Political time shortening fast in Brazil

By Alexis De Mones

This week we briefly comment on the strong returns of Emerging Markets (EM) assets for March. We also cover the main political developments in Latin America and South Africa: Jacob Zuma displays his incredible political survival skills, which Dilma Rousseff probably wishes she could emulate as Brazil may be one week away from an impeachment vote in the lower house. We highlight recent China economic data and some green shoots coming from Asian economic data. Finally, while global macro-economic conditions remain very challenging, the US economy continues to create jobs and the manufacturing sector may have bottomed out in Q1.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.6	–	1.74%
MSCI EM Small Cap	11.3	–	1.78%
MSCI Frontier	8.6	–	-0.19%
MSCI Asia	11.1	–	1.01%
Shanghai Composite	11.6	–	1.01%
Hong Kong Hang Seng	6.5	–	-0.34%
MSCI EMEA	9.1	–	3.20%
MSCI Latam	12.4	–	3.90%
GBI-EM-GD	6.49%	–	2.88%
ELMI+	3.76%	–	1.62%
EM FX spot	–	–	2.12%
EMBI GD	5.84%	404 bps	0.84%
EMBI GD IG	4.38%	250 bps	0.85%
EMBI GD HY	7.88%	619 bps	0.82%
CEMBI BD	5.80%	418 bps	0.67%
CEMBI BD IG	4.38%	277 bps	0.60%
CEMBI BD Non-IG	8.24%	660 bps	0.78%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.4	–	1.84%
1-3yr UST	0.74%	–	0.30%
3-5yr UST	1.22%	–	0.77%
7-10yr UST	1.77%	–	1.14%
10yr+ UST	2.60%	–	1.32%
10yr+ Germany	0.14%	–	1.21%
10yr+ Japan	-0.08%	–	0.62%
US HY	8.79%	756 bps	0.40%
European HY	5.58%	565 bps	0.29%
Barclays Ag	–	233 bps	0.59%
VIX Index*	13.10	–	-1.64%
DXY Index*	94.80	–	-1.14%
EURUSD	1.1364	–	1.50%
USDJPY	111.67	–	1.59%
CRY Index*	168.03	–	-4.15%
Brent	38.6	–	-4.17%
Gold spot	1218	–	-0.34%

Note: Additional benchmark performance data is provided at the end of this document. *See last page for index definitions.

Emerging Markets

A strong month for EM returns

EM assets closed the month on a very strong note and delivered extremely high returns in both the equity and fixed income space. The MSCI EM index returned 13.3% on the month vs. 6.8% for the S&P 500 index. EM currencies performed particularly strongly, pushed notably by strong portfolio flows from international investors trying to close their underweight positions and more recently by Fed Chair Janet Yellen's very dovish tone on Tuesday. For context, USD was 4.6% weaker against EUR during the month. The JP Morgan index of local currency government bonds posted a 9.1% return in March, 6.4% of which came from spot FX returns alone. This made March 2016 the strongest monthly return for EM currencies since 1998. Index returns were led by the higher yielding currencies where short positions and hedges are more expensive such as Brazilian real, South African rand and Turkish lira, and commodity currencies such as the Colombian peso and the Russian rouble. The index is now 11% up year-to-date and down just -1.6% over 12 months.

Emerging Markets

In Colombia, President Santos and the FARC failed to reach a peace agreement by the March 23 deadline but the presidency started formal negotiations with the other opposition armed group, the ELN. The government concessions include the possibility for guerrillas to escape jail time if they confess their crimes. This measure is strongly opposed by a large segment of the Colombian population, who was demonstrating again in Bogota this week. President Santos, now in his second mandate, has staked all his political capital on the success of these peace negotiations. A successful accord would be greeted by the majority of the population, and by financial markets. However, the President's focus on solving the guerrilla issue is currently holding up other important business, notably an important tax reform destined to increase government revenue and to close a yawning fiscal deficit estimated to reach 3.6% of GDP this year.

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Emerging Markets

In Brazil, political time is shortening quickly for the president's office. The parliamentary rapporteur of the impeachment committee could publish his report and his recommendation on April 11, and the lower house's vote could take place by April 17. The Supreme Court is reviewing Lula's appointment as President Dilma's chief of staff, and could approve the appointment during the week. There is heightened scrutiny on Vice President Temer, who is viewed as pulling the strings behind attempts to get Dilma Rousseff impeached, but he is keeping very quiet. Since the PMDB party, the senior partner in her coalition, decided to withdraw its support for the government, President Rousseff has been actively courting members of junior coalition parties, offering them ministerial positions to secure their support. Some may be tempted, just like a few ministers affiliated with the PMDB are insisting on keeping their jobs, so the vote count can shift in her favour. Meanwhile, the political battle becomes more acrimonious as new revelations are brought to light by the public prosecutor against senior politicians, and the Workers Party denounces a political 'coup'.

Economic data was mixed, with worse fiscal numbers and less terrible industrial production data. The February consolidated government primary budget was BRL 23bn in deficit versus BRL 11bn expected. This pushed the 12 month primary deficit to 2.1% of GDP, up from 1.8% in January and the fiscal deficit after interest payments to 10.8% of GDP. Industrial production fell 2.2% m-on-m in February but the y-on-y contraction continued to slow down to -9.8%.

Brazil's central bank (BCB) released the Inflation Report for Q1, in which it raised its 2016 and 2017 inflation forecasts: its baseline scenario, which assumes BRL at 3.70 to the USD and the SELIC rate at 14.25% until the end of the forecasting horizon, projects inflation at 6.6% in 2016 and at 4.9% in 2017, up from 6.2% and 4.8% previously estimated.

Following the successful vote in the lower house last month, Argentina's Senate approved, in a 54-16 vote in favour, the measures required for the deal with the holdout creditors to go through. The Senate approved the issuance of up to USD 12.5bn in bonds to pay the creditors and revoked the laws that prevented a new offer to be made.

The outlook is improving a little bit in Asia, based on recent manufacturing and trade data.

In China, economic data surprised on the upside, with March official (NBS) manufacturing PMIs up 1.2 points to 50.2, and the Caixin (Markit) manufacturing PMI up 1.7 points to 49.7. The jump is likely a reflection of more growth-supportive fiscal and monetary policies which led to the surge in total social financial last month.

Besides, China released the detail of its Balance of Payments data for 4Q 2015. Capital outflows for the period were recorded at USD 207bn, a little lower than the USD 226bn recorded during the previous quarter. In addition to being smaller, the outflows also had more to do with corporates being down their debt and foreign currency deposits. In contrast the numbers for Errors & Omissions (non-classified activity usually associated with capital flight) and an increase in offshore assets, was smaller than in the previous quarter, at USD 72bn in total for the quarter.

In neighbouring Taiwan, after three disappointing quarters, manufacturing PMI for March recovered nicely to 51.1 from 49.4 in February. The latest number is back to the levels recorded one year ago, and around 5 points ahead of the average manufacturing PMI series recorded during last year's very poor second quarter.

As usual, Korea was the first country to publish its trade statistics for March: exports remain weak but the drop slowed down to -8.2% y-on-y in value (from -12%) due to a sequential increase of +2.8% m-on-m (seasonally adjusted). In terms of exports destinations, exports to Europe held up relatively better than exports to the US and Asia. Exports to China, Latam and the Middle East continue to underperform, consistent with the contraction in exports of capital goods such as vessels.

In contrast, economic data in CEEMEA was generally weaker. March manufacturing PMI data was lower sequentially in Russia, Turkey, Hungary and the Czech Republic, with the first two countries down one point to 48.3 and 49.2, respectively, with Central European prints still at healthy levels. Poland was the out performer, with its manufacturing PMI up one point to 53.8.

In South Africa, the Constitutional Court's 11 justices voted unanimously to condemn President Jacob Zuma for 'failing to uphold the supreme law of the land' by refusing to repay the huge expenses lavished on his home in the city of Nkandla. The president had been ordered by the Office of the Public Prosecutor to repay the state for the cost of the work as far back as 2014, and has always refused. In response to this new ruling, Zuma apologised and promised to repay the state, but denied dishonesty. This judgment will reassure investors that the young democracy's institutions are holding up and serving the public well, but it further weakens the moral authority of the beleaguered president, who is facing increasing calls to step down before the end of his term.

In a long interview with Bloomberg, Saudi Arabia's deputy Crown Prince laid out his vision to raise USD 100bn annually from non-oil resources by 2020. The plan, which has been discussed for months and has been lacking in detail until now, hinges on a three-way combination of new levies including VAT, an ambitious reform of subsidies, and asset sales. The prince specified that the plan includes a steady ramp up in general government debt to 35% of GDP by 2020, from 2% today. The Kingdom is raising money domestically and via syndicated loans which investors have been eagerly awaiting a jumbo maiden Eurobond issue, which the Prince said could be issued in September.

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Ashmore

Emerging Markets

Snippets

- **Indonesia:** March inflation was unchanged at 4.4%
- **Russia:** 4Q 2015 real GDP growth was reported at a -3.8%, driven by a 12% y-on-y fall in domestic consumption; Fixed investment contracted less sharply and net exports contributed very positively to as exports increased 10% y-on-y.

Global backdrop

The week's highlights were Janet Yellen's dovish remarks to the Economics Club of New York, which we commented on last week and Friday's jobs report. The headline non-farm payroll number came in on the strong side of expectations with 215K jobs created, bringing the total for the quarter to 628K. Jobs were mainly created in services, while factory payroll fell 29K. The unemployment rate ticked up one tenth to 5.0% owing to a rise in the participation rate, the sixth consecutive increase, to 63%. The increase in the participation rate will please the Fed, and Yellen in particular, who is counting on this reserve of idle labour to moderate wage inflation, and indeed average hourly earnings have been contained at 0.3% m-on-m and 2.3% annualised rate for the quarter.

In apparent contradiction with the fall in manufacturing jobs in the US, manufacturing confidence data surprised positively in March: the ISM manufacturing index rose 2.3 points to 51.8, the highest level since July 2015, driven by a jump in new orders to a 16 month high of 58.3.

In Europe, the final composite PMI for March came in at 51.6 v 51.4 expected, with Germany (50.7), Spain (53.5) and Italy (53.4) all on the strong side of consensus. Harmonised inflation data still recorded deflation in the headline number (-0.1% from over a year ago), while core HICP was up to 1.0% from over a year ago.

In a great story of resilience, the comeback kid Ireland issued a 100-year bond this week less than 5 years after receiving an IMF bailout, at a yield of merely 2.35%.

In Japan, economic data continued to disappoint, particularly retail sales, which were down -2.3% in February m-on-m, the fourth negative print in succession. The latest Tankan survey also came below expectations. The large manufacturers' index came in at 6, the lowest print since June 2013. The non-manufacturer's survey is holding up better at 22, just off its recent high of 25.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	-1.26%	4.36%	-13.57%	-4.47%	-4.29%
MSCI EM Small Cap	-0.51%	0.45%	-10.26%	-2.54%	-2.59%
MSCI Frontier	-0.17%	-1.18%	-13.74%	1.66%	1.09%
MSCI Asia	-1.30%	0.42%	-13.05%	0.00%	-0.19%
Shanghai Composite	0.19%	-14.96%	-19.76%	13.36%	2.77%
Hong Kong Hang Seng	-1.78%	-8.45%	-27.28%	-3.11%	-4.68%
MSCI EMEA	-1.83%	10.90%	-13.98%	-8.35%	-7.88%
MSCI Latam	-0.32%	18.82%	-11.68%	-14.44%	-11.56%
GBI EM GD	-0.35%	10.62%	-2.84%	-6.82%	-2.13%
ELMI+	-0.53%	4.90%	-1.15%	-4.09%	-2.75%
EM FX Spot	-0.51%	5.19%	-7.99%	-11.27%	-8.99%
EMBI GD	0.12%	5.17%	3.74%	3.47%	6.18%
EMBI GD IG	0.16%	5.83%	1.48%	2.88%	5.54%
EMBI GD HY	0.08%	4.26%	7.05%	4.27%	7.15%
CEMBI BD	0.07%	3.96%	2.59%	2.86%	4.92%
CEMBI BD IG	0.05%	3.37%	2.06%	3.28%	5.45%
CEMBI BD Non-IG	0.10%	4.99%	3.41%	1.89%	3.97%

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Benchmark performance

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	0.63%	1.99%	2.81%	12.20%	11.59%
1-3yr UST	-0.02%	1.10%	1.06%	0.66%	0.77%
3-5yr UST	-0.05%	2.50%	2.23%	1.87%	2.41%
7-10yr UST	-0.04%	4.72%	3.54%	2.94%	5.88%
10yr+ UST	0.21%	8.51%	1.66%	6.28%	10.54%
10yr+ Germany	0.64%	10.85%	-0.34%	9.73%	12.36%
10yr+ Japan	1.51%	11.33%	15.13%	7.69%	7.72%
US HY	-0.01%	3.25%	-4.28%	1.70%	5.11%
European HY	0.10%	2.38%	0.25%	6.51%	9.11%
Barclays Ag	0.00%	3.37%	0.72%	3.40%	5.12%
VIX Index*	-6.09%	-28.06%	-10.70%	-5.69%	-25.14%
DXY Index*	0.23%	-3.88%	-1.81%	14.66%	24.88%
CRY Index*	-1.46%	-4.61%	-22.24%	-41.75%	-53.61%
EURUSD	-0.14%	4.62%	4.05%	-12.15%	-20.09%
USDJPY	0.81%	7.66%	7.05%	-13.73%	-24.72%
Brent	-2.55%	3.51%	-29.77%	-63.71%	-68.12%
Gold spot	-1.24%	14.74%	0.22%	-21.69%	-15.10%

*VIX Index = Chicago Board Options Exchange SPX Volatility Index. *DXY Index = The Dollar Index. *CRY Index = Thomson Reuters / CoreCommodity CRM Commodity Index.
Source: Bloomberg, JP Morgan, Barclays, Merrill Lynch, Chicago Board Options Exchange, Thomson Reuters, MSCI, total returns.
Figures for more than one year are annualised other than in the case of currencies, commodities and the VIX, DXY and CRY which are shown as percentage change.

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