Economic Viewpoint

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The growing weight of China and the emerging economies

Further changes in the world economic order are to be expected

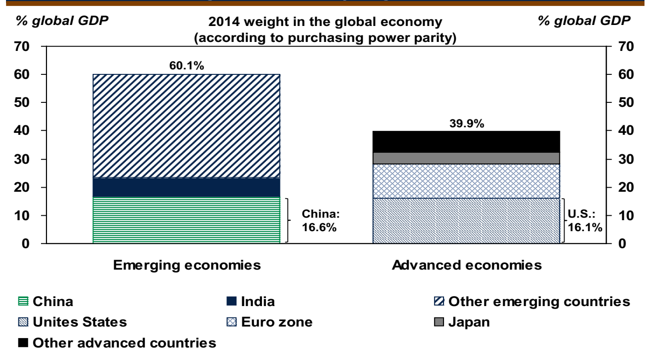
The emerging economies have a growing share of the global economy which, especially with China, clearly shows in the economic news and financial market movements. Boosted by demographics and relatively fast growth potential, this economic weight should keep growing, probably in tandem with emerging markets' influence on the financial markets and the leading international economic organizations. Note, however, that emerging economies are still poorer and less mature than advanced economies and that final global consumption remains dominated by advanced countries, particularly the United States.

In 2015 and early 2016, the economic and financial news focused heavily on the unstable health of the emerging economies[1], notably China's. Concerns over China were especially harmful to the equity and commodity markets.

Why are the emerging countries and China in particular getting so much attention? Simply put, because they are becoming increasingly important in the global economy. According to World Bank data, calculated using purchasing power parity[2], emerging economies' weight in global GDP was 60.1% in 2014, leaving the advanced economies with a share of just 39.9% (graph 1).

Note also that, for the first time in modern times, China now ranks first (16.6%), slightly outstripping the U.S. economy (16.1%). The United States had held the top of the podium since they unseated the British economy in the second half of the 19th century.

Graph 1 – The weight of China and emerging countries in the global economy is greater



Sources: World Bank and Desjardins, Economic Studies

CAUSES

Two factors are behind how important the emerging economies have become. Firstly, they obviously get a hand from the size of their populations. China, India and Indonesia, the main emerging countries in terms of population, account for 41.1% of humanity. Together, the emerging economies account for 80.7% of Earth's population. This ratio is rising—in 1990, it was 77.2%.

Secondly, emerging economies usually show more lively growth, which has of course boosted their weight above that of the advanced economies. By definition, and outside of conjonctural vagaries, emerging economies are in a faster phase of development than mature economies. Since 2000, the average annual real GDP growth of emerging

1. For ease of reading, this text uses the terms "emerging economies" or "emerging countries" to refer to all economies other than the advanced economies, including developing economies and the poorest or most underdeveloped economies. Country ranking in the various development categories can also vary from one international institution to another. Although not identical, the ranking used by Desjardins, Economic Studies is closest to that used by the International Monetary Fund (IMF). In October 2015, the IMF put the weight of emerging economies at 57.2% of global GDP.

2. See definition below in the text

François Dupuis
Vice-President and Chief Economist

Francis Généreux
Senior Economist

514-281-2336 *or* 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

Note to readers: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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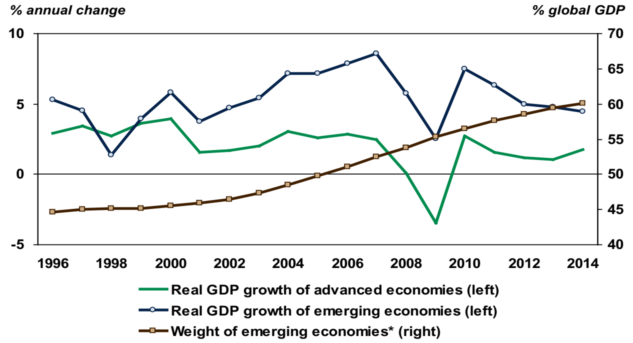
countries has been 3.5 times faster than that of advanced economies (graph 2).

Graph 2 – Emerging countries' rapid growth has given them a bigger share



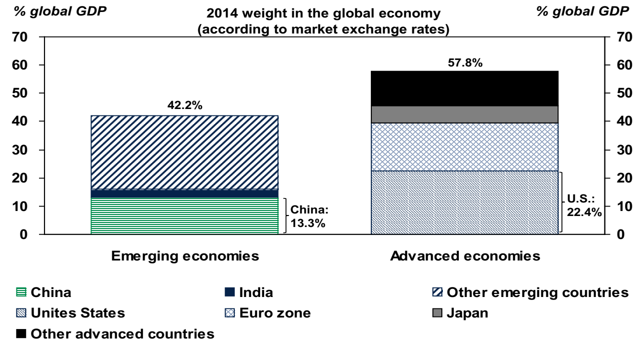
* According to purchasing power parity
Sources: World Bank and Desjardins, Economic Studies

PURCHASING POWER PARITY

A more technical reason for emerging countries' greater weight is the use of a "theoretical" exchange rate rather than market exchange rates in comparing the various national GDP values. Purchasing power parity suggests an exchange rate that makes it possible to balance the cost of living among economies. It helps to factor in differences in prices, including those for goods and services that are not traded internationally. It also limits the perverse influence of currency fluctuation on GDP values once they are translated into a single currency, in this case U.S. dollars. This is why international organizations such as the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF) and World Bank use this comparison metric, and forecasts of global and regional economic growth, and forecasts by economic category use purchasing power parity as a basis.

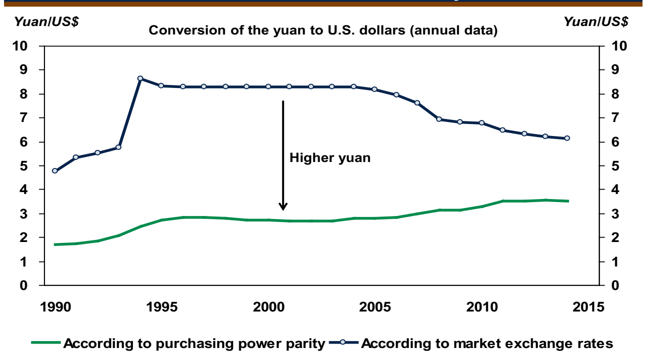
In some cases, the exchange rate dictated by purchasing power parity may be quite different from market exchange rates. This often occurs with emerging countries, where the cost of living, especially for services, is frequently much lower than it is in advanced economies. To achieve a balance, purchasing power parity will dictate an exchange rate that is much higher than the market rate, thereby inflating the value of the national GDP. Based on the purchasing power parity the World Bank used in 2014, the GDP of emerging economies accounted for 60.1% of global GDP. Using market rates, that proportion falls to 42.2%. Using market rates puts the advanced economies back on top with 57.8% of global GDP. In this case, the United States has a 22.5% share of the world economy, while China's weight shrinks to 13.3% (graph 3). China's case is especially striking: the rate dictated by purchasing power parity is much higher than the yuan's market value (its fluctuations are heavily controlled by authorities) (graph 4). With a market rate of US$1 = 6.14 yuan, China's GDP in 2014 goes from 63,613B yuan to US$10,360B. With a rate dictated by purchasing power parity, where US$1 = 3.53 yuan, GDP goes to US$18,030B, which compares advantageously with a U.S. GDP of US$17,419B. Aside from China, using purchasing power parity increases the U.S. dollar value of most emerging country GDPs.

Graph 3 – Using current exchange rates makes the weight of China and emerging countries much smaller



Sources: World Bank and Desjardins, Economic Studies

Graph 4 – Using purchasing power parity increases the value of China's real GDP substantially

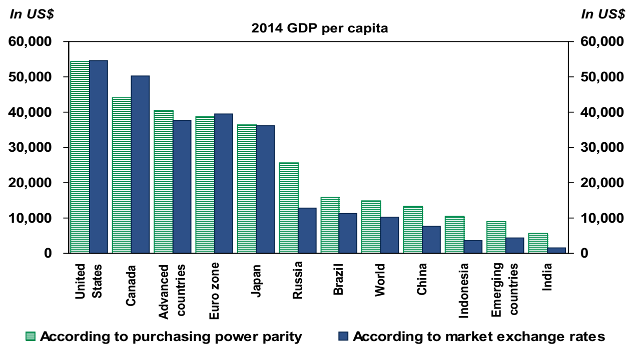


Sources: World Bank and Desjardins, Economic Studies

NOT NEARLY AS RICH

As seen, some of the weight of emerging countries comes from the number of people who live there. If we adjust for population size, we of course take away much of the strength of the emerging economies, and it becomes clear how much less wealth they have than the advanced economies. In 2014, annual GDP per capita was US$54,629 in the United States, US$44,057 in Canada, and US$38,701 in the euro zone. Together, the advanced economies average US$40,523. The average is just US$8,898 for the emerging economies, just over 20% of GDP per capita in the advanced countries. In 2014, this metric was US$13,206 in China and US$5,701 in India (graph 5 on page 3). The Chinese economy, which has been shaking up the financial landscape for some time now,

Graph 5 – Emerging countries lag well behind in terms of GDP per capita



Sources: World Bank and Desjardins, Economic Studies

therefore remains very poor; we cannot count too much on Chinese consumers to soon replace U.S. consumers. Here, in 2013 (the World Bank has not yet released the comparable numbers for 2014), total final consumption expenditure in China was just US$5,645B (10.9% of the world) compared with US$11,392B in the United States (22% of the world). U.S. consumers' strength and confidence is therefore, all in all, the main driving factor in the global economy.

A WEIGHT THAT WILL KEEP GROWING

The favourable demographic outlook for several emerging countries (with the noteworthy exception of China) and faster growth potential mean that emerging economies will continue to gain in weight. Assuming growth that does not really diverge as of 2020 from the consensus forecasts for the end of this decade, we can expect emerging countries to have a share of more than 70% by around 2035. In this context, with a long-term growth rate of 5%, China's weight would give it 20% of global GDP as of 2022, and 25% in 2030. Conversely, U.S. GDP would drop below 15% of global GDP starting in 2024. These long-term forecasts are of course shot through with risks; both structural and conjonctural changes could transform the outlook.

WHAT ABOUT CANADA?

The World Bank's numbers on global GDP only go back to 1990, the year in which Canada had the biggest share, at 1.9%. It has been dropping slowly since then. In 2014, Canadian GDP only accounted for 1.4% of global GDP. Using market rates rather than purchasing power parity takes the weight up to 2.3%. Over the long term, Canada's weight should keep dropping, without going under the 1% mark, however.

GREATER WEIGHT, MORE INFLUENCE?

The last few decades have seen profound changes in the planet's economic landscape. The growing importance of the emerging economies, particularly China, naturally has noteworthy geopolitical repercussions. Economic imperatives mean that the U.S.–Russia axis has been replaced by a U.S.–China axis. Even within the BRIC nations, China's influence dominates. Brazil and Russia have been in a severe recession for a year, but it is the Chinese economic slowdown (slight, according to the official numbers) that dominates the news and makes markets tremble.

The play of influence should be increasingly evident in the major international economic organizations, like the OECD, IMF and World Bank, historically controlled by developed countries. We are now seeing China try to shift the game, which has not changed much since the end of World War II. It launched the Asian Infrastructure Investment Bank, which seems to want to play the same role as the World Bank. Another sign: the IMF recently elevated the Chinese yuan to major currency status by adding it to the basket used to calculate the value of special drawing rights. China's constantly growing importance in the global economy should make this type of news more frequent. Will it be to the detriment of the major advanced nations? Already, the G7's weight in the global economy is in decline, dropping from more than 47% in the early 1990s to less than 32% in 2014. Since the financial crisis, moreover, the G20, which also includes emerging countries, has been the main platform for international influence.

We must also consider the financial and economic consequences of the increased weight of emerging countries. As we saw last year, the international economy is hurt by weaker growth by emerging countries while advanced economies seem to be doing better. Since the mid-2000s, and particularly during and after the crisis, the international markets have relied heavily on the Chinese locomotive. The fears of recent months remind us that relying too heavily on an economy that is still emerging, and thus less mature, introduces risks and increases volatility.

Francis Généreux
Senior Economist