Investor relevant news from Russia, China, and Malaysia

By Jan Dehn

Russia is preparing to introduce Euroclearable local currency corporate bonds in early 2014. This is an important milestone for Emerging Markets (EM) fixed income. Local currency corporate bonds are not recognised as an asset class, and do not even have an index. Yet, this asset class is among the fastest developing segments in Emerging Markets fixed income. China delivered more positive data and its currency appreciated to the strongest level for 20 years versus the US dollar. Malaysia's budget was exactly what the doctor prescribed; business friendly and prudent. Meanwhile, US data continued to deteriorate and the Dollar and US treasury bonds continue to destabilise markets in the rest of the world.

Emerging Markets	Index level/ yield	Spread over UST	1 week change
MSCI EM	1,027		-1.47%
MSCI FM	570		0.02%
GBI-GD	6.23%		1.07%
ELMI+	3.61%		0.37%
EMBI GD	5.52%	299 bps	0.44%
EMBI GD IG	4.61%	202 bps	0.49%
EMBI GD HY	7.72%	550 bps	0.33%
CEMBI BD	5.48%	344 bps	0.32%
CEMBI BD HG	4.61%	255 bps	0.45%
CEMBI BD HY	7.45%	546 bps	0.35%

Global backdrop	Index level/yield/ FX rate/price	1 week change
S&P 500	1,760	0.87%
VIX Index	13.09	-0.53%
5 year UST	1.30%	-6 bps
10 year UST	2.53%	-8 bps
10 year Bund	1.76%	-8 bps
EURUSD	1.381	0.93%
USDJPY	97.61	-0.59%
Brent	$108	-2.25%
Copper	$331	-1.35%
Gold	$1348	2.38%

Emerging Markets

There was no single strong unifying theme in Emerging Markets over the past week, but there were a number of developments of relevance to investors. We have chosen to highlight the following:

- Russian Deputy Finance Minister Alexei Vladimirovich Moiseev announced last week that Russia will formally launch Euroclear/Clearstream settlement of local currency corporate bonds starting 1January 2014. Over the last few years Russia has been highly successful in transitioning the settlement of local government bonds to Euroclear. Euroclear settlement significantly eases access for foreign investors, and in Russia's case resulted in an increase in foreign ownership of OFZ bonds from less than 3% to a peak of almost 30%. Russia's decision to make its local bond market Euroclearable is part of a wider effort to rotate the economy away from anchoring inflation using a currency peg towards more flexible exchange rates and using an interest rate anchor. It is therefore not a coincidence that central bank governor Naubiulina announced that the central bank is scaling down the volume of its regular FX intervention from USD 120m to USD 60m following the widening of the non-intervention band earlier in the month. Eventually the central bank hopes to end intervention in RUB bands by 2015. Efficient management of inflation via interest rates requires an easily accessible bond market. Foreign participation is particularly important, because it makes the interest rate transmission mechanism much more efficient if foreigners can enter the market, because their flow will help to appreciate the currency, which means that rates do not have to go up as much as they would without foreign involvement. We expect local currency corporate bond markets to become far more accessible over the next few years, ultimately exceeding in size the Dollar corporate bonds markets. In other news, Russian foreign exchange reserves rose by more than USD 1bn in the past week to reach USD 511bn.
- China's flash PMI number for October was stronger than expected at 50.9 (versus 50.2 in September). The PMI number points to a continuation in China's gradual economic expansion, which in Q3 produced 7.8% qoq real GDP growth. One of the main drivers of growth in the coming months is likely to be investment in railways infrastructure. China's currency also set another 20 year high against the Dollar and the Chinese authorities allowed financial conditions to tighten marginally. Both these measures will dampen the pace of expansion, which is taking place against an inflation rate which recently picked up to 3.1% yoy. Finally, we note that PBOC last week launched a new interest rate for commercial banks' prime customers. The Loan Prime Rate will eventually replace the PBOC benchmark lending rate as China moves towards using interest rates to manage the temperature of a domestic-demand led economy from using exchange rates to manage an export-led economy.

Continued overleaf

Emerging Markets

- Malaysia's much anticipated 2014 government budget was published on Friday. The budget proposes to reduce the fiscal deficit to 3.5% of GDP in 2014 from 4.0% in 2013. The tax changes are very business friendly. The government will introduce an efficient generalised sales taxes (GST) regime from 1April 2015 at a rate of 6%, while corporate taxes will be reduced from 25% to 24% at the same time. Personal income taxes will also be reduced, and further subsidy reductions of nearly 16% will be implemented by 2014. On the expenditure side, salary bonuses will be slashed in half.
- Although the performance of Asian economies varies widely from country to country, it was notable that a number of Asian economies released materially stronger than expected data last week. In the Philippines imports rose 6.9% yoy versus 3.6% yoy expected, suggesting strong domestic demand. Exports were stronger than expected, up 20% yoy. Hong Kong's September exports were stronger than expected at 1.5% yoy, up from -1.3% yoy in August. Taiwanese exports rose 2.0% versus 0.4% expected. South Korean exports for the first 20 days in October were up 2.7% yoy, a material improvement from the -2.9% yoy rate recorded in September. South Korean 3Q GDP was also strong at 1.1% qoq, or 3.3% yoy. And in Singapore industrial production surged to 9.3% yoy in September, exceeding expectations of 5.7% yoy. The recovery in tech production (+20% yoy) was the strongest since early 2011. The seasonally adjusted mom estimate 3.7% vs. 0.5% expected. But in a healthy reminder that Emerging Markets should never be viewed as an amorphous mass of countries, Thailand's exports dropped -7.1% yoy in September versus an expected gain of 0.5%. Imports also dropped sharply (-5.2% yoy versus +3.6% expected). Looking at the detail, exports to ASEAN expanded 6.6% yoy, but exports to Japan and G3 were particularly weak (for example exports to Japan fell 13.6% yoy, while G3 exports declined 5.9% yoy).

Global backdrop

In the past week, United States non-farm payrolls, existing home sales, house prices, mortgage applications, core durables orders, Markit's PMI release, and initial claims for unemployment all surprised to the downside.

The payroll data in particular impacted global sentiment. Since the data was collected before the government shutdown there is now a strong conviction in the market that the next payroll number will also be weak (reflecting the government shutdown). And in turn that means that Fed tapering will be pushed further into the future, with March has now becoming the consensus date for the Fed to re-try tapering. Meanwhile, cue a rally in US bonds and stocks. The strong positive reaction in both bond and stock markets underlines the dependence of US asset prices on the sugar highs from QE. But the strong market reaction also illustrates precisely why the Fed is keen to – and will try again – to taper. When asset markets rally on bad economic news because bad economic news increases the odds of more QE then clearly the markets have become addicted to money printing. And that means that bubbles are not far behind. The Fed sits on the horns of a dilemma – taper and risk killing an over-indebted economy or print and fuel bubbles and eventual inflation.

The disappointing performance of the US economy this year has resulted in expectations of easier monetary policy for a longer period. In turn, this has weighed on the Dollar. Since June last year the United States dollar has depreciated 15% against the EUR, a greater move that in each of the so-called 'Fragile Five' economies in EM during the summer's sell-off.[1] This weakness flies in the face of most analysts' predictions of a resurgent Dollar, which was predicated on expectations of stronger growth and higher rates than in other countries. These expectations have entirely failed to materialise, particularly in relation to Europe, which is the main benchmark against which the US dollar is usually compared. Over the past year, ten year US Treasury bond yields have risen 39% (compared to just 9.3% for Emerging Markets local currency bond yields). The weakness of the US economy and the erratic behaviour of both the Fed and Congress have inflicted tremendous volatility onto global markets, because of the Dollar's special status as global reserve currency and Treasuries' status as global bond benchmark. Intra-EM currency crosses are more stable than crosses involving the US dollar. Indeed, crosses between EUR and EM currencies have historically been more stable than crosses involving the Dollar. But because one way or another most investments benchmark against US markets the bulk of volatility in global currency and rates markets in the past 12 months can be traced back to US volatility. The world continues to pay a high price for the privilege of using the Greenback as its primary reserve currency.

Also of note was that oil prices dropped sharply in the past week. This follows a decision by the Saudi government to forego a seat on the UN Security Council, allegedly due to dissatisfaction over the US-backed UN position on Syria. The supposed rift between the US and the Saudis plus warming relations between the Americans and Iran appear to have been contributing to the decline in oil prices, the argument being that a more isolated Saudi Arabia would be a more vulnerable Saudi Arabia, and hence sell more oil. Regardless of the Syria situation, and indeed regardless of shale discoveries, we doubt that US-Saudi relations will turn sour on a permanent basis. Hence, in our view the dip in oil prices over the US-Saudi differences over Syria is likely to be temporary.

[1] Over the past 12 months the Indian Rupee depreciated 14.8%, South Africa's Rand 12.2%, Indonesia's Rupiah 12.0%, and the Brazilian Reais 8.95%.

Ashmore

Contact

Head office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE

T: +44 (0)20 3077 6000

@AshmoreEM

www.ashmoregroup.com

Other locations

Beijing
T: +86 10 5764 2601

Bogota
T: +57 1 347 0649

Jakarta
T: +6221 2953 9000

Istanbul
T: +90 212 349 40 00

Moscow
T: +74 9566 04258

Mumbai
T: +91 22 6608 0000

New York
T: +1 212 661 0061

Sao Paulo
T: +55 11 3556 8900

Shanghai
T: +86 21 3855 6766

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

Washington
T: +1 703 243 8800

Bloomberg page
Ashmore <GO>

Fund prices
www.ashmoregroup.com
Bloomberg
FT.com
Reuters
S&P
Lipper