Sujet traité : Et le gagnant est… / And The Winner Is…

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Special
Report by
Martin Barnes
Former Chief
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And The Winner Is...

Dear Client,

As I am travelling this week, we are sending you a Special Report by Martin Barnes, BCA's former chief economist, ranking the major economies by their economic and financial performance.

Next week, as we prepare our Quarterly Strategy Outlook, we will be sending you a joint Special Report with our Foreign Exchange Strategy service on what Sweden, a highly open and cyclically sensitive economy, is telling us about the outlook for global growth.

Our Quarterly Strategy Outlook will be published on March 25th and our MacroQuant Monthly Update on March 28th.

Best regards,
Peter Berezin
Chief Global Strategist

In this Issue

Competitions and award ceremonies are very popular, ranging from the high-profile Oscars to local pet shows. That is the inspiration for this report, ranking the major economies by their economic and financial performance under various categories. While I have endeavored to base my rankings on hard data, there inevitably is subjectivity, but this is true of all awards. Important choices had to be made about which countries, categories and data series to use, and what time period to measure.

For better or worse, I am using the following categories: per capita growth in real GDP, unemployment, inflation, government finances, financial market performance and investing in the future. I have focused on the G7 countries plus China although other countries may get a special mention for exceptionally good or bad performance. Finally, I have focused mainly on performance over the past one and five years which takes us to a pre-pandemic starting point although I do take some account of latest forecasts for the outlook.

No country dominates across all categories. Many would choose economic growth and financial market performance as the two most important and on that basis, the US clearly comes out on top. But, to some extent, this has been at the cost of a marked deterioration in government finances, raising risks for the future. And Asia leads in the important category of investing in the future. In many cases, Europe disappoints.

Category 1: Economic Growth

Economic performance is most commonly measured by the growth in real GDP – the change in the volume of goods and services produced in a country. However, relative performance is better captured by the growth in per capita GDP as it is important to adjust for demographic differences. Two countries may have the same real GDP growth but if the population is rising in country one and falling in country two, then the latter is doing better in per capita terms. Even that is not a perfect guide to the change in general living standards as it does not take account of income distribution within countries but current data on that is hard to obtain.

Table 1 shows the growth in per capita real GDP for our nominee countries in 2023 and the average of the five years 2019 to 2023 compared to the previous five-year period. Obviously, the recent five years cover the destabilizing effects of the pandemic but also the subsequent recovery. Overall, it is a reasonable measure of how economies have done relative to the pre-pandemic period.

Not surprisingly, China has the highest per capita growth because it is still an emerging economy in catch-up mode with more developed countries. However, its growth rate is slowing steadily and it suffered the largest deterioration between the two five-year periods. And it is one of the few countries where average growth in 2024 and 2025 is projected to be slower than over the 2018-23 period. Thus, it does not seem eligible for the top place in the growth category.

The award for best growth clearly must go to the US. Not only did it have the highest five-year growth rate among the G7 economies, it also is predicted, by far, to have the best 2024-25 performance according to the latest OECD forecasts. The US economy suffered a large pandemic-related decline in 2020, but much milder than other economies (**Chart 1**). And in 2023, it defied widespread expectations of recession, managing a respectable 2% increase in per capita growth.

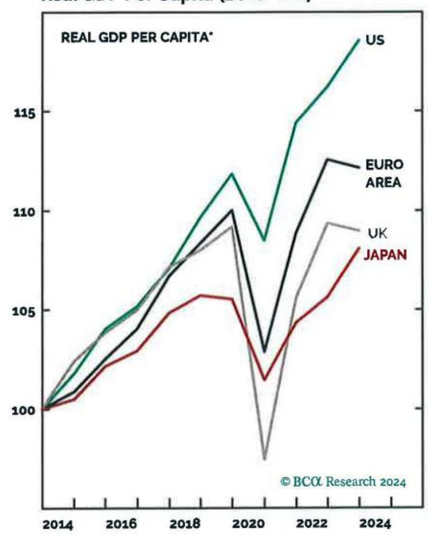
TABLE 1
Growth In Real GDP Per Capita

	AVERAGE ANNUAL GROWTH (%)				
Country*	2013-18	2018-23	2023	2024**	2025**
China	6.4	4.9	5.2	4.7	4.2
United States	1.9	1.6	2.0	2.1	1.7
Italy	1.0	1.1	1.0	0.7	1.2
Japan	1.1	0.4	2.3	1.0	1.0
France	1.1	0.4	0.4	0.6	1.2
United Kingdom	1.5	0.2	-0.3	0.7	1.2
Germany	1.4	0.1	-0.4	0.3	1.1
Canada	0.4	-0.2	-1.7	0.9	1.9

* RANKED BY 2018-23 GROWTH RATE.
** OECD FORECAST, JANUARY 2024.

CANADA pas fameux -

CHART 1
Real GDP Per Capita (2013=100)



* REBASED TO 2013 = 100.
SOURCE: IMF AND NATIONAL SOURCES.

Somewhat surprisingly, the runner-up prize goes to Italy which managed to maintain growth at the same pace over the two five-year periods shown in the table and it outperformed the other European economies in 2023. At the bottom of the scale, Canada, the UK and Germany vie for the booby prize as these economies barely grew over the 2018-23 period in per capita terms. In the case of the UK and Canada, rapid population growth undermined per capita growth in 2023.

Per capita GDP in the UK has declined for seven successive quarters so merits the bottom place. In fact, few countries in Europe have performed well, with the notable exception of Ireland which managed to sail through the pandemic with real per capita GDP growth of 5.7% in 2020 and 14% in 2021. That certainly justifies a special mention in the small country category.

Category 2: The Labor Market

Growth is good but successful economies also have healthy labor markets. The level of unemployment is a key determinant of popular perception of an economy's performance and governments ignore it at their peril. The unemployment rate can reflect structural factors as well as economic growth rates. For example, in Japan, a culture of low job turnover and the tradition of lifetime employment in many companies help to sustain a low unemployment rate. In contrast, unemployment has tended to be structurally high in southern European countries such as Spain, Italy and Greece.

Table 2 shows the unemployment rates for the overall population and for the 15-24 age group at end-2013, end-2018 and end-2023. Unemployment rates were high ten years ago, reflecting the slow recovery from the 2008-09 economic and financial meltdown, and great progress has been made everywhere since then. Not surprisingly, Japan has the lowest rates, followed by Germany. While these two countries share the top award in this category, the US and UK deserve a mention. In both cases, unemployment rates have remained at historically low rates. The tight labor market helps explain why the US defied expectations of recession in the past year and it clearly moderated the UK's economic downturn.

TABLE 2
Unemployment Rates

	TOTAL UNEMPLOYMENT RATE (%)			YOUTH UNEMPLOYMENT RATE (15-24, %)		
Country*	End 2013	End 2018	End 2023	End 2013	End 2018	End 2023
Japan	3.7	2.5	2.4	6.5	3.3	3.9
Germany	4.9	3.1	3.1	8.6	6.3	5.5
US	6.7	3.9	3.7	14.1	8.6	8.3
UK	7.2	3.9	4.2	20.1	11.8	12.6
Canada	10.2	8.8	7.3	13.6	10.5	11.4
Italy	12.6	10.3	7.2	41.5	32.4	23.1
France	10.2	8.8	7.3	25.5	21.1	18.4

* RANKED BY END-2023 RATE.

Black marks go to the Southern European countries and Sweden where youth unemployment remains disturbingly high at over 20%. But even these pale in comparison to South Africa with horrendous current unemployment rates of 48% for the 15-24 age cohort and 30% for those in the 25-54 age group.

Category 3: Inflation

After decades of disinflation, the worldwide spike in inflation rates in 2022 came as a profound shock to policymakers, businesses, consumers and investors. The blame fell largely on the impact of the pandemic and Ukraine conflict, but years of excessively easy monetary and fiscal policies in the major economies must also share the blame. Inflation rates subsequently fell sharply as supply disruptions eased and energy prices declined, but they remain above earlier lows.

The surprising top award in the inflation category goes to Italy, a country which historically has tended to have above-average inflation within Europe. The latest 0.9% inflation rate is not only the lowest among the G7 countries but also is the only one below its end-2018 level (**Table 3**). China has the lowest rate among our group but the fact that it has slipped into deflation is not good. The ideal situation is a low and stable inflation rate and China's deflation represents a problem for that economy.

At the other end of the spectrum, we have Argentina and Turkey with latest inflation rates of 254% and 65% respectively. In both countries, the cause is out-of-control monetary policy and there seems little prospect of a change.

Prior to the pandemic, central banks in the major developed economies struggled to get inflation up to their 2% target. Those days are over given the retreat of globalization, structurally tighter labor markets and central banks that will remain prone to ease aggressively in the face of economic or financial setbacks. Thus, the inflation award may be up for grabs in the coming couple

TABLE 3
Annual Inflation Rates

	ANNUAL INFLATION RATE (%)			JAN 2024 MINUS RATE AT	
Country*	End-2018	2022 peak	January 2024	End 2018	2022 peak
China	1.9	2.7	-0.3	-2.2	-3.0
Italy	1.1	11.8	0.9	-0.2	-10.9
Japan	0.3	6.3	2.6	2.3	-3.7
US	1.9	9.1	3.1	1.2	-6.0
Germany	1.6	8.8	3.1	1.5	-5.7
Canada	2.0	8.1	3.4	1.4	-4.7
France	1.6	6.2	3.4	1.8	-2.8
UK	2.0	9.6	4.2	2.2	-5.4

* RANKED BY JANUARY 2024 RATE.

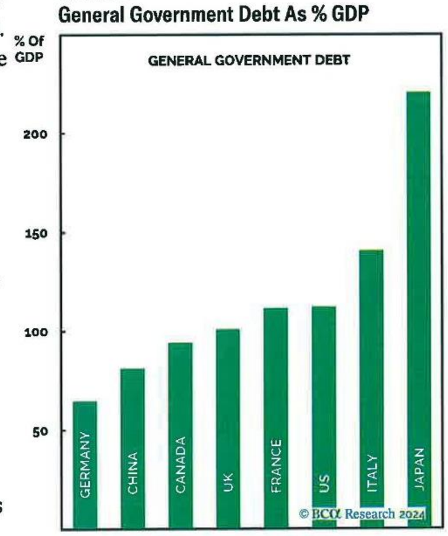
of years, depending on which central banks are prepared to keep policy tight enough for long enough to keep inflation under control. I am not optimistic that the Fed will stay the course in this respect.

Category 4: Government Finances

Marked country differences in government fiscal trends partly reflect structural factors such as demographics and cultural attitudes. For example, Germany has a much more conservative view of government deficits and debt than Italy. And Japan has faced a particular challenge by being at the leading edge of a rapidly aging population.

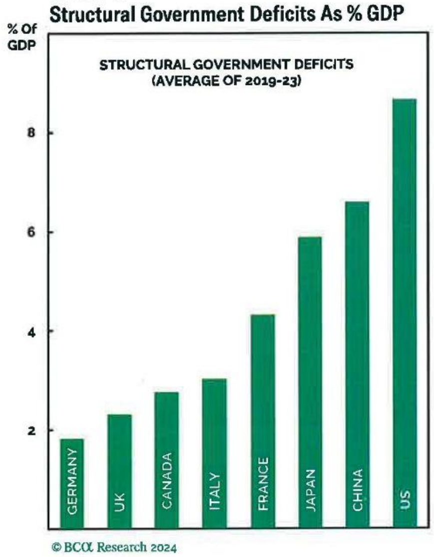
There is one clear G7 winner when it comes to fiscal trends and that is Germany. As shown in **Charts 2** and **3**, it has the lowest general government debt-to-GDP ratio, and the lowest average structural budget deficit over the past five years. Germany actually ran structural budget surpluses over the 2013-to-2019 period, the only major developed country to do so. Canada gets a runner-up award for running the smallest structural deficits over the past two years – at 1.4% and 0.8% of GDP in 2022 and 2023 respectively, according to IMF estimates.

CHART 2
General Government Debt As % GDP



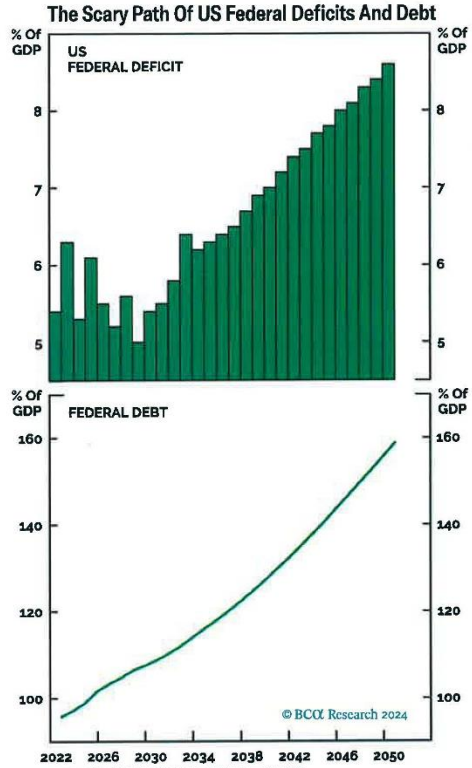
SOURCE: BANK FOR INTERNATIONAL SETTLEMENTS.

CHART 3
Structural Government Deficits As % GDP



SOURCE: IMF.

CHART 4
The Scary Path Of US Federal Deficits And Debt



SOURCE: CONGRESSIONAL BUDGET OFFICE.

Among smaller economies, Denmark and Sweden deserve a special mention. Denmark has run a healthy structural budget surplus over the past five years while deficits in Sweden have been tiny. In both countries, the ratio of net government debt-to-GDP is below 10%.

The fiscal picture for most countries deteriorated when the pandemic hit in 2020 as government revenues declined and spending climbed. The US took the biggest hit with the general government structural deficit soaring from 6% of potential GDP in 2019 to 10.7% in 2020 and 11.4% in 2021. Clearly, US fiscal profligacy partly explains its superior economic performance while austerity in Germany has been negative for growth.

While China has the lowest government debt-to-GDP ratio of our group, it started from a position of very low debt. It has suffered the largest rise in this ratio over the past decade and thus does not qualify for any award. Moreover, the corporate sector's debt-to-GDP ratio is very high in China compared to the average of developed countries. As a result, China's overall debt-to-GDP ratio is in a strong uptrend and above the international average.

It remains to be seen how the relative economic performance will play out between those countries that have pursued fiscal largesse and those that have pursued austerity. While fiscal expansion boosts growth in the short run, this could all be undone if rising debt burdens create a major financial and economic crisis down the road. That is the risk for the US, with deficits and debt projected to rise steadily over the coming decade under current policies (**Chart 4**).

Category 5: Financial Markets

Thus far, the ranking of countries on economic performance has been rather subjective. One could argue that financial markets make this ranking every day as they assess the economic, political and financial risks in each country. The famous investor Ben Graham stated that "*In the short run, the stock market is a voting machine. Yet, in the long run, it is a weighing machine.*" By that he meant short-run market movements can reflect emotions while over the long run it is fundamentals such as earnings that matter. Of course, defining the long run is an issue because as Keynes quipped "*Markets can stay irrational longer than you can stay solvent*".

In assessing market performance, I look at the changes over one, five and ten years. And I take the perspective of an international investor which means looking at returns in common-currency terms – i.e., the US dollar.

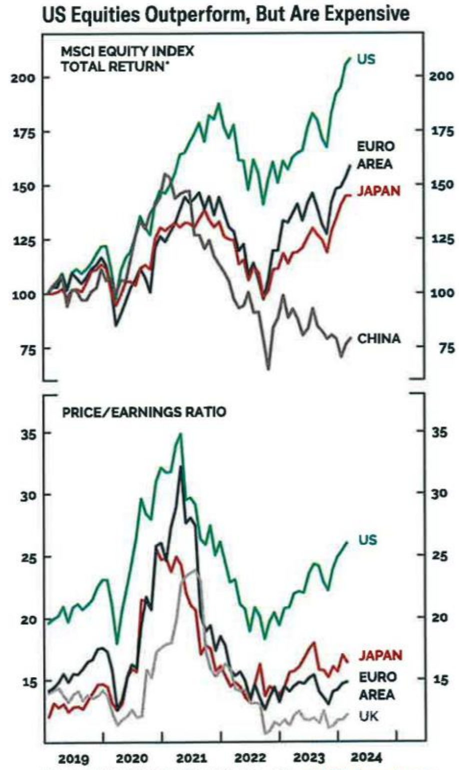
With regard to the stock market, the US is a clear winner over one, five and ten years (**Table 4** and **Chart 5**). The past year's market advance was turbo-charged

TABLE 4
Equity Market Performance

TOTAL EQUITY RETURNS IN US$, ANNUALIZED GROWTH TO FEBRUARY 2024			
Country*	Ten years	Five years	One year
US	12.6	7.1	30.7
Canada	5.4	4.3	11.5
Euro area	4.9	4.0	15.7
Japan	6.6	3.8	27.4
UK	2.2	2.2	5.5
China	1.2	-3.0	-14.0

* RANKED BY 5-YEAR PERFORMANCE.
SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).

CHART 5
US Equities Outperform, But Are Expensive



* IN USD, REBASED TO JANUARY 2019 = 100. © BCA Research 2024
SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).

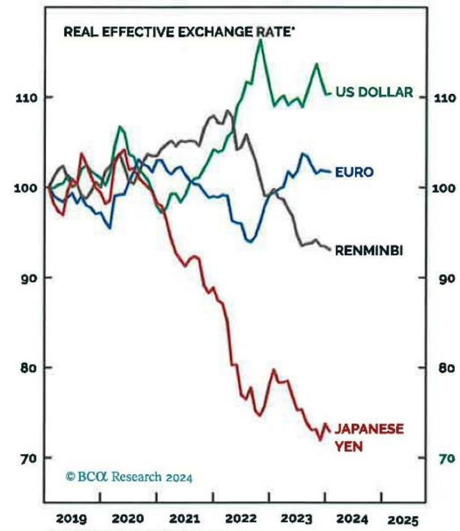
by spectacular gains in a few technology stocks. For example, the equally-weighted S&P500 increased by only 11.6% in the year to December 2023, compared with a 24.2% gain in the capitalization-weighted index. Nevertheless, the US performance was still good after allowing for that issue. Over a five-year period, Canada was not too far behind the US.

At the other end of the spectrum, the performance of the Chinese stock market has been dismal, but it is not a very liquid or transparent market and only the bravest international investors would venture there.

One implication of US equity outperformance is that valuations are very high relative to other regions. The current US price-earnings ratio (MSCI data) of 26 compares to 12.1 in the UK and 14.8 in the euro area. While the US P/E ratio is above its historical average, the UK and euro area ratios are below theirs. The high US ratio only partly reflects its high weighting of technology stocks as the US is more expensive than the MSCI World-ex US index across all major sectors.

The trend in exchange rates is a good measure of how international investors view country risks. Once again, the dollar comes out on top (**Chart 6**). This may seem surprising given the trend in US public finances, but the dollar retains its 'exorbitant privilege" of being the world's dominant reserve currency. The dollar tends to benefit from a world of geopolitical and economic uncertainty.

CHART 6
The Dollar Retains Its Strength



* REBASED TO JANUARY 2019 = 100.
SOURCE: IMF.

The dollar accounts for 59% of international currency reserves, down from over 70% 20 years ago. However, no other currency has stepped forward to significantly increase its role. Perhaps, the renminbi one day will take on a bigger role in Asia, but China remains reluctant to free up their currency to the whims of international traders. Meanwhile, efforts by an expanding BRIC conglomeration to reduce dependence on the dollar are likely to have little impact given the massive economic and financial divergences between these various countries.

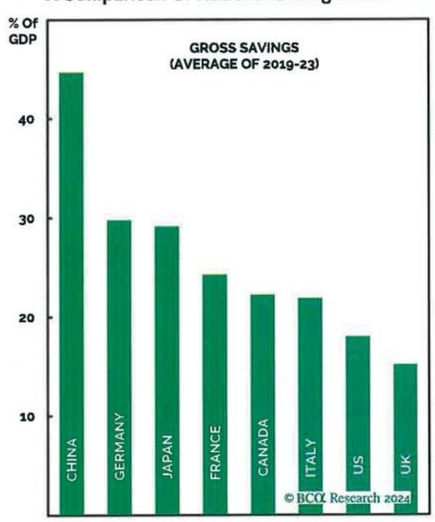
Category 6: Investing in the Future

This final category is highly subjective but is motivated by the concern that there is a general over-emphasis on short-term performance, not developments that will ensure success over the long run. Countries that invest heavily in physical and human capital should have above-average long-run economic and financial performance.

High investment rates are correlated closely with high savings rates and the top prize for saving goes to China. Of course, there is the important issue of whether investment is directed into the right areas and China has clearly overinvested in many dubious real estate projects. But China, along with other Asian countries such as Singapore, Korea and Taiwan also have invested heavily in productive areas. At the other end of the spectrum, the US and UK save and invest far too little compared to other developed economies and this poses a threat to future growth prospects (**Chart 7**). The UK record is especially dismal.

The relevance and quality of investment and innovation also can be measured by spending on research and development and by the number of patent applications. The latest data on this are shown in **Table 5**. The US and Japan score well on R&D spending as a share of GDP and the number of patent applications per million of the population aged over 20. However, both are eclipsed by Korea. China has a high level of patent applications but is closer to the middle of the pack in R&D. Once again, Europe fares poorly, explaining why it lags the US in leading-edge technologies. But at the bottom of the pile are Russia and India. The latter has an extremely low level of patent applications, challenging the view that technology is one of India's strengths.

CHART 7
A Comparison Of National Saving Rates



SOURCE: IMF.

TABLE 5
Spending On Research And Development And Patent Applications

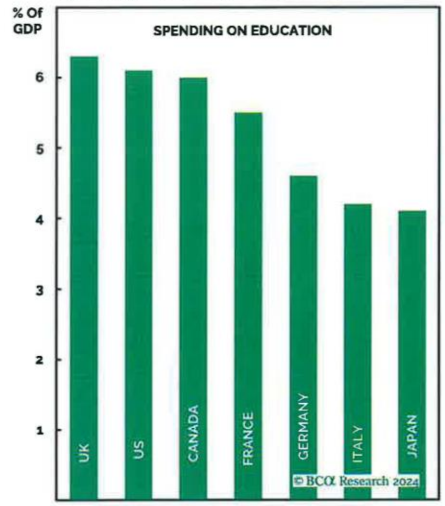
COUNTRY*	R&D SPENDING AS % GDP	PATENT APPLICATIONS PER PERSON AGED 20+
Korea	4.9	5559
US	3.5	2345
Japan	3.3	2819
Germany	3.1	981
UK	2.9	378
China	2.4	4175
France	2.2	313
Singapore	2.2	2931
Canada	1.6	1264
Italy	1.5	226
Russia	1.1	316

* RANKED BY R&D SPENDING.
SOURCE: OECD AND WORLD INTELLECTUAL PROPERTY ORGANIZATION.

A final important area to consider is investment in human capital and for this I use spending on primary through tertiary education and the results from the OECD's Programme for International Student Assessment (PISA). This tests the skills and knowledge of 15-year-old students in mathematics, reading and science. In terms of education spending, the latest data is for 2020 and the UK leads the list at 6.3% of GDP, with the US, Canada and France not far behind **(Chart 8)**. Japan's low ranking undoubtedly reflects demographics – the shrinking number of young people as a share of the population. Of course, spending a lot on education does not guarantee good outcomes and that is where the PISA results come in.

Within the G7, the clear winner across all three PISA categories is Japan **(Table 6)**. However, it is eclipsed by Singapore and all the Asian countries are top performers. It is no secret that education is given very high priority within the Asian culture and that shows up in these results. The other countries in our group were relatively closely clustered with one glaring exception – the poor performance of the US in mathematics. Not only is the latest result at the bottom of the pile, but the trend has been down over the past 20 years. That is a troubling result as one would expect some correlation between math skills and technological innovation. One

CHART 8
Spending On Education As % GDP



SOURCE: OECD.

TABLE 6
PISA Results (2022)

MATH		READING		SCIENCE	
Japan	536	Japan	516	Japan	547
Canada	497	Canada	507	Canada	515
UK	489	US	504	UK	500
Germany	475	UK	494	US	499
France	474	Italy	482	Germany	492
Italy	471	Germany	480	France	487
US	465	France	474	Italy	477

SOURCE: OECD.

compensation is that many highly-educated Asians emigrate to the US to work in the technology sector.

The overall winner in this category is Japan, Although the US does well in R&D spending, the low saving rate and poor PISA math score is a big concern. Singapore, Korea and China also deserve a special mention for excelling in high saving rates, the PISA results and R&D spending.

Conclusions

The US experience suggests that running irresponsible fiscal policies pays off in terms of short- and medium-term economic growth and asset price performance. Similarly, Germany continues to pay a price for its bias toward fiscal discipline and austerity. Those who favor the Austrian School of Economics obviously believe that the US approach will end in disaster, but such views have been held for decades and thus far have been proven wrong.

Asset managers are duty bound to tell their clients that past performance does not guarantee future performance. Thus, as with all competitions, this year's winners may not feature so well next time around. The US avoided recession in 2023, but the outlook for the coming year is still in doubt. Consumers have spent the bulk of the excess savings built up in the past few years, housing is soft, the commercial real estate sector faces severe debt problems and there is no extra stimulus coming from fiscal policy. Of course, the outlook for Europe is not great either and forecasts from the IMF and OECD still have the US as the fastest growing G7 economy.

The trends in government finances and investment will matter a lot for future economic and financial performance. Despite having a relatively low overall saving and investment rate, the US has managed to maintain a leading role in the development of new technologies. And its absolute productivity level is still very high compared to most countries. However, we should not underestimate China's ability to catch up.

Table 7 summarizes the results of these economic and financial "Oscars". The US does very well in what would generally be regarded as the two most important categories: economic growth and financial

TABLE 7
The Results

	THE WINNER	SPECIAL MENTION	BLACK MARK
Economic Growth	US	Italy, Ireland	Canada, UK, Germany
Labor Market	Japan, Germany	US, UK	Southern Europe, Sweden, South Africa
Inflation	Italy	China	Argentina, Turkey
Government Finances	Germany	Canada, Denmark, Sweden	US
Financial Markets	US		China
Investing In The Future	Japan	Singapore, Korea, China	UK

market performance. The UK's performance has been dire – poor growth in the past and poor prospects for future growth given its low investment.

The categories I have included cover many of the broad issues that determine a country's economic and financial success. But there are other important things to consider in deciding a country's overall record: health, crime, political stability and the population's general sense of wellbeing. These were outside the scope of this report but can be captured by the annual World Happiness Report produced by the Wellbeing Centre, Oxford University. The latest report ranks 137 countries based on results of Gallup poll surveys about six questions: GDP per capita, life expectancy, social support, freedom, generosity and corruption.[1]

The Scandinavian countries consistently rank at the top in terms of happiness, with Finland at number one and Denmark at number two. Among the G7 countries, Canada ranks highest at 13th place, followed by the US at 15 and Germany at 16. Generalizing about a country as large and diverse as the US is problematic and it should be noted that Finland's GDP is about the same as that of Alabama. There could be wide divergences in the "happiness" of US states although that is pure speculation.

Japan comes in at a distant 47th place in the happiness rankings, with China at 64. The Scandinavian countries have high taxes compared to the US but the offset is much more generous social support systems and lower income inequality. They also have extremely low levels of government debt.

The question of whether happiness trumps strong economic growth and equity prices would make for an interesting discussion over a large glass of wine. Personally, I would vote for happiness with the proviso that it is accompanied by living standards at Scandinavian levels, and I don't have to spend the winter in Finland.

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