# Flash Economics

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# Advantages and risks of a very high market capitalisation

Market capitalisation is much higher in the United States than in Europe (165% of GDP compared with 50% of GDP). The higher level of market capitalisation in the United States is due to the higher profitability of companies and the higher valuation of the stock market.

Having a very high market capitalisation entails several advantages:

- A positive wealth effect that supports both consumption and investment (high Tobin's q);
- The ability to carry out external growth operations, to have large research and development budgets, and to attract highly qualified employees.

But a very high market capitalisation entails the associated risk of a stock market correction, as an excess of optimism about the value of companies ends.

Moreover, in the United States, it is a sign of the presence of monopolies or oligopolies that are unfavourable to consumers.

**Patrick Artus**
**Senior Economic Advisor**
patrick.artus-ext@ossiam.com
@PatrickArtus

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## Market capitalisation much higher in the United States than in the euro zone

**Market capitalisation is much higher in the United States** (165% of GDP) **than in the European Union, the United Kingdom and Switzerland** (50% of GDP), **Charts 1A/B**.

**Chart 1A**
**Market capitalisation**

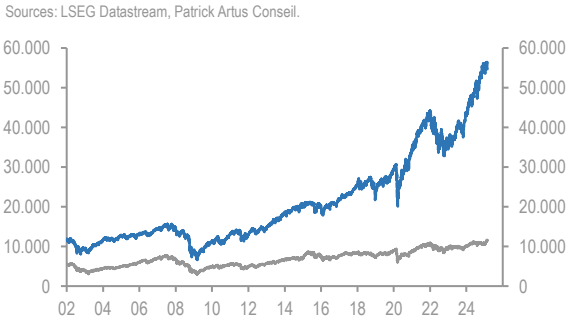
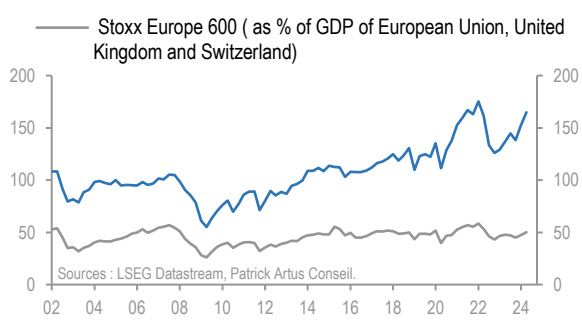



**Chart 1B**
**Market capitalisation (as % of nominal GDP)**




This significantly higher level of market capitalisation in the United States can be explained by:

- **The higher profitability of US companies**, with the distortion of income distribution in the United States in favour of companies and at the expense of employees (**Chart 2A/B**);

**Chart 2A**
**United States: Real compensation per hour and productivity per hour (business sector, 2002.Q1 = 100)**

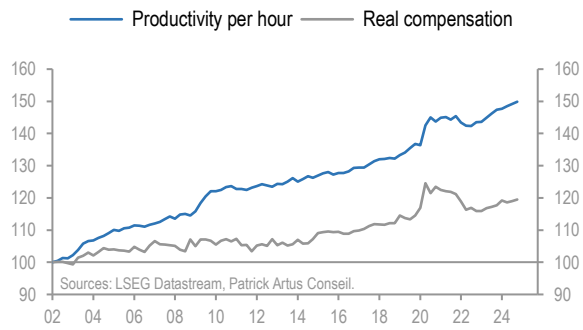
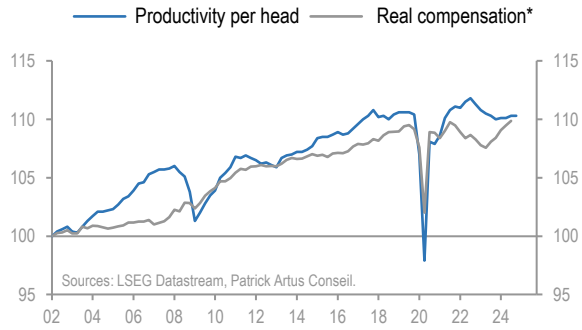



**Chart 2B**
**Euro zone: Real compensation and productivity per head (2002.Q1 = 100)**




* Deflated by GDP deflator

- **The higher valuation of the US stock market compared with the European market** (**Chart 3**).

**Chart 3**
**PER**

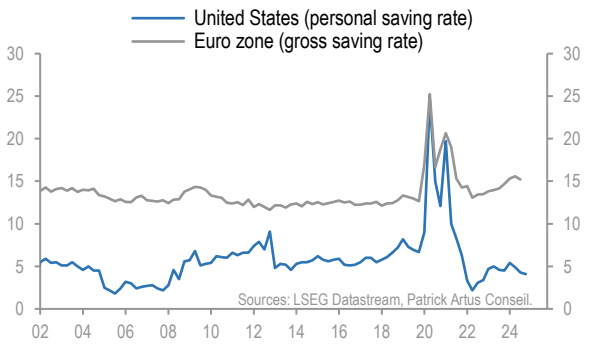


## The advantages of a very high market capitalisation

If market capitalisation is very high, **a number of advantages materialise**:

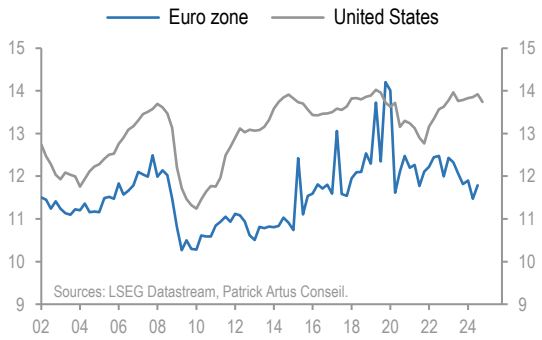
1. **A positive wealth effect**, which supports household consumption and **thus leads to a lower savings rate** (**Chart 4**);

**Chart 4**
**Household savings rate (as %)**



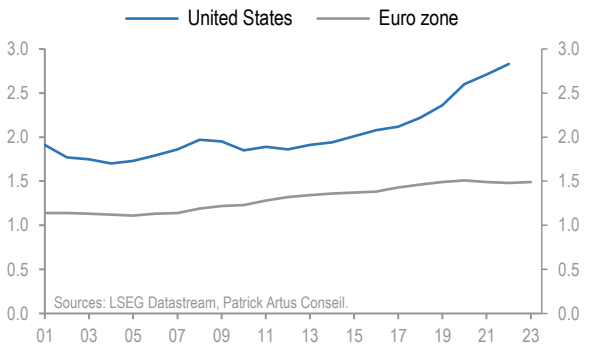

2. **A positive wealth effect, which supports investment** (**Chart 5**), (this is the effect of Tobin's q, since a given investment increases the company's stock market value and therefore encourages shareholders to make it);

**Chart 5**
**Investment of corporations**
**(in value terms, as % of nominal GDP)**




3. The ability to carry out major **external growth** operations (the value of mergers and acquisitions - M&A - reached only 330 billion dollars in Europe in the 1st half of 2024 against 780 billion dollars in the United States - source: PwC), to finance major R&D spending (**Chart 6**), to attract highly qualified employees...

**Chart 6**
**Corporate R&D spending (as % of nominal GDP)**



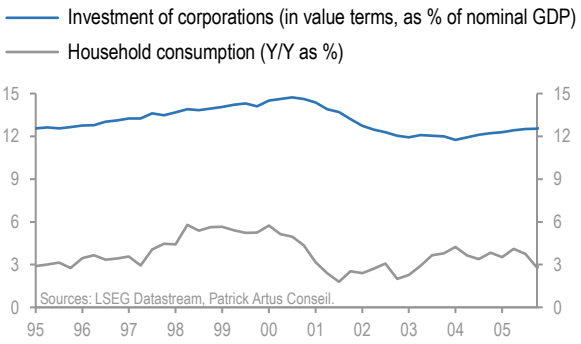
## But a very high market capitalisation entails risks, and may also reflect insufficient competition in the goods market

If companies' earnings expectations turn out to be too optimistic (which may be the case for companies developing artificial intelligence), **a potentially severe downward correction in share prices unfolds**, generating a loss of wealth and a drop in consumption and investment. This was the case when the dot.com bubble burst in the 2nd quarter of 2000 (**Charts 7 and 8**).

Chart 7
United States: Nasdaq composite index (01.01.1995 = 100)

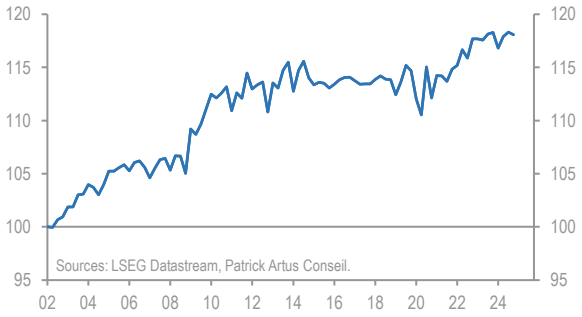



Chart 8
United States : Investment of corporations and household consumption




In addition, **in the United States, the strong growth in market capitalisation is the result of weak competition in the goods and services market**, which is evidenced by a rise in profit margin (**Chart 9**).

Chart 9
United States: Ratio between GDP deflator and unit labour cost (2002.Q1 = 100)




The distortion of income distribution in favour of companies and at the expense of employees is naturally unfavourable to consumers and leads to a rise in income and wealth inequalities (**Chart 10**).

Chart 10
United States: Share of national wealth held by the 1% of individuals with the highest wealth (as %)



## Summary: advantages and drawbacks of a very high market capitalisation

Market capitalisation is much higher in the United States than in the euro zone.

This situation has favourable consequences for the United States: a positive wealth effect that stimulates consumption and investment; the ability to carry out major acquisitions, to devote a lot of resources to research and development, and to attract talent.

On the other hand, there is always the risk, in the United States, of a stock market correction, with major negative effects, and it needs to be acknowledged that part of the rise in the market capitalisation of the United States is due to the increase in the margin rates of companies as a result of the weakness of the competition authorities.

In addition, this rise in stock market capitalisation mainly benefits the very rich, who are able to invest a significant proportion of their income in shares.

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