

Global Macro Views – Credit-Dependent Growth in EM



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- Recent Turkish Lira weakness stems from another large credit expansion in Q1, ...
- with global capital markets unwilling to fund credit-dependent EM growth models.
- We scan across EM for where – besides Turkey – growth is heavily credit dependent.
- Colombia, Russia, Indonesia, Brazil and Poland have growth heavily linked to credit.

One lesson from the 2018 EM sell-off is that global capital markets have grown unwilling to fund heavily credit-dependent growth models. Turkey was in the crosshairs because of a large credit expansion in 2017 that widened the current account deficit to unsustainable levels. Argentina became vulnerable because of a ramp-up in public borrowing, which again translated into increased dependence on foreign capital. Depreciation pressure on the Turkish Lira has recently been rising again, a direct consequence of another ramp up in credit in Q1 (Exhibit 1), which this time has been led by state banks. The resulting credit impulse to the economy is [larger](#) in our models than in 2017 (Exhibit 2), once again widening the current account deficit and – as a result – [destabilizing](#) the currency. One lesson to draw is that global markets remain reluctant to fund heavily credit dependent growth. This **Global Macro Views** therefore examines where credit systematically leads GDP growth, which could be a sign of vulnerability. Colombia, Russia, Indonesia, Brazil and Poland all look vulnerable in this regard.

Exhibit 1. Another credit expansion in Q1, ...

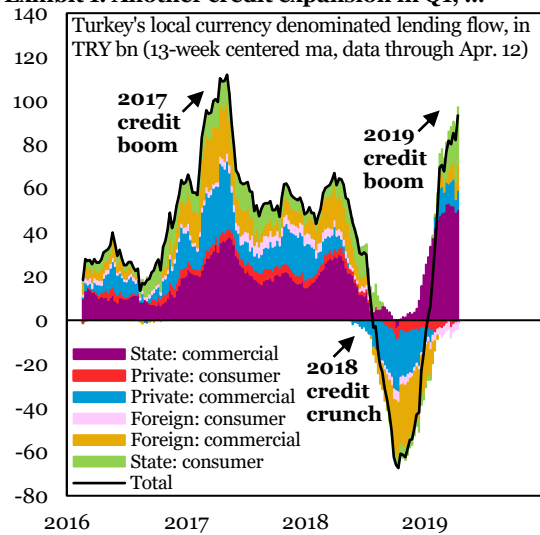
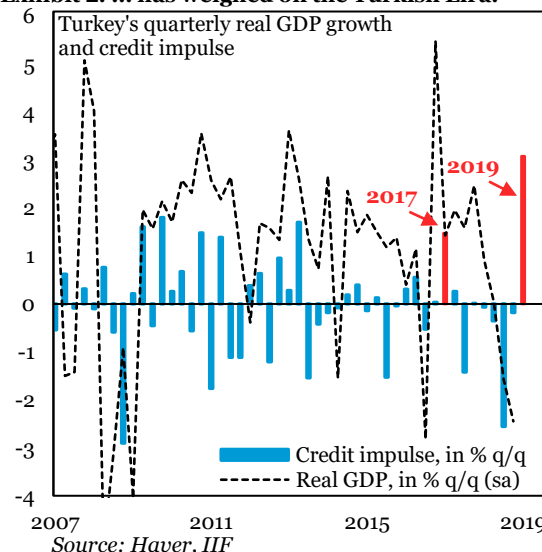


Exhibit 2. ... has weighed on the Turkish Lira.



We calculate the FX-valuation adjusted credit impulse for the major emerging markets. The credit impulse is defined as the change in credit flow, which we measure on an annual average basis to smooth out high-frequency fluctuations. Exhibit 3 shows the range of this credit impulse [across](#) EM in the grey area, which illustrates just how large Turkey's credit cycles have been since 2008. But in one important respect Turkey is not an outlier relative to the rest of EM, namely in the degree to which this credit impulse leads activity. We look systematically across EM to see where the credit impulse leads real GDP growth, where we lag the latter to reduce the scope for spurious correlation. Colombia, Russia, Indonesia, Brazil and Poland all look like they have GDP growth that is heavily dependent on credit (Exhibit 4).

Exhibit 3. Turkey's credit cycles are large, ...

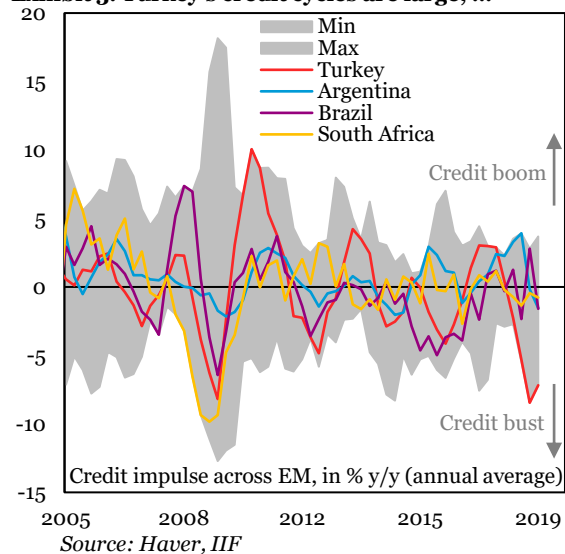
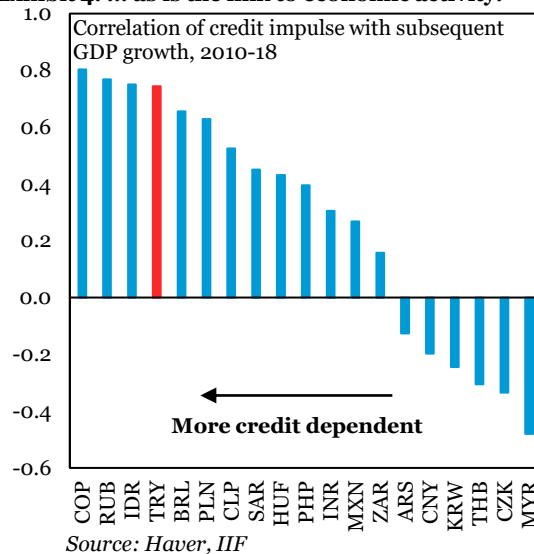


Exhibit 4. ... as is the link to economic activity.



These correlations obviously don't tell the whole story, but they do illustrate where growth historically closely tracks credit extension, i.e. where the growth model is heavily credit-dependent. This is a separate point from the magnitude of the recent credit impulse, which may or may not be high (Exhibit 5). The one obvious outlier in all this is China, where growth is remarkably stable, despite large fluctuations in the credit impulse (Exhibit 6). This is because the authorities use credit as a countercyclical stabilizer, using a ramp-up in credit extension as a tool to boost the economy when activity is weak, as is the case recently. On the surface, this means the correlation of the credit impulse with GDP growth is near zero, but this is misleading. The true correlation of credit with economic activity – and thus the credit-dependence of the Chinese economy – is high, as we have shown using our China growth [tracker](#).

Exhibit 5. Others are also credit dependent.

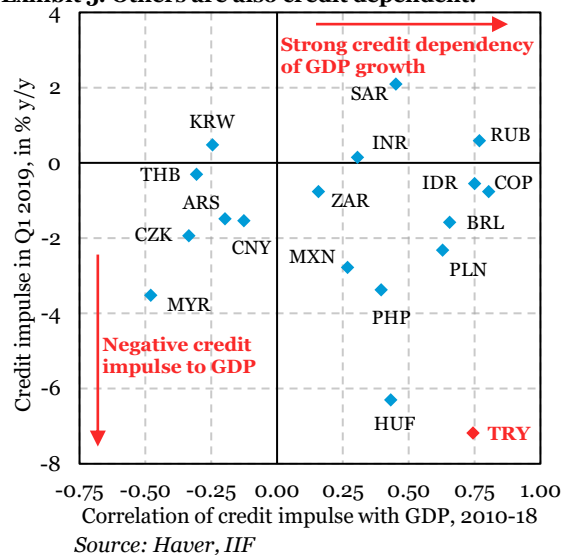


Exhibit 6. China looks like an outlier, but isn't.

