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The baby boom generation that required large houses and cars now has different needs

US housing hit by demographic shift

The end of the Boomer-led SuperCycle is challenging existing business models while creating new opportunities for companies that recognize the change at hand

PAUL HODGES INTERNATIONAL ECHEM

US housing demand used to be a major support for the US economy and the US chemical industry. During the subprime boom, housing was directly responsible for 6.5% of GDP and $33bn in chemical demand, as housing starts peaked at a record 2.2m level.

But that was the final hurrah for the days when millions of new Baby Boomer families wanted to set up home in the suburbs and raise a family. The rule then was simple – if home prices were too high, you simply drove 10 miles down the freeway to find a new suburb where prices were $10,000 cheaper.

Today, the Boomers' kids have left home, and they themselves are closing in on retirement. So they don't need family homes in the suburbs any more. And falling fertility rates mean there are fewer young families to replace them.

Since 2000, 92% of US population growth has been in the low-earning Hispanic and black communities. The recent temporary recovery in home prices has thus made owning a home even less affordable for this key group of potential buyers:

- Latest Census Bureau data shows 73% of white non-Hispanics own their home
- Only 46% of Hispanics, and 43% of blacks own their own home

Therefore, US home ownership rates are now in long-term decline. They were just 65% in Q1 2014, returning to the levels of 20 years ago, when the youngest Boomer families were setting up home for the first time.

This paradigm shift is bad news for GDP growth and chemical demand, particularly by comparison with the SuperCycle level of demand seen between 1989 – 2001. Then the entire Boomer population was in the 25 – 54 age range, widely recognised as being the peak period for wealth creation and demand. And demand was also being turbo-charged by the transformation taking place in women's employment and income status.

US fertility rates halved from 2.7 children per woman in 1955 to just 1.8 children today. The participation rates of women in the workforce doubled versus 1950s level, and their wage rates increased to 80% of men's. For the first time in history, women had their own source of income with which to buy domestic appliances for the family home and other products. Central bankers may have claimed the credit for this unique period of almost constant growth. But everyone else will recognise its real cause was the unprecedented demographic changes that took place.

It is therefore no surprise that central bankers are powerless to counter the transition now underway from the "Demographic Dividend" of the SuperCycle to today's "Demographic Deficit". The combination of falling fertility rates with increasing life expectancy means that the US has now become an ageing society. Older people already own most of what they need, and are fundamentally a replacement economy:

- Annual household formation has halved to just 569k between 2007-2013, versus 1.35m between 2001-2006
- Residential investment as a share of the economy is around half its average post-War level
- On its own, this has reduced GDP growth by around 2% compared to the pre-2008 period

PARADIGM SHIFT

This paradigm shift has enormous implications for GDP growth and chemical demand over the next decades, as ageing Boomers continue to downsize from family homes in the suburbs into cheaper multi-family units.

As the Wall Street Journal reported in March 2014: "Growth in rental demand is combining with long-run demographic trends that are expected to continue to tilt US home construction toward "multi-family" units, a category that includes everything from garden-style apartments to towering condominiums. The baby-boom generation is moving into retirement and empty-nesthood, prompting many to downsize to smaller quarters. The generations behind them, meantime, are having fewer children, later in life, so need less space."

Equally important, as the Pew Institute reports, is that the US is now returning to pre-Boomer levels of multi-generational homes:

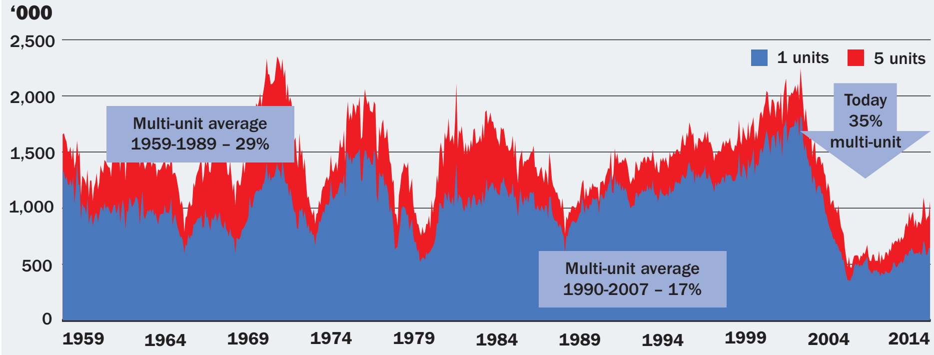
- 1 in 4 young adults lived at home in 1950
- By 1980, only 1 in 10 young Boomers were living at home with parents
- Today we are going "back to the future", with 1 in 5 young adults living at home with parents, and their numbers are rising all the time

As the chart shows, one in three new homes are now being built as multi-family units. This is double the percentage of those built between 1990 – 2007, when Boomers were busy bringing up families.

This demographic paradigm shift is inevitably driving major change in consumer demand patterns, and reducing potential levels of economic growth. One obvious impact is on employment, as multi-family units require only half the number of people to build them – 1.8 workers on average, versus 3.7 for a single family home. The units are also smaller than single-family homes, thus creating far less demand for chemical products.

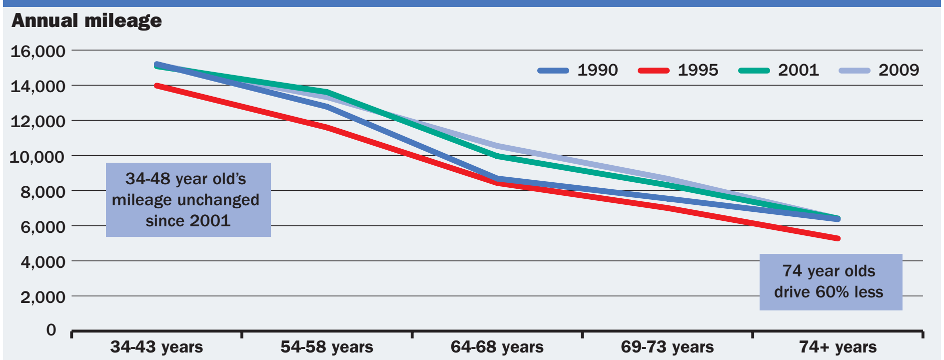
Affordability rather than "affordable luxury" is now the key factor. Retiring Boomers are time-rich and cash-poor, the opposite of their working days. They are also uncomfortably aware that their own income will likely halve as they move into retirement. And would-be homeowners in the college Class of 2014 have record average debt of $33,000 – double the inflation-adjusted level of 20 years ago.

US HOUSE STARTS: SINGLE-FAMILY AND MULTI-UNIT SPLIT 1959 ONWARDS



SOURCE: International eChem Analysis; US Census Bureau

ANNUAL US MILEAGE BY AGE OF DRIVER 1990-2009



SOURCE: International eChem Analysis; US Dept. of Transport data

The impact of this paradigm shift is also spreading outward into other major demand areas. Boomers are heading back to the cities in increasing numbers. This is creating a powerful ripple-effect in the auto industry. As the chart based on government data shows:

- People in the 34-43 age group drive around 15,000 miles/year
- This reduces to 13,000 miles/year by 54-58
- They are driving just 10,500 miles/year, down 30%, by 64-68
- Parents no longer drive kids around, and retired people no longer drive to work

This means the US has reached "peak car" demand. The average driving age has increased to 45 for men, and 47 for women, while the average age of the US auto fleet is 11.4 years and rising steadily. Demand is also not helped by young people's changed attitudes to cars. Only 70% of 19-year olds now have a driving licence. The combination of these two trends means that nearly 1 in 10 households no longer own a car.

The more far-sighted auto companies are changing their business models in response. The Boomers' move back into the cities means car-sharing, rather than ownership. Why bother to own a car, if you can rent a two-seater Smart car from Mercedes by the minute, with free parking and one-way rentals?

Or as BMW noted last year: "Now you can pay per use of a car. It's like the music industry. You used to have to buy an album, now you can pay per play." US housing markets thus demonstrate the powerful impact of today's demographic changes on the US economy, and for future US chemical demand. The impact of falling fertility rates and rising life expectancy is cumulative and long-lasting. Each vehicle used in a car-sharing fleet reduces future sales by 32 cars, according to Alix Partners research.

Of course, disruptive change on this scale is always difficult to handle. That's why major companies often simply disappear when it occurs in their markets. Who today remembers Polaroid – the early giant of the photo industry?

The rising tide of the Boomer-led SuperCycle boosted sales and profits for everyone. But now the tide is going out. This is challenging existing business models, while creating new opportunities. Companies that missed the first wave of these changes are already on the back foot. They need to catch up quickly, before they are completely left behind.

Tomorrow's winners will be those who now recognise and embrace the need for fundamental change. ■

Paul Hodges is chairman of International eChem (IeC), trusted advisers to the chemical industry and its investment community. With John Richardson, he authored 'Boom, Gloom and the New Normal', published by ICIS. Board-level strategy workshops are available to help companies exploit today's new opportunities. Visit www.iec.eu.com/strategy-development