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VIEWPOINT

A Stephens Inc. Economic and Financial Commentary
by Thomas Goho, Ph.D., Chief Economic Consultant

July 1, 2015

The July 4th holiday is a time Americans commemorate the birth of the United States of America and celebrate this country's remarkable heritage. But is our country losing the dynamism that has characterized it for over a quarter of a millennium? Recent data suggests that the U.S. is losing some of its economic edge—or at least there is a fear among many Americans of losing its edge.

This issue of Viewpoint focuses on America's position relative to countries said to be nipping at the heels of our economic powerhouse. Let's take a look at:

- The size and growth of the U.S. economy compared to other major economies of the world.
- U.S. productivity compared to our major trading partners.
- America's employment position relative to the other large industrialized and newly industrialized countries.
- The U.S. government's fiscal responsibility compared to countries of a similar economic size.

Size and Growth of the U. S. Economy

The total economic output of the United States, Gross Domestic Product (GDP), dwarfs that of any other global power by a significant margin. U.S. GDP of $17.5 trillion is just a little less than one-quarter of the total world GDP of $75 trillion. (*See Figure 1.*)

Figure 1:
World's 13 Largest Economies in 2014
(Real GDP in Trillions of U.S. dollars)

Country	GDP 2014
United States	**$17.5**
China	10.4
Japan	4.8
Germany	3.8
France	2.9
United Kingdom	2.8
Brazil	2.2
Italy	2.1
Russia	2.1
India	2.0
Canada	1.8
Australia	1.5
South Korea	1.4

Source: International Monetary Fund. World Economic Outlook Database. (Updated October 7, 2014). Extracted from the database on May 12, 2015.

The real test of a country's economic strength is not just its size but its ability to generate output and income for **each** of its citizens—its per capita GDP. By that standard the United States is clearly the world leader in per capita income among the world's 13 largest economies. (*See Figure 2.*) Even an exporting powerhouse like Germany has per capita income that is 16% less than that of the United States. China, whose economic power seems to alarm Americans, has per capita income of about one-fifth that of the United States.

Figure 2:
Per Capita Income for the Largest World Economies in 2013

Country	Per Capita Income
United States	**$53, 042**
China	11,907
Japan	36,449
Germany	44,469
France	37,872
United Kingdom	38,542
Brazil	15,037
Italy	35,597
Russia	24,114
India	5,413
Canada	43,247
Australia	43,544
South Korea	34,140

Source: International Monetary Fund. World Economic Outlook Database (updated October 7, 2014). Extracted from the Database on May 5, 2015.

Not only is the American economy large and productive, but it also has the ability to grow at a fairly competitive rate compared to its worldwide trading partners. Only emerging economies such China and India have a significantly higher growth rate than the Unites States, because such growth rates are a common characteristic of the less developed countries as they strive to become more industrialized. (*See Figure 3.*)

Figure 3:
Current Growth Rates for the Largest World Economies (2010-2014) in Constant 2005 Dollars

Country	Annual Growth Rate for 2010-2014
United States	2.2%
China	7.7
Japan	1.6
Germany	0.1
France	0.3
United Kingdom	1.7
Brazil	2.5
Italy	-1.9
Russia	1.3
India	5.0
Canada	2.0
Australia	2.5
South Korea	3.0

Source: The World Bank. World Bank Open Data. Extracted from the database on May 10, 2015.

This dichotomy between the slower growth of highly developed countries and the rapid growth in newly emerging countries such as China and India is likely to continue as large segments of the population in these countries move from rural areas into industrialized urban areas. In China and India, hundreds of millions of people are moving from the low-productivity rural sectors to higher productivity jobs in urban areas. This trend could continue for several decades, especially in India where development has lagged compared to China's recent growth.

Best Guess About U.S. Economic Growth

American economic growth in recent years was muted—even though it is very competitive with its major industrialized trading partners. This muted growth was especially notable in the first quarter of 2015 when growth was -0.2%. That negative growth was due in part to severe weather and weak U.S. exports as a result of the strong dollar. We expect American growth will likely rebound for the second half of the year to a rate between 2.5% and 3.0%. Strong employment gains will be the catalyst for that growth.

Unemployment Rates

Americans have vivid memories of the labor market dislocations that occurred during the harsh recession of 2008-2009 when the unemployment rate was briefly over 10%. The unemployment rate subsequently dropped to 5.6% at the end of 2014 and is now even lower at 5.5%. Yet Americans are still uneasy about labor markets conditions. Compared to our European trading partners, such as France and Italy where unemployment was at double-digit rates at the end of 2014, the United States labor markets were robust and still are. (*See Figure 4.*)

Figure 4:
Unemployment Rates in the Largest Economies at the End of 2014

Country	Unemployment Rate-End of 2014
United States	5.6%
Australia	6.1
Brazil	4.3
Canada	6.7
China	4.1
France	10.3
Germany	6.5
India	8.8
Italy	12.9
Japan	3.4
Russia	5.3
South Korea	3.4
United Kingdom	5.8

Source: The Economist. “Economic and financial indicators.” February 7, 2015. Page 84.

The U. S. is approaching full employment—an unemployment rate around 5%. American workers’ real wages, which have been stagnant since the last recession, are on the verge of modest increases as market pressures are being felt across the country. Firms such as Walmart are raising their minimum hourly wage to $10 over the next two years. Other firms making similar positive wage and/or benefit adjustments include McDonald’s, Whole Foods, Costco, Target, and Aetna. These wage and benefit changes are sporadic but indicative of labor markets that are definitely stronger than they were one year ago. Real wage increases likely will be more common in the second half of the year.

Job Growth

A test of the vibrancy of a country's labor markets is in its ability to generate job growth. The most recent available international governmental data indicate that the United States is competitive with most other industrialized countries. (*See Figure 5.*) The number of jobs created has increased by about 2%, about the same as output growth.

Figure 5:
Percent Change in the Number of Employed Workers in 2012 for Major Industrialized Countries

Country	Growth in Employment
Mexico	3.2%
Turkey	2.8
United States	1.9
South Korea	1.8
Canada	1.2
United Kingdom	1.2
Germany	0.8
France	-0.2
Japan	-0.3
Italy	-0.4
Spain	-4.5

Source: U.S. Bureau of Labor Statistics. International Comparisons of Annual Labor Force Statistics, 1970 to 2012. June 7, 2013.

Worker Productivity

The ability to pay higher wages is inextricably linked to worker productivity. Worker productivity is measured by GDP output per hour. (*See Figure 6.*) American workers are highly productive even compared to workers in other developed countries. Compared to workers in emerging economies like Mexico and Turkey, American workers are significantly more productive. Mexican workers on an hourly basis are only producing about a quarter of the output of American workers.

Figure 6:
Foreign Competitors' GDP per Hour Worked as a Percent of the U.S. Output Per Hour Worked in 2012 (US=100)

Country	GDP per Hour as a Percent of U.S. Output per Hour
United States	100.0
Canada	73.9
France	93.1
Germany	93.1
Italy	75.7
Japan	61.9
Korea	48.3
Mexico	28.8
Spain	75.7
Turkey	47.2
United Kingdom	74.2
European Union	71.7

Source: Organization for Economic Co-operation and Development (OECD). Extracted from the OECD StatExtracts database on April 21, 2015.

Foreign workers could close the output gap between themselves and American workers by working more hours per year. (*See Figure 7.*) Workers in Canada, Japan, Korea and Mexico are doing just that. However, workers in Europe not only are less productive on an hourly basis than American workers, but they also work fewer hours. The European "work rate" is unlikely to change any time soon.

Figure 7:
Hours Worked in Select Countries as a Percent of U.S. Hours Worked in 2014 (U.S. = 100)

Country	Hours Worked as a Percent of U.S. Hours Worked
United States	100.0
Canada	109.2
France	76.1
Germany	87.4
Italy	87.4
Japan	110.0
Korea	129.3
Mexico	110.6
Spain	81.5
Turkey	74.2
United Kingdom	97.4
European Union	89.7

Source: Organization for Economic Co-operation and Development (OECD). Extracted from the OECD StatExtracts database on April 21, 2015.

If our trading partners are going to close the per capita income gap between themselves and the United States they will need to:

1. be more productive per hour worked
2. work longer hours

These output changes are unlikely to occur in the short or intermediate future, so we expect the United States to remain the per capita income leader. None of the **major** economic powers is likely to knock us down from the top position.

Labor Participation Rates

A third way that countries can close the per capita income relative to the United States is by having more workers in the labor force — the labor participation rate. The labor participation rate measures the number of employed individuals (age 16 and older) relative to the total working age population of that country. (*See Figure 8.*) Most large economies, with the exception of Canada and China, have lower labor participation than the United States.

Figure 8:
Labor Force Participation Rates of Selected Countries in 2012

Country	Labor Force Participation Rate
United States	63.7%
Canada	66.7
China	71.3
France	55.9
Germany	59.2
Italy	49.0
Japan	58.4
Korea	61.3
Mexico	58.4
Spain	59.8
Turkey	48.3
United Kingdom	63.4

Source: U.S. Bureau of Labor Statistics. International Comparisons of Annual Labor Force Statistics, 1970 to 2012. June 7, 2013

When the three elements of labor performance are combined, it is easy to understand how the United States has excelled economically. On balance, American workers are more productive, they work longer hours and more workers are participating in gainful employment. A few countries such as Canada and Korea compare favorably with the United States, but overall, America has a winning combination to compete on a global basis.

Best Guess About American Employment

American labor markets will continue to improve in the second half of 2015. We expect that the unemployment rate will stay near its current level of 5.5%. Jobs will be created at a rate of about 200,000 per month. Real wages will continue to show an improvement as a result of tightening labor market conditions and a modest improvement in labor productivity.

Government Finances

Americans may worry about the economic performance of the private sector but also about the Federal government's ability to perform in a manner supportive of long-term U.S. economic viability. Many Americans fear that the government is driving the country toward an economic disaster with burdensome deficit spending. That may be true in the future, but the U.S. fiscal position is currently healthy compared with many other countries.

Our short-term budget situation looks significantly better than most of the other large global economies. Our government budget deficit is 2.8% of American GDP, which is less than a 3% deficit that many economists think is a sustainable for most countries. (*See Figure 9.*)

Figure 9:
Recent Federal Government Budget Surpluses/Deficits as a Percent of GDP for Select Countries in 2014

Country	Federal Surplus/Deficit as a % of GDP
United States	-2.8%
Brazil	+1.2
Canada	-2.3
China	-2.9
France	-4.3
Germany	+0.4
India	-5.0
Italy	-3.0
Japan	-7.9
South Korea	+0.5
Mexico	-3.7
Russia	+0.4
Spain	-5.8
Turkey	-2.4
United Kingdom	-4.8

Source: U.S. Central Intelligence Agency. *The World Factbook 2013-2014*.

Another good measure of a government's long-term fiscal situation is the size of its net government debt relative to the size of its economy. (*See Figure 10.*) Net government debt is defined as a government's liabilities minus its financial assets. The data indicate that the Unites States federal government is hardly drowning in debt at the present time. Tax revenues have increased significantly with the expanding economy limiting the size of the domestic budget deficit.

Figure 10:
Net Government Debt as a Percent of Gross Domestic Product (GDP) for the Largest Economies in 2014

Country	Net Government Debt as a Percent of GDP
Japan	226%
Italy	133
France	93
United Kingdom	91
Canada	86
Germany	80
United States	72
Brazil	59
India	52
South Korea	36
Australia	33
China	22
Russia	8

Source: U.S. Central Intelligence Agency. The World Factbook 2013-2014.

Overall, European and North American countries are more indebted than the Asian countries. Part of that difference in indebtedness is explained by the fact that the former countries have a longer history of accessing international financial markets, and therefore were and are able to accumulate greater debt burdens. Countries such as China and Russia lacked access to international capital because their economies were until recently closed to international trade and finance.

Best Guess on Governmental Finances

The United States government is not on the brink of a financial disaster. Its finances in the short-term and intermediate term are not likely to change significantly for the better or the worse. The budget deficit and its net government debt to GDP ratio will remain about the levels shown above. However, this situation is likely to worsen in the next decade—around 2020—if Congress and the President fail to make difficult decisions on entitlement spending and tax policy.

Global Payments

The strength of the U.S. economy and its government is apparent in how global commerce is transacted. About forty-five percent of the world's transactions are executed in U.S. dollars. (*See Figure 11.*) The United States has about one-quarter of the world's GDP of $75 trillion, yet the fact that its currency is used to consummate such a high percentage of transactions is a testament to the economic power and stability of the United States. The U.S. dollar is viewed by international merchants, currency traders and investors as the most liquid global currency, a view that is supported by the data.

Figure 11:
Shares of World Payments by Currency (December 2014)

Country (and Currency)	Share of World Payments
United States (dollar)	44.6%
Europe (euro)	28.3
United Kingdom (British pound)	7.9
Japan (yen)	2.7
China (renminbi)	2.2
All other countries	14.3

Source: Society for Worldwide Interbank Financial Telecommunications (SWIFT). "Renminbi breaks into the top five as a world payments currency." January 28, 2015.

Best Guess About the Role of the U.S. Dollar in Global Business

The fragility of the Euro and China's capital controls on its currency will probably prevent either currency from displacing the U.S. dollar as the most important international currency for global transactions. If at some point the U.S. economy begins to weaken or its government undertakes imprudent fiscal policies, something perverse is likely to happen; international investors and speculators may not sell dollars but buy them because it is the most trusted and most liquid global currency.

Final Thoughts

While you are sitting on the beach this summer sunbathing, think about this. You live in a country that has:

- The largest economy in the world.
- The highest per capita income of any of the major world economies.
- Almost full employment.
- The most productive workers of any of the major world economies.
- Workers who voluntarily work long hours.
- Government spending that is almost within its means.
- A government with a debt burden that is currently manageable.
- A currency that is known, sought after and used worldwide.

A short-term look at the American economy reveals similar positive conditions.

- New jobs are being created at a healthy rate—about 200,000 per month.
- The unemployment rate has dropped to 5.5% according to recent reports.
- Inflation is minimal—between 1% and 2%.
- Likelihood of a recession is minimal notwithstanding the weather-related first quarter contraction in the economy.
- The U. S. stock market is near an all-time high, powered in part by strong corporate profits.
- Total wealth of households is at a record level.
- Borrowing rates are near record lows for the purchase of homes and cars due mainly to easy monetary policy by the Federal Reserve.
- A strong dollar is making foreign goods and international travel more affordable than they were last year.

Are there negative conditions that could keep economists and policymakers awake at night? Yes, absolutely. They include such economic conditions as:

- A large number of underemployed workers in part-time jobs who seek full-time employment.
- Falling real wages for the least skilled and educated American workers.
- A loss of millions of manufacturing jobs to less developed countries.
- A regulatory and tax environment that is anti-growth.

Every country has some economic conditions that are less than optimal. European countries are plagued with very high unemployment rates, decreasing populations and inflexible labor markets. Japan has experienced a relatively stagnant economy for decades. Russia's economy is contracting in 2015. China's slowing economy is characterized by a high level of corruption and a lack of protection for property rights.

All facts considered, the United States is a paragon of growth, productivity, stability and strength compared to its major trading partners. Savor and enjoy it.

And don't forget to put on your sunscreen. With all this good summer news, you don't want to ruin your vacation with painful sunburn.

Thomas Goho, Ph.D. is Chief Economic Consultant for Stephens Inc. He also serves as the Co-Director of Stephens University at Wake Forest University. Tom enjoys a successful career in both education and business. He served as a professor of finance, Wayne Calloway School of Business and Accountancy, Wake Forest University for 30 years. Before retiring in 2007, Tom was the first to hold the Thomas S. Goho Chair of Finance. Tom also served on the Board of Directors of the Wells Fargo Family of Mutual Funds for 20 years, and also was on the Board of Directors of Lifepath Funds of Barclay's Bank. A former Certified Financial Planner, Tom earned his BS and MBA from Pennsylvania State University and his Ph.D. from the University of North Carolina-Chapel Hill.

Stephens

111 Center Street
Little Rock, AR 72201
501-377-2000
800-643-9691
stephens.com

linkedin.com/company/stephens-inc.
@Stephens_Inc
facebook.com/about.stephens

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