Good news from Brazil (if you like bonds, that is)

By Jan Dehn

The good news from Brazil continues, if you are a fixed income investor, that is. Argentina steps back into the global capital markets with a bang. Hard landing fears in China are immediately replaced by fears of debt, but most critics fail to account for China's high savings rates. Peru's presidential run-off election scheduled for 5 June looks too close to call, not that it matters a great deal. Colombia's trade deficit is finally beginning to narrow. Mexican inflation is impressively low and India's long season of Senate elections kicks off. The US data weakened further last week and investors should ask themselves what policymakers would do in a renewed downturn.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.9	–	-0.14%
MSCI EM Small Cap	11.5	–	0.07%
MSCI Frontier	7.7	–	0.65%
MSCI Asia	11.3	–	-0.18%
Shanghai Composite	11.5	–	-3.86%
Hong Kong Hang Seng	6.7	–	-1.02%
MSCI EMEA	9.8	–	1.46%
MSCI Latam	12.7	–	-0.66%
GBI-EM-GD	6.36%	–	0.07%
ELMI+	3.77%	–	0.11%
EM FX spot	–	–	0.01%
EMBI GD	5.70%	379 bps	0.13%
EMBI GD IG	4.28%	230 bps	-0.05%
EMBI GD HY	7.68%	589 bps	0.33%
CEMBI BD	5.65%	392 bps	0.29%
CEMBI BD IG	4.31%	259 bps	0.05%
CEMBI BD Non-IG	7.91%	617 bps	0.69%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.6	–	0.53%
1-3yr UST	0.82%	–	-0.19%
3-5yr UST	1.35%	–	-0.51%
7-10yr UST	1.88%	–	-0.98%
10yr+ UST	2.70%	–	-2.46%
10yr+ Germany	0.22%	–	-2.13%
10yr+ Japan	-0.05%	–	0.29%
US HY	8.15%	685 bps	1.15%
European HY	5.09%	521 bps	0.83%
Barclays Ag	–	235 bps	-0.05%
VIX Index*	14.09	–	0.74%
DXY Index*	94.93	–	0.44%
EURUSD	1.1248	–	-0.57%
USDJPY	111.23	–	2.21%
CRY Index*	179.65	–	6.02%
Brent	44.8	–	4.43%
Gold spot	1234	–	0.16%

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

Emerging Markets

- **Brazil:** The news from Brazil is awesome, if you are a fixed income investor, that is. Firstly, disinflation is intense. The mid-month IPCA-15 inflation index decelerated sharply from 9.95% yoy in March to 9.34% yoy in April, while core inflation fell to 7.96% yoy in April from 8.39% yoy in March. Secondly, the current account deficit narrowed further to just USD 0.9bn in March, lower than anticipated (USD 1.2bn). FDI flows over the past twelve months have remained solid and now stand at USD 78.9bn, which is equivalent to 4.6% of GDP, or more than twice the twelve-months rolling current account deficit. Thirdly, without in any way qualifying as strong, some of the indicators of economic activity are beating very negative expectations. For example, the monthly indicator of economic activity – known as IBC-Br – declined by less than expected in February (-0.3% mom versus -0.5% mom expected), while activity was revised marginally higher in January. The fiscal outturn, though weak, was also better than expected in March (BRL 95.8bn vs BRL 93.6bn expected). The downturn in inflation, the improving external balances and the process of impeachment of President Dilma Rousseff, now underway, have strongly supported the fixed income market in Brazil this year.

- **Argentina:** Judge Griesa of the Second District Court of New York on Friday lifted all injunctions against Argentina following an extremely successful bond issue last week. The holders of the discount and par bonds that were pushed into default last year when the court forbade the payment agent from processing coupon payments in order to put pressure on the government at the time are now likely to be paid in full, in our view. The government raised USD 16.5bn in last week's bond issue. This money will be used to pay holdout investors and to finance the fiscal deficit. The new bonds were large and liquid benchmarks, which are likely to become attractive trading vehicles. Specifically, Argentina issued USD 2.75bn, USD 4.5bn, USD 6.5bn and USD 2.75bn of three, five, ten and thirty year bonds respectively, with coupons of 6.25%, 6.875%, 7.5% and 7.625%. The total combined demand for the new bonds exceeded USD 68bn, which is the largest ever demand ever recorded for an EM bond issue (for context, the demand was twice as great as the combined issuance of all Latin American sovereigns in the whole of 2015). The government has indicated that it will not

Continued overleaf

Emerging Markets

issue any more bonds in external markets this year, although we expect more supply from provincial governments and corporates as well as from the central government under local law, either in USD or local currency. Griesa can now retire in peace.

- China: It seems that China cannot get any peace. If the country is not experiencing a hard landing it must be collapsing under excessive levels of debt (see for example the Financial Times front page today). Fortunately, not all the analysis on China is superficial. China's debt levels are in fact sustainable. When looking at outstanding credit – debt – it is important also to look at the source of funding – savings. Taking into account differences in savings rates across countries, China's debt stock is entirely in line with the debt stocks of other EM countries, which, of course, are much lower than those in developed economies. The mistake many make is to look at the absolute level of debt in China without taking into account China's extra-ordinarily high savings rates. High savings means high levels of deposits in the banking system, which in turn leads to high levels of lending (but not excessive banking sector leverage). China is a high saving – high investment – high growth economy. Investors are right to always ask questions about debt, but they should be more concerned about debt levels in the Western world, which are as high or in some cases higher than those in China and not supported by high levels of savings. We would also argue that the gradual slowdown in China over the last few years has very little to do with the level of debt. Rather, the slowdown is a consequence of China's rapid pace of reforms, including interest rate liberalisation, price liberalisation, deep financial reforms at local government level, capital account liberalisation, changes to the FX regime and reforms of state-owned enterprises. These deeply intrusive but necessary reforms cause consumers and investors to temporarily delay their spending decisions, thus slowing the economy. However, the reforms will place the country on a much better footing to sustain healthy growth rates over the longer-term. Do not bet against China.

- Peru: The Pesidential election run-off between Keiko Fujimori (Keiko) and Pedro Pablo Kuczynski (PPK) scheduled for June 5 2016 looks set to be a close-run contest after two polls published last week gave conflicting indications as to who would win. CPI's poll showed Keiko winning marginally, while an IPSOS poll had PPK winning, both by very narrow margins. Both pollsters are credible. Both candidates would do a decent job running Peru, though we think PPK, a former finance minister, would be favoured by many investment bank analysts. As such, we would not be surprised to see Wall Street analysts soon begin to exaggerate the differences between the two candidates in the hope of generating completely unnecessary trading in the name.

- Colombia: One of the last EM countries to show improvement in its external balances is finally beginning to improve as well. Colombia's trade deficit narrowed sharply to USD 1.0bn in February, down from USD 1.5bn in January and USD 1.3bn in the same month last year. Imports in particular declined as domestic demand adjustment, necessary, but painful, takes hold. Colombia's government has been holding back on adjusting domestic demand in response to lower oil prices, in part because the country's strong fundamentals has given it some breathing room, partly for political reasons as the government hopes to strike a final peace accord with the FARC rebel movement (a peace deal would require a referendum, hence the political sensitivity of the economic slowdown).

- Mexico: Headline inflation surprised to the downside in the first half of April, declining outright by 0.34% mom (2.60% yoy). The consensus expected a decline of just 0.24% mom. Core inflation is running at 2.76% yoy. MXN was one of the market's favourite 'shorts' during the negative sentiment towards EM in the last few years, resulting in sharp depreciation. However, the consistently low inflation prints in Mexico are testimony to the credibility of monetary policy, which has prevented temporary factors such as currency moves from impacting core inflation.

- India: Senate elections are now underway in Tamil Nadu, Kerala, Assam, West Bengal, and Puducherry. Results are due 19 May. There are then further Senate races in other parts of India in the months of July and August. In total, some 56 seats are up for re-election. This is enough to swing the majority in the Senate to BJP control, provided the ruling party can form coalitions with smaller Senate parties. Investors should follow this closely: if BJP can regain control of the Senate then the government will be well-placed to pass its flagship GST (Goods & Services Tax) reform. GST would in effect create a single market within India by removing state taxes to the Federal level.

Snippets:

- El Salvador: Remittances from workers overseas increased by 6.3% yoy in Q1 2016 to USD 1.1bn. Remittances increased 3.3% in 2015 to USD 4.3bn. Remittances were 16.5% of GDP in 2015.
- Indonesia: Bank Indonesia has indicated that more than USD 40bn could be repatriated in response to a tax amnesty under consideration – this large flow would be sufficient to finance the current account deficit for two years running.
- Kazakhstan: Moody's downgraded Kazakhstan to Baa3 from Baa2 with negative outlook.
- Malaysia: Inflation slowed to 2.6% yoy in March versus 3.4% yoy expected and 4.2% yoy in February.
- Russia: Retail sales, investment and unemployment worsened in March, but industrial production picked up. Russia's adjustment to lower oil prices has been passed to consumers via higher interest rates and a weaker

Continued overleaf

Emerging Markets

RUB. On the other hand, these policies should improve the terms of trade for Russian producers, particularly those that target exports. Recent declines in inflation suggest that the central bank may soon resume the resumption of rate cuts.

- **South Africa:** Inflation was much lower than expected in March, especially core inflation. The yoy print for core inflation was 5.4% versus 5.8% expected, while headline inflation declined from 7.0% yoy in February to 6.3% in March (6.4% expected).
- **South Korea:** Bank of Korea left the policy rate unchanged at 1.5%.
- **Taiwan:** Industrial production declined at a rate of 3.6% yoy in March compared to -5.5% yoy expected. The better than anticipated result was mainly technical, including one extra working day in the month, new product launches and accelerated production during the month to make up for shipment delays caused by the earthquake in February.
- **Thailand:** In line with improving external balances across most EM countries, Thailand's trade surplus surged to USD 8.3bn in Q1 versus USD 1.5bn in the same quarter last year.
- **Turkey:** The MPC left the benchmark rate unchanged at 7.5%, but cut the overnight lending rate to 10.0% (-50bps). The one-week repo rate and overnight borrowing rates were left unchanged at 7.50% and 7.25% respectively.
- **Zambia:** Moody's downgraded Zambia's credit rating to B3 with negative outlook from B2 (stable) on concerns about large fiscal deficits and rising debt.

Global backdrop

US manufacturing remains in the gutter due to a combination of an overvalued currency and low productivity. The PMI release from Markit declined from 51.5 to 50.8, the lowest number since September 2009. The Philadelphia Fed manufacturing index, a key regional metric alongside the Chicago PMI, also declined, dropping to -1.6 in April from +12.4 in March and +9.0 expected. Housing starts and permits were also weak, although existing home sales were in line with expectations. Q1 growth numbers will be released in the US, UK and the Eurozone this week, while BOJ and the Federal Reserve have monetary policy meetings. Last week, we published April's *Emerging View* which is titled *"Beyond 'conventional unconventional' policies"*. The publication highlights the likely direction of policies in developed economies in the coming months and years.[1] The main argument is that developed economies, having already exhausted most of their conventional stimulus options as well as their 'conventional unconventional' policies, which leaves only third-rate policy options now remain; such policies are likely to be even more distortionary and ineffective than their predecessors.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	1.14%	6.89%	-17.04%	-3.18%	-4.20%
MSCI EM Small Cap	1.63%	2.61%	-14.26%	-1.94%	-2.82%
MSCI Frontier	1.89%	0.86%	-13.45%	1.88%	0.72%
MSCI Asia	0.98%	2.73%	-17.15%	0.92%	-0.38%
Shanghai Composite	-1.47%	-16.36%	-31.65%	12.60%	2.13%
Hong Kong Hang Seng	1.31%	-5.57%	-35.89%	-1.18%	-4.45%
MSCI EMEA	2.91%	16.25%	-13.33%	-5.47%	-7.18%
MSCI Latam	1.90%	21.48%	-14.17%	-13.16%	-11.12%
GBI EM GD	0.84%	11.95%	-2.22%	-7.13%	-2.48%
ELMI+	-0.18%	5.26%	-2.29%	-4.18%	-3.13%
EM FX Spot	-0.35%	5.37%	-8.54%	-11.36%	-9.33%
EMBI GD	1.49%	6.60%	3.93%	3.19%	6.37%
EMBI GD IG	1.31%	7.04%	2.24%	2.47%	5.71%
EMBI GD HY	1.69%	5.94%	6.29%	4.15%	7.35%
CEMBI BD	1.33%	5.27%	2.57%	3.05%	5.03%
CEMBI BD IG	0.78%	4.12%	2.11%	3.23%	5.49%
CEMBI BD Non-IG	2.26%	7.25%	3.16%	2.52%	4.19%

[1] *'Beyond 'conventional unconventional policies'*, The Emerging View, April 2016.

Continued overleaf

Ashmore

Emerging Markets

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	1.65%	3.02%	1.41%	12.54%	11.70%
1-3yr UST	-0.20%	0.93%	0.84%	0.59%	0.69%
3-5yr UST	-0.51%	2.03%	1.99%	1.65%	2.18%
7-10yr UST	-0.80%	3.92%	3.39%	2.34%	5.60%
10yr+ UST	-1.52%	6.64%	3.25%	4.35%	10.04%
10yr+ Germany	-1.64%	8.33%	-2.92%	8.48%	11.60%
10yr+ Japan	2.70%	12.65%	15.36%	8.25%	7.78%
US HY	3.01%	6.36%	-2.63%	2.43%	5.57%
European HY	1.87%	4.19%	1.83%	6.64%	9.20%
Barclays Ag	0.64%	4.04%	1.68%	3.21%	5.08%
VIX Index*	1.00%	-22.62%	14.65%	3.45%	-10.65%
DXY Index*	0.37%	-3.75%	-2.05%	14.73%	28.31%
CRY Index*	5.36%	1.99%	-19.82%	-37.43%	-50.99%
EURUSD	-1.16%	3.61%	3.27%	-13.55%	-22.86%
USDJPY	-1.19%	-7.35%	-6.56%	12.07%	35.93%
Brent	13.16%	20.20%	-31.36%	-56.67%	-63.76%
Gold spot	0.14%	16.30%	2.70%	-15.90%	-18.10%

*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.

Contact

Head office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE

T: +44 (0)20 3077 6000

@AshmoreEM

www.ashmoregroup.com

Bogota
T: +57 1 347 0649

Dubai
T: +971 440 195 86

Jakarta
T: +6221 2953 9000

Istanbul
T: +90 212 349 40 00

Mumbai
T: +91 22 6608 0000

New York
T: +1 212 661 0061

Riyadh
T: +966 11 483 9100

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

Washington
T: +1 703 243 8800

Other locations
Shanghai

Bloomberg page
Ashmore <GO>

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