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Developed markets' business cycle dynamics and time-variation in emerging markets' asset returns

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Abstract

This paper empirically studies the predictability of emerging markets' stock returns by business cycle variables and the role of developed markets' business cycle dynamics in this respect. The evidence shows that the link between business cycles and future stock market returns among emerging markets is considerably weaker than among developed markets. By contrast, I find strong evidence of stock return predictability by the respective country's dividend-price ratio. This latter finding could reflect that variation in dividend-price ratios potentially reflects both the temporary impact of "hot money" inflows on emerging markets' asset prices and rational expectations of future returns.

JEL: E32, F44, G15

Keywords: business cycle risk, output gap, predictability, stock return

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