ECRI
International Cyclical Outlook
ESSENTIALS

Emerging Economies to Outshine Advanced Economies

A brighter global growth outlook — driven in part by cyclical industrial growth prospects — benefits developing economies.

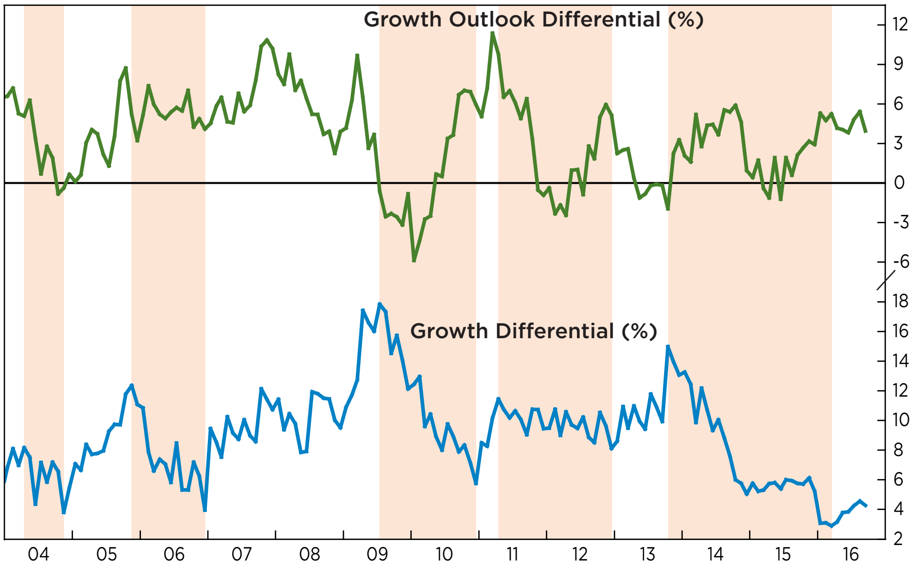
Dissonant Divergences Emerging markets have been crushed in recent weeks by the surging U.S. dollar and spiking bond yields. Yet, the cyclical outlook for emerging market (EM) growth, having improved substantially this year, outshines developed market (DM) growth prospects.

In fact, growth in ECRI's 20-Country Long Leading Index (20LLI) – which, as of last month, had "risen to its strongest reading in nearly two years" (*↗ICO Essentials, October 2016)* – has now climbed to a 26-month high. But growth in our 19-Country Long Leading Index (excluding the U.S.) has surged to a 76-month high (not shown). This is because the improvement in the global growth outlook is more EM-led than DM-led.

As a result, growth in ECRI's Emerging Markets Long Leading Index (EMLLI) is hovering near its best reading in nearly two years, while growth in our Group of Seven (G7) Long Leading Index (G7LLI) has increased to a 1½-year high (not shown). Consequently, the divergence between EMLLI growth and G7LLI growth – the EM-DM growth outlook differential – having troughed last year, is holding near its highest reading in almost two years (Chart 1, top line). Following this upturn, the current EM-DM growth differential – the difference between their respective coincident index growth rates – also turned up earlier this year (bottom line), and is poised to climb further.

While the *cyclical* outlook for global growth is favorable, the *structural* backdrop remains grim. But the common man may be ready to tolerate those travails if there is at least an attempt to serve connected insiders their just desserts.

Chart 1: Growth Outlook Differential Between Emerging and G7 Economies



Shaded areas represent cyclical downturns in the growth differential.

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To be clear, our outlook flies in the face of the consensus view based on the notion that the actions of the incoming Trump administration will damage global trade and therefore EM economies, as well as the rush away from EM securities triggered by higher U.S. interest rates. But our long leading indexes for the major EM economies – including China, Brazil, and India (whose recent demonetization decision we will discuss) – zero in on their domestic *cyclical* growth prospects that are glossed over by such speculative perspectives.

Moreover, the brighter global growth outlook underscored by the 20LLI is driven in part by better cyclical industrial growth prospects, with the Global Industrial Growth Short Leading Index approaching a 2½-year high (not shown). In the context of global industrial supply chains, it is therefore important to recognize the positive aspect of the Bullwhip Effect, due to which smaller shifts in end-consumer demand growth translate into larger fluctuations in intermediate goods demand, and even bigger ones in the demand for basic inputs, and especially in raw material prices – essentially, in the demand for most EM exports. Adding in greater price competitiveness, thanks to the stronger dollar, EM cyclical prospects look even more promising. Again, ECRI's cyclical perspective presents a variant view of the relative strengths of EM economies.

Indeed, DM growth prospects look pretty patchy in comparison. In particular, growth in our Eurozone Long Leading Index (EZLLI) remains in a cyclical downturn (Chart 2, top line), following which growth in our Eurozone Coincident Index (EZCI) has also turned down (second line), and is thus set to fall further.

In contrast, ECRI's Eurozone Future Inflation Gauge (EZFIG) remains in a decisive cyclical upturn (third line), and Eurozone CPI growth is following suit (bottom line). Hence, with economic growth poised to decline further – especially outside Germany – and inflation continuing to climb, the Eurozone is facing its own version of "stagflation lite," which we had accurately predicted in the U.S. case *(↗USCO Essentials, March 2016)*. In fact, this cyclical upswing in inflation is part of the phenomenon of global reflation – now widely acknowledged – that we had flagged back in the summer *(↗ICO Essentials, August 2016)*.

