Ashmore

Global growth – myth versus reality

By Jan Dehn

EM growth has held up well in the period since the Developed Market Crisis (DMC) of 2008/2009, while developed economies have significantly slowed. Moreover, EM is set to accelerate between 2016 and 2021, while developed economies will slump. We discuss Argentina's return to global bond markets, Brazil's impeachment process and China's latest data. We also touch upon politics in South Korea and Ukraine and briefly discuss changes to the monetary policy framework in Indonesia. Do take a look at the snippets section – almost all of EM's data releases in the past week surprised to the upside, which should please those who worry about the progressively gloomier outlook in developed economies.

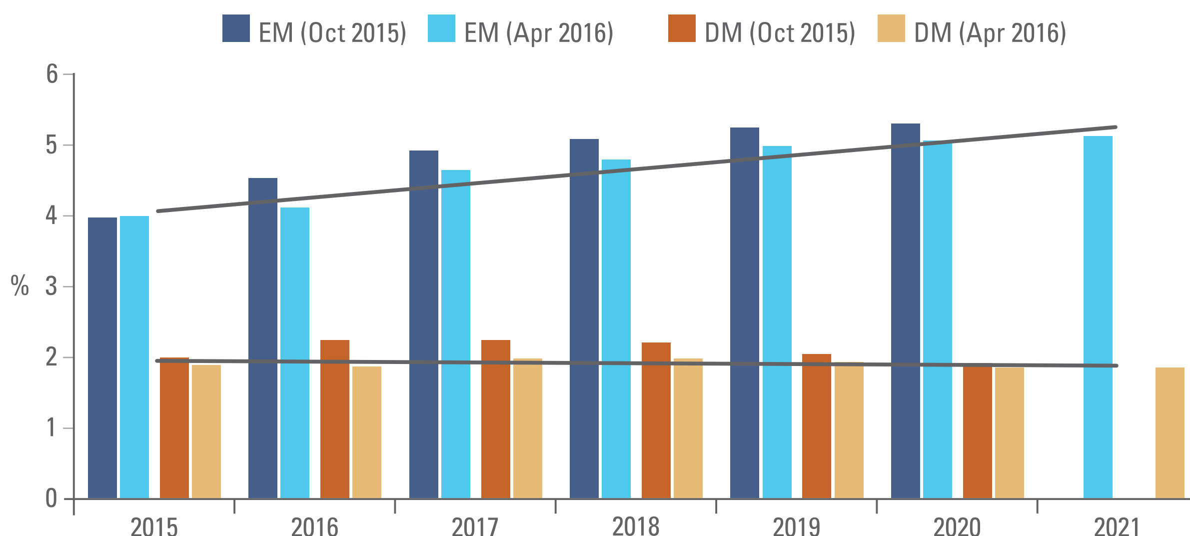
Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.9	–	2.43%
MSCI EM Small Cap	11.5	–	1.29%
MSCI Frontier	8.5	–	1.81%
MSCI Asia	11.4	–	2.33%
Shanghai Composite	11.8	–	0.00%
Hong Kong Hang Seng	6.9	–	3.22%
MSCI EMEA	9.6	–	2.59%
MSCI Latam	12.6	–	2.99%
GBI-EM-GD	6.32%	–	0.72%
ELMI+	4.04%	–	-0.11%
EM FX spot	–	–	-0.13%
EMBI GD	5.71%	392 bps	0.84%
EMBI GD IG	4.27%	241 bps	0.75%
EMBI GD HY	7.73%	605 bps	0.95%
CEMBI BD	5.68%	407 bps	0.68%
CEMBI BD IG	4.30%	270 bps	0.45%
CEMBI BD Non-IG	8.03%	641 bps	1.09%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.6	–	2.59%
1-3yr UST	0.77%	–	-0.07%
3-5yr UST	1.26%	–	-0.25%
7-10yr UST	1.79%	–	-0.38%
10yr+ UST	2.60%	–	-0.39%
10yr+ Germany	0.18%	–	-0.67%
10yr+ Japan	-0.12%	–	0.36%
US HY	8.38%	716 bps	1.19%
European HY	5.32%	547 bps	0.77%
Barclays Ag	–	234 bps	0.11%
VIX Index*	13.13	–	-1.72%
DXY Index*	94.36	–	0.40%
EURUSD	1.1333	–	-0.47%
USDJPY	109.31	–	0.71%
CRY Index*	174.11	–	2.29%
Brent	43.2	–	-3.29%
Gold spot	1242	–	-1.07%

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

Emerging Markets

Fig 1: **Real GDP growth – IMF forecasts out to 2021 as of April 2016**



Source: IMF World Economic Outlook, Ashmore.

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Emerging Markets

EM growth is set to accelerate as growth in developed economies is slowing. In its April 2016 outlook for global growth, the IMF anticipates EM growth rates to accelerate in the next five years compared to an outright deceleration in developed economies. The IMF sees EM growing 4.1% in 2016 rising to 5.1% per year by 2021, while developed economies will slow from 1.9% in 2016 to 1.8% by 2021. On average EM countries will grow 4.8% over the period compared to just 1.85% for developed market economies.

The IMF adjusted growth rates for developed economies down by an average of 9 percent for the period from 2016 to 2021, while the average growth rate for EM countries was revised down by only 5 percent. The larger percentage downwards revision for growth in developed economies is more economically significant because it is happening against a base of already much lower growth than in EM.

It is customary within the finance industry to shamelessly data mine in order to make a point. For example, most analysts have been flogging the 'EM slowdown story' in recent years by pointing to EM's deceleration relative to the years of exceptionally high growth rates in 2010-2011. But this basis for comparison is obviously highly misleading; EM economies experienced strong 'exit velocity' from the global crisis in 2010-2011 as global financial markets re-opened after the capital stop in 2008/2009. The fairer way to analyse growth rates is to exclude data points that are obvious known outliers – such as the crisis and bounce-back years between 2008 and 2011 – and instead to rely on longer-term averages that smooth out cyclical effects.[1]

The table below does precisely this. It compares real GDP growth rates in developed economies and EM economies in (i) the post-Cold War/pre-DMC period (1990-2007); (ii) the post-crisis/post bounce-back period (2012-2015); and (iii) through IMF's forecast period (2016-2021).

Fig 2: **Long-term growth rates: average real GDP per annum**

	(i) Pre-crisis	(ii) Post-crisis		(iii) IMF forecast	
	1990-2007	2012-2015	% change versus pre-crisis	2016-2021	% change versus pre-crisis
Advanced economies	2.7	1.6	-42%	1.9	-30%
Emerging economies	5.0	5.0	1%	4.8	-4%

Source: World Economic Outlook, IMF.

The table – based on hard data – tells a very different story from the consensus perception of a major slowdown in EM:

1. EM economies actually grew marginally faster between 2012 and 2015 than in the pre-crisis period (about 1% faster). By contrast, growth rates in developed economies have declined by a whopping 42% relative to the base period.
2. EM economies are expected to grow only marginally slower than their long-term average growth rates in next five years, while developed economies are not expected to recover to anywhere near the growth rates they sustained before the crisis.
3. The EM convergence story – a strong rationale for investing in EM – is completely intact. EM economies will continue to 'catch up' with developed economies at a rapid pace in the years ahead, complete with all the structural changes that accompany this process.

These observations, which are based entirely on the IMF's newly published data, begs the question why the IMF, many members of the media and so many bank analysts continue to insist on making shrill warnings about EM growth, when – evidently – the real growth crisis is taking place in the developed economies.

One reason is that these observers are either ignorant about EM or simply choose deliberately to pander to prejudice. While this is expected among bank analysts and sections of the media, it is disappointing that the outdated myths about EM also to find such strong adherents by those who ought to know better, namely the international organisations, such as the IMF, whose own data clearly tells a quite different picture.

We are not naïve enough to believe that misguided perceptions about the asset class will change overnight. The silver-lining is that such inefficiencies can be turned into profits. More often than not EM asset prices overreact to events, whether they occur within EM and outside the asset class. Episodes of exaggerated risk perceptions about EM present good opportunities to add to the asset class.

[1] For those that are curious, EM countries grew on average 5.6% in the years 2008-2011, while developed economies averaged only 0.4% growth during this difficult period.

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Emerging Markets

- **Argentina:** The US Court of Appeals decision last week paved the way for Argentina to formally settle its dispute with holdout investors. The Court of Appeals upheld the ruling of Judge Thomas P. Griesa of the Southern District of New York which issued injunctions barring Argentina from issuing debt can be lifted. Argentina's re-entry into global capital markets is hugely significant. On the broadest perspective, a country is far better placed if its government and corporations have access to finance as opposed to existing in financial autarchy. Argentina's sovereign default risk is low and falling on account of improving willingness and ability to pay. While Argentina faces some near-term macroeconomic adjustment challenges, we expect those gradually to be overcome.

Investors should, in principle, care about willingness and ability to pay, the technical picture and also take into consideration the likely trajectory for the country's ratings. As far as the willingness to pay is concerned, we think that this is high. The Macri Administration is taking explicit steps to cure the default and return the country to global capital markets. The government's economic program relies heavily on deepening its access to global capital markets, given the emphasis on fiscal policy and rebuilding Argentina's crumbling infrastructure. The economic team also favours Argentina's re-integration into global capital markets. The next general election is not until 2019.

As regards the ability to pay, it is improving, but with some near-term challenges. Argentina has a benign debt profile with low repayments in the near-term after more than a decade of exclusion from global capital markets. Net government debt is less than 35% of GDP, foreign currency denominated public debt is less than 25% of GDP and Argentina only has about USD 6bn in public and private foreign currency debt services obligations in 2016. The main short-term challenge is to rebuild the country's stock of FX reserves, which currently stand at less than USD 30bn. FX reserves were depleted due to excessive reliance on monetary stimulus during the Kirchner Administration. The level of FX reserves should rise steadily over the next few years due to the macroeconomic adjustment currently underway in Argentina. Specifically, the government is placing a greater emphasis on fiscal policy – soon to be supported by renewed access to global financial markets – while monetary policy is being tightened. The currency has also been given greater flexibility to find its own level. Ability to pay will also be supported by renewed access to financial support from International Financial Institutions, such as the IMF, IADB and the World Bank, though we do not expect Argentina to need an explicit adjustment program with the IMF. Other recent policy changes, such as the removal of punitive export taxes should also significantly boost agricultural exports in the coming years and encourage the return of some of Argentina's estimated USD 120bn in flight capital. The macroeconomic adjustment is deliberately being done in a gradual manner to avoid a rapid depletion of the government's political capital; it is important to protect the government's political capital, because the government faces many other reform challenges beyond the holdout issue.

Once the immediate objective of restoring access to global capital markets has been achieved we expect the government to place greater emphasis on bringing the domestic bond market back to life. The domestic bond market will ultimately become the backbone of the government's financing strategy as is the case in most other Latin American countries. Greater reliance on domestic rather than foreign savings for financing purposes will significantly reduce Argentina's vulnerability to the vagaries of global capital markets. The key to achieving this objective is to convincingly break the inflationary momentum – something that will take some time.

Longer-term, the main risk to Argentina's ability is political; the country's Constitution places too much power with provincial governments vis-à-vis the central government, a fact that has led to moral hazard problems and rising debt levels in the past. However, the risk of unsustainable debt levels in the near-term is low in the foreseeable future due to the starting point of overall low levels of debt.

The underdeveloped state of Argentina's current fixed income markets suggests strong growth in the coming years as the capital constraint is lifted. Indeed, Argentina should eventually resume its role as one of Latin America's biggest issuers of fixed income, including sovereign local and external debt, corporate debt in local and foreign currency, structured finance, infrastructure investment and provincial level debt. Near-term, however, the technical position is influenced by the market's ability to absorb the expected heavy volume of supply arising from the settlement with holdout investors and the need to finance the fiscal deficit.

The new bonds from the deal with holdout investors could hit the market this week. We expect large liquid benchmark bonds with 3y, 5y, 10y and 30y maturities in total size of about USD 15bn. Some of this supply will be absorbed as investors adjust their overall exposure in anticipation of a greater weight in the benchmark indices (the EMBI GD weights is expected to rise at least to 3% from the current 2.6% weighting). Market expectations have become very bullish, however. This implies strong goodwill among investors, but the magnitude of the reform challenges and the gradual nature of the adjustment mean that some slippage relative to the government's ambitious fiscal targets is entirely possible. If so, the government may struggle to close its financing gap without additional issuance, particularly if the economy picks up more slowly than expected. Having said this, we see these challenges as transitional and do not expect them to pose material risks of non-payment during Macri's first term.

Last week, Moody's upgraded Argentina from Caa1 to B3, while S&P and Fitch issued expected ratings of B– and B, respectively. This means that the new bonds are likely to carry a rating in the region of B, putting them in the same neighbourhood as Ecuador, Jamaica, Zambia and Uganda. Argentina's current bonds trade more expensively than these and other average B- and B credits. Provided Argentina makes progress on fiscal and inflation dynamic, however, the ratings momentum is likely to be positive – in other words the market is already pricing in benign fundamental outlook for Argentina.

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Emerging Markets

- **Brazil:** Brazil is building a tradition of impeaching presidents deemed to be grossly corrupt. This is obviously a positive thing. Last night the Lower House voted in favour of impeachment of President Dilma Rousseff following a Lower House committee vote last week, which also approved the impeachment process. The process has firm constitutional backing following a ruling by the Supreme Court that the basis for the impeachment process against the President, as laid out in the current impeachment proposal, is constitutional. It now remains to be seen if Dilma will resign or continue the battle in the Senate. In the instance Dilma doesn't resign, a Senate commission will be formed to judge whether the impeachment process is tabled on the Senate floor. A simple majority in favour would effectively lead to a 180-day period when the President is forced to step down and concentrate on her defence, and Vice-President Temer takes over. The vote to formally impeach Dilma Roussef then requires a two-thirds super-majority in the Senate. It is unlikely that the Dilma would survive the impeachment vote in our view given the lack of political clout of the PT party and municipal elections in October. On a separate note, retail sales picked up strongly (1.8% mom versus 0.5% mom expected).

- **China:** Those who predicted China to have a hard landing can once again pack away their misleading rhetoric until the next time global risk aversion requires an episode of unfounded EM panic in order to generate some unnecessary trading. China's economy expanded by 6.7% yoy in 1Q16 and the macroeconomic data releases pointed to broad-based improvement, particularly in industrial production (up 6.8% yoy in March versus consensus 5.8% yoy). Lending data was strong; it is refreshing to find a country where stimulus actually works, though strong trade data also contributed to the better outlook. Several banks revised up their forecasts for Chinese growth last week. Property prices rose 1.0% mom in March (5.50% yoy), which represented an acceleration relative to February (4.1% yoy).

- **South Korea:** The government lost considerable power following the election on 13 April, where the governing Saenuri Party saw its number of seats in the National Assembly (NA) cut to 122 out of 300. The change is not material to the immediate outlook for Korea, because day to day macroeconomic policy will continue to be done competently, while the government already had less than a majority of seats in the NA prior to the election. A number of required reforms, notably of labour markets, will be tough to pass.

- **Ukraine:** The new government led by Volodymyr Groysman has a narrow majority of 227 seats out of the Rada's 450 seats. The integrity of this majority will soon be put to the test as Ukraine prepares to pass legislation required for keeping the IMF on track. Passage of the required legislation will likely pave the way for a rally in Ukraine debt, while failure to pass reforms would usher in a period of considerable nervousness, in our view. The government says it will prioritise anti-corruption legislation.

- **Indonesia:** Bank Indonesia, Indonesia's central bank, is moving towards a sophisticated monetary policy framework by changing the main reference rate to the 7-day reverse repo rate (5.5%). The corridor around this rate will be 150bps (4.75% and 6.25% for the upper and lower bands, respectively). The new system is intended to give greater stability to the interbank rates and therefore help transmit policy rates more effectively to lending rates (BI gains greater influence over liquidity in the system without formally changing monetary policy). In other news, the trade balance in March was in surplus to the tune of USD 490m compared to an expected surplus of USD 465m.

Snippets:

- **Costa Rica:** Real GDP growth rose to 5.4% yoy in February from 4.8% yoy in January. This is the strongest rate of growth in 45 months.
- **Dominican Republic:** The number of tourists coming to Dominican Republic rose 6.2% yoy in Q1 2016. This means the tourism is now 9.2% of GDP, up from 8.8% of GDP at the same time the previous year.
- **India:** Industrial production was up 2.0% yoy in February versus 0.8% yoy expected. The rates of inflation declined to 4.8% yoy in March from 5.3% yoy in February. Four states have started local elections, which, over the next four months will significantly impact the composition of the Upper House where the ruling BJP party does not have a majority. If this changes, Goods and Services Tax (GST) reform could return to the political agenda.
- **Mexico:** The central bank has racked up an impressive USD 13.6bn surplus of which the government is spending USD 6.0bn to buy back local bonds. To put this buyback operation in perspective, the entire Argentinean bond transaction with holdout investors is expected to be about USD 12-15bn. Industrial production rose 2.6% yoy versus 1.4% yoy expected.
- **Peru:** The central bank left rates unchanged at 4.25%. Real GDP accelerated to a pace of 6.0% yoy in January versus a consensus expectation of 5.1% yoy.
- **Philippines:** Remittances of overseas income from Philippines workers posted overseas was up 9.1% yoy in February compared to 4.0% yoy expected.
- **Poland:** The yoy rate of inflation in March declined to -0.9% yoy from -0.8% yoy in February.

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Emerging Markets

- **Russia:** Industrial production surprised to the upside, rising 0.4% mom, which means that it is up 1.1% since the start of the year. The market had expected the yoy number to fall by 1.0% but it only declined by half of that. Russia accumulated reserves despite a lower current account surplus due to capital inflow.
- **Singapore:** The Monetary Authority of Singapore eased monetary policy by shifting the currency peg to neutral from a slight appreciation bias.
- **Turkey:** Murat Cetinkaya, a technocrat, has taken over as central bank governor following the conclusion of the term of his predecessor, Erdem Basci. His appointment is a positive surprise, though we think the central bank in Turkey will continue to receive pressure from the Executive.

Global backdrop

US data weakened in the past week, including retail sales, industrial production and consumer sentiment. Earnings were also softer than expected. Despite this, US stocks set new highs, which clearly demonstrate that asset prices are taking their cue from expectations of central bank stimulus rather than anything happening in the real economy. Greece is becoming more important as a driver of risk sentiment as the IMF and the European Union once against fight over the correct recipe for healing this troubled country. After two major haircuts, Greece needs to inflect yet further losses on lenders before it gets to a sustainable debt levels. The International Energy Agency said that the oil market will move into balance in H2 2016 due to collapsing supply from shale fields in the US and marginally stronger demand from EM countries. Oil prices weakened in the aftermath of a failure of the world's major oil producers to agree on cuts. This is positive for the vast majority of EM countries, which are oil importers, but negative for US stocks, which traditionally benefit from the re-investment of oil windfalls.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	0.93%	6.68%	-16.79%	-2.76%	-3.52%
MSCI EM Small Cap	1.52%	2.50%	-14.44%	-1.58%	-2.40%
MSCI Frontier	1.17%	0.15%	-14.22%	1.79%	0.84%
MSCI Asia	0.80%	2.55%	-17.07%	1.48%	0.10%
Shanghai Composite	1.00%	-14.26%	-28.11%	14.29%	2.32%
Hong Kong Hang Seng	0.97%	-5.88%	-35.52%	-0.26%	-4.12%
MSCI EMEA	1.86%	15.07%	-14.11%	-5.81%	-6.20%
MSCI Latam	1.33%	20.79%	-13.66%	-13.01%	-10.51%
GBI EM GD	0.96%	12.08%	-2.60%	-7.16%	-2.04%
ELMI+	-0.29%	5.15%	-2.56%	-4.29%	-2.81%
EM FX Spot	-0.34%	5.38%	-8.69%	-11.48%	-8.99%
EMBI GD	1.26%	6.37%	3.87%	3.13%	6.39%
EMBI GD IG	1.24%	6.97%	2.25%	2.44%	5.75%
EMBI GD HY	1.29%	5.52%	6.16%	4.04%	7.37%
CEMBI BD	0.99%	4.91%	2.22%	2.96%	4.99%
CEMBI BD IG	0.71%	4.05%	1.96%	3.23%	5.50%
CEMBI BD Non-IG	1.45%	6.40%	2.50%	2.28%	4.06%

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Benchmark performance

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	1.77%	3.15%	2.85%	13.09%	12.28%
1-3yr UST	-0.02%	1.11%	0.99%	0.66%	0.73%
3-5yr UST	-0.04%	2.51%	2.15%	1.82%	2.26%
7-10yr UST	0.08%	4.84%	3.52%	2.63%	5.76%
10yr+ UST	0.59%	8.92%	2.79%	4.99%	10.47%
10yr+ Germany	-0.04%	10.10%	-2.81%	9.08%	11.91%
10yr+ Japan	2.57%	12.50%	15.02%	8.33%	7.94%
US HY	1.81%	5.13%	-3.60%	2.07%	5.37%
European HY	1.02%	3.33%	0.89%	6.38%	9.05%
Barclays Ag	0.59%	3.98%	1.05%	3.21%	5.07%
VIX Index*	-5.88%	-27.90%	-5.47%	-12.29%	-17.06%
DXY Index*	-0.24%	-4.33%	-3.24%	14.08%	25.76%
CRY Index*	2.11%	-1.15%	-22.25%	-38.52%	-51.75%
EURUSD	-0.41%	4.34%	5.54%	-13.17%	-20.94%
USDJPY	-2.90%	-9.08%	-8.28%	9.84%	32.35%
Brent	9.14%	15.93%	-31.88%	-56.63%	-64.38%
Gold spot	0.76%	17.06%	3.87%	-11.51%	-16.99%

*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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