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Advanced economies vs emerging markets

Given the growth differential between emerging markets and the advanced economies, the former will continue to attract fund flows over the longer term

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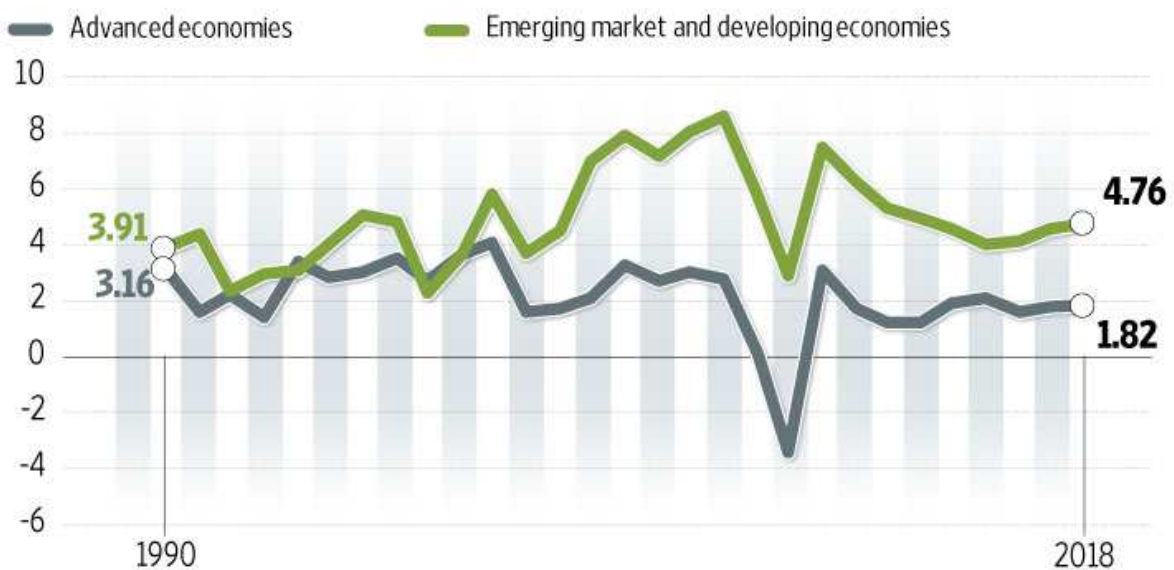
The latest estimates of gross domestic product (GDP) growth by the International Monetary Fund (IMF) show that while advanced economies will see lower growth this year, emerging economies will expand at a faster pace.

Chart 1 compares the trajectory of growth between the advanced economies and emerging markets from 1990. Note how the rates of growth in emerging markets suddenly picked up during the boom years of 2003-07, which is when the differential in growth rates between the emerging and advanced economies was the highest. While growth rates have come down in both developed and developing countries after the financial crisis, the difference between emerging market and advanced countries' growth rates continues to be substantial.

Chart 1

Emerging market growth is picking up

Gross domestic product, constant prices Percent change

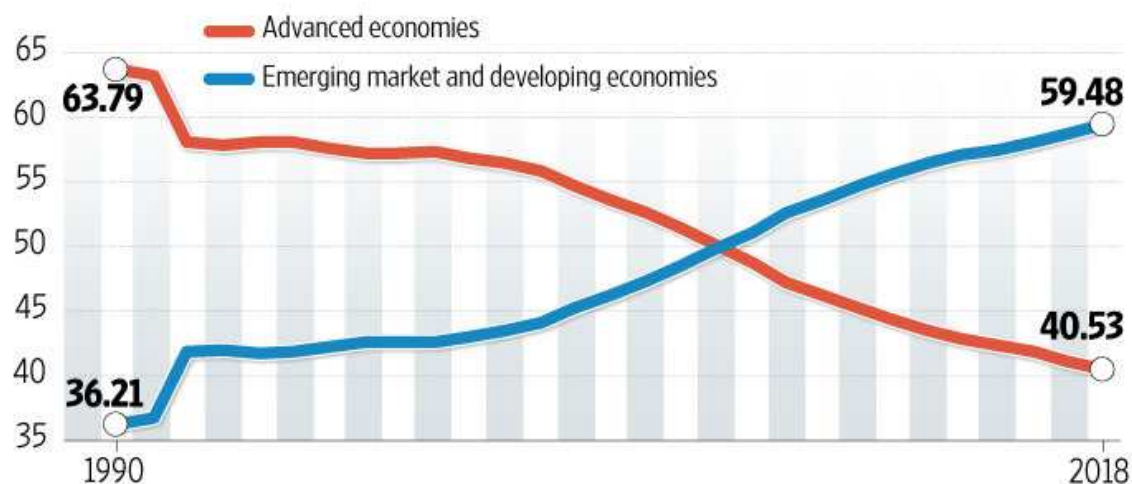


International Monetary Fund, World Economic Outlook Database, October 2016

Another way of putting this change in perspective is shown in chart 2, which has the shares of the world total GDP based on purchasing power parity (PPP). The chart shows how the share of the advanced economies in global GDP, which was 63.8% in 1990, has now fallen to 41.8%. The share of emerging markets became larger than the share of the developed economies in 2008.

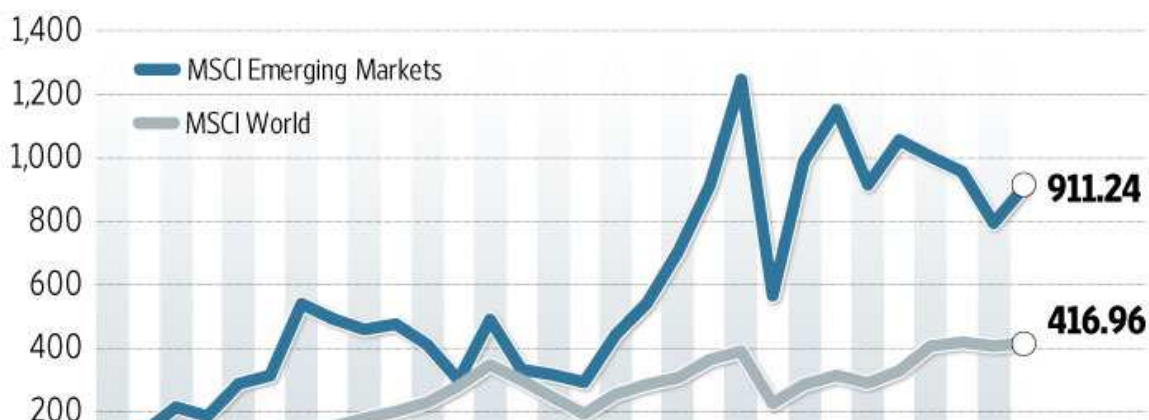
Chart 2**Emerging economies now account for almost three-fifths of world GDP**

Gross domestic product based on purchasing power parity share of world total (in %)



International Monetary Fund, World Economic Outlook Database, October 2016

The impact of the higher growth in emerging markets is shown by chart 3. Note the step rise in the MSCI Emerging Markets index, as growth picked up sharply between 2002 and 2008. In contrast, the MSCI World index, which reflects the advanced economies, saw muted growth over the period, as fund flows favoured emerging markets. In more recent years, the emerging markets index fell between 2012 and 2015, reflecting lower growth. On the other hand, the improvement in the advanced economies was reflected in higher growth in the world index. But with growth picking up in emerging markets again this year, MSCI EM is outperforming MSCI World. Year to date, MSCI EM is up 14.75% in dollar terms, while MSCI World is up 2.31%.

Chart 3**Emerging markets have hugely outperformed developed markets**

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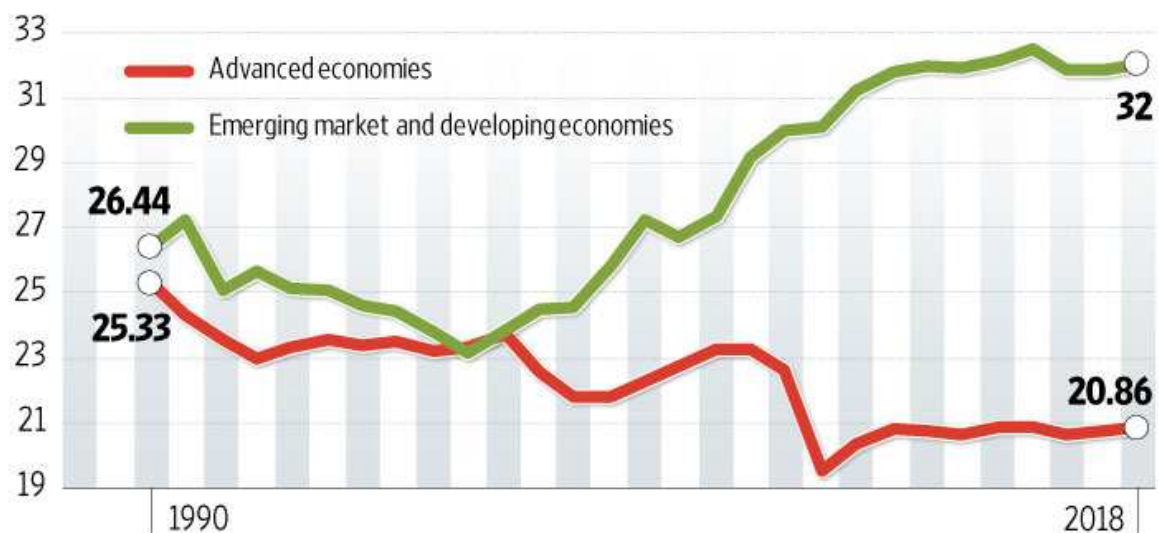


Chart 4 shows that while investment as a percentage of GDP has come down in the advanced economies, it has increased in the emerging markets and developing economies. Indeed, investment as a proportion of GDP is now higher in emerging markets than it was during the boom years of 2003-07. That is not surprising, as it is in the emerging economies that there's vast scope for building infrastructure.

Chart 4

Investment in developing world continues to be robust

Investment % of GDP



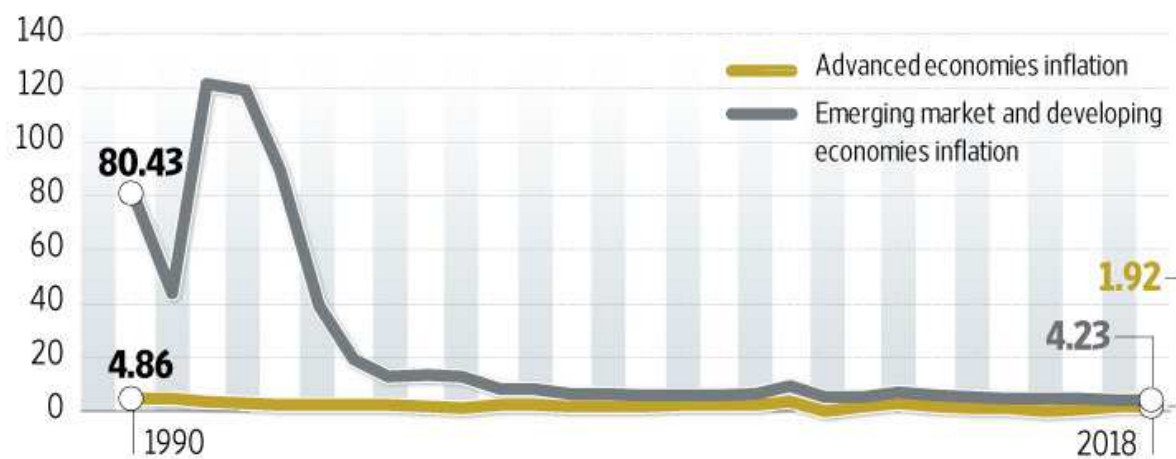
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Emerging economies have also become more attractive as their inflation rates have come down. That reduces the concern investors have about exchange rate depreciation. As chart 5 shows, the threat of deflation is also one that hangs over the advanced economies and there is no such concern about emerging markets in general.

Chart 5

Inflation has come down drastically in developing countries while advanced economies grapple with deflation

Average consumer prices (% change)



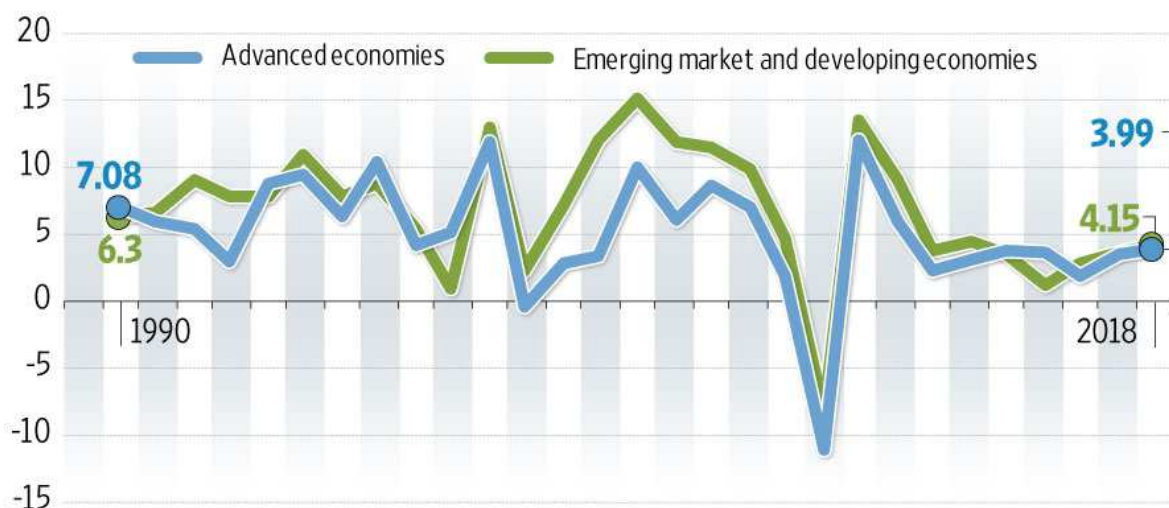
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Finally, chart 6 shows that while global trade as a whole has slowed, in the past couple of years growth in the volume of exports from emerging markets has been lower than the volume of exports from the advanced economies. This trend should correct from the current year, according to the IMF forecasts.

Chart 6

Emerging markets have been hit harder by the slowdown in world trade

Volume of exports of goods and services (% change)



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To sum up, given the growth differential between emerging markets and the advanced economies, the former will continue to attract fund flows over the longer term, regardless of the US Fed raising interest rates. The big risk to

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the outlook for emerging markets remains, of course, a crisis in the Chinese economy.

Manas Chakravarty looks at trends and issues in the financial markets. Comments are welcome at manas.c@livemint.com

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