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Victoria Atanasov

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# World Output Gap and Global Stock Returns

Victoria Atanasov\*

## Abstract

This paper shows that world output gap exhibits substantial in-sample and out-of-sample predictive power for global excess stock market returns. High world output gap today signals low expected returns in the future, consistent with a countercyclical equity risk premium. In contrast to the global economic growth which influences returns only at the end of the year, world output gap reveals stable and significant predictability all over the calendar year. Also, world output gap contains important predictive elements for local stock markets and often captures a larger fraction of return variation than the national output gap. Both cash-flow and discount-rate channels strongly reinforce the forecasting power of the world output gap.

**JEL Classification:** G12, G14, G15

**Keywords:** world output gap; global stock returns; predictability

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\*Chair of Finance, University of Mannheim, L9 1-2, 68161 Mannheim, Germany; email: atanasov@uni-mannheim.de, phone: +49 621 181 2984.

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