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2011 Economic Report Card: Room for Improvement

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With the global economy dealing with a myriad of challenges in 2011, the overall economic performance in the industrialized world left much to be desired. For instance, an already lacklustre performance for the OECD economies took another step back this year according to our measure of economic health. Since the late 1990s, we have been tabulating a year-end report card for the major industrialized economies, and Canada's score of 81.6 on our **Economic Performance Indicator (EPI)** this year is the second highest in the G7 (behind Germany). Still, it was up just a tick from last year, which represented the lowest grade for Canada since 1994.

TABLE 1

ECONOMIC PERFORMANCE INDICATOR

2011

	Inflation (%)	Jobless Rate (%)	Budget Deficit (% of GDP)	Current Account Deficit (% of GDP)	Credit Rating Factor *	Overall Grade (EPI)
Canada	2.9	7.5	5.0	3.0	0.0	81.6
U.S.	3.2	9.0	10.0	3.1	3.0	71.7
Japan	-0.8	4.6	8.9	surplus	9.0	76.7
U.K.	4.5	8.0	9.4	0.6	0.0	77.5
Germany	2.5	7.1	1.2	surplus	0.0	89.2
France	2.2	9.8	5.7	2.3	0.0	80.0
Italy	2.9	8.3	3.6	3.6	12.0	69.6
Euroland	2.7	10.1	4.0	surplus	6.5	76.7
OECD	3.1	8.0	6.6	0.6	6.6	76.3
China	5.4	4.1	2.2	surplus	9.0	80.3
Greece	3.2	16.6	9.0	8.6	51.0	11.6
Portugal	3.6	12.5	5.9	8.0	27.0	43.0
Spain	3.1	21.5	6.2	4.0	9.0	56.2
Ireland	1.2	14.1	10.3	surplus	21.0	55.8

* 3 demerit points for every notch below AAA (S&P Foreign Debt Rating)
Credit rating factors for Euroland and OECD weighted by credit ratings of member countries

Our Economic Performance Indicator (EPI) is an upgrade on the traditional Misery Index. We take CPI inflation and the unemployment rate into account, but also consider a country's budget balance, current account balance and its foreign currency credit rating (from S&P). The last variable was a new addition in 2007, replacing per capita GDP growth, and is playing an increasingly important role in the grades, with many sovereign ratings under the microscope. The index is constructed by subtracting inflation (or deflation), the jobless rate, and the budget and current account deficits (as a share of GDP) from 100. If a country runs a budget surplus or a current account surplus, these are treated as zero (no bonus points for hoarding large surpluses). Finally, we deduct a further 3 points for every notch a country is rated below AAA.

So, a country with no unemployment, no inflation, twin surpluses, and a triple-A credit rating would score 100. (The closest any G7 country has come to a perfect score in the past 30 years was Japan in 1988, when it had near-zero inflation, a 2.5% jobless rate, and boasted a sea of surpluses. Canada's highest mark in the past 40 years was 91.8 in 2007.)

Canada's 2011 EPI of 81.6 will be up 0.1 ppts from last year's tally, with the modest improvement due to a narrower budget deficit and a lower unemployment rate (7.5% versus 8.0%), offsetting a higher inflation rate (2.9% versus 1.8%). The credit rating remained AAA, and was thus not a factor. We foresee a slight improvement in next year's EPI score, with fractionally better results on all four major categories. Based on our latest forecasts, next year's EPI for Canada would strengthen slightly to 83.3.

Looking at other major economies, **Germany is again the top-ranked economy in the G7**, with a better performance than Canada on all four of the key measures. While the differences are generally modest, the major weak spot for Canada—and this is a relatively new development—is our 3% of GDP current account deficit, compared with a surplus for Germany. As well, on the budget deficit front, Germany made big strides to rein in its shortfall, while Canada's deficit remains relatively large at 5% of GDP (in part due to a still-wide gap at the provincial level).

Meantime, **the U.S. score weakened yet again in 2011** to the second worst in the G7 (ahead of only Italy) amid a high jobless rate, and still-large twin deficits. The credit downgrade by S&P also hit the U.S. score. We look for a solid improvement in the U.S. rating next year as the jobless rate eases slightly, and the budget and current account deficits moderate. Britain has similar attributes as the U.S. economy, with higher inflation and a hefty budget deficit, but lower unemployment and smaller trade deficit. It also benefits—for now—from its AAA rating.

Italy is the lowest ranked economy in the G7, due to twin deficits, a weak credit rating and a high jobless rate. Many of Italy's macroeconomic measures are actually not that different from Canada's at present, although its lower credit rating (reflecting the overhang of its massive government debt and slow economic growth) puts it in a much lower league. **Japan is hurt by its low credit rating**, a large budget deficit and deflation, but still sports a low unemployment rate and a current account surplus. Its score suffered the biggest G7 drop this year, as Japan's credit rating was also cut a notch by S&P.

Looking beyond the G7, a rough measure of **China's 2011 EPI is around 80** (above the OECD average)—it is undercut by high inflation and a low credit rating. Its score could rise over time given a strong trade position and an improving credit rating.

On the flip side, **peripheral Europe has seen its scores plunge** as government deficits and joblessness soar, and credit ratings tumble. For instance, both Greece and Portugal posted failing grades in 2011 (given that both required bailouts, anything but a failing grade would be odd). Ireland and Spain both scored in the 50s, barely rating a passing grade, although Ireland rebounded nicely from a sub-40 reading in 2010.

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