

Macro Focus

Poorer than their parents: the struggles of Europe's young

- Hit most by great recession and rising house prices
- Upcoming challenges: population ageing and tech revolution
- Negative effects on growth, public finances, and political stability

In some respects, the current young Europeans can be thought of as lucky. They are more educated than any other generation in history, they have not experienced wars or any other major conflicts, and they can enjoy borderless travels. Medical advancements are on their side; thus they are likely to live longer than any other generation in history. Nevertheless, today's younger generation has been facing multiple headwinds, both of a cyclical and structural sort, and is at risk of ending up poorer than their parents. The wasted potential of the young could lead to weaker growth in productivity and thus lower potential output, stagnant wages, poor public finances, and growing support for populism.

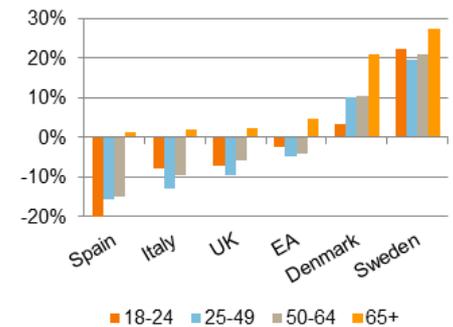
Hit most by the great recession

Europe's young have been disproportionately affected by the latest financial crisis and the European sovereign debt crisis. The double-dip recession and the weak recovery that followed have had profound negative effects on the income of the young and their ability to find work and launch their careers. Young adults have been among those most affected by falling real disposable income since the great recession (see graph). As a result, the at-risk-of-poverty rate has increased more for the young (20-29-year-olds) than that for any other age group over the past decade. The young have replaced the over-65-year-olds as the group at the highest risk of poverty.

An increase in youth unemployment has been the main factor behind the recent economic woes of the young. Although youth unemployment rates have declined from their heights reached in the midst of the recession, in some southern European countries they still remain elevated, standing at around 35-45%. Even those who do get employment cannot fully enjoy good and secure jobs as a large fraction of the young end up on temporary contracts. The strict rules that protect the "insiders," who are typically older workers, have created two-tier labour markets in some EU countries (e.g., Spain, France), leaving few good employment opportunities for the young (see graph).

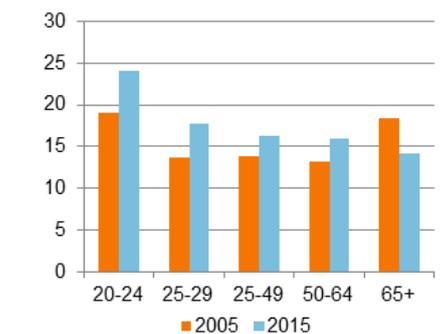
Although it is often thought that this is largely a cyclical problem that is likely to fade away as economic growth picks up, it has a structural component, too. The fading economic woes are likely to have long-lasting negative effects on the lifetime earnings, savings, and occupational attainments of the current young. Research by economist Lisa Kahn at Yale University, who studied the impact of the 1981-1982 recession on the lifetime earnings of young workers in the US, found large, negative, and persistent wage effects from graduating

Real disposable income, change over 2008-2015



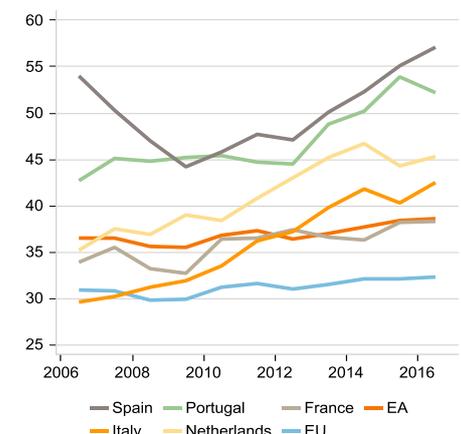
Source: Eurostat, Swedbank calculations

At risk of poverty rate in the EU, %



Source: Eurostat

Employed 15-29 year-olds, % on temporary contracts



Source: Macrobond and Swedbank

Senior Economist:
 Laura Galdikienė
 Email: laura.galdikiene@swedbank.lt
 +370 5 258 2275

from school during a bad economy.¹

Housing troubles

Flat or falling income in the crisis-hit European countries has placed financial restraints on the youngsters, limiting their access to housing. But even in countries where the young did not go through a harsh income adjustment process, their chances to acquire their own housing have worsened recently due to steep house price increases. An increasing share of young people in the EU live with their parents, with trends most pronounced in the southern European countries. More people now live with their parents than a decade ago also in Sweden, Norway, and the UK – the countries that have seen the steepest increases in house prices over the past decade.

Over the past two decades, house prices in real terms have doubled in the UK and more than tripled in Sweden, boosting the wealth of older home owners while limiting the chances of owning a home for the young. According to data provided by *The Economist*, the Swedish house price-to-income ratio was 48% above the long-run average at the end of last year – its highest level on record.

One of the most important reasons for such steep price increases has been the overregulation of new construction, often supported by existing homeowners. However, shutting the young out of the housing market can have important economic implications. It may restrict the mobility of the young, as they are tending to stay put in regions with less economic potential and few good jobs; in turn, this could limit cities' economic development. The young may postpone starting a family and having children, which may lead to reduced fertility rates.

Buying overpriced housing could place a heavy debt burden on the young, making them highly sensitive to volatility in housing prices, interest rates, and income. These vulnerabilities are pronounced in Sweden and Norway, where over the past two decades the gross debt-to-income ratios of households have almost doubled.

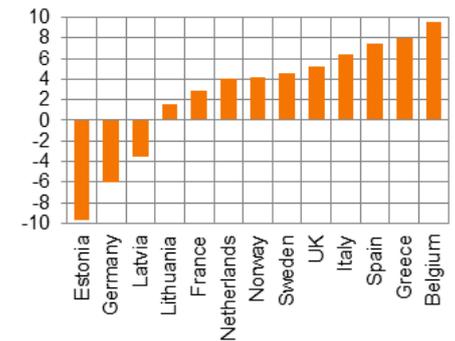
The burden of population ageing

The economic woes of the young are likely to be exacerbated by population ageing. The European Commission (EC)² forecasts that the proportion of workers supporting those in retirement will halve from an average of four today to just two by 2060. Moreover, it outlines that population ageing will put upward pressure on public spending, with public expenditure on pensions, health care, and long-term care rising by 2 percentage points (pp) of GDP on average by 2060; for some countries, the increases could be as high as 7 pp of GDP.

These numbers could become even higher if pensions are perceived as “too low” or the retirement age “too high”, which could eventually result in changes in pension policies. Rising age-related public spending obligations, servicing and repayment of government debt may eventually require higher taxes on the current young generations, leaving less income for their consumption and saving.

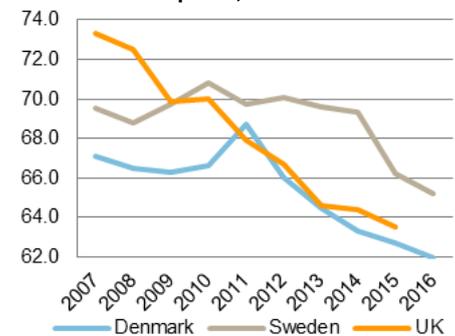
The EC projects accelerating productivity and wage growth over the next decades, which should alleviate the burden on the current young placed by

Share of 18-34 year-olds living with parents, pp changes over 2005-2015/06



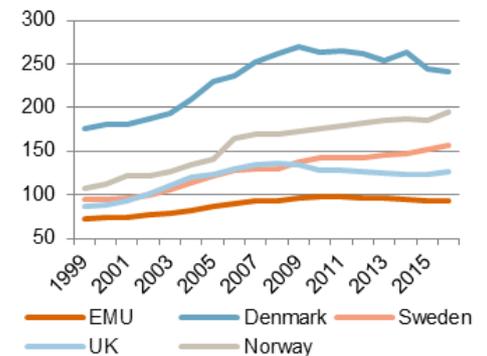
Source: Eurostat

Home ownership rate, %



Source: Eurostat

Gross debt-to-income ratio of households



Source: Eurostat

¹Kahn (2009), “The Long-Term Labor Market Consequences of Graduating from College in a Bad Economy,” extracted from: https://www.researchgate.net/publication/222666100_The_Long-Term_Labor_Market_Consequences_of_Graduating_from_College_in_A_Bad_Economy.

² European Commission (2015), “The Ageing Report: Economic and Budgetary projections for the 28 EU Member States (2013-2060),” European Economy 3/2015.

the ageing societies. However, this will not necessarily be the case. Productivity growth has been weak over the past two decades and may stay this way for longer. Due to high rates of unemployment during the recession, Europe’s young have lost the opportunity to accumulate human capital and to become more productive; this may weigh on productivity growth going forward. Moreover, research shows that ageing societies tend to be less innovative.³ In addition, due to the pressure on public finances from ageing, there may be fewer resources available for government spending on education, which is a crucial element for innovation and productivity growth.

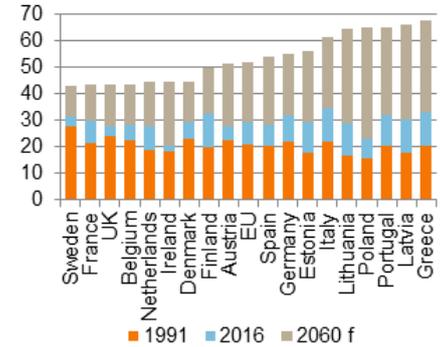
Also, when the current young themselves grow old, they are likely to be worse off than the current elderly. One reason for this is that their savings will be negatively affected by reduced lifetime earnings and low real interest rates, which may stay this way for some time. Another reason is related to the pension reforms implemented in the crisis years that were intended to address sustainability questions of public finances. An analysis by Bruegel,⁴ an economic think tank, found that the burden of cutting overall entitlements has not been shared equally across most EU countries, favouring current over future pensioners, especially in crisis-hit southern Europe. But some countries did better than others - the analysis of benefit ratios⁵ revealed that most continental welfare states and the UK had relatively equitable pension schemes.

Political underrepresentation

With the population ageing, the structure of voters is changing as well, tilting towards older voters. Over the past 15 years, the share of citizens aged over 55 has increased dramatically in the EU (see graph) - in some countries, e.g., Lithuania, the Netherlands, and Finland, the increase was as high as 8-9 pp. As a result, the views, values, and priorities of younger generations in political representation may be increasingly overwhelmed by those of older generations. Meanwhile, older voters may base their decisions on a shorter horizon when prioritising areas of government spending (e.g., pensions versus education), making decisions regarding the direction of their country (e.g., remaining versus leaving the EU), or addressing longer-term issues, such as climate change, globalisation, or inequality.

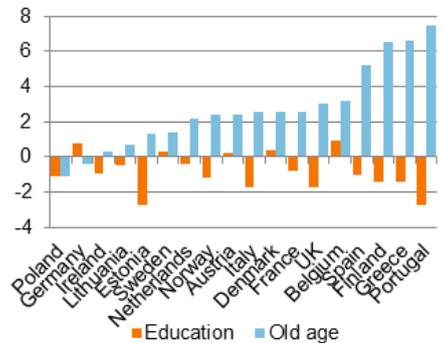
Surveys, as well as the outcomes of recent political events, indicate that there is a growing intergenerational divide in attitudes and values - young adults in the EU tend to have more favourable views on the EU project,⁶ as well as on immigration,⁷ globalisation,⁸ and minorities, than their older counterparts. In the Brexit referendum, where the discussions focussed predominantly on the immigration issue, a majority of young adults voted to remain in the EU (see graph), while most of those aged 50 and over voted to leave the EU. As societies continue to age, there is a growing threat that the voice of the young will become even more muted.

Old-age dependency ratio (population aged 65+ to 15-64)



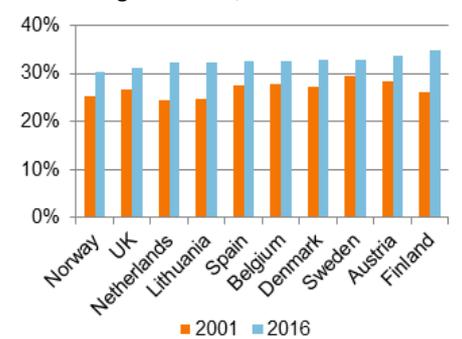
Source: Eurostat

General government expenditure, pp changes in composition over 2005-2015



Source: Eurostat

Citizens aged over 55, % of all



Source: Eurostat, Swedbank calculations

³ Aksoy, Basso, Grasl, and Smith (2015), “Demographic Structure and Macroeconomic Trends,” Banco de Espana.

⁴ Huttli, Wilson, and Wolff (2015), “The Growing Intergenerational Divide in Europe,” Policy Contribution 2015/17, Bruegel.

⁵ Average pension benefit divided by an economy-wide average wage.

⁶ Pew Research Center (June 2017), “Post-Brexit, Europeans More Favorable Toward EU. “

⁷ International Organization for Migration (2015), “How the World Views Migration” http://publications.iom.int/system/files/how_the_world_gallup.pdf

⁸ Standard Eurobarometer 81 (2014), „Public Opinion in the European Union,“ Spring 2014 Report.

Technological disruption and changing labour markets

The current young generation is about to face another headwind – the technological revolution, which could lead to high technological unemployment as well as an increasingly polarised labour market. It is widely acknowledged that the adoption of new technology (e.g., machine learning, artificial intelligence, 3D printers, driverless cars, etc.) could displace workers from tasks they were previously performing, including those of a nonroutine cognitive type, but mostly requiring middle skills. Research by the OECD found that 9-12% of workers in the largest EU economies are at high risk of automatibility (see graph).

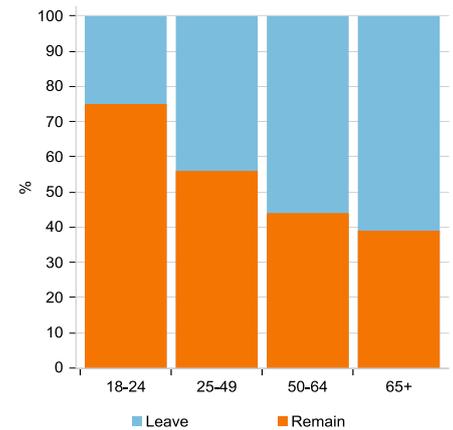
History shows that technological change may not create mass unemployment (at least not for long periods of time) if workers are able to find other jobs in the same skill range or ramp up their education levels. But finding new jobs may be increasingly difficult due to a decline in middle-skill jobs in general (see graph). As middle-skill jobs continue to decline, the current young will have to either shift towards lower-paying jobs in the service sector or upgrade their skills.

Even though the current young tend to be more educated and technologically literate than previous generations, this advantage might be insufficient due to rapid changes in skills required. If continuous education and public policies do not step in to accommodate these changes, more youth may end up in the lower end of the job market, with stagnant incomes. This would risk wasting the talent and potential of the most educated generation in human history.

Saving the talent – what can be done

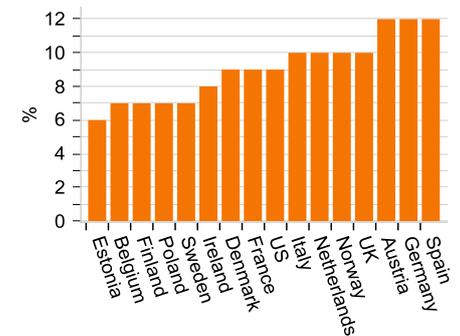
More rapid economic growth could alleviate some of the problems facing the young; thus governments should embrace productivity-enhancing measures, such as improving the quality of education as well as access to it, and stimulating innovation and investment. Implementing labour market reforms that prevent double standards is also of crucial importance. Regarding pensions, taxation, and the government debt burden, public policy should ensure as much intergenerational equity as possible. Cutting red tape and excessive building restrictions could lead to more affordable housing for the young. The young need to do their part, too, by participating more actively in elections and standing up for themselves. In order to combat future challenges and insecurities posed by technological change, governments need to ramp up their educational policies and improve their social security models. If the young are left to combat these challenges on their own, the once-promising generation could revert to populism—and an even stronger version than that of their wealthier parents.

Brexit vote split by age



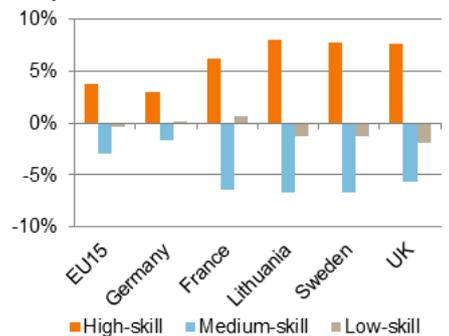
Source: YouGov exit poll via Politico

Share of workers at high risk of automatibility



Source: Amtz, Gregory and Zierahn, OECD (2016)

Employment by skill level, pp changes in composition over 2005-2016



Source: Eurostat, Swedbank calculations

Swedbank Research's disclaimer

What our research is based on

Swedbank Macro Research, a unit within Large Corporates & Institutions, bases the research on a variety of aspects and analysis. For example: A fundamental assessment of the cyclical and structural economic, current or expected market sentiment, expected or actual changes in credit rating, and internal or external circumstances affecting the pricing of selected FX and fixed income instruments. Based on the type of investment recommendation, the time horizon can range from short-term up to 12 months.

Recommendation structure

Recommendations in FX and fixed income instruments are done both in the cash market and in derivatives. Recommendations can be expressed in absolute terms, for example attractive price, yield or volatility levels. They can also be expressed in relative terms, for example long positions versus short positions. Regarding the cash market, our recommendations include an entry level and our recommendation updates include profit and often, but not necessarily, exit levels. Regarding recommendations in derivative instruments, our recommendation include suggested entry cost, strike level and maturity. In FX, we will only use options as directional bets and volatility bets with the restriction that we will not sell options on a net basis, i.e. we will only recommend positions that have a fixed maximum loss.

Analyst's certification

The analyst(s) responsible for the content of this report hereby confirm that notwithstanding the existence of any such potential conflicts of interest referred to herein, the views expressed in this report accurately reflect their personal views about the securities covered. The analyst(s) further confirm not to have been, nor are or will be, receiving direct or indirect compensation in exchange for expressing any of the views or the specific recommendation contained in the report.

Issuer, distribution & recipients

This report by Macro Research, a unit within Swedbank Research that belongs to Large Corporates & Institutions, is issued by the Swedbank Large Corporates & Institutions business area within Swedbank AB (publ) ("Swedbank"). Swedbank is under the supervision of the Swedish Financial Supervisory Authority (Finansinspektionen). In no instance is this report altered by the distributor before distribution.

In Finland this report is distributed by Swedbank's branch in Helsinki, which is under the supervision of the Finnish Financial Supervisory Authority (Finanssivalvonta).

In Norway this report is distributed by Swedbank's branch in Oslo, which is under the supervision of the Financial Supervisory Authority of Norway (Finanstilsynet).

In Estonia this report is distributed by Swedbank AS, which is under the supervision of the Estonian Financial Supervisory Authority (Finantsinspeksioon).

In Lithuania this report is distributed by "Swedbank" AB, which is under the supervision of the Central Bank of the Republic of Lithuania (Lietuvos bankas).

In Latvia this report is distributed by Swedbank AS, which is under the supervision of The Financial and Capital Market Commission (Finanšu un kapitāla tirgus komisija).

This document is being distributed in the United States by Swedbank AB (publ) and in certain instances by Swedbank Securities U.S. LLC ("Swedbank LLC"), a U.S. registered broker dealer, only to major U.S. institutional investors, as defined under Rule 15a-6 promulgated under the US Securities Exchange Act of 1934, as amended, and as interpreted by the staff of the US Securities and Exchange Commission. This investment research is not intended for use by any person or entity that is not a major U.S. institutional investor. If

you have received a copy of this research and are not a major U.S. institutional investor, you are instructed not to read, rely on or reproduce the contents hereof, and to destroy this research or return it to Swedbank AB (publ) or to Swedbank LLC. Analyst(s) preparing this report are employees of Swedbank AB (publ) who are resident outside the United States and are not associated persons or employees of any US registered broker-dealer. Therefore the analyst(s) are not subject to Rule 2711 of the Financial Industry Regulatory Authority (FINRA) or to Regulation AC adopted by the U.S. Securities and Exchange Commission (SEC) which among other things, restrict communications with a subject company, public appearances and personal trading in securities by a research analyst.

Any major U.S. Institutional investor receiving the report, who wishes to obtain further information or wishing to effect transactions in any securities referred to herein, should do so by contacting a representative of Swedbank LLC. Swedbank LLC is a U.S. broker-dealer registered with the Securities and Exchange Commission and a member of Financial Industry Regulatory Authority and the Securities Investor Protection Corporation.

Its address is One Penn Plaza, 15th Fl., New York, NY 10119 and its telephone number is 212-906-0820. For important U.S. disclaimer, please see reference:

<http://www.swedbanksecuritiesus.com/disclaimer/index.htm>

In the United Kingdom this communication is for distribution only to and directed only at "relevant persons". This communication must not be acted on – or relied on – by persons who are not "relevant persons". Any investment or investment activity to which this document relates is available only to "relevant persons" and will be engaged in only with "relevant persons". By "relevant persons" we mean persons who:

- Have professional experience in matters relating to investments falling within Article 19(5) of the Financial Promotions Order.
- Are persons falling within Article 49(2)(a) to (d) of the Financial Promotion Order ("high net worth companies, unincorporated associations etc").
- Are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) – in connection with the issue or sale of any securities – may otherwise lawfully be communicated or caused to be communicated.

Limitation of liability

All information, including statements of fact, contained in this research report has been obtained and compiled in good faith from sources believed to be reliable. However, no representation or warranty, express or implied, is made by Swedbank with respect to the completeness or accuracy of its contents, and it is not to be relied upon as authoritative and should not be taken in substitution for the exercise of reasoned, independent judgment by you.

Be aware that investments in capital markets – such as those described in this document – carry economic risks and that statements regarding future assessments comprise an element of uncertainty. You are responsible for such risks alone and we recommend that you supplement your Decision-making with that material which is assessed to be necessary, including (but not limited to) knowledge of the financial instruments in question and the prevailing requirements as regards trading in financial instruments.

Opinions contained in the report represent the analyst's present opinion only and may be subject to change. In the event that the analyst's opinion should change or a new analyst with a different opinion becomes responsible for our coverage of the company, we shall endeavor (but do not undertake) to disseminate any such change, within the constraints of any regulations, applicable laws,

internal procedures within Swedbank, or other circumstances.

If you are in doubt as to the meaning of the recommendation structure used by Swedbank in its research, please refer to "Recommendation structure".

Swedbank is not advising nor soliciting any action based upon this report. If you are not a client of ours, you are not entitled to this research report. This report is not, and should not be construed as, an offer to sell or as a solicitation of an offer to buy any securities.

To the extent permitted by applicable law, no liability whatsoever is accepted by Swedbank for any direct or consequential loss arising from the use of this report.

Conflicts of interest

In Swedbank Research, a unit within LC&I, internal guidelines are implemented in order to ensure the integrity and independence of the research analysts. For example:

- Research reports are independent and based solely on publicly available information.
- The analysts are not permitted, in general, to have any holdings or any positions (long or short, direct or via derivatives) in such Financial Instruments that they recommend in their investment analysis.
- The remuneration of staff within the Swedbank Research department may include discretionary awards based on the firm's total earnings, including investment banking income. However, no such staff shall receive remuneration based upon specific investment banking transactions.

Planned updates

An investment recommendation is normally updated twice a month. This material may not be reproduced without permission from Swedbank Research, a unit within Large Corporates & Institutions. This report is not intended for physical or legal persons who are citizens of, or have domicile in, a country in which dissemination is not permitted according to applicable legislation or other Decisions.

Produced by Swedbank Research, a unit within Large Corporates & Institutions, Stockholm.

Address

Swedbank LC&I, Swedbank AB (publ), SE-105 34 Stockholm.

Visiting address: Malmkillnadsgatan 23, 111 57 Stockholm