

Master Thesis

How Demographics Influence Interest Rates

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Abstract

I examine the link between bond yields and demographic changes through a panel data analysis covering Canada, France, Germany, Japan, UK and the US over the past 50 years. Unlike most extant work, I focus on the ratio of retirement- to working age people, a number that is expected to nearly double for several developed countries until 2050. The results indicate an evident link between the population ageing and the bond yield levels. Generally, a faster growth of the share of retirees in the population compared to working age people significantly decreases bond yield levels. This evidence speaks against the simple life cycle hypothesis and supports literature that relates a decreasing interest rate level to population ageing. The possible explanation for the negative relation could be the inverse impact of the ageing population on GDP growth and on the natural rate of interest, higher capital intensity, higher aggregate savings by households facing longevity, a consequently stronger demand for financial assets - particularly for safety assets - and an ongoing shift to fully funded pension schemes.