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Are stocks a good hedge against inflation? evidence from emerging markets

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Abstract

Theory suggests that equities are a good hedge against inflation. However, most of the empirical evidence for industrialized economies suggests that the relationship between stock returns and inflation is negative. One explanation is the negative correlation between inflation and real output growth. This paper examines the relationship between inflation and stock returns for ten important Emerging Stock Market (ESM) markets, namely, Chile, Mexico, Brazil, Argentina, Thailand, S. Korea, Malaysia, Hong Kong, Philippines and Turkey, during the 1990s. To anticipate the results, the relationship between stock returns and inflation, for the whole sample period, is positive and statistically significant for three of the sample ESMs, while it is positive (but statistically insignificant) for a further three. Only for one ESM is the relationship negative and statistically significant. This result may be due to the role of money and the positive relationship between consumer prices and output.

Notes

[1] Many earlier studies often use GDP as a proxy for economic activity. However, GDP for most emerging markets is reported annually and in some cases the series is discontinued. Here, one needs to employ long-run monthly observations for the empirical testing and therefore one has to find another variable to proxy for economic growth. Industrial production includes manufacturing, mining, construction and public goods production, and thus, it should be a good proxy for real economic activity (see also Ghatrath et al., 1997).

[2] Due to unavailability to the author of some macro data for Hong Kong this market is excluded from this part of the analysis. Also, since the CPI series for Argentina appears I(0) no subsequent cointegration analysis for this market takes place, and due to data limitations the subsequent analysis for Brazil covers the period 1995–2000.

[3] Testing for the correct lag structure in the VAR with the Akaike Information Criterion suggests taking 1 lag, for all countries, except the Philippines (8 lags).

[4] Not reported here, but available upon request.

[5] Furthermore, in order to establish the stability of the relationship over time, we repeated the above tests during two subperiods, 1989–1995 and 1995–2000. For all countries we still detect one cointegrating vector and (with the exception of money supply for Thailand [1st subperiod], Korea [2nd sub-period] and Malaysia [2nd subperiod]) both real activity and money supply are significantly related to consumer prices for all countries. These results are not reported here but are available from the author, upon request.

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