INSIGHT

QUARTERLY MARKET REVIEW

Q4 2023

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PODCAST

Shifting sands

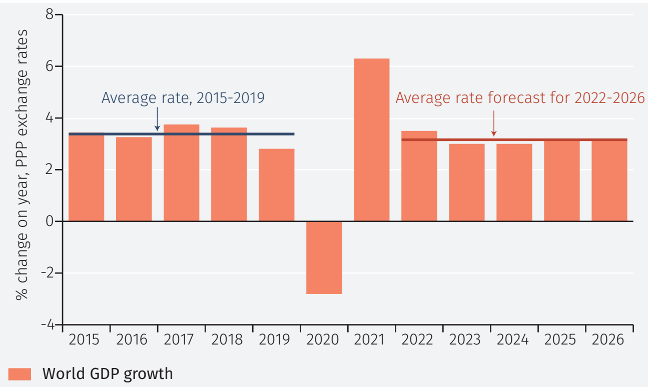
OVERVIEW

World growth in 2023 is set to be a little lower than the pre-pandemic rate but, more importantly, the pattern is changing. Where interest rates settle after the tightening process comes to an end remains key for financial markets.

Shifting sands of global growth

Overall world growth in 2023 seems likely to be a little lower than the rate seen in the years immediately pre-Covid (see Figure 1). But the composition of that growth is changing. The US economy has proved surprisingly strong, with growth running at an annualised rate of around 5% in the third quarter, according to one estimate.[1] In contrast, the German economy remains in (admittedly, a mild) recession. China's growth has been disappointing, especially for those expecting a big surge following the end of the zero-Covid policy. But elsewhere in emerging economies, Brazil's strength has surprised and India is set to be the fastest growing major economy, not just this year, but for the next five years. Its contribution to world growth is set to increase steadily (see Figure 2), albeit still below the contribution of China.[2]

1. World GDP growth



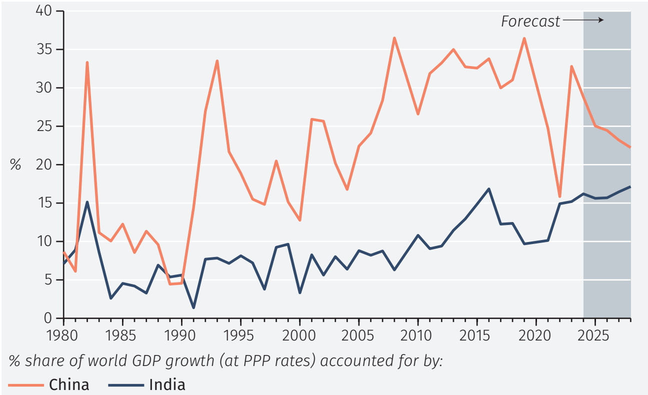
Source: IMF via LSEG Data and Analytics. Data as at 1 October 2023.

These shifting sands of global growth are nothing new. Country, regional and industry-specific patterns of growth vary over time. From the end of World War 2 to the mid-1960s, Italy enjoyed a prolonged economic boom; now it has a stagnant economy and demographic trends which will perpetuate that trend. In the 1970s, Gulf economies boomed as the west suffered from two oil price shocks. In the 1980s, no one seriously thought of the US as a major global car producer and exporter. Now, it is a leader in electric vehicles (EVs). European car makers are finding life difficult, especially as they face the threat of cheap Chinese imports. In the Covid pandemic, there was a worldwide shift from consumer spending on services (travel and entertainment, in particular) to goods (such as working-from home technology), a trend which has now reversed.

US technology lead

The perceived lead of US companies not just in EVs but in technology, especially AI (artificial intelligence), has propelled

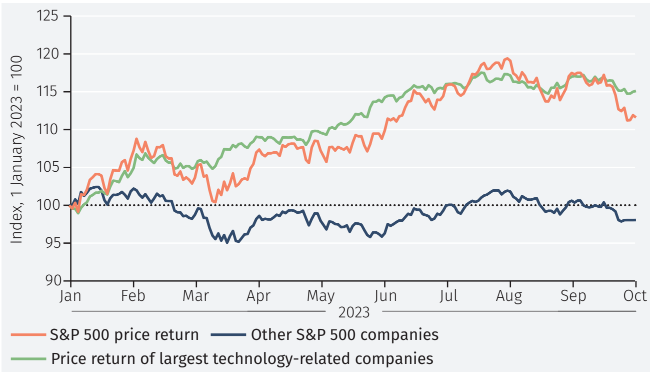
2. Contributions to world growth



Sources: IMF via LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

the strong equity price performance of the largest technology-related companies (see Figure 3). This technological lead combined with strong balance sheets and cash flows mean that they are increasingly seen as defensive, taking on the role conventionally attributed to consumer staples and utilities. Not all technology companies are in such a strong position, of course. For some, profitability may be some way in the future: they are 'long duration' assets and so are sensitive to higher interest rates.

3. US S&P 500 performance



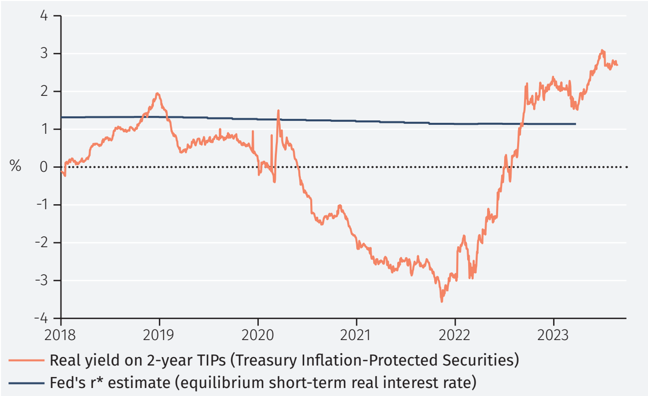
Sources: Refinitiv and EFGAM calculations. Data as at 1 October 2023.
Past performance is not necessarily a guide to the future.

Stars and TIPs

That raises the issue of how close we are to peak policy interest rates and at what level they may stabilise. One answer is provided by the Fed, which has resumed publication of its estimate of r* (r star) – the equilibrium real short-term interest rate which produces on-target inflation and growth at its potential rate. It has been stable for some time: the near-horizontal line at just over 1% shown in Figure 4. If that is correct and the Fed is successful in returning inflation to 2% (or, as we

[1] The Atlanta Fed's GDPNow 2 October estimate is for growth of 4.9% at an annualised rate in Q3 2023. http://tinyurl.com/4dexjas5
[2] See EFG *Infocus*, 'India: A light in a dimming global economy', September 2023. https://tinyurl.com/3c67vwd8

4. Real yields: Back to 'normal'?

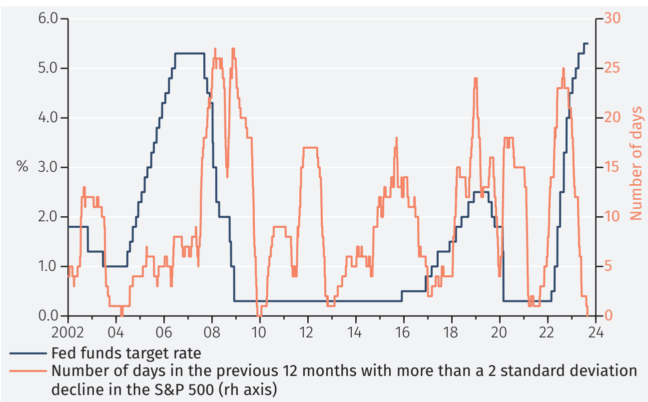


Sources: LSEG Data and Analytics; Federal Reserve Bank of New York. Data as at 1 September 2023.

consider more realistic, sufficiently close to that – say, 2.5%), it suggests a neutral nominal rate of around 3.5%. But this stability of r* is in sharp contrast to the volatility of other real rate measures. The real yield on 2-year Treasury Inflation-Protected Securities has swung from minus 3% to plus 3% over the last two years. The contrast between the steady Fed estimate and the wild ride of market rates raises the question of which measure provides the best guide to equilibrium long-term rates.

When the Fed started to raise interest rates, many were concerned about the implications for economic growth - it could trigger recession – and the equity market – which could suffer due to weaker corporate earnings and already high valuations. Neither has happened. Over the last 12 months there have been no days when the S&P 500 index has fallen by more than two standard deviations – such losses were much more common in the past (see Figure 5). But low equity market volatility has been a temporary phenomenon in the past.

5. Fed funds rate and equity market volatility

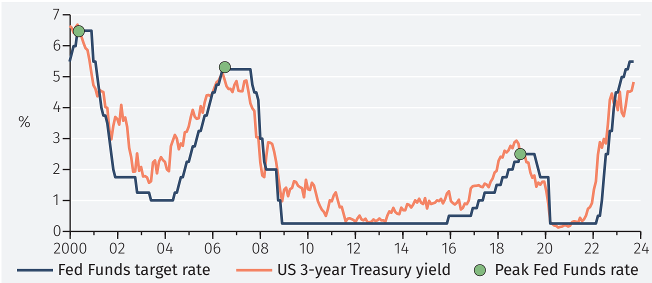


Sources: LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

With interest rates having been raised to pre-2008 levels and, perhaps more importantly, the Fed reducing its balance sheet, a rise in US equity market volatility is feasible.[3]

After the Fed's three previous tightening episodes – interest rates fall back quite quickly. What is clear from those three previous episodes is that 3-year Treasury bonds provided a higher return than shorter maturity, money market investments (see the table below Figure 6). Reinvestment risk can be very high once the interest rate cycle turns. The historic pattern of equity returns in those three periods is mixed: weakness after the interest rate reversals following the June 2000 and July 2006 peaks, but strength after the peak in January 2019.

6. Peak Fed funds and subsequent returns



	Total returns over subsequent 3 years:		
From:	June 2000	July 2006	January 2019
3-year Treasury bonds	29.1%	22.2%	5.8%
3-month Treasury bills	9.1%	8.3%	2.4%
S&P 500	-30.0%	-17.4%	126.9%

Sources: LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

Delayed reaction

Of course, it could well be that the reaction of the US economy to higher rates is simply delayed and that weaker US growth is now in prospect. For some time, we have seen the inverted yield curve as signalling a recession potentially starting around the end of the year. Higher longer-term bond yields feed directly to higher mortgage rates and a weaker housing market; and a weaker housing market has been an important determinant of the US business cycle in the past.[4]

Furthermore, it may be too early to claim victory over high inflation, in which case policy rates may not yet have peaked. And, in a world buffeted by repeated shocks, it is unwise to claim any certainty about what is over the horizon, especially when half the world's population votes for new leaders in 2024.

[3] See EFG *Infocus*, 'Is equity market volatility set to increase?', October 2023. https://tinyurl.com/3688ttat
[4] Edward E. Leamer, 'Housing is the business cycle', *NBER Working Paper 13428*. http://www.nber.org/papers/w13428

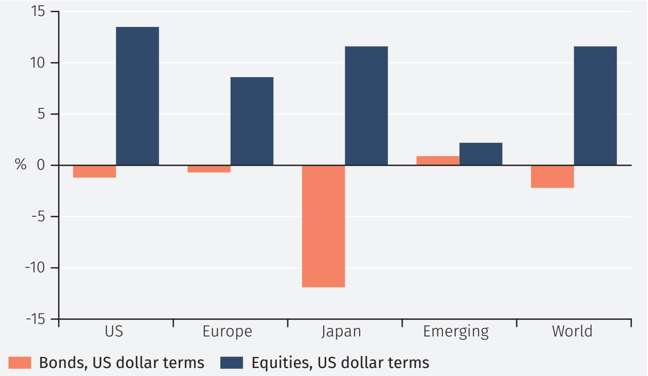
ASSET MARKET PERFORMANCE

The solid gains in equity markets in the first half of 2023 were partly reversed in the third quarter. The third quarter also saw poor returns from bond markets, despite an easing of inflationary pressures.

Asset market performance

Global equity market returns were positive in the first three quarters of 2023. In contrast, returns from global bonds were negative, particularly after poor performance in September. Returns from global equities in US dollar terms were 11.6% in the year to 30 September 2023; from global bonds, minus 2.2% (see Figure 7).[5] Although there were clear signs of an easing of inflationary pressures, and a growing consensus that policy interest rates were close to their peak, bond markets were generally weak in September.[6] Additionally, bond returns in some markets (notably Japan) were undermined by currency weakness. In overall terms (on the basis of its DXY index), the US dollar strengthened by 2.5% in the first three quarters: it gained against the Australian and New Zealand dollars as well as the yen; weakened against the Swiss franc; and was little changed against sterling.

7. Asset market performance

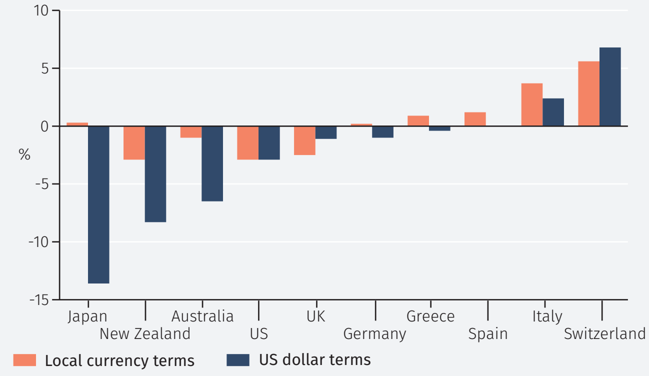


Sources: Barclays Bloomberg (bonds); MSCI (equities). Data for year to date as at 1 October 2023.
Past performance is not necessarily a guide to the future.

Bond markets

In bond markets, volatility and higher yields were the main features of the third quarter. By the end of September, US 10-year bond yields had risen to 4.6%. That was higher than the 3.8% yield at the start of the year and the 3.3% low point of early April. The consequent decline in price meant that, for the year to the end of the third quarter, total returns from US 10-year bonds were minus 2.9% (see Figure 8). Similar local currency returns were seen in the UK. Other bond markets saw stronger performance. In Switzerland, 10-year yields declined, bond prices rose and gains in US dollar terms were further enhanced by Swiss franc appreciation: it was the best-performing bond market in US dollar terms. Japan was at the other extreme, mainly because of the weakness of the yen.

8. Bond market returns

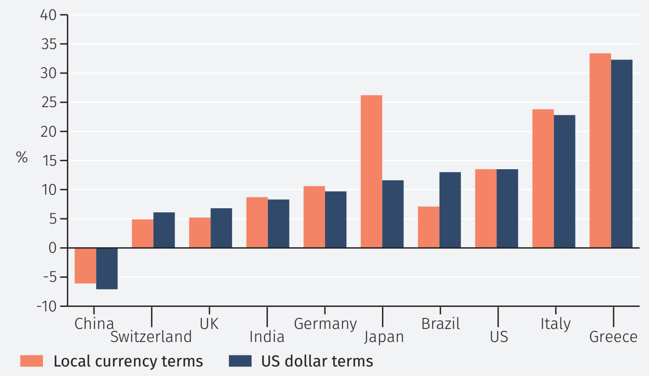


Source: LSEG Data and Analytics. 10-year benchmark bond total returns. Data for year to date as at 1 October 2023.
Past performance is not necessarily a guide to the future.

Equity markets

The overall 13.5% returns from the US equity market in the period owed much to the renewed strength of large cap, particularly technology, stocks after poor performance in 2022 (see Figure 9). Although local currency returns in Japan were particularly strong – over 25% – these were undermined is US dollar terms by the yen's weakness. Concerns about the relatively muted recovery in China's economy weighed on that market. Two European markets – Greece and Italy – produced particularly strong returns.

9. Equity market returns



Source: MSCI. Data for year to date as at 1 October 2023.
Past performance is not necessarily a guide to the future.

[5] Global bond returns are measured by the Bloomberg Barclays Global Aggregate Bond Index, which comprises government and investment grade corporate debt from developed and emerging markets issuers in 24 countries. Global equity returns are measured by the MSCI World Index which represents large and mid-cap equities across 23 developed markets.

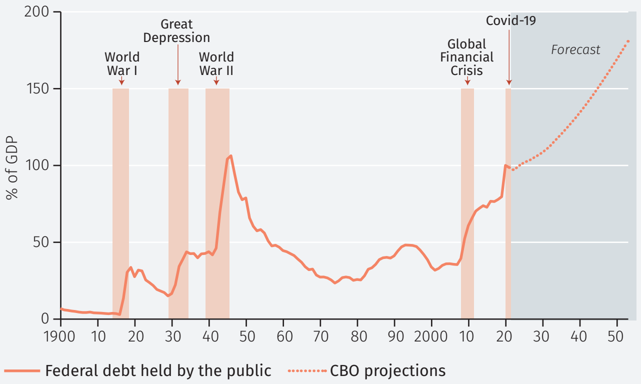
[6] For a discussion of the reasons see EFG *Infocus* publication, 'Thinking about yields and yield curves', September 2023. https://tinyurl.com/yra8y9bz

With the US Fed seen as at, or close to, the end of its increase in interest rates, attention has turned to fiscal policy. Structural pressures are set to keep the federal government deficit high and the debt burden rising. What can be done?

Rising deficits and debt

The US federal government probably ran a deficit in fiscal year 2023[7] of USD 1.7 trillion, around 6.5% of GDP. While that is lower than the Covid-era deficits (just over and just under USD 3 trillion in 2021 and 2022, respectively) there is a concern that deficits are now, structurally, set to remain high leading to a steady rise in the stock of outstanding debt (see Figure 10).

10. Government debt as a share of GDP

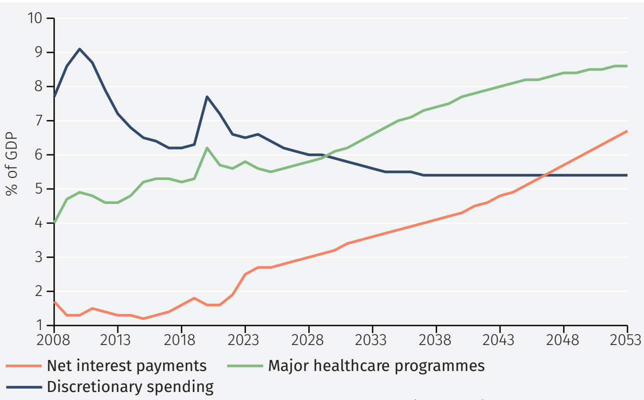


Source: US Congressional Budget Office, Long-Term Budget Projections (March 2023).

Higher interest payments, discretionary spending squeeze

For some time, the longer-term pressures on government spending from increased mandatory spending (particularly on healthcare and social programmes) have been well recognised. The new factor which is expected to put upward pressure on borrowing is higher interest payments on government debt. Not only is the stock of debt higher, but the average interest rate paid on it is now set to be double the rate of the years pre-Covid. Discretionary spending, as a result, will be squeezed in the Congressional Budget Office's projections (see Figure 11).

11. US government spending squeeze



Source: US Congressional Budget Office, Long-Term Budget Projections (March 2023).

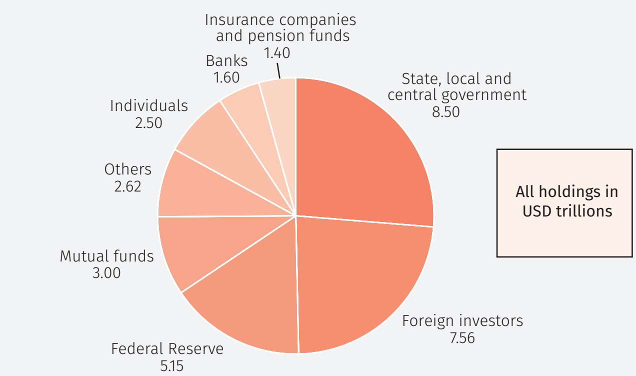
What can be done?

But that might not happen. An alternative would be to just to carry on spending. There are sound reasons for doing so: support for the new green infrastructure and increased pressure on defence budgets, for example, can be seen as essential causes. Taxes could be raised to pay for these so that any deficit increase is avoided. But reversing the tax cuts of recent years (technically, allowing them to expire as they were 'temporary') will be politically difficult. However, deficit reduction is the only feasible way of bringing debt burdens down.[8] 'Inflating away the debt' is sometimes suggested as a way out of the problem. That is, tolerating a higher level of inflation which would reduce the real value of outstanding debt while raising nominal GDP. That would provide only temporary relief (as higher inflation brings higher interest rates). Another option - default - must surely be unconscionable.

Continued pressure

But pressure to rein in deficits may come from foreign holders of US government bonds (see Figure 12). Already, large foreign holders of US Treasuries (Japan and China in particular) have reduced their holdings. In the 1980s and 1990s periodic 'buyers' strikes' forced bond prices and the value of the US dollar down, putting pressure to tighten policy. Similar pressures do not look imminent but the rise in bond yields seen in recent months may be a foretaste of greater pressures to come.

12. Holders of US Treasuries



Source: US Treasury via LSEG Data and Analytics. Data as at 1 October 2023.

[7] The fiscal year runs from 1 October to 30 September.

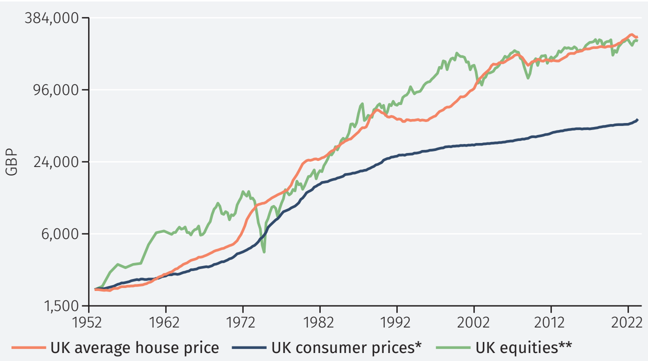
[8] See *Living with High Public Debt*, Serkan Arslanalp and Barry Eichengreen, in paper presented at the Jackson Hole Symposium, August 2023

UK house prices are closely watched for three reasons: their influence on household wealth; their impact on consumer confidence and consumer spending; and as a general barometer of the perceived state of the economy.

Safe as houses?

Popular discussion of UK house prices often includes a comment about how substantial the rise in prices has been over a long period of time. That is true. One measure of average UK house prices shows that they were just under GBP 2,000 in 1952 but are now around GBP 250,000. House prices have doubled seven times over that period. That is well ahead of the rise in average consumer prices. Although housing's historic inflation-beating credentials are clear, UK equity prices have broadly matched the rise in house prices, admittedly with more volatility (see Figure 13).

13. Safe as houses?



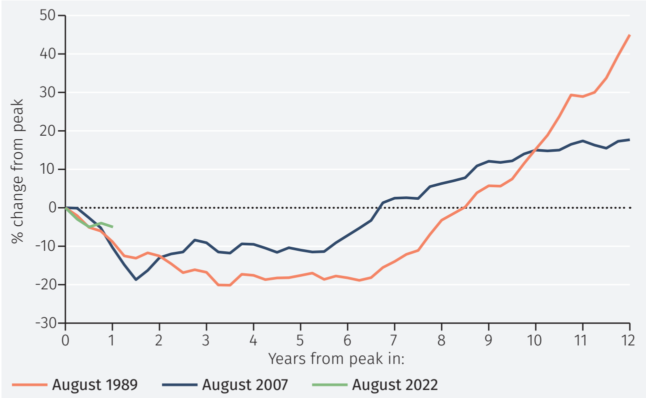
*Retail Price Index from 1952 to 1988 Q1; Consumer Price Index afterwards, rebased to 1952 house price.
**FT30 price index from 1952 to 1962; FTSE All-Share price index afterwards, rebased to 1952 house price.
Sources: Nationwide; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

House price falls in nominal...

However, as with all asset prices, house prices do not rise in a smooth manner. Indeed, another element of the popular discussion is the extent of short-term house price declines. There have been two major periods of decline in nominal house prices, both preceded by strong price appreciation. These followed the peaks in house prices in 1989 and in 2007. After both, the decline in average prices, which took between 18 months and three years, amounted to around 20% (see Figure 14). In both periods 'negative equity' became a phenomenon: a house valuation lower than the outstanding mortgage secured on it.

Prices took a long time to regain their previous peaks: six years after the 2007 peak and eight years after the 1989 peak. Bad memories of negative equity did condition expectations of owner-occupied housing as an investment after the 1989-late 1990s period. But they were relatively quickly dispelled by the phenomenon of home equity withdrawal ('using your home as an ATM') which took hold before the 2007 peak. Home equity withdrawal is no longer an important phenomenon (reflecting a more cautious approach on behalf of households and the suppliers of credit).

14. UK house prices: declines from previous peaks



Sources: Nationwide; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

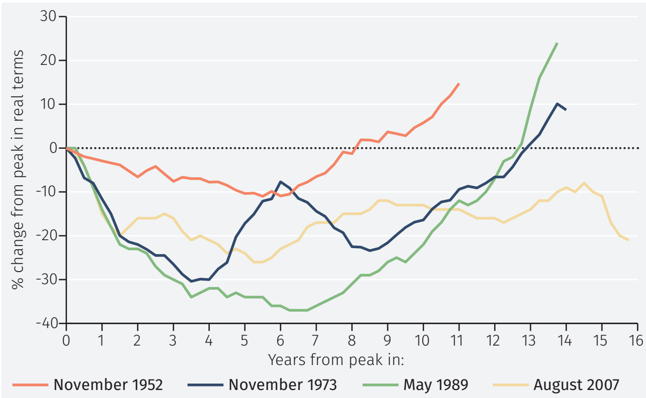
More recently, house prices seem to have peaked in August 2022. So far, the 5% decline over twelve months is in line with those seen in 1989 and 2007.

...and real terms.

In the inflationary decade of the 1970s, house prices recorded only very modest short-lived falls in nominal terms, but real house prices saw substantial declines, as they did in three other periods (see Figure 15). In the 1970s, house prices essentially moved sideways for more than ten years and real house prices are still 20% below their August 2007 peak.

Houses may well have provided a good long-term nominal and real return in the past. But in the short-term, nominal and real price declines have been common.

15. UK house prices: declines from previous peaks (real terms)



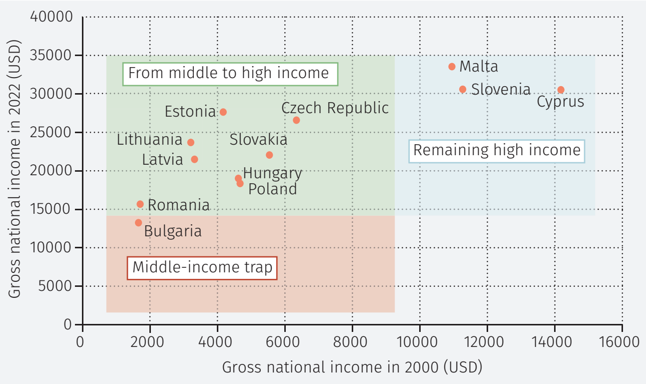
Sources: Nationwide; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

Enlargement of the EU is back on the agenda, notably with the potential membership of Ukraine. It can take some years for new countries to be admitted. But, when they are, increased prosperity can be expected.

Enlargement of the EU has been a success

The European Union has expanded a number of times in its history. In 2004, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia joined. In 2007, Bulgaria and Romania. In 2013, Croatia. Nine of these thirteen countries made the transition from middle to high income between 2000 and 2022 (see Figure 16).

16. EU enlargement: avoiding the middle-income trap



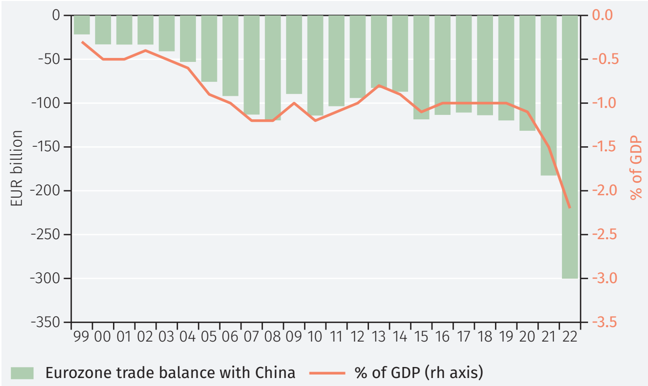
Sources: World Bank; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

That is a significant achievement, especially in the context of the general global problem of countries tending to be stuck in the 'middle income trap'. Of the recent accession countries, only Bulgaria has failed to make that progression. The explanation lies not just in EU membership itself, but rather in the measures that are required to be accepted. In particular, to join the EU, a country needs to fulfil economic and political conditions called the Copenhagen criteria, which require a stable democratic government that respects the rule of law, and its corresponding freedoms and institutions. Meeting those criteria is no easy task. Of the 13 countries which joined between 2004 and 2013, the average time from application to membership was 10 years. The calls for another round of expansion – for up to nine new countries – should be seen in that context.[9]

But sands have shifted

The nature of the EU has, of course, changed over the years. The UK has left. Germany's economy has changed, with recent concerns that is once again the 'sick man of Europe'. It faces a '3D' set of structural problems: increasing defence spending (under pressures from NATO, particularly the US and the war in Ukraine); decarbonisation of its economy, especially after the closure of its nuclear power capacity; and digitalisation – a process in which Germany lags. For example, the process of registering a new company takes 120 days, far longer than

17. Eurozone trade balance with China

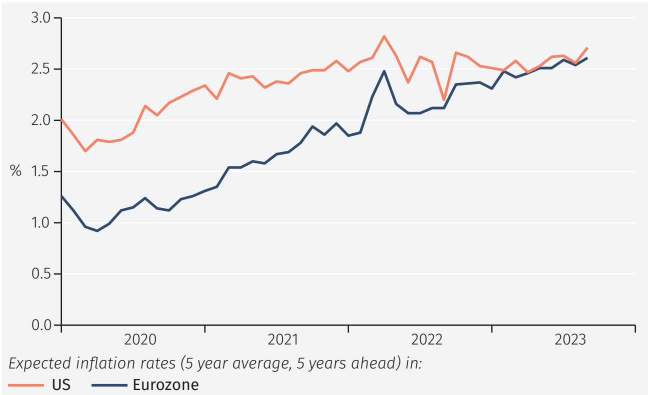


Source: LSEG Data and Analytics. Data as at 1 October 2023.

in Estonia, an economy which has embraced digital technologies.

Germany is no longer an economy propelled by strong exports. The trade deficit that the eurozone has with China (see Figure 17) is described as "the highest in the history of mankind" by Jorge Toledo, EU ambassador to China. Germany's low inflation credentials, acting as an anchor for the entire eurozone, are also in question. Eurozone inflation expectations are now in line with, rather than comfortably below, those in the US (see Figure 18).

18. Expected inflation rates (5-year average, 5 years ahead)



Sources: Nationwide; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

Despite, or perhaps because of, these concerns eurozone equity markets are attractively priced relative to other markets and the euro is fairly valued. Europe has risen to difficult challenges in the past. Another test of that ability is just starting.

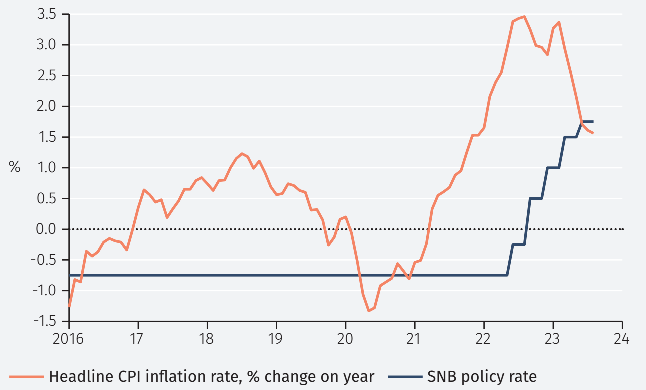
[9] See 'Why the EU must get bigger', *The Economist*, 6 October 2023.

The Swiss National Bank (SNB) has maintained its policy interest rate at 1.75% in what is seen as a 'hawkish pause'. Considering the delayed effects of past tightening, we think interest rates may well have peaked.

The SNB's 'hawkish pause'

The Swiss National Bank (SNB) left its policy interest rate unchanged at 1.75% in September. The central bank noted that past "significant tightening of monetary policy" is helping to limit inflation, suggesting it is more confident that financing conditions are tight enough to maintain price stability (see Figure 19).

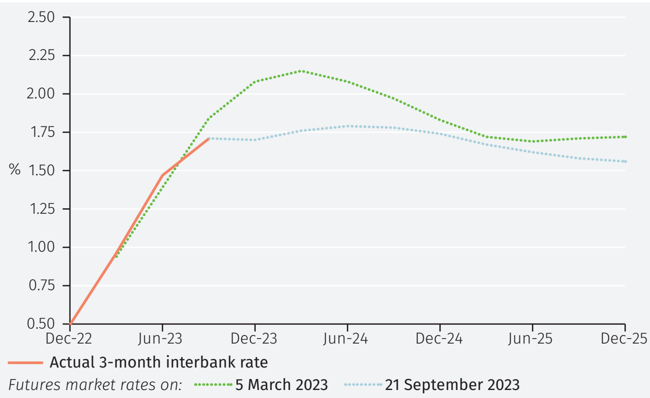
19. Switzerland: inflation and policy rate



Source: LSEG Data and Analytics. Data as at 1 October 2023.

However, the central bank did not rule out higher interest rates in the future. It can be seen as a 'hawkish pause'. The SNB's bias reflects the fact that its new conditional forecasts anticipate inflation rising above 2% in 2024 before stabilising at 1.9% from 2025. That would be just within the SNB's 0-2% target range. The expected inflation rebound reflects announced increases in energy prices and rents (which are indexed to mortgage rates). High inflation in the eurozone could also spill over to Switzerland. Hence, tight monetary policy is considered necessary to lower domestic demand and support the Swiss franc.

20. Switzerland: three-month interest rates



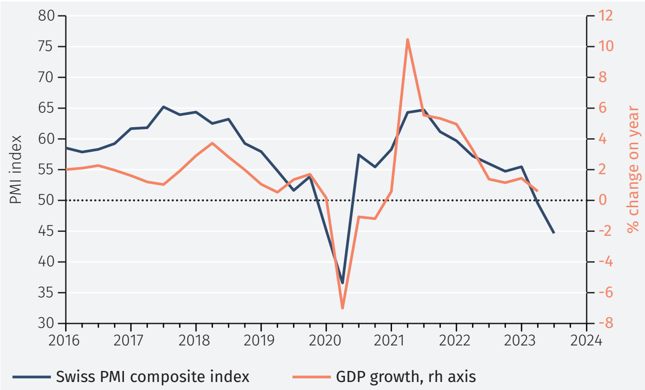
Source: LSEG Data and Analytics. Data as at 1 October 2023.

Futures contracts anticipate that Swiss short-term rates will stay around their current level until the end of 2025 (see Figure 20). Future interest decision by the SNB, as for the US Fed, will be data dependent. That being said, there are reasons to believe that, barring new shocks, Swiss policy rates have peaked. Indeed, we think there will be room to reduce them earlier than markets anticipate.

This scenario is supported by the recent trend in prices most sensitive to the SNB's policy: since February, services prices have risen at an annualised pace of less than 1% while core goods prices have fallen.

Another factor dampening Swiss inflation is the strength of the franc: in trade weighted terms, it is more than 5% stronger than a year ago. Furthermore, the SNB, which sold over CHF70 bn of foreign currency reserves in the first half of 2023 in order to support the franc, is likely to continue to intervene in foreign exchange markets to complement its interest rate policy.

21. Switzerland: business confidence and GDP growth



Source: LSEG Data and Analytics. Data as at 1 October 2023.

Loss of economic momentum

Furthermore, the Swiss economy has lost momentum (see Figure 21). Annual GDP growth in the second quarter was 0.6%, below the potential rate of around 1.5%. Business and household confidence fell over the summer. It is possible that GDP will contract in the second half of 2023. Absent a recovery of the global business cycle, Swiss growth is likely to remain anaemic in 2024.

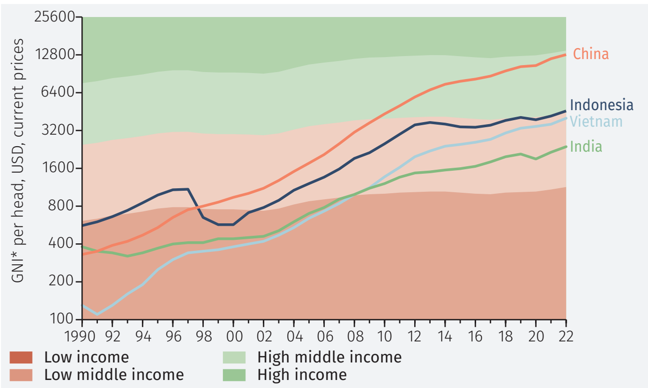
The SNB's hawkish pause seems appropriate to balance still high inflation against the downside risks to the economy. But given the moderation in underlying inflation and a strong currency, Swiss interest rates have likely peaked at 1.75%.

China has been the economic success story in Asia over the last two decades. But India is emerging as a more important global power and has great potential, while Vietnam's economic progress is rapid.

China's progress

China's rapid economic development in recent years has seen it transition from being, on the World Bank's classification, a low income economy, to one at the top of the high middle income bracket (see Figure 22). It may well break through to the high income category soon (that is, with GNI, Gross national income per capita, above USD 13,845 – China currently stands at USD 12,850). Martin Wolf recently noted that if China's per capita income rose to the level of Portugal (requiring it to double), China's GDP would be as large as all the western economies combined.

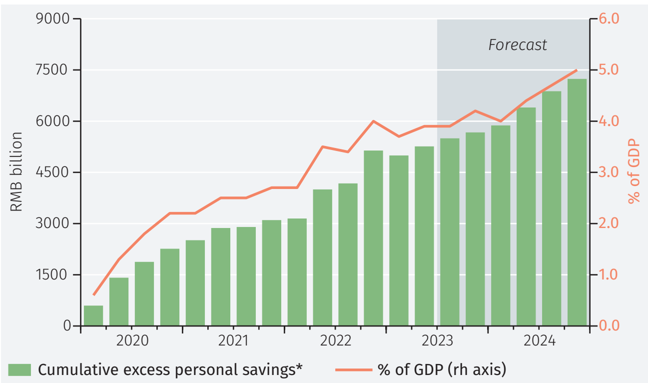
22. Asian income levels: China, Indonesia & Vietnam



*Gross National Income. Sources: World Bank; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

Yet, the current mood is downbeat. Housing, for so long a propellant of growth and accounting for a quarter of GDP, is now a drag. Chinese leadership both domestically and on the global stage is being questioned. China's consumers are cautious. One measure of the latter is accumulated excess savings (see Figure 23). These continue to be accumulated, in contrast to the run-down of Covid-era savings seen in other economies (notably the US). Corporate sector savings also remain high. Domestic demand growth is, consequently, restrained.

23. China: excess savings



*Savings rate relative to 2018-19 average.
Sources: Oxford Economics via LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

One reason for the caution is that much of the economic expansion in recent years was fuelled by higher debt levels, which in turn facilitated a construction and property boom. Private sector debt rose to a level (well above 100%), and by an amount (more than 30 percentage points over 5 years) which has ended badly – a major growth slowdown or a financial crisis – in other economies.[10]

Indonesia's economy was set back after a similarly rapid credit expansion in the mid-1990s (see Figure 24). Since then, it has been moderate. In India, private sector credit growth has not been excessive, on this assessment. Furthermore, India's state-owned banks appear to have made good progress in strengthening their balance sheets.[11]

24. Asia: private sector credit

Source: BIS via LSEG Data and Analytics. Data as at 1 October 2023.

India versus Vietnam

India and Vietnam are both benefitting from a shift in supply chains away from China. Vietnam has a much smaller population (100 million) than India, but it has a similar demographic profile: around half the population are under the age of 35. Both economies have lower labour costs than China. Previously Vietnam was the greater beneficiary of western outsourcing but India is now catching up significantly, helped by recently introduced supportive policy, which has benefitted areas such as textiles and low-end IT manufacturing. In the short-term, India seems to be in a stronger economic position than Vietnam, with the latter struggling from a property sector downturn and funding issues affecting consumer confidence.

[10] 'Credit Booms – Is China Different?', *IMF Working paper WP/18/2*, January 2018.
[11] See https://www.economist.com/finance-and-economics/2023/05/11/indias-once-troubled-banks-are-generating-huge-profits

Much attention will be on Brazil as the G20 presidency is passed to it in late 2023. Brazil has the potential to lead the world on a sustainable growth trajectory; realising that potential will be trickier.

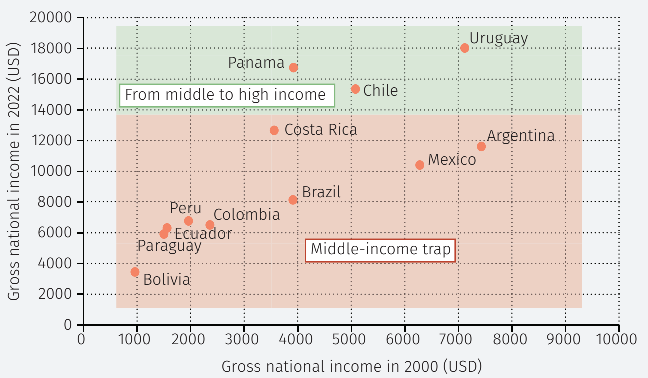
Brazil: the country of the future

"Brazil is the country of the future... and always will be" commented Charles de Gaulle about Latin America's largest economy in the 1960s. That assessment seemed harsh at the time. And in the 1970s, when Brazil enjoyed rapid economic growth it seemed wrong. But that growth spurt proved short-lived. By the early 1980s Brazil was embroiled in the Latin American debt crisis.

In 2001, optimism about Brazil's future returned as it became one of the four BRICs, a set of four economies considered to be in a strong position to grow. Indeed, rapid growth, driven by the strong rise in commodity prices over the 2000-2012 period, materialised, But, again, this was not sustained. Brazil's gross national income per head was just under 10% of the US level in 2000; in 2022 it was still around 10%.

This means Brazil has been stuck in the 'middle income trap' along with all the other large Latin American economies. Only three smaller economies – Chile, Panama and Uruguay – have progressed to high income status since 2020 (see Figure 25).

25. Latin America: few have escaped the middle-income trap



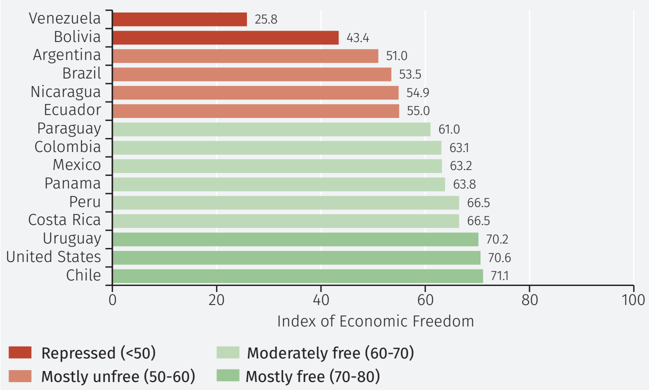
Sources: World Bank; LSEG Data and Analytics; EFGAM calculations. Data as at 1 October 2023.

But in one other area, Brazil's can rightly be seen as a leader. In control of inflation, the central bank, made independent as recently as February 2021, has set an example to other economies in raising interest rates early and successfully curbing inflation.

Argentina: another recipe

Recurrent weak growth and high inflation have plagued many other Latin American economies. In that context, it is no surprise that new, innovative solutions are often sought. In Argentina, for example, the one-for-one peg of the peso to the US dollar from 1991 did help bring inflation down. But by hurting Argentina's competitiveness, inducing a recession, hampering fiscal stability and commercial banks' solvency, the policy was abandoned in 2002. Now, a new approach – involving dollarisation and the abolition of the central bank – is favoured by Argentina's presidential hopeful Javier Milei. We are sceptical about the prospects for success with such a policy.[12] Rather, lasting success for Latin America more likely hinges on pro-market reforms: economies with greater economic freedom, on one measure, have generally performed better (see Figure 26).

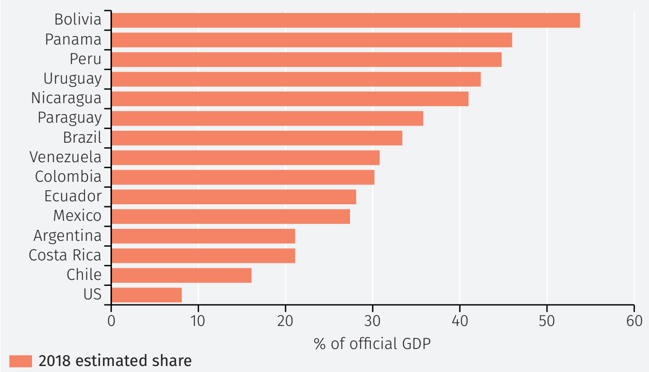
26. Index of Economic Freedom



Source: Heritage Foundation. Data as at 1 October 2023.

Unfettered freedom can be chaotic, of course. Reducing the size of the informal economy – which accounts for almost half the size of some Latin American economies (see Figure 27) – would also help growth and prosperity.

27. Size of the informal economy



Source: 'Understanding Informality', Elgin, C., M. A. Kose, F. Ohnsorge, and S. Yu. 2021, *C.E.P.R. Discussion Paper 16497*, Centre for Economic Policy Research, London.

[12] See EFG *Infocus*, 'Argentina: on the verge of another crisis?', October 2023. https://tinyurl.com/3a4ss2ah

SPECIAL FOCUS: IS THE G20 FIT FOR PURPOSE?

Since the mid-1970s, various country groupings have been formed, amended and extended with the purpose of co-ordinating international policies. How useful and effective are these groupings?

The G20's significance

The Delhi G20 Summit in September 2023 brought attention to the role of India on the world stage, but at the same time highlighted the tensions between some of its members. With the world's main issues being global in nature, however, and the G20 representing a large proportion of the world's GDP and population it is an important forum for discussion and, hopefully, action. As Martin Wolf has commented, "If the G20 did not exist, we would have to invent it".[13]

A diverse grouping

The G20 is certainly not a homogenous grouping. One way of looking at it is, as the IMF does, to split it between advanced and emerging economies (see Figure 28). Furthermore, the G20 advanced economies can be seen as the G7 plus two other countries – Australia and South Korea – and one country grouping – the EU.

Similarly, the G20 emerging economies can be viewed as the BRICS[14] plus five other economies – Argentina, Mexico, Indonesia, Saudi Arabia and Mexico – and one country grouping – the African Union. The latter became a member of the G20 only in September: the name of the group has not (at least, yet) changed from G20 to G21. But it could probably better be named the G100, reflecting its country and country-grouping representation.[15]

Together, the G20 economies are expected to have a GDP of USD 94 trillion in 2023, 89% of the global total; a population of over 5 billion, 79% of the world total; and account for three quarters of the world's CO2 emissions.

Fit for purpose?

But that broader representation has prompted some to question its importance, notably Gordon Brown.[16] He was UK prime minister when the UK had the G20 presidency in 2009 and a collective response to the Global Financial Crisis was agreed. Now, however, Brown sees the G20 as much less important because of "the shift from a unipolar to a multipolar world, from a hyper-globalised economy to one that might be called 'globalisation lite' and from neoliberalism toward neo-mercantilism."

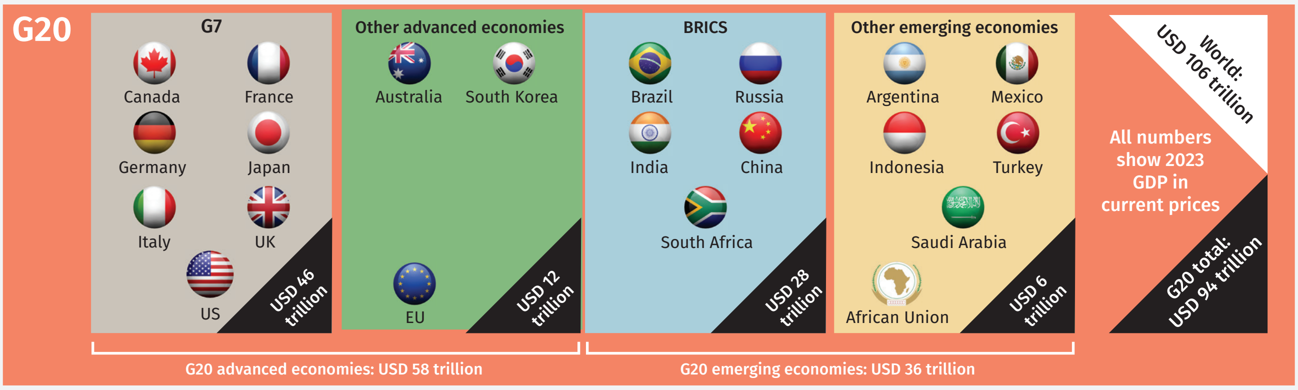
Exclusions

Other issues have also been raised. Despite the G20's breadth, important economies are excluded. Three of only the four economies in the world judged 'free' by The Heritage Foundation[17] – Singapore, Switzerland and Taiwan – are not included.[18] Eight of the G20 economies have levels of corruption that are seen as high enough to compromise economic growth.[19] Hong Kong, Ukraine, Israel and all the Gulf economies (apart from Saudi Arabia) are not included. Most Latin American economies are not included (Argentina and Brazil are members). None of the 10 ASEAN economies are included.

G- Zero

Of course, widening membership further could be a recipe for an even greater 'cacophany of competing voices' as meetings of such international bodies have been described by Ian Bremmer. He sees a G-Zero world in which no one country (or country group) is willing or able to assume global leadership.[20] That seems too pessimistic. "Jaw Jaw" as Winston Churchill commented is better than "War War".

28. G20: a dissection



Source: Current price GDP data are IMF forecasts for 2023. Data as at 1 October 2023.

[13] https://www.ft.com/content/53256c79-5d17-48f0-b604-80c28a2c1a48
[14] The BRICS grouping has itself been widened to include Iran, Saudi Arabia, the United Arab Emirates, Egypt, Ethiopia and Argentina..
[15] The G7 plus Australia and South Korea, the EU (27) minus the 3 in the G7 but adding the 2 EU representatives plus the BRICS (5), the other emerging economies (5) and the African Union (55) minus the one already in the G20 (South Africa) plus one African Union representative.
[16] Gordon Brown Fixing Global Governance. Project Syndicate 25 September 2023. https://tinyurl.com/y8wbr7nh
[17] https://tinyurl.com/4fx7hnmn
[18] Ireland, the fourth, is represented as an EU member state.
[19] Transparency International Corruptions Perception Index. Data as at 1 October 2023.
[20] https://www.gzeromedia.com/gzero-world-with-ian-bremmer/

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