Does the 2016 Bounce in Emerging Markets Have Legs?

Stockholm (HedgeNordic) – If macro markets are efficient at discounting consensus views then, in theory, only economic surprises should move markets. But active managers cannot realistically hope to “out-forecast the market at every stage of the cycle”, according to GAM’s Michael Biggs, who helps manage the JB Local Emerging Bond Fund. However, he finds “the market is prone to making specific forecast errors in a systematic way” particularly in terms of how credit data is interpreted. Biggs views the market consensus and IMF mind-set as being that credit growth must be good for economic growth, and vice versa. But this conflates two conceptually different variables: the stock of credit and the flow of growth. Biggs argues that flows should be compared with flows, and on this basis the second derivative is what counts. Whether credit growth is positive or negative matters far less than whether it is accelerating or decelerating, Biggs contends. Hence, when he worked as an economist on the sell side at Deutsche Bank, Biggs coined the term “Credit Impulse”, defined as the change in the rate of credit growth. The indicator has been the subject of some collaborative academic and central bank research papers, for instance with St Anthony’s College at Oxford University and the Central Bank of the Netherlands.

When credit growth is high, but slowing, as in 2007-2008 in the US, this can be a warning sign. Conversely, negative credit growth can be consistent with positive economic growth, when the rate of credit contraction is declining. This has occurred in the US since 2009 and in Spain since 2012: when credit growth was negative but the Iberian economy was the strongest in the Euro area.

Currently, Biggs concurs with consensus views of weak US growth around trend level of 2%, but thinks anything above 1% growth is above trend for Europe and reckons the continent could be more resilient than the market thinks given strong domestic demand in some countries such as Spain and France. China has clearly been slowing down every year since 2010, with a negative credit impulse each year and downwards IMF revisions every year as well. Biggs is not in the hard landing camp but does think that China’s policymakers are well aware that credit growth needs to further decelerate – to below nominal GDP growth – to prevent the debt to GDP ratio from rising.

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