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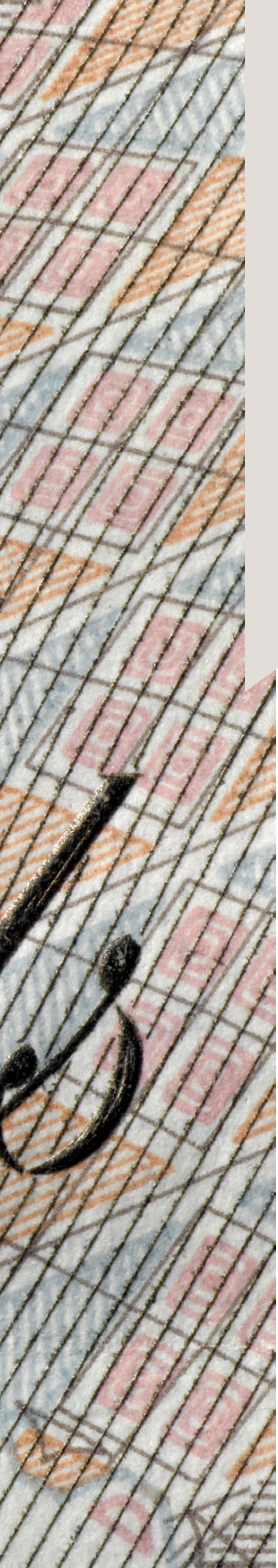
MARKET PERSPECTIVE | MAY 2023

Not such a bad mix



Foreword

CONTENTS

Markets have quickly regained some poise, but it is too soon to conclude that we are out of the banking and economic woods just yet.

Interest rates may be close to peaking – or, more likely, plateauing – but their full effect has not yet been felt; meanwhile, the informal restriction of credit associated with more cautious banks has barely begun. And even if systemic risk is more muted these days, it is a safe bet that we have not seen the last of the likely financial accidents that will follow such a sharp normalisation in borrowing costs. Geopolitical stress remains high.

Nonetheless, confident predictions of an imminent, severe economic downturn remain premature; and one important headwind is turning into a tailwind: European gas prices have collapsed. Meanwhile, labour markets remain quiescent: wages are not accelerating wildly, perhaps because many of those missing workers weren't really missing after all.

We continue to see banking risk as contained, and a severe economic setback as neither necessary nor likely. We also see inflation – both headline and, eventually, core rates – falling markedly, which is why we think interest rates are close to that peak (or plateau). In the months ahead we expect the cyclical risks around interest rates and corporate profitability to fade, and when they do, we expect to advise buying, not selling, securities. In this *Market Perspective,* we update that cyclical call and our inflation monitor.

In a longer essay, we stand back from the short-term debate and take a look at the emotive topic of relative economic performance, and how it matches up to received wisdom. We report that Switzerland is actually rather exciting, while the UK is far from bottom of the class, even in Europe. The direct read-across to portfolios may be limited, but if this raises the macro signal-to-noise ratio we will have done a service.

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Image sources: Fifty pound note, detail © Gettyimages

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Not such a bad mix

GROWTH: HEADWIND TO BECOME A TAILWIND

Widespread predictions, now a year old, of a significant, imminent economic setback have been wrong. Most big economies have grown modestly, and the first quarter of this year looks to have been a respectable one.

Unusually, recent forward-looking indicators – the widely watched business surveys – have overall been firmer in Europe than in the US, but even in the latter there is as yet little sign of a technical recession, let alone a severe one. Here in the UK, the lengthy recession first predicted by the Bank of England as long ago as August – and widely reported as established fact – has yet to start.

We have consistently argued that a severe global setback is neither necessary nor likely. This remains our view.

There have been two main reasons for the collective economic gloom: the big hit to European terms of trade caused by spiking energy bills, and tighter US and European monetary policy – the latter compounded now by the likely informal restriction of credit as banks circle the wagons after the demise of Silicon Valley Bank (SVB) and Credit Suisse.

European natural gas prices have in fact collapsed, and are now down by more than four-fifths from their late August highs. It is not a big surprise, though it is still not as widely reported as it could be. That's what commodity prices often do after a surge. Buyers economise, and use substitutes, while sellers increase supply (Russia accounts for around a tenth of global carbon-based energy output, and uses perhaps half of that itself).

Consumers have not benefited yet, but unless there is a renewed surge, they will do in the months ahead: what was a headwind is about to become a tailwind. Consumer prices overall may not just slow, but fall. Meanwhile, wages will continue to rise more quickly than usual. As a result, real pay is poised to start rebounding firmly in the second half of 2023 – at employment rates which are still likely to be healthy then.

The jury is still out on the impact of monetary tightening. But it does not have to be dramatic. The fabled 'long and variable lags' may be stretched and smoothed this time by the remarkably loose starting point – even now, real policy rates are mostly still negative – and by the workings of fixed rate mortgages. The less formal tightening of credit conditions might yet do more damage, of course, and we are watching lending and deposit behaviour carefully. As yet, working capital seems adequate.

INTEREST RATES: NEARLY THERE NOW...

Despite this economic resilience, inflation pressures do seem to be subsiding. Again, this is not a huge surprise. Aggregate demand has been firm, perhaps even too strong for central bank comfort, but aggregate supply conditions have improved – assisted by a predictable rebound in workforce participation rates, by improved freight rates and by China's re-opening. Wages have accelerated somewhat, as noted, but the feared 'wage price spiral' has not arrived, and seems unlikely to do so.

Headline inflation rates have rolled over, and as those lower European energy prices kick in, will slow significantly in coming months (as noted, consumer prices overall may actually fall). Core inflation rates are proving stickier – again, not a major surprise – but not, yet, sufficiently to doubt that they too will gradually roll over in due course.

With unemployment still low, and core inflation rates still firm for now, central banks are unlikely to feel that they have yet done enough on interest rates. The uncertainties and sensitivities associated with heightened banking nerves suggest that they are unlikely to hike as far as they would have done before SVB and Credit Suisse, but as we write at least one more 25 basis point (bp) hike seems likely in the US, and more in the eurozone (and probably the UK, though the Bank of England remains the least determined of the three, perhaps because it believes its economists' forecasts). If economies remain resilient, it is unlikely that rates will then fall back as quickly as money markets expect – we still see more of a 'plateau' profile – even when core inflation does turn down. But the upward distance yet to travel is now small relative to that behind us: we are – perhaps – nearly there now.

INVESTMENT CONCLUSION

Significant uncertainty persists of course, not least surrounding that more informal monetary tightening. As we suggested in March's *Market Perspective*, not every butterfly causes a tornado – but (to mix the metaphor) if someone shouts 'fire' in even the best-designed cinema, damage can still be done, even if there isn't one.

The Wall of Worry remains big, then: pundits still stress the downside risks. But as those gas prices have fallen, and labour markets have mostly remained quiescent, we can imagine positive surprises too. We still think that the main investment decisions of 2023 will be about what and when to buy, not sell. For the first time in many years, we can envisage those acquisitions including bonds as well as stocks.

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Inflation update

Headline inflation rates appear to have definitively rolled over across most of the world. Our developed market aggregate has been trending lower for almost half a year, and is around 2.5 percentage points (ppts) below its October high (figure 1). Inflation in emerging markets has also exhibited a similar pattern (figure 2) – even if we exclude China from the total (inflation has been remarkably low there by historical standards, mostly due to the government's COVID-related restrictions). However, core inflation – that is, excluding food and energy – is proving to be more stubborn, and is yet to turn lower in developed markets (see figure 1 again).

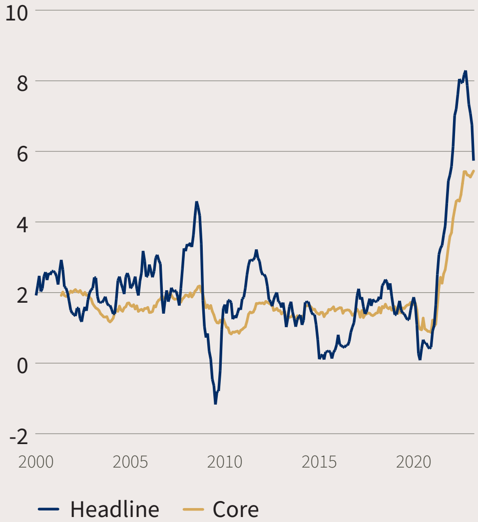
Banking risk has – so far – subsided since March's *Market Perspective*, and so a new deflationary force seems unlikely to be unleashed for now. Even so, the usual global inflationary pressures we track across the major CPI categories – energy, food, goods and services – have continued to abate.

To start with, inflationary pressures in the energy and food categories – key components of headline inflation rates – have been cooling.

In the energy space, oil prices have been slowly trending lower since Russia's invasion of Ukraine. Oil prices only experienced a short-lived bounce following the surprise decision from OPEC+ to cut production, they are still well below last year's levels, and in real terms are close to a 10-year average. This was evident in the US inflation data for March, where we saw energy price *deflation* for the first time since January 2021. Separately, European wholesale natural gas prices have also continued to move lower and are nearly 90% below their summer highs, though this collapse is yet to be reflected fully in consumer prices.

FIGURE 1: DEVELOPED MARKET INFLATION RATES

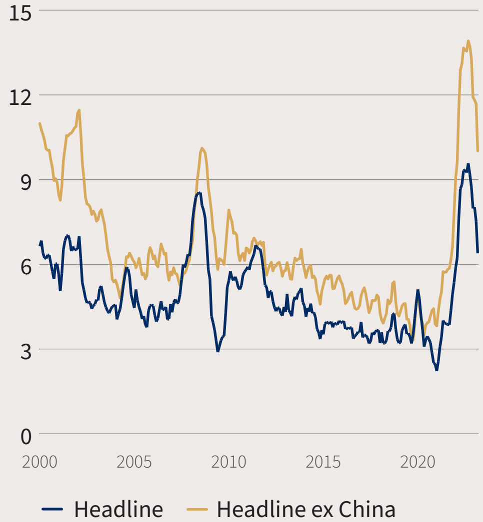
Year-on-year change (%)



Source: Refinitiv Datastream, Bloomberg, Rothschild & Co

FIGURE 2: EMERGING MARKET INFLATION RATES

Year-on-year change (%)



Source: Refinitiv Datastream, Bloomberg, Rothschild & Co

Footnote: Developed market series is a GDP-weighted average of US, Canada, UK, eurozone, Switzerland, Denmark, Norway, Australia, Japan, New Zealand and Singapore inflation data. Emerging markets series is a GDP-weighted average of China, India, Indonesia, Korea, Malaysia, Philippines, Taiwan, Thailand, Vietnam, Czech Republic, Egypt, Greece, Hungary, Poland, Russia, South Africa, Turkey, Brazil, Chile, Colombia and Mexico inflation data

Gas storage levels also appear to be at a record high for this time of the year even though imports from Russia have slumped, and so a renewed surge in natural gas prices seems unlikely for now (figure 3).

Global food prices have also continued to fall. As of March, the UN FAO's World Food Price Index decreased for the twelfth consecutive month, to -21% in year-on-year terms (figure 4). The food disinflation process has so far been uneven across countries: the US food CPI rate has started to roll over, but it is still rising in several European countries. While it's hard to pinpoint what has caused this disparity – local climate and transport costs play a role as food makes its way from farms to supermarket shelves, as do processing and distribution costs – one would still expect European countries' food CPI rates to also fall towards zero over the course of this year, given that the price of the primary commodity itself has been on the decline for some time.

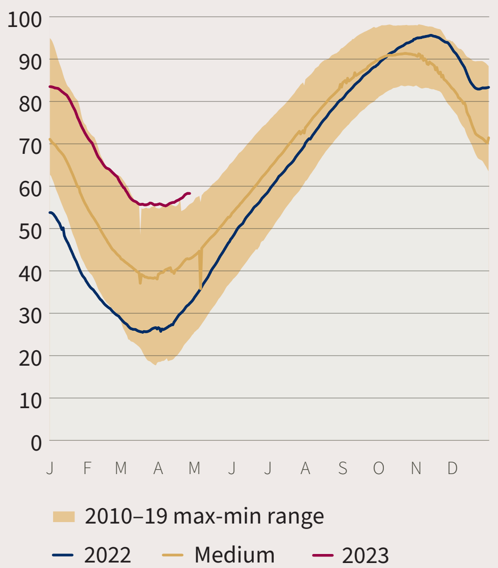
Core inflation, as noted, has been more stubborn, but there are signs that both goods and services components should moderate more clearly later this year.

The outlook for goods-related inflation has clearly improved following China's relaxation of COVID-related restrictions. Supply chain conditions have normalised and there are even indications that capacity is freeing up: the New York Fed's Global Supply Chain Pressure Index is over one standard deviation below the long-run average – its lowest reading since 2009 (figure 5). In addition, more 'raw' supply chain metrics, such as the spot rate of chartering a shipping container, have returned to pre-pandemic territory.

The impact from easing supply chain conditions is yet to be fully reflected in most European countries' goods-related core CPI baskets – it is more visible in the US data – but this may partly be due to European firms having faced relatively higher input costs to begin with, after last year's spike in wholesale gas prices. For instance, while they are not directly comparable, producer price inflation rates in the eurozone and UK have been far higher on average than the US equivalent (though they are moving lower and have more than halved from their respective peaks).

FIGURE 3: EUROPEAN GAS STORAGE LEVELS

Total capacity (%)



Source: Gas Infrastructure Europe – AGSI, Bloomberg, Rothschild & Co

FIGURE 4: GLOBAL FOOD PRICES

Year-on-year change (%)

Source: UN Food and Agriculture Organisation, Refinitiv Datastream, Rothschild & Co

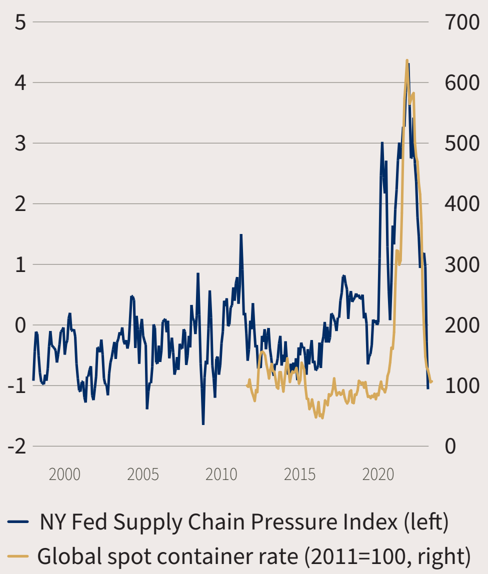
Finally, the persistence of above-trend nominal wage growth has perhaps been the most important – and potentially more troubling – aspect of the inflation backdrop, particularly for services-related consumer prices. That said, the pace of wage growth has arguably been unremarkable considering that unemployment rates are at-or-near record lows in several major economies: in real (inflation-adjusted) terms, US wage growth has in fact been negative for most of the post-pandemic period (figure 6).

It's likely that real wage growth will now start to turn positive as headline inflation rates continue to move lower, as suggested by the Atlanta Fed's US median wage growth tracker (see figure 6 again). But a 1970s-style wage-price spiral, in which wages and prices chase each other to ever-higher levels, seems highly unlikely to us: for context, in the most inflation-prone big economy, the UK, real wage growth was mostly positive back then, and actively leading inflation higher. There are also structural differences: unionisation rates are far lower nowadays, management practices and labour relations generally have been transformed, and global labour supply has been boosted by China and other Asian economies (to name a few).

Overall, we think both headline and core inflation rates are likely to move lower over the course of this year. We expect the latter to be stickier – particularly as consumer demand has remained firm in recent months – but it should still slowly abate, perhaps settling eventually in the above-target 2-4% range in both the US and Europe.

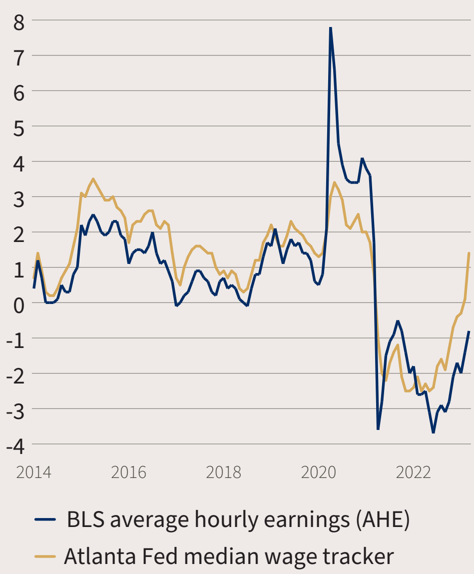
It's likely that real wage growth will now start to turn positive as headline inflation rates continue to move lower.

FIGURE 5: SUPPLY CHAIN CONDITIONS
Various metrics



Source: Federal Reserve Bank of New York, Drewry Research, Bloomberg, Rothschild & Co

FIGURE 6: US REAL WAGE GROWTH METRICS
Nominal wage growth less headline CPI inflation (year-on-year change, %)



Source: US Bureau of Labor Statistics, Federal Reserve Bank of Atlanta, Bloomberg, Rothschild & Co

Local heroes or zeros?

People often have strong views on how their national economies are doing – usually negative ones.

In the space of fifteen short years we have seen: a Global Financial Crisis; a eurozone debt crisis; amplified political populism and dysfunction; the pandemic; and most recently, the rise of energy insecurity and the resurgence of inflation and geopolitical trauma (and now an uncomfortable increase in bank risk).

Against this backdrop, there has been plenty of local bad news. The Wall of Worry has rarely looked bigger than in recent months, and it has been easy to imagine that our respective economies and authorities have fared particularly badly, that we are somehow specially inept or unlucky.

In reality, of course, countries can't all be bottom (or top) of the table. We offer here some plausible economic performance rankings based on a number of macro variables. They are not designed to help mechanically in making investment decisions – macroeconomics is just one of many potential inputs to the investment process, and not all aspects of economic performance matter similarly – but they at least offer some quasi-objective perspective, and filter some sort of economic signal from the polemical noise

WHAT MATTERS

How exactly should we measure macroeconomic performance, and decide which are the best-performing big economies? Despite the strength of feelings on display, there is no single, widely-accepted "right" answer. Opinions differ as to what might be the main object of economic activity. Is it prosperity, durability, fairness – or a mix, or something else again?

There are many facets of economic performance, and we choose 19 variables that each capture some distinctive angle. For each variable, we rank country performance, and then calculate an average rank across all 19 in order to arrive at an overall standing. We let the numbers largely speak for themselves – most readers will find that their national economy is after all not doing so badly.

When it comes to economic welfare, we know that what matters is not always measurable, and that what is measurable does not always matter. Many important variables – including such central quantities as output, productivity, inequality, utility or happiness – are in reality difficult or even impossible to measure with confidence. At the same time, many variables that are easy to measure – money supplies, foreign currency reserves, government and consumer borrowing – are ultimately not so important.

We also know that despite the best efforts of statisticians to standardise definitions and measurement practices, these measurement ambiguities can vary across countries – as the pandemic revealed so visibly in the case of output (that is, GDP – perhaps the most widely-used economic statistic – see comments below). But in considering a wide range of indicators, and a lengthy period for comparison, we are looking at a playing field that is as wide and level as we can make it.

We have grouped our 19 variables under the three broad sub-headings mentioned above, namely:

- Prosperity (growth and material living standards);
- Durability (finance, the environment – we were going to use the label "sustainability", but it is too closely associated with environmental matters only);
- Fairness (wider social well-being, stability).

These may not be definitive, but they each seem to capture a distinct, desirable quality. The three sub-headings have different numbers of component variables.

In arriving at an overall ranking we set the sub-headings aside and give each component variable the same weighting. Nonetheless it might be of interest to see how economies fare under each of the three (see Appendix). Some readers may feel that (for example) prosperity is what it's all about, others may think that fairness matters most.

HOW DOES IT MATTER?

Having decided what things might matter, we have to decide in what form those variables should be considered. Do we focus on (for example) the *level* of GDP per capita, its *rate of growth*, or both? Do we consider annual data, or longer-term trends? Do we confine ourselves to rankings, or do we need to quantify the differences (that is, do we take an ordinal or cardinal approach)? A country might rank lowly, but the quantitative difference in its performance might be insignificant (in the measurement or statistical sense).

Again, there is no 'right' answer. Under the "prosperity" heading, we include both levels and growth rates, and for GDP growth we use a three-year moving average to smooth some of the noisier annual fluctuations. And we have looked at standings derived both from simple rankings and from Z-scores (where divergences are expressed in terms of deviation from mean), though here we present raw rankings only.

RESULTS

Overall, considering rankings across the board, the economy which ranks highest both recently and over the 2011-22 period as a whole is one that we rarely talk about: Switzerland (figure 7). It tops the table on durability, but also ranks highly under fairness and prosperity headings too. It is followed by Sweden, and by Germany, which also score strongly under all three headings.

At the other end of the table, Italy ranks lowest most recently (figure 8), and Brazil over the whole period. Spain ranks third lowest recently and overall. They mostly rank lowly under each heading – the exception being Italy, which scores mid-table on durability (perhaps unexpectedly).

FIGURE 7: OVERALL COUNTRY RANKINGS
2011–2022 average

	Overall	Prosperity	Durability	Fairness
Switzerland	1	5	1	3
Sweden	2	6	2	1
Germany	3	8	3	2
Netherlands	4	9	4	6
Australia	5	3	14	4
Canada	6	7	11	7
US	7	2	15	9
UK	8	10	10	5
China	9	4	8	12
France	10	12	6	10
Japan	11	14	7	8
Eurozone	12	13	5	11
India	13	1	13	15
Spain	14	15	12	13
Italy	15	16	9	14
Brazil	16	11	16	16

Source: Rothschild & Co, see remaining in 'Sources' section
Footnote: To calculate the 'Overall' rank, we have first calculated each country's average rank across all 19 variables for each year. We have then calculated the overall average score for each country across 2011-2022, then ranked them. The same process has been repeated for the three categories, using only the relevant variables under each heading (see individual variables in 'Sources').

The highest-ranked major (G7) economy is Germany (pretty consistently), followed by Canada and then the US (less consistently). The lowest-ranked major economy is Italy (very consistently), and the second-lowest is Japan (occasionally it has been France).

Some caricatures strike home: Sweden pretty consistently tops the fairness category, while the US scores highly under prosperity. But there are some unexpected rankings too: India scores very highly under prosperity, which seems odd until you remember that we are including growth rates as well as GDP levels in our rankings, along with population growth. Current incomes can be low, but rates of improvement high. Similarly, Japan scores poorly under the same heading: its high living standards are stagnating, and it has an ageing population.

China – a big economy, but not part of the developed G7 group – ranks unremarkably, scoring well on prosperity, but less well elsewhere.

The UK, home to all that angst and breast-beating, is recently flagging (but see below: this partly reflects measurement issues which understate its recent growth relative to its peers). Nonetheless, it still ranks overall above Japan and Italy in the G7. For the period as a whole it is firmly mid-table. It consistently scores highest under “fairness” (perhaps unexpectedly).

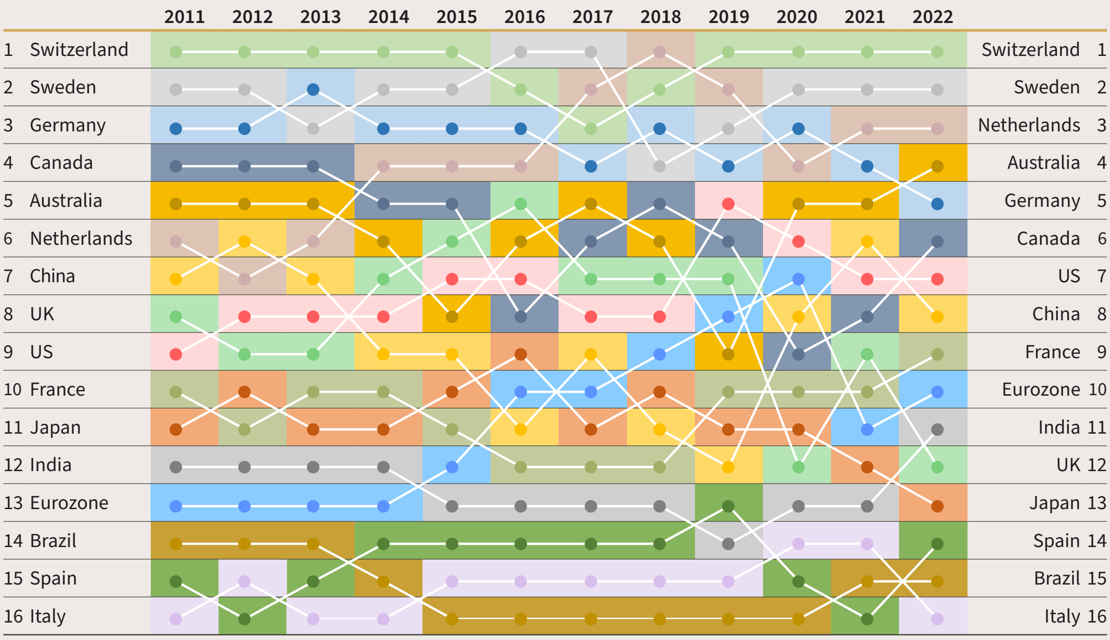
At the risk of stating the obvious, for the lower-ranking big economies in particular, it should be remembered that these are still sophisticated, developed economies, and that their low scores in our rankings do not necessarily imply poor investment performance (see below).

A POST-PANDEMIC MEASUREMENT FOOTNOTE: THE UK VS EUROPE

We do not attempt to adjust for the different measurement methodology that contributes significantly to diverging GDP paths since the pandemic. Specifically, UK statisticians use measures of some public sector activity based on delivery (school lessons, GP appointments), whereas other countries use measures that are based more on incomes (wage bills). When schools closed, fewer lessons were delivered, even though staff were still paid, and UK output appeared to fall further, and has been slower to recover, as a result.

FIGURE 8: OVERALL COUNTRY RANKINGS OVER TIME

2011–2022



Source: Rothschild & Co, see remaining in ‘Sources’ section

Footnote: Each year’s rankings are based on the average score across all 19 variables. If two countries score the same, we have given a higher rank to the one with the better ‘Prosperity’ score.

The UK Office for National Statistics made this point back in 2021[1]. Most recently, the UK Treasury's March 2023 budget report suggested that it can explain all of the measured real GDP divergence between the UK and the major eurozone economies GDP since 2019[2]. Nonetheless, it is still overlooked by most UK commentary, which in the last six months or so has displayed an even more negative home bias than usual.

We have not attempted to adjust for it because comparable time series are not available. But even allowing for this downward bias to the UK's post-2019 relative GDP and productivity performance – which will likely fade as working practices normalise – the UK's most recent performance under the "prosperity" heading ranks above Germany and Spain, for example (figure 10). Its average "prosperity" rank over the full period for which we've constructed rankings (2011-2022) is 10, above France, Italy, the eurozone as a whole and Japan (figure 7).

A LONG-TERM MEASUREMENT FOOTNOTE: THE UK VS THE REST

As noted, the recent negative home bias in UK commentary has been unusually pronounced. The spike in energy bills has been particularly painful here, and domestic politics has been especially trying of late. But some comparative comments seem overstated.

For example, it is reported that recent UK productivity growth trends have been the worst for three hundred years. This seems alarming (which is the point, of course). But at the risk of stating the obvious, it is not that meaningful an observation.

For one thing, if it is difficult to measure the modern economy, it is even more difficult to compile, retrospectively, convincing data for periods when the concept of GDP had not even been imagined. Natural scientists can infer long-ago climates from ice cores, tree rings and the like: economists have nothing as accurate at their disposal when they try to gauge historically-distant economic temperatures.

For another, the UK is one of the few countries for which such long time series are available, and so there is an availability bias. If we had data for other countries, they too might be exhibiting similarly-downbeat historical comparisons – we just don't know.

INVESTMENT IMPLICATIONS

Macro performance must have some impact on investment performance, but so too do many other factors. Corporate earnings are driven by growth, but also by taxes and other variables: China's disappointing long-term stock market performance has not carried into faster earnings per share growth. And our rankings are not driven by growth alone, but by all those other variables. Would we expect fairness to visibly drive stock market performance? It ought to play some role – but would it do so systematically, and in the way that we measure it? Similar considerations apply to the environmental component of our macro scorecard.

Other, much more prosaic considerations matter too. The Swiss stock market generates more than nine-tenths of its earnings outside Switzerland, and the bulk of UK corporate earnings are also made outside the UK. More of Brazil's profits may be made locally – but they are shaped largely by global commodity prices.

[1] International comparisons of GDP during the coronavirus (COVID-19) pandemic, 1 February 2021

[2] Spring Budget 2023, pg 15–16

... we know that what matters is not always measurable, and that what is measurable does not always matter.

More generally, expectations can matter as much if not more than outturns. If India is thought likely to grow quickly, its local stock and bond markets may already be reflecting that. It is consistently one of the more expensive emerging markets (figure 9).

The chances of our scorecard aligning with capital markets are perhaps greatest in the fixed income and currency arenas, which are purer 'macro' plays. Switzerland's real exchange rate has generally been expensive, and its borrowing costs low. Meanwhile, Brazil's currency and bond market can be volatile, as might be Italy's if it were not in the euro. But even there, we doubt that an exploitable link between our scores and investment performance will be unearthed.

Nonetheless, if these rankings help dispel some misconceptions they will be doing a service, by reducing some of the background noise, and allowing investors to ignore some of the more fanciful tales being told.

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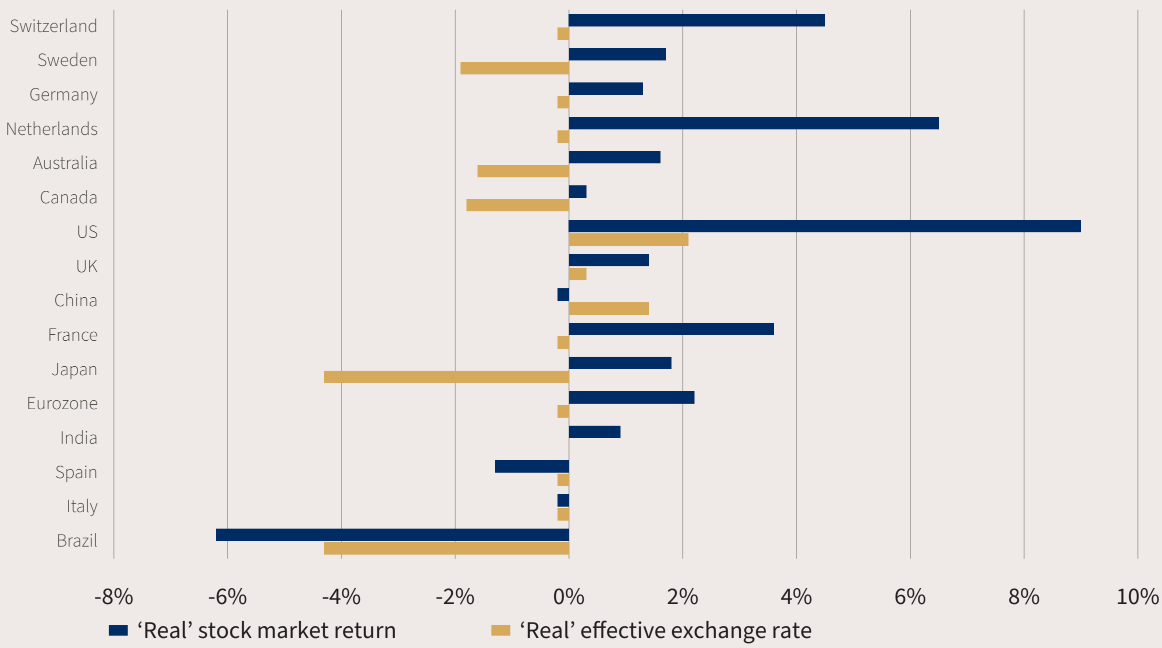
FIGURE 9: STOCK MARKET AND CURRENCY RETURNS

Sorted by country rank (2011-2023*, annualised)



Source: Rothschild & Co, Bloomberg
*Period reflects January 2011 to March 2023. Stock market returns are shown in US dollar, total returns terms, adjusted by US headline inflation.

Appendix: the inputs

These are the 19 variables, grouped according to the sub-headings identified above. In each case, the data are taken from a single source to ensure comparability. Those sources are listed below.

PROSPERITY

The variables under this sub-heading are intended to capture each country's success in generating the flow of real (that is, inflation-adjusted) output, income and spending (at the aggregate level the three things are synonymous), before depreciation, in the domestic arena – namely, Gross Domestic Product (GDP). We are interested in such things ultimately because they hopefully correlate with general welfare (the happiness, or utility, derived from the goods we make and the services we supply – which is not the only sort of happiness that exists, but is the easiest to measure).

This is not the only flow variable that could be used, but it is the most useful and widely-watched. We could use nominal data, for example, but when inflation rates diverge this would mislead us about underlying quantities. Similarly, measures of Net National Product exist, but they are not so readily available and would rarely tell a significantly different story.

We are not so interested in GDP in absolute terms – the sheer size of the US and Chinese economies would otherwise dominate this heading, and size alone tells us little about performance per se. Instead, we focus on **GDP per capita** (in real exchange rate adjusted terms – that is, taking into account the different purchasing powers of local currencies). We also look at **growth in GDP**, and at **growth in GDP per capita**, on a trend basis (to avoid short-term cyclical volatility).

FIGURE 10: PROSPERITY COUNTRY RANKINGS OVER TIME
2011–2022

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Australia	2	2	2	1	2	5	2	3	7	5	2	1
Brazil	9	9	9	11	15	15	15	15	14	9	8	9
Canada	4	5	4	4	7	9	7	6	4	6	8	8
China	3	3	3	4	4	4	3	4	2	4	6	7
Eurozone	12	13	14	14	14	12	11	12	9	11	13	10
France	10	11	11	12	13	13	13	13	10	12	11	11
Germany	7	6	7	9	8	7	9	8	12	10	10	14
India	1	1	1	1	1	1	1	1	3	3	7	3
Italy	16	16	16	16	16	16	16	15	15	13	14	12
Japan	14	12	11	10	11	14	14	14	16	15	15	16
Netherlands	13	13	13	13	10	8	6	5	5	8	4	5
Spain	15	15	15	15	12	10	10	10	13	16	16	15
Sweden	5	4	8	8	2	2	5	8	8	7	4	6
Switzerland	5	8	4	6	6	6	7	7	6	2	3	3
UK	11	10	10	7	9	10	11	10	10	14	11	13
US	8	7	4	3	5	3	3	2	1	1	1	2

Source: Rothschild & Co, see remaining in 'Sources' section

We confine our GDP readings to trends up to 2019 (after which the pandemic seems to have brought differing statistical practices to the fore: see comment above).

We are also interested in how efficiently GDP is produced, and so include trend **growth in labour productivity**, and **corporate profitability** (quoted-sector return on equity, a proxy perhaps for capital productivity). Labour productivity differs from per capita GDP to the extent that employment rates (and working hours) can vary for any given population.

Finally, to incorporate some forward-looking content we include prospective trend **population growth**. In the short term, a growing population means more people to share the cake, other things equal – but on a longer-term view, it is arguably a proxy for future dynamism and growth. Labour is a resource, not a burden.

Not included under this heading, but which arguably could be, are such measures as consolidated total assets – the stock of national wealth, that is, as opposed to the flow of national income. There are two main reasons. First, a practical matter: credible and comparable balance sheet data are hard to get. Second, and more theoretically, the stock might be seen as (largely) simply the cumulation of the flow.

Doubtless we could find other variables to consider. But puritans might suggest using fewer variables, not more: they might argue that (say) growth in real per capita GDP matters above all else, and that the overlap between (for example) output per capita and productivity just confuses things. As we say above, there is no right answer. But there are several distinct strands to the debate about prosperity, and we think our list captures most of them.

DURABILITY

This group of variables we think tells us something about the likely durability of national economies – can current activities be sustained, or do financial and environmental risks suggest bad news lurking further down the road? And not just bad news about GDP and productivity, because otherwise this would arguably be simply an extension of the "prosperity" heading, but broader threats such as financial and constitutional crisis – threats to the national economy as a going concern, perhaps.

FIGURE 11: DURABILITY COUNTRY RANKINGS OVER TIME
2011–2022

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Australia	16	14	16	15	8	15	14	14	13	13	13	11
Brazil	11	12	15	15	15	16	15	16	16	15	15	13
Canada	9	7	7	10	12	12	11	12	11	14	12	8
China	5	5	6	7	7	11	9	10	12	10	8	5
Eurozone	10	9	8	5	6	6	6	5	5	5	5	9
France	6	6	5	6	5	7	7	8	7	6	7	6
Germany	3	3	3	3	2	2	3	3	2	1	4	4
India	15	15	13	13	14	13	13	13	14	12	14	11
Italy	11	12	10	8	9	8	8	7	7	6	9	15
Japan	7	7	9	12	8	5	5	6	6	8	6	6
Netherlands	4	4	4	3	3	3	1	2	3	4	3	3
Spain	11	16	11	8	10	10	12	11	9	9	11	10
Sweden	2	2	2	2	4	4	4	4	3	2	2	2
Switzerland	1	1	1	1	1	1	1	1	1	3	1	1
UK	8	10	12	11	11	8	10	9	9	11	10	13
US	14	11	13	14	13	14	16	15	15	16	16	15

Source: Rothschild & Co, see remaining in 'Sources' section

This sub-heading has the biggest number of inputs of the three, but is arguably the most difficult to capture quantitatively.

We include a measure of **carbon emissions** as a proxy for looming environmental adjustment – whether it takes the form of mitigation or adaptation, or even political disruption – with a low reading being good. **Inflation** is included as a broad proxy for macro risk, as are **10-year government bond yields**: in each case, again, the lower the reading, the higher the ranking. Having both inflation and bond yields in the mix may implicitly capture the real interest rate dimension: a country that has to pay higher real yields may be viewed as more of a risk.

Government debt is widely seen as a threat to financial sustainability, as is the **government deficit** (we include both the stock of outstanding debt and the flow of new borrowing – both scaled by GDP – as they might tell us different things). We also include a measure of the stock of **net international investment** – the country's net assets vis-à-vis the rest of the world – and of the **balance of payments** (the current account, a sort of national flow-of-funds picture), again both scaled by GDP.

Finally, we also include a measure of **export diversification**, the idea being that a country dependent on a narrow range of products or commodities is more vulnerable to shocks than a more diversified economy.

FAIRNESS

The variables grouped under this heading are intended to capture some of the less material aspects of economic life which nonetheless contribute to social well-being. As noted, whether fairness matters more or less than prosperity is a moot point – is inequality really as troubling as poverty? – but not one we discuss here.

Unemployment is related to growth and prosperity, but is also a proxy for fairness: an economy which is growing strongly, but which isn't providing employment for people who want or need to work, is leaving people behind. Joblessness is a key indicator not just of low income, but of poor physical and mental health. **Inequality of income** (measured here by a 'Gini coefficient') is a more direct measure of (un)fairness, as is inequality of wealth, though data on the latter are harder to come by.

FIGURE 12: FAIRNESS COUNTRY RANKINGS OVER TIME

2011–2022

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Australia	3	3	2	4	4	6	6	6	6	2	2	2
Brazil	15	14	13	15	16	16	16	16	16	16	16	16
Canada	5	3	6	7	7	7	7	3	7	8	7	7
China	12	12	12	12	12	12	12	12	12	12	12	12
Eurozone	10	11	11	11	11	11	11	11	11	11	11	11
France	10	10	10	10	10	10	10	10	10	9	10	10
Germany	4	2	3	3	3	2	2	2	2	2	3	3
India	16	16	16	16	15	15	15	15	15	15	15	15
Italy	12	13	13	14	14	14	14	14	14	14	14	14
Japan	8	8	8	9	9	9	9	9	9	7	7	7
Netherlands	5	6	7	5	4	4	4	4	2	6	5	5
Spain	14	14	15	13	13	13	13	12	12	13	13	12
Sweden	2	5	4	1	1	1	1	1	1	1	1	1
Switzerland	1	1	1	2	2	4	4	6	5	5	5	5
UK	7	7	5	5	4	3	3	4	4	2	3	4
US	9	9	9	8	8	8	8	8	8	9	9	9

Source: Rothschild & Co, see remaining in 'Sources' section

The **human development index** captures a number of softer but revealing measures of well-being such as life expectancy, educational standards and Gross National Incomes. The **political risk index** measures such key things as the extent of democracy, government effectiveness and control of corruption – or at least, we hope it does: this is clearly one of the more subjective and unverifiable variables. Finally, the **ease of doing business index** – another of the more subjective measures – tries to capture the business climate, a liberal marketplace being favourable both to choice and to equality (or at least, equality of opportunity, if not of outcome).

SOURCES

Prosperity

GDP growth: IMF GDP in constant prices (annual change, three-year moving average)

GDP per capita: IMF GDP per capita in PPP terms (levels)

GDP per capita growth: IMF GDP per capita in PPP terms (annual change, three-year moving average)

Population growth: US Census population growth forecasts (10-year ahead change)

Productivity: Conference Board GDP growth per hour worked

Profitability: MSCI indices, Return on equity (Bloomberg data)

Durability

Inflation: IMF annual average inflation rate

10-year government bond yields: Year-end yield (Bloomberg data)

Current account: IMF current account balance as a % of GDP

Net international investment: IMF net international investment position as a % of GDP

Government net lending/borrowing: IMF net lending and borrowing as a % of GDP

Government debt: IMF general government gross debt as a % of GDP

Export diversification: UNCTAD diversification index

Carbon emissions: Global Carbon Project CO_2 per person

Fairness

Unemployment rates: IMF data

Gini coefficient: World Bank income Gini coefficient

Human Development Index: UN Development Programme indices

Ease of Doing Business: World Bank indices

Political risk: Bloomberg indices

Economy and markets: background

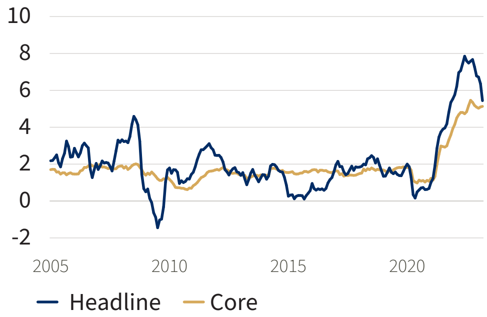
GROWTH: MAJOR ECONOMIES

Business optimism: standard deviations from trend

Source: Bloomberg, Rothschild & Co
Composite of the forward-looking components of manufacturing surveys from China, Germany, Japan, UK and US loosely weighted by GDP

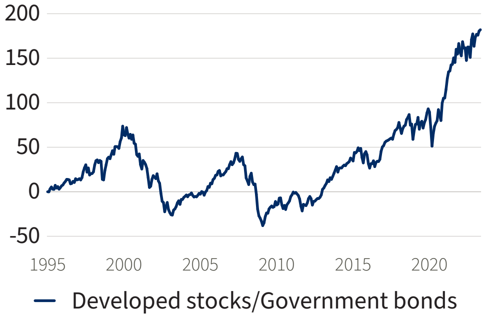
G7 INFLATION

Year-on-year, %



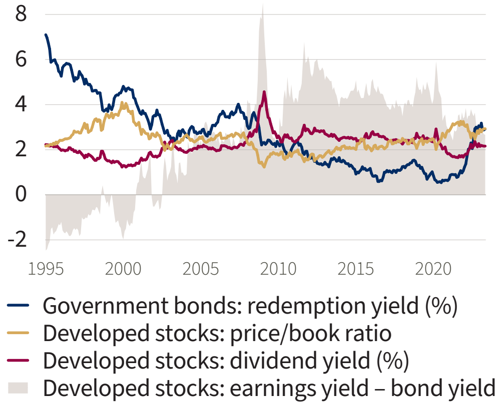
Source: OECD, Bloomberg, Rothschild & Co

STOCKS/BONDS — RELATIVE RETURN INDEX (%)



Source: MSCI, Bank of America Merrill Lynch, Bloomberg, Rothschild & Co

STOCKS/BONDS — RELATIVE VALUATIONS



Source: MSCI, Bank of America Merrill Lynch, Bloomberg, Rothschild & Co

SELECTED BONDS

Current yields, recent local currency returns

	YIELD (%)	1YR (%)	3YR (%)
10-yr US Treasury	3.6	-1.9	-15.5
10-yr UK Gilt	3.7	-10.0	-19.3
10-yr German bund	2.3	-8.7	-19.0
10-yr Swiss Govt. bond	1.0	-0.9	-10.2
10-yr Japanese Govt. bond	0.4	-0.4	-1.9
Global credit: investment grade (USD)	3.6	-1.1	-7.6
Global credit: high yield (USD)	9.2	0.3	11.6
Emerging (USD)	7.4	-0.3	-2.4

Source: Bloomberg, Rothschild & Co

SELECTED STOCK MARKETS

Dividend yields, recent local currency returns (MSCI indices)

	YIELD (%)	1YR (%)	3YR (%)
World: all countries	2.3	2.4	45.6
Developed	2.2	3.2	49.8
Emerging	3.1	-3.9	18.1
US	1.6	1.4	51.1
Eurozone	3.1	11.9	51.2
UK	4.3	8.3	54.9
Switzerland	2.8	-4.6	22.8
Japan	2.4	10.8	55.4

Source: Bloomberg, Rothschild & Co

SELECTED EXCHANGE RATES

Trade-weighted indices, nominal (2000 = 100)

	LEVEL	1YR (%)	3YR (%)
US Dollar (USD)	114	1.0	-1.7
Euro (EUR)	133	6.9	4.5
Yen (JPY)	76	-3.3	-23.0
Pound Sterling (GBP)	80	-1.4	2.1
Swiss Franc (CHF)	186	8.2	10.1
Chinese Yuan (CNY)	141	-3.4	7.4

Source: Bloomberg, Rothschild & Co

COMMODITIES AND VOLATILITY

	LEVEL	1YR (%)	3YR (%)
CRB spot index (1994 = 100)	266	-13.6	126.4
Brent crude oil ($/b)	79	-27.5	200.0
Gold ($/oz.)	1,983	4.5	16.6
Industrial metals (1991 = 100)	342	-19.4	70.6
Implied stock volatility: VIX (%)	16	-51.9	-56.8
Implied bond volatility: MOVE (bps)	128	-0.2	166.4

Source: Bloomberg, Rothschild & Co

Data correct as of
1 May 2023.

Past performance should not be taken as a guide to future performance.

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