Wealth Transfer to Emerging Markets

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TrackMacro ™ is a software tool providing equity risk signals in 40 countries

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One of the notable financial events of 2019 was the switch by major central banks to a 'Keynesian-type' global monetary policy. Indeed, we discussed this extensively in our latest Quant Corner note 'Gold is Money, Everything Else is Credit'

In this discussion, we defined "Keynesian times" as the periods when cash rates are set at artificially low levels, leading to fiat currencies' debasement.

We suggest a simple method to track such "Keynesian times "; compare the return of Gold with the return of an equiweighted basked of the top five global currencies in the previous rolling 12 months, in USD.

If gold pays more than the fiat currencies in the previous year, the world enters into a "Keynesian time".

Keynesian polices target the 'euthanasia of the rentier', so we know quite well who is likely to suffer from them. The question is, however: who benefits from the crime?

Wealth Transfer from Developed to Emerging Markets

Figure 1 on the next page shows the GDP growth per capita in various countries (in constant USD price) since the end of the gold standard in August 1971. Globally, the economic performance has been strickly the same in 'Keynesian times' and in other periods, herein dubbed 'Wicksellian times' (when cash rates follow the natural growth rate of the economy, as stated by Wickell, and not maintained artificially low).

World growth per capita stood at 1.5% per annum on average in both situations.

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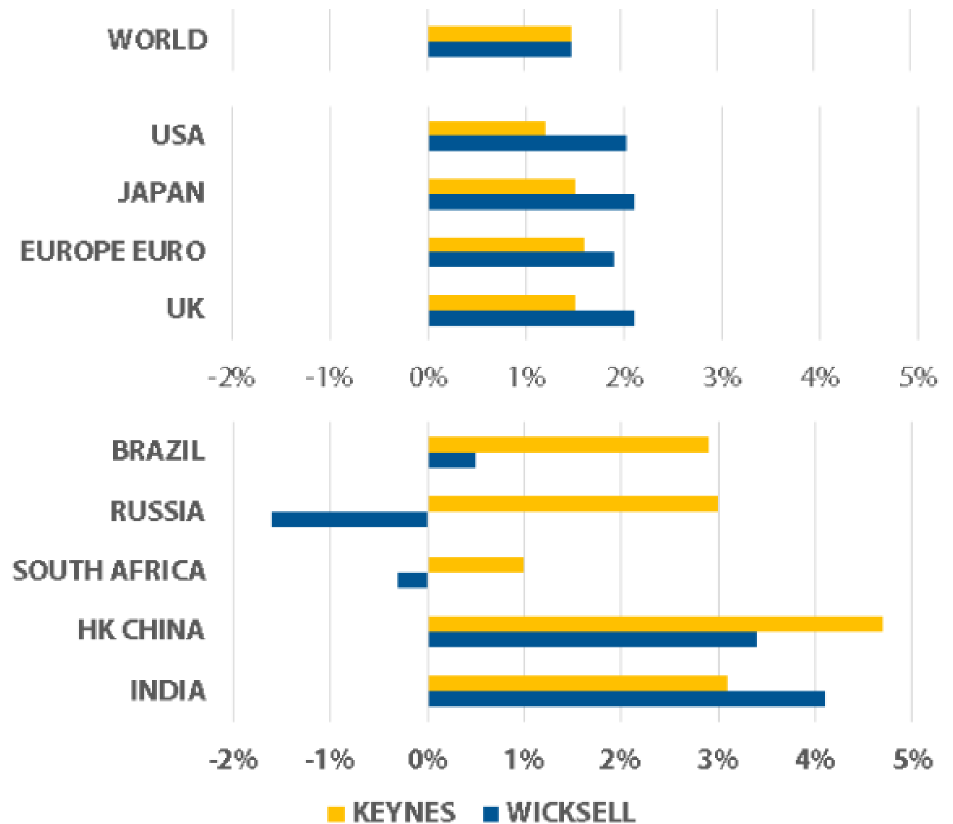
The picture, however, changes when the world is split between developed economies and emerging economies. 'Keynesian times' benefitted emerging economies at the expense of developed economies.

Fig 1. GDP growth per capita at constant USD price since 1972



Source: TrackRisk, World bank data from 1972 to 2018, Russia from 30/11/1989

But why do emerging markets grow faster in 'Keynesian times'?

Cause One: The Commodity Market

The first reason for such a wealth transfer comes from the commodity market.

Real assets tend to spike when denominated in depreciating currencies. All commodity exporters benefit from higher commodity prices; most of these exporters are located in emerging economies.

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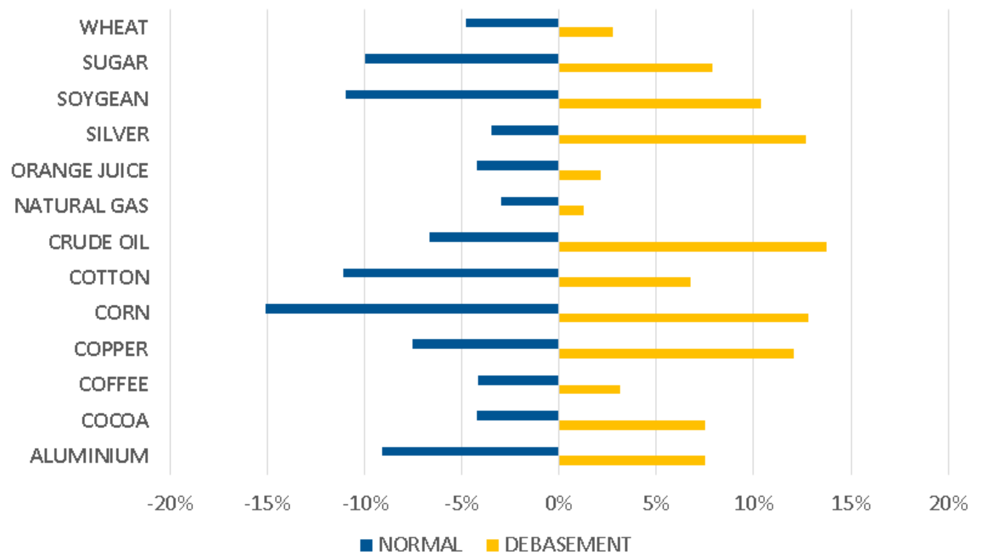
Figure 2 below confirms our thesis that commodities return more than USD cash deposit in 'Keynesian times', but less in 'Wicksellian times'

Fig 2. Commodities' excess return in 'Keynesian' and 'Wicksellian' times



Source: TrackRisk,Bloomberg data from 31/01/1996 to 31/08/2019

Cause Two: The USD Debt Market

Many emerging economies need external capital to grow, and issue debt in USD. Low cost of USD funding increases the profits of local companies.

We can measure the 'saved cost' associated with external funding in USD by comparing the cost of funding in USD vs in the local currency, during 'Keynesian times'.

Figure 3 on the next page shows that the excess cost of local currency borrowing ranges between +4% to +12% per annum in all BRICS markets. Emerging markets save significant funding costs when issuing USD debt in 'Keynesian times'.

With cash investors from developed economies, the situation reverses. They benefit from placing their cash in emerging currencies with an open currency risk, in 'Keynesian times'.

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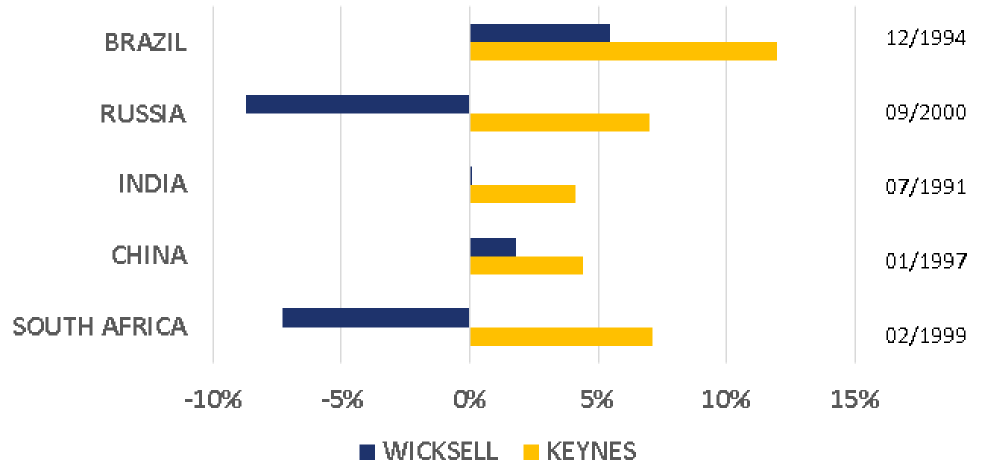
Fig 3. Total excess return of local cash deposit above USD cash deposit

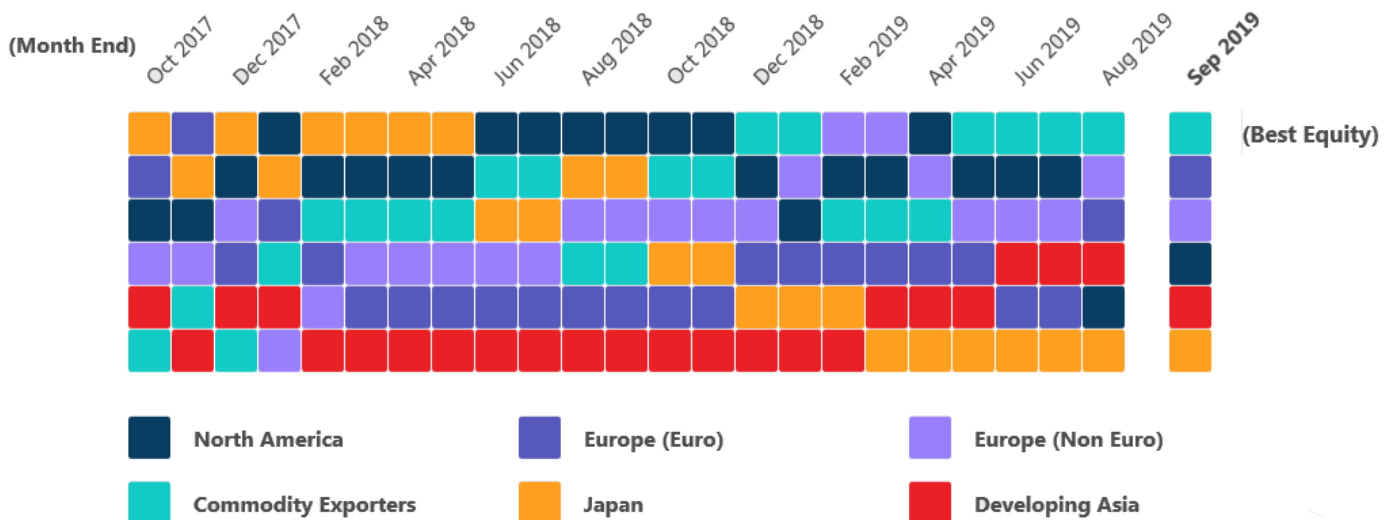


Source: TrackRisk, World bank data from 1972 to 2018, Russia from 30/11/1989

TrackMacro Double Confirmation

As of September 30, 2019, TrackMacro concluded on the following equity risk ranking across major economic zones: commodity exporters led the competition for five months in a row.

Fig 4. Best economic zones in terms of equity excess return remuneration by TrackMacro



Source: TrackMacro

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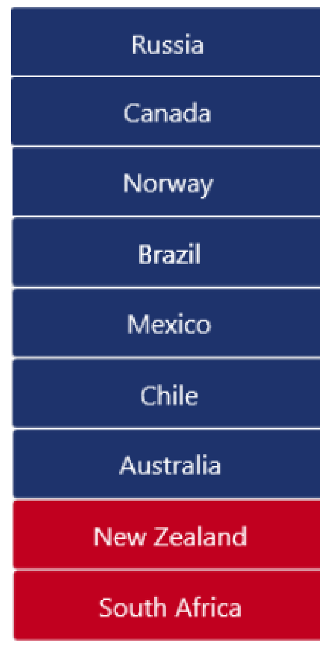
TrackMacro also concludes that, according to macro fundamental indicators, most commodity exporters today exhibit an attractive equity value for risk.

Fig 5. TrackMacro equity risk on and risk off signals for October 2019



Source: TrackMacro

Conclusion

'Keynesian' policies in major developed economies are supposed to fight deflationary forces, to stimulate local growth, and to strengthen companies facing emerging markets' competition.

The result might well be the exact opposite. Currency debasement leads to wealth transfer from developed to emerging economies, as evidenced in this letter.

Investors today face an asymmetrical situation due to the inability of major currencies to play their role as stores of value. The current situation favors gold, real assets, and emerging market equities, at the expense of developed economies' government bonds and equities.

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