



real value of exchange rates over long periods, i.e., deviations are long lived but cyclical and mean reverting. But EM FX by contrast is massively structurally (always) cheap on a PPP basis, given their earlier stage of economic development. EM real exchange rates will likely converge to PPP only with the convergence of per capita incomes, i.e., in the very very long run. So the cheapness of EM FX on a PPP basis is not cyclical but structural (How Much Will Fast Growing EM Currencies Appreciate, Sep 2005).

- **The \$35 trillion myth.** Using PPP exchange rates raises the size and weight of EM in the global economy massively. To get some idea of how much, consider some of the bigger emerging markets exchange rates versus their PPP levels. For China, a market CNY of 6.4 versus the dollar compares with a PPP rate of 3.6. So measuring Chinese GDP at PPP exchange rates raises it 1.8 times. For India, a market INR of 66.5 compares with a PPP rate of 18, which is 3.7 times higher. For EM as a whole, nominal GDP of \$30 trillion at current market exchange rates compares with \$65 trillion at PPP rates, i.e., a more than doubling. This is \$35 trillion of EM and global GDP which does not and has never existed. To put it in perspective another way, the size of the overstatement is about two US GDPs.

Global growth has been rising when measured using market rate based weights

Using rolling market exchange rate based weights global GDP growth has historically been lower than the IMF's headline measure based on PPP rates, averaging 2.9% versus 3.5% at PPP weights. Global growth bottomed with the European financial crisis in 2012 at 2.4% then rose to 2.7% by 2014, still somewhat below trend or average rates.

The arithmetic of EM and global growth:

- **DM still bigger than EM.** At PPP rates, EM accounts for 57% and DM 43% of global GDP. This differential is the source of current perceptions that EM is more important for the global economy than DM. At market exchange rate weights on the other hand, EM accounts for a smaller 40% and DM for 60%. Some other arithmetic facts of note: the US and Eurozone together (24%+16%) equal the size of all of EM (40%) in the global economy, while the US is 1.5 times the size of China (24%:16%);
- **1pp of DM growth equals 1.5pp of EM growth.** The weights at market exchange rates (60:40) imply that 1pp of additional DM growth offsets a 1.5pp slowing in EM. The arithmetic of the US vs China (24:16) is similar in that 1pp of additional US growth offsets 1.5pp of slowing in China.

Where is global growth going? What about commodities? Earnings?

- **Continued normalization of EM growth but almost there, while DM growth picks up.** We have long argued that the large multi-year outperformance of EM during 2001-2010 represented the confluence of a variety of circumstantial factors. That each of the factors had gone into reverse, but had not run its course (When Will EM Stop Derating, Sep 2013). EM growth in 2015 is expected to have reverted further back into its historical range though still above the mid-point of the range and we expect it to be nearing the bottom. EM growth should be supported by a pickup in DM growth which DB economists and the consensus see continuing to pick up in 2016 (China's impact on the global economy and the Fed, Sep 3 2015).
- **Expect global growth to hold steady at near trend rates, measured at conventional PPP weights and accelerate above trend at market weights in 2016.** The EM growth advantage will continue to erode further and fall to the middle of the historical pre-boom range. With the EM-DM growth differential back to modest levels, we expect the EM share of global GDP to rise only modestly further whether measured in PPP weights or market weights.