CIO Insight

The Soft Data-Hard Data Conundrum

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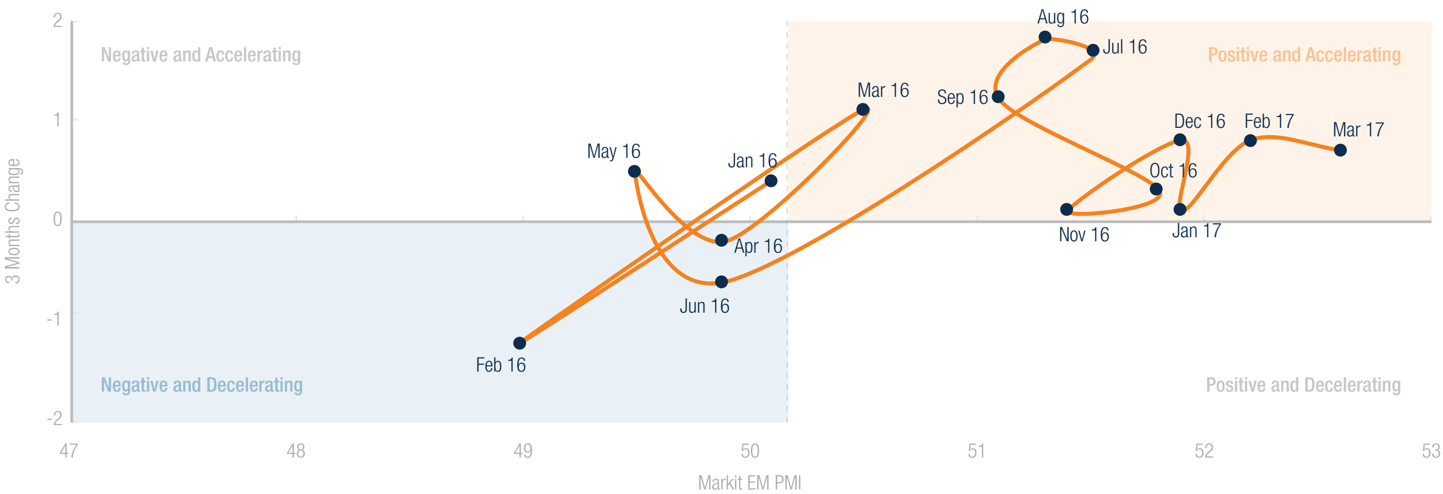
It is quite extraordinary how quickly sentiment can change in stock markets. Last February, we were all worried about deflation and a hard landing scenario in China. Now, nearly 15 months later, the world seems to be in a better place. Since February 2016 markets were faced with the shock of Brexit, the surprise election of Mr. Donald Trump as US President, and to top it all demonetization in India, repudiating 85% of the currency in circulation. Yet, merely three months post each of these events markets were trading higher.

This is not to say that markets were oblivious to the reality or gravity of these situations, but still consumer and business confidence bounced back sharply following an initial dip. The reassurance to the consumer was the absence of tail risk and the realization of a long-term path towards improving productivity and enhancing competitiveness in the economy.

Charting the Territory of Economic Cycles

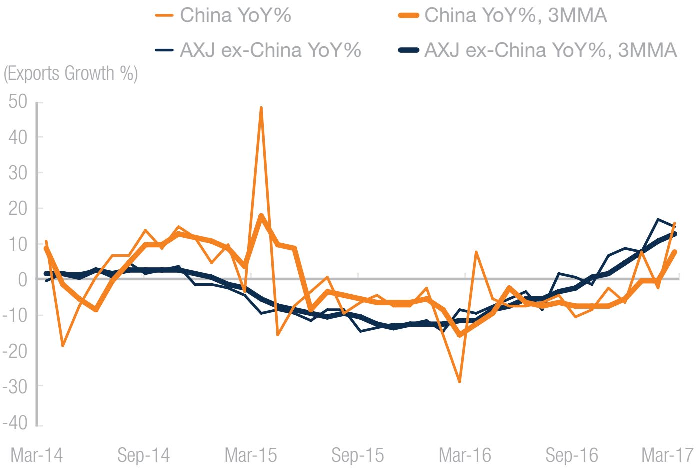


Source: Bloomberg, Mirae Asset Global Investments (2017)

The Paradox of Feelings and Facts

As we write this article, the strong consumer and business confidence is evident in the robust purchasing managers index (PMI) data, the income from operations (IFO) expectation readings, and the various consumer surveys across the world. The positive impact of this is seen in the revival of Asian exports, fairly broad-based improvement across all key demand regions. However, despite the recovery in exports, the strength of other key economic data or hard data such as gross domestic product (GDP) and index of industrial production (IIP) expansion comes in far lower than the confidence shown by the soft data, i.e. business or confidence surveys.

A Revival in Asian Exports



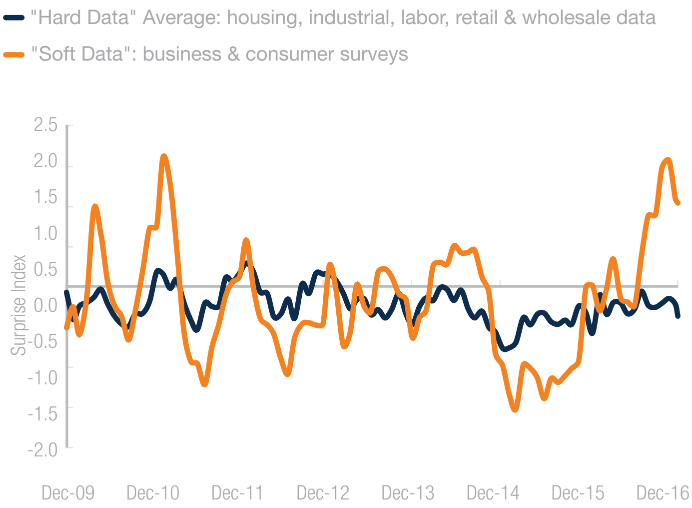
Source: CEIC, Morgan Stanley Research (2017)

It is remarkable how often corporates have been quick to comment on observing green shoots of demand in last three to four years, which subsequently fade in a couple of quarters. In a normal business cycle, an embryonic recovery builds on itself and gets entrenched as consumer and business confidence gets positive reinforcements. Often in an early upcycle, consumers are induced by promotions to start spending, meaning that businesses in turn see higher revenues. More importantly, as costs remain relatively fixed in the short-term, the superior sales figures on stable cost bases should drive significantly elevated profits. These profits then go back into the economy in the form of wage hikes and larger capital expenditures to meet rising future demand, hence creating a virtuous cycle.

Converging and Diverging

So then the million dollar question is: if and when will the soft and hard data converge in the current cycle? Historically, we have seen that the soft data leads hard data by about 6-9 months.

Animal Spirits and Concrete Data



Source: Bloomberg, Mirae Asset Global Investments (2017)

Thus, taking the same precedent, we believe that businesses are to gain confidence on demand recovery and consumers get used to better economic conditions; both will spend more, unleashing "animal spirits" in the economy. From a market perspective, the enabling conditions would be the Trump administration kick starting a private capital expenditure cycle through tax cuts. The corporates who have become accustomed to cash hoards and buybacks in recent years are likely to then switch tracks as the age of capital stock is fairly high in the US. Furthermore, any progress on infrastructure improvement would be an additional bonus. Meanwhile in China, the recovery in exports will boost GDP growth, though it is important that the government continues with supply-side reforms of cutting excess capacity within the economy and controlling the credit bubble.

With the top two economies in the world (together accounting for nearly 37% of world GDP[1]) getting their act together, it is highly likely that optimism for both businesses and consumers will continue to grow and the markets can escape the low-growth rut.

[1] World Bank (2017)

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