Issued: 4 September 2017



# Brazil. Venezuela. Kenya. Chile. Peru. India. Guatemala. Russia.

By Jan Dehn

Brazil returns to positive growth. There will be no major bond index implications from recent US sanctions against Venezuela. Kenya has to vote again as the Judiciary asserts itself. The resignation of two senior ministers bolsters Pinera's chances in Chile. Ceviche just got dearer in Peru. Indian growth disappointed in Q2 2017, but high frequency indicators are already rebounding. Guatemala's president on the ropes over corruption. South Korea looks to boost fiscal spending as the economy picks up. Russia's central bank isolates Otkritie Bank and prevents any fallout to the wider economy. Meanwhile, in the risky part of the world low PCE inflation and softer than expected payrolls should ensure that US monetary policy normalisation remains very gentle. US President Donald Trump's proposal to withdraw from a free trade agreement with South Korea seems poorly timed as tensions once again ratchet higher over North Korea. In Europe, Merkel and Macron look to deepen integration on fiscal matters as UK Brexit talks stall over the exit bill – we propose a simple way to deter countries from "doing a runner" when it comes to their obligations to the EU.

| Emerging Markets | Next year forward PE/Yield | Spread over UST | P&L (5 business days) |
|---|---|---|---|
| MSCI EM | 12.2 | – | 0.65% |
| MSCI EM Small Cap | 12.6 | – | 1.98% |
| MSCI Frontier | 11.1 | – | -0.03% |
| MSCI Asia | 12.7 | – | 0.65% |
| Shanghai Composite | 13.2 | – | 1.07% |
| Hong Kong Hang Seng | 7.9 | – | -0.02% |
| MSCI EMEA | 10.4 | – | 1.25% |
| MSCI Latam | 14.1 | – | 0.66% |
| GBI-EM-GD | 6.03% | – | 0.64% |
| ELMI+ | 3.49% | – | 0.45% |
| EM FX spot | – | – | 0.35% |
| EMBI GD | 5.13% | 296 bps | 0.53% |
| EMBI GD IG | 3.97% | 175 bps | 0.51% |
| EMBI GD HY | 6.43% | 432 bps | 0.54% |
| CEMBI BD | 4.95% | 291 bps | 0.39% |
| CEMBI BD IG | 4.00% | 197 bps | 0.32% |
| CEMBI BD Non-IG | 6.30% | 424 bps | 0.50% |

| Global Backdrop | Next year forward PE/Yield/Price | Spread over UST | P&L (5 business days) |
|---|---|---|---|
| S&P 500 | 17.1 | – | 1.43% |
| 1-3yr UST | 1.35% | – | 0.01% |
| 3-5yr UST | 1.74% | – | 0.07% |
| 7-10yr UST | 2.17% | – | 0.11% |
| 10yr+ UST | 2.78% | – | -0.13% |
| 10yr+ Germany | 0.38% | – | -0.36% |
| 10yr+ Japan | 0.00% | – | 0.14% |
| US HY | 5.57% | 373 bps | 0.39% |
| European HY | 2.90% | 333 bps | 0.18% |
| Barclays Ag | – | 250 bps | 0.04% |
| VIX Index* | 10.13 | – | -1.15% |
| DXY Index* | 92.67 | – | 0.46% |
| EURUSD | 1.1883 | – | -0.80% |
| USDJPY | 109.81 | – | 0.51% |
| CRY Index* | 180.95 | – | 3.12% |
| Brent | 52.5 | – | 1.12% |
| Gold spot | 1334 | – | 1.97% |

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

## Emerging Markets

- **Brazil:** Economic growth turned positive in Q2 2017. Real GDP was 0.2% qoq (sa), which was better than expected (0.0% qoq sa). The quarterly growth rate is equivalent to a yoy growth rate of 0.3%, which happens to be the first yoy positive growth print in Brazil since Q1 2014. Unemployment also declined to 12.8% in July from 13% in June. The economy has been improving for some time, but the recovery is likely to be gentle, in our view. In other news, Brazil's Senate is expected to vote on interest rate reform this week, while markets will pay even closer attention to the central bank's rate decision, which is also due this week. Finally, we note that ratings agency Moody's responded positively to the government's announcement of planned privatisations, including Electrobras, an energy giant.

- **Venezuela:** Following the imposition of US sanctions on Venezuela and PDVSA, JP Morgan, an index provider, has announced that there will be no impact on the composition of the EMBI GD bond index. The US Office of Foreign Assets Control (OFAC) published a list of sanctions exempted bonds for secondary trading and all the 21 Venezuela and PDVSA bonds, which are currently in the index, are included in the exemption list. The only change from an index perspective is that new bonds will not be included, but Venezuela has not tapped the primary markets for a while, so this measure is largely innocuous. Even so, ratings agency Fitch cut the sovereign rating of the government to CC from CCC in response to the US sanctions announcement. It is always wise, politically speaking, to shut the stable doors after the horse has bolted.

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**Emerging Markets**

- Kenya: In a surprise development the Supreme Court annulled last month's presidential election and ruled that a new election must take place within 60 days. The reason for annulment was irregularities in the transmission of election results. The court did not support opposition claims of rigging nor did it accuse the incumbent administration of wrong doing. International election monitors said that there was no evidence of fraud. However, Kenya's election commission introduced the new electronic voting system for last month's election, which appears to have malfunctioned. Both sides in the election have agreed to re-run the election. One of the great trends in EM in recent years has been a rise in the influence of judiciaries in terms of holding executives to account. This trend reflects the fact that middle-classes are becoming more influential in many EM countries. Other countries showing a similar trend include Brazil, Romania and Peru. See also our comment on Guatemala below.

- Chile: Both the Finance and Economy ministers resigned last week in protest against a government decision to halt a mining project in northern Chile. Nicolas Eyzaguirre, a former finance minister (2000 to 2006), has been appointed to the post of Finance Minister. Divisions within the centre-left administration of President Michelle Bachelet are likely to strengthen the position of conservative presidential candidate Sebastian Pinera ahead of elections scheduled for November this year. A new CEP poll shows that Pinera's poll lead has increased. Pinera's share of voting intentions increased to 31.3% in July from 24% in June. In economic news, manufacturing was strong in June (+2.6% yoy versus 2.0% yoy expected).

- Peru: The yoy rate of CPI inflation increased from 2.85% in July to 3.17% in August due to a 133% spike in lemon prices caused by weather related damage to the lemon harvest. Peru is the home of ceviche, a delicious dish of raw fish marinated in lemon juice. We do not think the lemon shock should be interpreted as anything other than a temporary spike in inflation and in particular we do not think it will impact inflation expectations in Peru adversely. Inflation expectations have been firmly anchored for years due to sound monetary policies under the stewardship of Julio Velarde, a veteran Latin American central banker.

- India: Q2 GDP growth disappointed relative to expectations in Q2 2017. This was probably due to temporary interruptions in output caused by implementation of Goods and services Tax (GST). Even so, the economy expanded at a solid rate of 5.7% yoy (down from 6.1% yoy in the previous quarter). Encouragingly, higher frequency data releases are already rebounding. For example, manufacturing PMI for the period after Q2 2017 jumped sharply to 51.2 in August from 47.9 in July. GST tax collections amounted to INR 922bn in the first month of collection. This was deemed by tax experts to be rather robust for the first month of collection. Revenue collections are likely to increase further in the coming months.

- Guatemala: Efforts by President Jimmy Morales to oust Ivan Velasquez, the Head of a UN-backed anti-corruption unit, appear to have backfired badly after the Constitutional Court overruled Morales' decision. Attorney General Thelma Aldana has also threatened to resign unless Ivan is allowed to continue to do his job. Guatemala's previous president Otto Perez Molina was forced to resign over corruption allegations.

- South Korea: The government is turning to greater fiscal spending. Total fiscal spending will rise 4.6% in 2018 compared to 2017 according to new budget proposals. Net government debt to GDP was 36.5% as at the end of 2016, according to the IMF, so South Korea has plenty of fiscal room unlike most developed countries. Meanwhile, CPI inflation was 2.6% yoy in August versus 2.2% yoy expected, core inflation was in line with expectations (1.8% yoy). Exports were stronger than expected in July (17.4% yoy versus 15.8% yoy anticipated in the market) and industrial production rose strongly in July (+1.9% mom sa). The Bank of Korea left the policy rate unchanged at 1.25% in the August policy meeting.

- Russia: The Russian central bank acted swiftly to shore up Russia's eighth largest bank, Otkritie, after it got into trouble. As a result of the swift policy response and the fact that Otkritie's problems are specific to the company rather than reflective of the wider Russian banking sector we do not expect any significant macroeconomic fallout. The Russian economy is improving, which is generally providing a supportive backdrop for Russian banks.

Snippets:

- Argentina: Industrial production was 5.9% higher in July 2017 than in the same month of 2016. A new DiTella University survey shows rising confidence in the Macri Administration ahead of upcoming mid-term elections.
- China: The privately operated Caixin PMI index accelerated to 51.6 in August from 51.1 in July (the consensus expectation was 51.0). The official PMI index also rebounded to 51.7 in August from 51.4 in July (better than expected).
- Czech Republic: Fitch revised the outlook for the sovereign rating of the Czech Republic to positive from stable. The rating is A+.
- Colombia: The central bank cut the policy rate by 25bps to 5.25%.
- Hong Kong: Retail sales beat expectations in July (4.0% yoy versus 0.8% yoy expected).
- Indonesia: CPI inflation in August was lower than anticipated. Prices were 3.8% higher than in August of last year versus 3.9% yoy expected. Core CPI inflation was stable at 3.0% yoy.

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## Emerging Markets

- **Malaysia:** The budget surplus in July was MYR 2.5bn on the back of a sharp rise in tax revenues.
- **Mexico:** The Mexican government's gross and net debts declined as a share of GDP according to the latest release of data on the public finances. Public sector net debt declined to 44% of GDP, while gross debt to GDP was 46%.
- **Poland:** Real GDP growth was 1.1% qoq sa in Q2 2017, unchanged from the previous quarter.
- **Thailand:** CPI inflation was 0.3% yoy in August compared to 0.2% yoy in July. The consensus expectation was 0.4% yoy and Bank of Thailand's target range for inflation is 1%-4%.
- **South Africa:** The trade surplus reached ZAR 9bn in July versus ZAR 0.4bn in the same month of 2016.
- **Sri Lanka:** Inflation rose to 6.0% yoy in August from 4.8% yoy in July. The increase in inflation was driven by health and communications related spending. The consensus expectation was for 6.0% yoy inflation.
- **Taiwan:** The Taiwanese PMI index reached a four-month high of 54.3 in August.
- **Thailand:** CPI inflation remained very modest at 0.32% yoy in August, up from 0.17% yoy in July.

## Global backdrop

It is a well-established market convention that US non-farm payrolls is the single most important event in the monthly cycle of US data releases. Despite the fact that non-farm payroll data is regularly revised significantly ex-post the market is nevertheless likely to conclude – following a softer than anticipated non-farm payroll number of just 156K for August – that major tightening in US monetary policies is not yet on the cards. Average hourly earnings were also softer than anticipated (0.1% mom versus 0.2% mom expected) and the rate of unemployment unexpectedly increased to 4.4% from 4.3%. To add insult to injury core PCE inflation for the month of July also declined to 1.4% yoy from 1.5% yoy in July.

On the trade front, speculation mounted last week that that the United States might pull out of a free trade agreement with South Korea even as tensions with North Korea suddenly spiked following an alleged test of a hydrogen bomb by the Kim Jong-un regime. In addition to undermining growth and hurting business interests in both the US and in South Korea, a US withdrawal from the South Korean free trade agreement would also weaken political ties between the US and South Korea. It would signal that it may well be in South Korea's long-term national interest to deepen ties with China.

German Chancellor Angela Merkel responded positively to proposals by her French counterparty Emmanuel Macron to deepen European integration, especially in fiscal matters. Merkel proposed the establishment of a European Monetary Fund along the lines of the IMF (which extends finance in exchange for macroeconomic adjustment and reforms), the establishment of a European Finance Minister and banking union. Meanwhile, talks between the European Union (EU) and the UK over Brexit turned soured as David Davis, a senior UK government official, accused Michel Barnier, the EU's chief Brexit negotiator, of "blackmail" when Barnier insisted that the UK pay its dues before exiting the EU. The UK exit bill is about 2% of UK GDP, that is, equivalent to a full year's economic growth, so the UK government is terrified about the political fallout if voters have to face the full cost of Brexit. The risk that the UK leaves without paying its bill is serious, in our view. This raises the question how such non-payment can be avoided in the event other countries should wish to leave the EU. One simple and easy way to deter other countries from leaving without paying would be to put clauses within EU government bond prospectuses, which define absconding from established financial obligations as an event of default. Default triggers of this kind would not (and should not) prevent countries from leaving the EU if they so choose, but they would act as an effective deterrent against non-payment of financial obligations to the EU.

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## Benchmark performance

| Emerging Markets | Month to date | Year to date | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| MSCI EM | 0.34% | 29.03% | 25.73% | 2.77% | 5.71% |
| MSCI EM Small Cap | 0.60% | 23.37% | 17.61% | 1.92% | 6.21% |
| MSCI Frontier | 0.25% | 22.61% | 26.06% | -1.70% | 9.16% |
| MSCI Asia | 0.17% | 31.54% | 25.56% | 6.02% | 9.28% |
| Shanghai Composite | 0.19% | 10.61% | 12.17% | 16.84% | 13.16% |
| Hong Kong Hang Seng | -0.09% | 24.56% | 22.06% | 4.83% | 8.13% |
| MSCI EMEA | 0.42% | 16.92% | 23.16% | -1.57% | 0.43% |
| MSCI Latam | 1.37% | 26.73% | 24.70% | -4.70% | -0.97% |
| GBI EM GD | 0.37% | 15.09% | 10.35% | -1.20% | -0.26% |
| ELMI+ | 0.26% | 10.33% | 7.47% | -1.06% | -0.15% |
| EM FX Spot | 0.33% | 7.31% | 3.29% | -7.76% | -6.29% |
| EMBI GD | 0.04% | 9.02% | 5.31% | 5.84% | 5.25% |
| EMBI GD IG | 0.01% | 8.36% | 2.61% | 4.49% | 3.68% |
| EMBI GD HY | 0.07% | 9.76% | 8.40% | 7.02% | 7.32% |
| CEMBI BD | 0.04% | 6.90% | 5.76% | 5.14% | 5.23% |
| CEMBI BD IG | 0.04% | 5.88% | 3.12% | 4.15% | 4.37% |
| CEMBI BD Non-IG | 0.04% | 8.44% | 9.92% | 6.43% | 6.73% |

| Global Backdrop | Month to date | Year to date | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| S&P 500 | 0.20% | 12.16% | 16.47% | 9.57% | 14.36% |
| 1-3yr UST | -0.04% | 0.82% | 0.47% | 0.79% | 0.66% |
| 3-5yr UST | -0.10% | 2.06% | 0.20% | 1.84% | 1.22% |
| 7-10yr UST | -0.28% | 3.99% | -1.82% | 2.82% | 1.66% |
| 10yr+ UST | -0.72% | 7.69% | -6.11% | 4.65% | 2.69% |
| 10yr+ Germany | -0.56% | -2.03% | -7.97% | 4.71% | 5.16% |
| 10yr+ Japan | 0.12% | 0.33% | -2.75% | 5.33% | 5.20% |
| US HY | 0.06% | 6.12% | 8.74% | 4.78% | 6.47% |
| European HY | 0.06% | 4.76% | 6.35% | 5.09% | 8.52% |
| Barclays Ag | -0.17% | 4.55% | 2.17% | 3.78% | 4.10% |
| VIX Index* | -4.34% | -27.85% | -15.44% | -19.86% | -43.66% |
| DXY Index* | 0.00% | -9.33% | -3.31% | 10.56% | 13.97% |
| CRY Index* | 0.05% | -6.01% | 0.53% | -37.31% | -41.41% |
| EURUSD | -0.23% | 12.96% | 6.60% | -8.20% | -5.44% |
| USDJPY | -0.15% | -6.15% | 6.17% | 4.31% | 40.03% |
| Brent | 0.17% | -7.66% | 12.04% | -48.47% | -54.05% |
| Gold spot | 0.96% | 15.78% | 0.50% | 5.72% | -21.33% |

*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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