

The Cross-Section of Country News, Decoupling Expectations, and Global Business Cycles

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Summary

We define decoupling as an increase in the cross-country heterogeneity in long-term growth expectations. We identify growth expectations from a cointegrating relation between a country's output level and its stock market valuation. Fluctuations in this output-price or yp -ratio reflect changes in perceptions about future real activity (output growth) or changes in the expectation of long-term stock market returns or both. Shocks to the cross-country dispersion of yp -ratios therefore provide information on the heterogeneity of the international cross-section of country-specific news about future real (output growth) and financial (return) opportunities. We show that shocks to the international cross-section of news have particularly high trend growth effects in Emerging Asia including China, particularly in the period since the Asian financial crisis. A factor analysis of the cross-section of stock market and output growth expectations reveals an increasing role for regional factors in both financial markets and for output growth. Whereas the role of regional factors in output growth has increased at the expense of global factors -- a possible instance of decoupling -- financial factors have become more regional at the expense of purely country-specific influences.