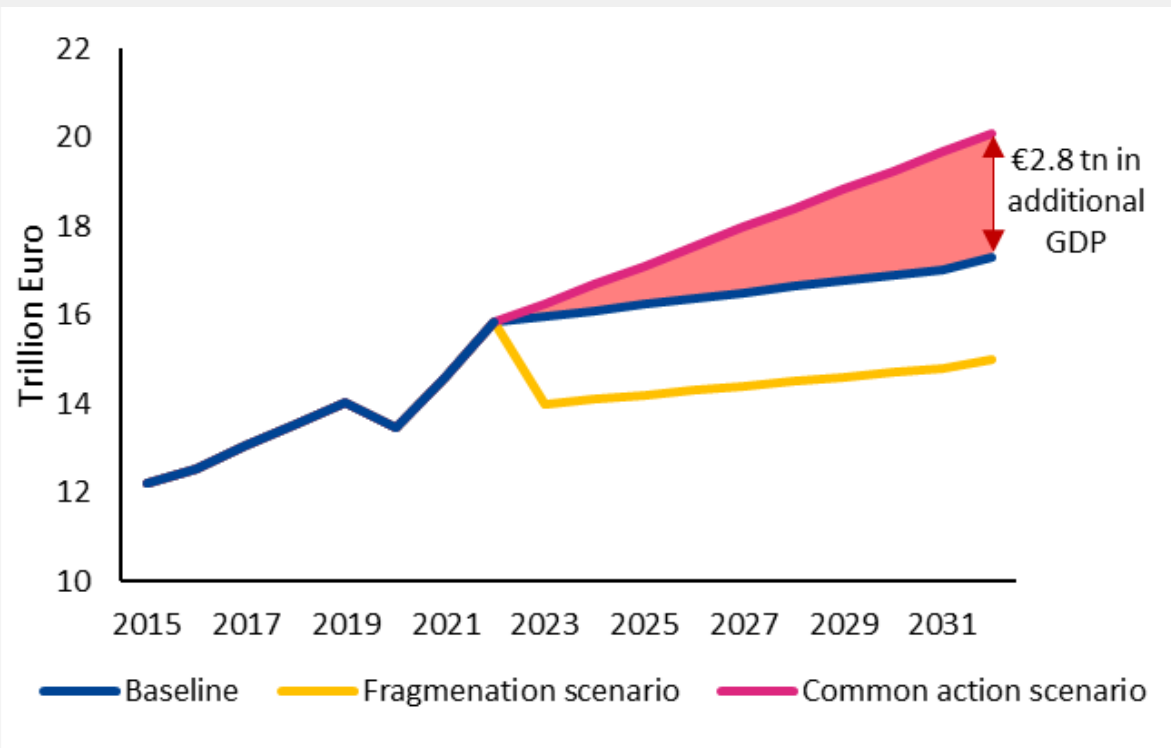
Compliance with new fiscal framework will enhance resilience.

European institutions should preserve financial stability and provide public goods.

ESM as permanent crisis mechanism is updating its toolbox to address future crises.

CRISIS-PREVENTION: ENHANCING RESILIENCE BY DEEPENING INTEGRATION

Nominal GDP
(in €)



Source: European Parliamentary Research Service: Mapping the Costs of non-Europe (2023).

Finance, communication, energy (and defence) need deeper integration

Unleashing the untapped growth potential necessary to deal with ageing and finance the twin transition

Diversification of assets across Europe supports private sector risk sharing and stability

CONCRETE STEPS TO REDUCE LIKELIHOOD OF CRISES

Banking and Capital Market Union

Deepen banking and capital market integration to:

- Facilitate effective resource allocation
- Stimulate technological change
- Enable effective risk-sharing across countries

Digital euro

Introduce the digital euro to:

- Creates electronic cash for the digitalised world
- Strengthens the international role of the euro
- Improves efficiency and security of payment systems

ESM and EA architecture

Adopt the revised ESM Treaty for:

- Common Backstop to the Single Resolution Fund
- More effective precautionary instruments
- Greater role in preventive monitoring and programme design

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