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STRATEGIES

The U.S. Stock Market Towers Over the Others. But at What Cost?

By Jeff Sommer

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Much of the world has recovered from the global financial crisis of a decade ago, but one market has prospered above virtually all others: the United States stock market.

In addition to outpacing other major markets, the American market has outstripped the growth of the United States economy to such an extent that it is a global outlier. Whether the surge — which has helped fuel economic inequality in the United States — can continue, and what the domestic and global consequences might be, are unresolved questions.

The American market's exceptional performance stands in stark relief in a global survey of post-crisis markets and economies published this month by the Brookings Institution and conducted by Eswar Prasad, a Cornell University economics professor and senior fellow at Brookings, and Karim Foda, a former associate fellow at the institution.

"There has been a disconnection between stock markets and economies around the world, with stock markets generally outperforming their economies," Professor Prasad, a former International Monetary Fund official, said in an interview. "But the United States stands out. There's a much greater degree of outperformance and disconnection from domestic economic growth. And you don't typically see a disconnect like this for such a long period."

The Brookings survey shows, for example, that while the two biggest emerging market economies — those of China and India — have grown far faster than America's in the past decade, those countries' stock markets have not fared as well as their American counterpart. India's stock gains were substantial in its local currency, the rupee, but were almost eliminated when translated into dollars. The Chinese stock market has actually lost value since the financial crisis.

Since the end of 2007 through June of this year, the survey says, gross domestic product in the United States grew by 18 percent, after adjusting for inflation. "The U.S. leads the pack among major advanced economies," the report says, while noting that the American economy's growth trailed that of emerging market economies like those of China and India.

In nominal terms, without the inflation adjustment, gross domestic product in the United States grew more: 38 percent. But the Standard & Poor's 500-stock index nearly doubled from December 2007 through August 2018, a better return than other major stock markets experienced.

This trend — stock markets growing much faster than domestic economies — also appeared in advanced economies like those of Britain, France, Germany, and Japan, but it was much more extreme in the United States, the report says.

The American stock market's outperformance can be explained by factors like the rising share of corporate profits in the domestic economy and by the sheer force of American financial power on a global scale, Professor Prasad said.

Although the United States contributed mightily to the global financial crisis, it has been a source of financial stability for most of the last 10 years, attracting investments from around the world. The dollar has strengthened against most other currencies in that time, becoming, if anything, an even more central part of the world financial system, he added.

What's more, the dollar's strength has magnified the outperformance of the American stock market when compared against markets in most other countries.

India outpaced the United States in economic growth, and its stock market rose roughly 90 percent from December 2007 through last month, almost as much as the American stock market did, when both are tracked in their domestic currencies. But the Indian rupee lost ground against the dollar, and its weakness has wiped out most of the value of its stock market's gains: When converted into dollars, the Indian stock market rose only 6 percent.

China is the rare country whose currency, the renminbi, actually has strengthened modestly against the dollar since the end of 2007. But that was not enough to offset the decline of the Shanghai stock market, which fell 48 percent in renminbi and 45 percent in dollar terms.

The Chinese stock market, like the United States market, is an outlier, Professor Prasad said, but in a radically different dimension: The Chinese market has significantly trailed other markets as well as the Chinese economy.

One reason is that the Chinese stock market, to an even greater degree than the United States stock market, represents only a small slice of the country's overall economy. Publicly listed Chinese corporations, Professor Prasad said, tend to suffer from endemic structural problems: high debt levels, poor accounting disclosure and weak governance. Until these problems are solved, China may be risky for global stock investors.

The United States stock market, which has been a global magnet, is rife with its own anomalies. For one thing, Professor Prasad said, stock market growth has exceeded G.D.P. growth by so much and for so long that it bears close attention. “Over long periods there is typically a close correlation between stock market growth and economic growth,” he said. “And this is already a long period.”

That does not mean that the American stock market will necessarily fall soon. It is being supported by several macroeconomic factors, aside from cash inflows from foreigners. Corporate profits, supported in part by tax cuts and relaxed regulation and low interest rates, have been rising more rapidly than the G.D.P., while wage growth has been constrained.

Because stock ownership is concentrated among richer people, the rising market wealth has exacerbated economic inequality in the United States. “Most of the stock market wealth has been going to those who are already very rich rather than to the poor,” Professor Prasad said. “The disconnect between the stock market and the real economy is manifest in the disconnect between corporate profits and real wages. It has potential sociopolitical implications.”

In short, the American stock market could well keep rising for some time. But that might increase domestic political tensions, if increasing corporate and stock market riches are not accompanied by broad-based growth in wages.

From a global perspective, the American stock market appears to be attracting capital that might otherwise bolster other markets and economies. The United States market is exceptional and it has enriched stock investors. But the decade of outperformance has incurred mounting costs.

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