Discussion of "Real decoupling and financial recoupling"

Juan Ruiz

Chief Economist – Economic Scenarios - BBVA

Banco de España – World Bank – CREi Conference
Madrid, 1-2 July 2010

Section I

Aim of paper: revisit debate on decoupling from 3 angles

A

Real decoupling:
lower sensitivity of EMEs growth to G7 growth

- G7 growth appears to have increased explanatory power in last decade
- But including China paints a different picture: within EMEs recoupling
- Similar theme to Kose, Otrok & Prasad (2008): global vs. regional factor

B

Financial recoupling:
comovement between EME and US assets has risen

- Strong correlation for equity returns. Has increased for credit and FX.
- Not just due to synchronization during sell offs
- And asset prices continue to influence activity

C

Could increased financial globalization explain
tighter comovement of assets? Not really.

- It could be that having more global investors make them behave more homogeneously across markets …
- Quantity measures of financial globalization do not explain tighter comovement of assets. If anything, seems to reduce it!

Section II
General comments

1

Purely empirical paper, as theory has no conclusive answers… but some structure would help clarify what's being done

- No clear a priori answer to how real synchronization and asset price correlations behave with increased globalization.
- Debate can only be settled by empirical studies, but beware of direction of causality and theory-based benchmarking of globalization measures.

2

Do fundamentals matter for asset performance? Not incompatible with high asset return correlations (EMEs-G7)

- Better fundamentals (i.e. closer to G7) might actually expose asset prices to more similar shocks.
- Might explain similar pattern in advanced peripheral markets.

3

Is "real decoupling" the odd piece in this puzzle?

- Is China really decoupled from G7?

Section III
On real decoupling

A

Real decoupling: can EMEs really decouple?

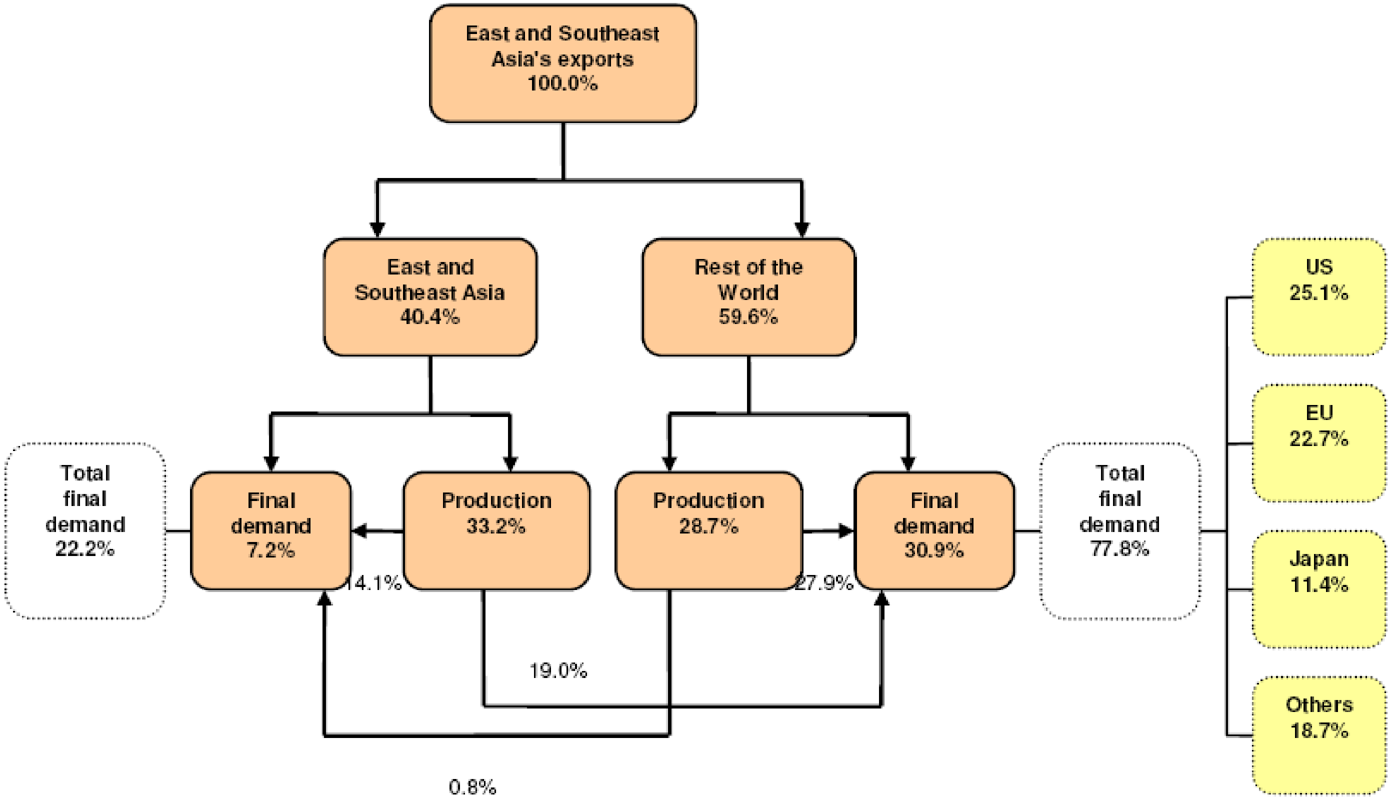
- It all probably depends on the source of the shock:
  - if it is financial, then paper suggests it should affect activity in developed economies and also translate financially to EMEs.
  - If it starts in the real side (and it is sector-specific) maybe EMEs can decouple.
- One of the factors supporting real decoupling:
  - Significant increase in intra-regional trade, especially Asia
- Can real decoupling work in practice?
  - A large-part of intra-Asian trade reflects intra-Asian production fragmentation
  - East Asian countries heavily depend on global demand, despite of their huge portion of intraregional trade.
  - Therefore, East Asia is not likely to be decoupled from industrial countries.

Section III
On real decoupling

A

Real decoupling: can EMEs really decouple?

- **As much as 2/3 of East Asia's exports are ultimately consumed in the G7**



Source: Data sourced from Global Trade Analysis Project (GTAP) version 7.

Section III
On real decoupling

A

Real decoupling: can EMEs really decouple?

- An important part of the positive effect on EMEs growth found in regressions due to the “China effect”.
- But the “China effect” could, in turn, be just associated with global (i.e. G7) growth.
- That is, China could just be the channel through which G7 growth gets transmitted to EMEs. Not really a decoupling story.
- In fact, a regression of China’s growth on G7 growth gives high “alphas” and significant and increasing “betas” in last 10 years.
- In the end, decoupling seems at odds with globalization. Total decoupling is not possible on a globalized world economy.

Section IV
On financial recoupling

B

Financial recoupling: is it surprising?

- Less so if we accept real synchronization.
- Many studies point to link between real synchronization and financial integration, hence tight comovement of financial prices.

C

Could increased financial globalization explain tighter comovement of assets?

- Measures of financial globalization (stocks or flows) give different answers, but no theory behind them to establish a clear benchmark for financial globalization.
- But price measures have a clearer benchmark for the degree of globalization
- In fact, stronger comovement of assets is a sign of increased financial integration!

Section V
Conclussions

I

Interesting question and paper

- Globalization and synchronization: many theories with possible conflicting effects
- So, data should answer this as the approach of this paper
- But be careful with endogeneity (some attempt to take care of that)

II

Is there really a puzzle in the data?

- Not clear there is a puzzle between real (de)coupling and financial recoupling
- Data hints that we have both real and financial synchronization
- China as the channel for G7-EMEs real recoupling.

BBVA Research

Discussion of “Real decoupling and financial recoupling”

Juan Ruiz

Chief Economist – Economic Scenarios - BBVA

Banco de España – World Bank – CREi Conference
Madrid, 1-2 July 2010

Section V
Final comments

I

Bad news:

- Real and financial recoupling means:
  - Less stable global growth: no shock absorbers
  - Less opportunities for risk sharing across countries

II

Good news

- Real and financial recoupling might also reflect better fundamentals bringing EMEs closer to advanced economies.
- Multidimensional interdependence between EMEs and advanced economies. Better than old unilateral (one way) dependence of EMEs on G7