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The Arithmetic of EM and Global Growth: The \$35 Trillion Myth

- *The recent slowing in China and EM more broadly has raised concerns about the level and sustainability of global growth;*
- *But EM growth has been slowing for the last 5 years, while DM growth picked up and global growth over the last few years has been perfectly steady at near trend rates, measured using conventional PPP exchange rate weights;*
- *Conventional PPP exchange rate based measures massively overstate the size of EM in the global economy: by \$35 trillion or 2 US GDPs;*
- *Global growth has been rising over the last few years when measured using market exchange rate based weights;*
- *The arithmetic of global growth: DM (60%) is still bigger than EM (40%) and 1pp of additional DM growth offsets 1.5pp of slower EM growth;*
- *We expect a continued normalization of EM growth lower though we are almost there; DM growth to pick up; and global growth (i) at conventional PPP weights to be near trend rates while (ii) at market rate weights to accelerate above trend rates in 2016*

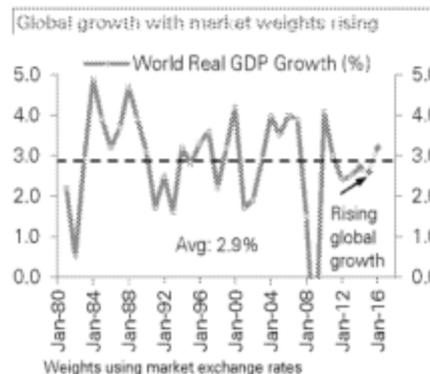
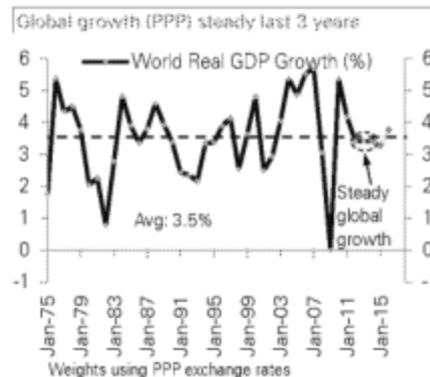
The recent slowing in China has raised concerns about global growth. It is widely believed that if China, and the emerging markets (EM) more broadly, which represent the faster growing part of the global economy, are slowing, it means a slowing in, if not the end of, global growth. The decline in commodity prices is often seen as evidence of this slowing in global growth and a driver of slow multinational corporate earnings growth.

But growth in EM has been slowing for the last 5 years while global growth has been perfectly steady, measured using conventional PPP exchange rate weights.

EM real GDP growth, as measured by the IMF at purchasing power parity (PPP) exchange rates, fell from a peak of 7.4% in 2010 down to 4.6% in 2014. Developed markets (DM) growth on the other hand rose after the European financial crisis ended and was up from 1.2% in 2012 to 1.8% in 2014. The pickup in DM growth simply offset the slowing in EM growth and global growth was perfectly steady during 2012-2014 at slightly below its long run trend rate of 3.5%, its average over the last 40 years.

Conventional PPP exchange rate based measures massively overstate the size of EM in the global economy: by \$35 trillion or 2 US GDPs

- **PPP vs market exchange rates for EM.** The IMF's headline measure of global growth uses PPP exchange rates to aggregate country GDPs into a global composite. The approach seeks to avoid changes in measured global real GDP simply because of changes in the value of the dollar which has historically exhibited big (40-50%) long cycles (6-7 years). In our view, the approach makes sense for DM where PPP corresponds to the average



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