

## South African and Brazilian inflation hit new lows

By Jan Dehn

Brazilian and South African inflation rates were lower than expected, which further increases the attractiveness of local rates in these two countries. Large protests hit the streets in Venezuela. Turkey's election court approves the referendum result and China's property market responds to government intervention. In Chile, the government formally launches a challenging pension reform programme. In the snippets, we touch on robust trade numbers from Asia and industrial production surprises to the upside in Poland and Russia. The global backdrop meanwhile looks brighter this morning: Macron, a protest candidate, won the day, but there are protest vote candidates and protest vote candidates. Vive la difference!

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.1	–	0.17%
MSCI EM Small Cap	11.8	–	0.36%
MSCI Frontier	9.0	–	-0.41%
MSCI Asia	11.8	–	-0.11%
Shanghai Composite	11.9	–	-2.24%
Hong Kong Hang Seng	7.5	–	-1.55%
MSCI EMEA	9.4	–	0.48%
MSCI Latam	12.3	–	-0.01%
GBI-EM-GD	6.49%	–	0.38%
ELMI+	3.70%	–	-0.06%
EM FX spot	–	–	-0.07%
EMBI GD	5.35%	312 bps	0.31%
EMBI GD IG	4.20%	192 bps	0.30%
EMBI GD HY	6.83%	468 bps	0.32%
CEMBI BD	5.10%	301 bps	0.27%
CEMBI BD IG	4.22%	212 bps	0.13%
CEMBI BD Non-IG	6.50%	441 bps	0.48%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	16.2	–	0.87%
1-3yr UST	1.25%	–	0.06%
3-5yr UST	1.84%	–	0.04%
7-10yr UST	2.31%	–	-0.07%
10yr+ UST	2.96%	–	0.02%
10yr+ Germany	0.35%	–	-0.75%
10yr+ Japan	0.02%	–	0.08%
US HY	5.81%	392 bps	0.13%
European HY	3.50%	398 bps	0.13%
Barclays Ag	–	245 bps	-0.02%
VIX Index*	14.63	–	-1.33%
DXY Index*	99.06	–	-1.23%
EURUSD	1.0849	–	1.93%
USDJPY	110.16	–	1.15%
CRY Index*	181.87	–	-5.90%
Brent	52.3	–	-5.56%
Gold spot	1272	–	-1.02%

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

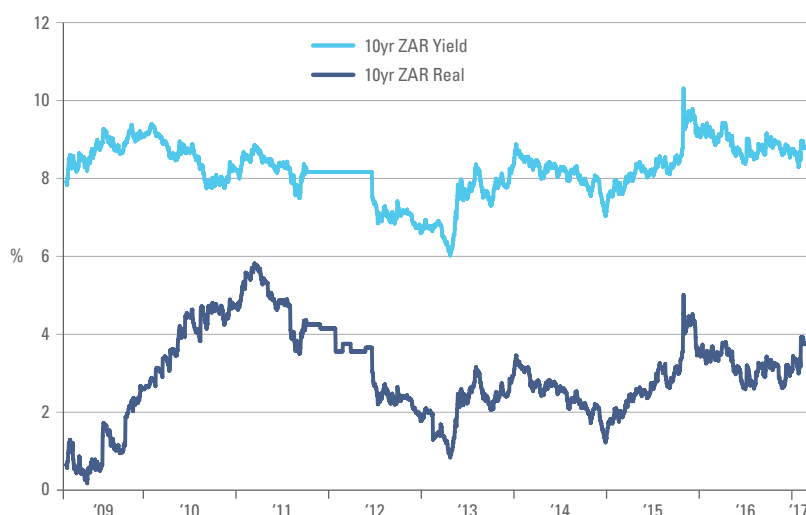
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- Brazil:** Minutes from the April monetary policy committee meeting revealed that some participants favoured cutting rates by 125bps instead of the 100bps cut which was eventually implemented. This reflects continuing downside surprises in inflation dynamics. For example, CPI inflation for the first half of April (IPCA-15) showed the rate of inflation declining from 4.74% yoy to 4.41% yoy, which means that inflation is now already inside the official 4.5% inflation target. The central Bank also surprised the market by announcing it will roll all swaps expiring at the end of April (approximately USD 6bn), which means that the central bank will not buy any US Dollars at the end of the month. Given the large trade surplus and strong inflows, which are still likely to come to Brazil over the next few years the outlook for the currency is positive, which may allow for a deeper easing cycle over the longer-term. This will have positive fiscal implications, because it gets progressively less onerous to service the debt the lower nominal rates go. In this way, the central bank is helping the fiscal authorities, which has to be welcome news for a country grappling with high levels of debt inherited from the previous government. The central bank's bias towards a stronger BRL will also help to calm the political environment as the pension reform moves into some critical phases and complexity increases. The government was hoping to approve the pension reform within the special committee of the Lower House this month, but the reading of the new text has been postponed. The rapporteur of the bill has agreed to some dilution, including reducing the minimum retirement age for women to 62 years (that for men remains at 65) and a more gradual transition to the new higher retirement ages for both sexes. Our base case remains that a meaningful reform will be approved, even if it is diluted from its original version.
- South Africa:** The rate of inflation declined faster than expected in March from 6.3% yoy in February to 6.1% yoy. Core inflation declined even more from 5.2% yoy to 4.9% yoy. This means that core inflation is now running a full percentage point lower than at its peak in December 2016 and at the lowest rate since January 2013. In spite of declining inflation, bond yields remain high due to the recent change of finance

## Emerging Markets

minister and ratings downgrade. With 10-year bond yield at 8.8%, core real rates are now close to 4%. Real rates have only been above 4% on fewer than a quarter of the days since February 2009. Even so, bond prices could get even more attractive depending on the amount of forced selling triggered from passive IG-only investors when the GBI EM GD bond index weights change at the end of April (Czech Republic also enters the index at this time). We think ZAR is attractive in both real and nominal exchange rate terms. As for the political situation that brought about the reshuffle, we do not expect a change for the better at least until the ANC convention in December of this year.

Fig 1: South Africa: 10-year bond yield and ZAR real effective exchange rate



Source: Ashmore, BIS, Bloomberg.

- Venezuela:** The opposition last week organised a so-called 'mother of all protests', which took place on 19 April. Large numbers of people participated despite strong attempts by the government to discourage participation. It is evident that momentum against the Maduro Administration is now building again, since government-orchestrated tear gas and violence from the pro-government militias were not enough to keep people away. The large protests will increase international scrutiny of the government. Only widespread protests on the streets seem to be able to unify the opposition and put strains on the government coalition, including the military. The odds of regime transition have therefore increased, albeit possibly only temporarily. Maduro has responded by offering to hold already-delayed local elections later this year. The challenge for the opposition is to keep up the pressure on the government instead of engaging in pointless negotiations. If so, the tipping point could come within reach.
- Turkey:** The electoral council has rejected the opposition's appeal against last Sunday's referendum, which saw a majority of Turks vote in favour of greater presidential powers. The opposition party CHP announced that it would appeal to the Constitutional Court and the European Court of Human Rights if needed. The appeals are unlikely to generate any meaningful result, in our view.
- China:** Property sales declined at a rate of 22% yoy in the first quarter due to recent government measures to prevent bubbles, but sales still remained at a high level by historical standards. Within the quarter, sales surprised on the upside in both February and March. Land sales are also holding up well. They declined moderately (-6% yoy) for tier 1 and 2 cities with levels still high. This suggests there's still plenty of final demand for property development and the modest slowdown has been led by policy restrictions. The Chinese economy has excessive savings, so bubbles keep emerging in stocks and housing. As such, it is positive that the government is on course to achieve its objective of avoiding inflation bubbles in real estate pending a full opening of the capital account. Data from State Administration of Foreign Exchange (SAFE) and The People's Bank of China (PBOC) suggested last week that net outflows remained moderate in March in the range from USD 8bn to USD 13bn. This is far lower than the average monthly outflows of USD 55bn in H2 2016.
- Chile:** The government of Michelle Bachelet has responded to widespread public protests by submitting a pension reform plan to parliament. The reform includes a 5% contribution from employers, which is intended to help to pay for broader coverage in the population, but this particular measure has so divided the political class that passage seems unlikely during Bachelet's term in office. The next election is in November of this year.

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### Snippets:

- **Argentina:** One-year ahead inflation expectations declined from 25% in March to 20% in April. This follows a recent decision by the central bank to hike the policy rate from 25% to 26.5%.
- **Asian Trade:** Taiwan's March exports rose at a solid rate of 12.3% yoy following 22% yoy in February. Demand is particularly strong from China. Export numbers were also robust in South Korea, where they were 14.8% higher than the previous month (based on exports in the first 20 days of April). South Korean imports rose marginally at a rate of 8.1% yoy, so the result was a strong USD 5bn trade surplus (following a surplus of USD 0.8bn in the previous month).
- **Colombia:** The trade deficit was stable in February at USD 0.8bn. This means that the deficit declined in terms of percentage of GDP from 4.2% to 3.6%, mainly due to lower imports.
- **Georgia:** Prime Minister Kvirikashvili has pledged his willingness to implement reforms as part of an IMF programme to Georgia. The associated adjustment programme includes fiscal consolidation and improvements in monetary policy and financial supervision.
- **India:** The monetary policy committee minutes expressed concerns over the inflation outlook. This suggests that the Reserve Bank of India will remain vigilant in order to keep inflation consistent with the 4% medium-term target.
- **Indonesia:** The Central Bank kept interest rates unchanged at 4.75% in line with expected.
- **Malaysia:** The annual rate of headline inflation rose 5.1% yoy in March from 4.5% yoy in February (expectations were 5.2% yoy). Core inflation was unchanged at 2.5% yoy.
- **Pakistan:** The Supreme Court decided not to disallow Prime Minister Sharif from holding office despite his alleged association with the Panama Papers case. Sharif has implemented sweeping economic and institutional reforms during his first term and remains favourite to win next years' presidential election.
- **Poland:** Industrial production surprised on the upside in March, rising 2.1% mom compared to 0.6% mom in February. Retail sales also rose strongly (2.0% mom) after expanding healthily in February (1.5% mom). Poland's GDP is now on track to expand by more than 3.5% in 2017.
- **Russia:** Industrial production recovered strongly in March, rising at a rate of 0.8% yoy compared to -2.7% yoy in February. The decline in Russian retail sales also eased to -0.4% yoy in March from -2.8% yoy the previous month.
- **Singapore:** March CPI inflation was 0.7% yoy in line with expectations.

## Global backdrop

Vive la difference! The real significance of the result of the first round of the French election is not that Marine Le Pen got through to the second round. Rather, it is the rise of Emmanuel Macron and what he stands for. Both Macron and Le Pen are protest vote candidates, but Macron is a brand new kind of protest vote candidate. Now a clear favourite for the presidency in the second round on 7 May Macron's rise is a stinging defeat for both the old Left and Right mainstream politics AND for traditional Left and Right populism a la Melenchon, Le Pen and, indeed, British Brexitism and American Trumpism. The Old World has therefore delivered something genuinely novel: a new kind of politics. Macron's promise is to take the best from left and the best from the right and to try to do what is best for the country in the broadest possible sense, that is, in ways that acknowledge upfront that globalisation, including the European Union, is a positive and inevitable feature of the France's future. Macron's promise of a modern, pragmatic and more open style of government less tainted by established vested interests will go down especially well with young and urban populations, that is, exactly the opposite demographic drawn to conventional populism. If Macron is also able to deliver on this promise – a very big if indeed – then there is hope.

## Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	0.47%	11.97%	15.70%	1.07%	1.59%
MSCI EM Small Cap	0.21%	13.26%	12.25%	1.34%	3.50%
MSCI Frontier	0.49%	9.32%	11.09%	-3.44%	6.12%
MSCI Asia	0.19%	13.59%	15.98%	4.11%	5.22%
Shanghai Composite	-1.51%	2.28%	9.69%	18.05%	8.35%
Hong Kong Hang Seng	-2.18%	6.97%	13.33%	3.75%	2.03%
MSCI EMEA	1.87%	4.75%	7.52%	-3.90%	-2.31%
MSCI Latam	-0.12%	11.99%	19.08%	-4.77%	-5.23%
GBI EM GD	0.94%	7.51%	4.79%	-2.62%	-1.42%
ELMI+	0.17%	5.36%	3.17%	-2.39%	-1.29%
EM FX Spot	0.22%	3.39%	-1.97%	-9.36%	-7.68%
EMBI GD	1.12%	5.03%	8.26%	6.27%	5.83%
EMBI GD IG	0.91%	4.61%	4.26%	5.07%	4.20%
EMBI GD HY	1.36%	5.50%	12.95%	7.22%	8.01%
CEMBI BD	0.87%	3.87%	8.16%	5.41%	5.61%
CEMBI BD IG	0.76%	3.17%	4.83%	4.57%	4.84%
CEMBI BD Non-IG	1.04%	4.95%	13.63%	6.43%	6.95%

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	-0.49%	5.54%	14.70%	10.15%	13.63%
1-3yr UST	0.27%	0.67%	0.77%	0.75%	0.65%
3-5yr UST	0.76%	1.44%	0.63%	2.06%	1.39%
7-10yr UST	1.23%	2.38%	-0.66%	3.76%	2.34%
10yr+ UST	2.17%	4.10%	-1.81%	6.65%	3.91%
10yr+ Germany	1.93%	0.20%	0.99%	9.25%	6.95%
10yr+ Japan	1.23%	0.13%	-4.65%	6.05%	5.58%
US HY	0.49%	3.20%	13.38%	4.60%	6.88%
European HY	0.30%	1.74%	7.46%	4.94%	9.37%
Barclays Ag	0.93%	2.14%	4.35%	4.13%	4.52%
VIX Index*	18.27%	4.20%	10.67%	9.83%	-19.17%
DXY Index*	-1.28%	-3.08%	4.15%	24.14%	25.04%
CRY Index*	-2.16%	-5.53%	1.23%	-41.74%	-39.64%
EURUSD	1.84%	3.13%	-3.72%	-21.57%	-17.79%
USDJPY	-1.10%	-5.85%	-0.94%	7.67%	35.46%
Brent	-1.04%	-7.99%	15.89%	-52.61%	-55.75%
Gold spot	1.78%	10.35%	2.72%	-1.68%	-22.57%

\*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](http://www.ashmoregroup.com)

### Bogota

T: +57 1 347 0649

### Dubai

T: +971 440 195 86

### Jakarta

T: +6221 2953 9000

### Mumbai

T: +91 22 6608 0000

### New York

T: +1 212 661 0061

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