Change afoot in South Africa

By Jan Dehn

It would seem that South African President Jacob Zuma has overstayed his welcome. Ramaphosa is likely to clean up the corruption in the government and refocus attention on economic issues. This is key to getting the stagnant economy back to growth. The latest batch of retail sales data suggests that this may already be happening. It is also a big week for politics in Brazil, where, on Wednesday, a court looks set to reject former President Lula's appeal against corruption charges, therefore ruling him out of the presidential race. In other news, China is going solar and Kazakhstan is moving to develop its local bond market. Anaya gains in Mexico and Erdogan appears to prepare for an election by using time-honoured tactics, a lovely little war.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.0	–	2.02%
MSCI EM Small Cap	12.1	–	0.70%
MSCI Frontier	11.7	–	1.34%
MSCI Asia	12.6	–	1.72%
Shanghai Composite	11.9	–	1.72%
Hong Kong Hang Seng	7.7	–	5.70%
MSCI EMEA	10.6	–	2.47%
MSCI Latam	12.8	–	2.89%
GBI-EM-GD	6.09%	–	0.51%
ELMI+	3.60%	–	0.52%
EM FX spot	–	–	0.47%
EMBI GD	5.32%	267 bps	-0.20%
EMBI GD IG	4.14%	148 bps	-0.22%
EMBI GD HY	6.54%	391 bps	-0.18%
CEMBI BD	5.13%	254 bps	-0.10%
CEMBI BD IG	4.25%	165 bps	-0.12%
CEMBI BD Non-IG	6.33%	373 bps	-0.08%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	16.9	–	1.56%
1-3yr UST	2.07%	–	-0.12%
3-5yr UST	2.45%	–	-0.39%
7-10yr UST	2.65%	–	-0.77%
10yr+ UST	2.93%	–	-0.86%
10yr+ Germany	0.59%	–	0.09%
10yr+ Japan	0.08%	–	-0.02%
US HY	5.65%	319 bps	-0.07%
European HY	2.50%	327 bps	0.13%
Barclays Ag	–	252 bps	-0.24%
VIX Index*	11.53	–	1.37%
DXY Index*	90.48	–	-0.50%
EURUSD	1.2253	–	-0.09%
USDJPY	110.68	–	0.13%
CRY Index*	195.50	–	0.34%
Brent	68.7	–	-2.21%
Gold spot	1333	–	-0.55%

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

Emerging Markets

- **South Africa:** The likelihood that Jacob Zuma, South Africa's president, will leave office prematurely has increased materially in recent days. Zuma has alienated large sections of the National Executive Committee (NEC) by appealing a court ruling, which transferred powers to investigate corruption to newly elected ANC President Cyril Ramaphosa. Ramaphosa has also not wasted time in using his anti-corruption powers to undermine Zuma's supporters within the Top Six of the ANC, Eskom and other agencies. Zuma is an election liability for Ramaphosa at a time when the ANC is losing credibility in South Africa. It seems likely that Ramaphosa will want to get rid of Zuma as early as possible. Ramaphosa is then likely to focus on economic reforms to stimulate the growth potential of the South African economy. Everything suggests that the transition of power in South Africa will follow the rules set out in the country's constitution as well as ANC's own internal rules. It would seem that Zuma will relinquish power in the same way that he forced his predecessor, Thabo Mbeki, to step down. In other news, the South African Reserve Bank left the policy rate unchanged at 6.75%. Retail sales in November rose at the fastest rate in 5 years.

- **Brazil:** This is a big week in Brazil. A regional court will decide on Wednesday whether to uphold a conviction against former President Lula. If the conviction is upheld then Lula will not be able to run in the presidential election later this year. Lula still has the option to appeal to higher courts, but in principle he would be ineligible to run, barring some clever legal manoeuvre. The Brazilian real economy expanded at a rate of 2.8% yoy in November.

- **China:** China increased energy from solar and wind energy by a whopping 39.8% last year to 3,300bn KwH (from 2385bn KwH). China total energy usage last year was 6,900bn KwH and global energy usage in 2016 was 22,000bn KwH. This means that last year alone China increased solar/wind generation by an amount equivalent to 4% of global energy consumption. China's real economy expanded 6.8% in Q4 2017 relative to the year before. Industrial production in December was stronger than expected, while retail sales fell a bit short of expectations.

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Emerging Markets

- **Kazakhstan:** The government announced that it is working with Clearstream to connect its domestic market to the global market. This would make it easier for international investors to access the local bond market. Kazakhstan hopes to launch direct trading of local government debt this year. The central bank cut the policy rate to 9.75%. The market had expected the rate to remain at 10.25%.

- **Mexico:** Ricardo Anaya of the PAN party gained in the polls ahead of Mexico's election scheduled for 1st July 2018. With just over 20% of voting intentions he is still behind Andres Manuel Lopez Obrador of Morena, who leads with 23.6% of voting intentions. MXN rallied as fears of a bad outcome in NAFTA negotiations faded. NAFTA and the election are likely to be the main drivers of asset prices in Mexico the next 5-6 months.

- **Turkey:** President Erdogan has picked a fight with the US government in response to news that the US intends to boost support for the Kurds in Northern Syria fighting Islamic State. Erdogan is threatening to send troops to defeat the US sponsored Kurdish forces. The sudden focus on US support for the Kurds in Northern Syria may also have domestic political reasons; speculation is rising that Erdogan wants to hold an early election on the anniversary of last year's coup, which took place on 15 July. A bit of patriotic fervour stirred up by a little war with the Kurds will not hurt Erdogan's election chances, especially since two of the main opposition parties support Kurds and nationalists. The central bank left the rate in the late liquidity window unchanged at 12.75%.

Snippets:

- **Bulgaria:** European Commission President Jean-Claude Juncker said that Bulgaria will join the ERM and the Euro in the foreseeable future.
- **Costa Rica:** Fitch revised the sovereign credit outlook to negative from stable (BB).
- **Colombia:** Retail sales were down 1.2% yoy in November versus -1.0% yoy expected.
- **Ecuador:** The government successfully issued USD 3bn in the bond market and thereby secured about 75% of its total external market financing requirements for 2018.
- **India:** Exports increased at a rate of 12.36% yoy in December. Imports were 21.12% higher yoy. The trade deficit increased to USD 14.88bn versus USD 13.83bn in November.
- **Indonesia:** Bank Indonesia left the policy rate unchanged at 4.25%.
- **Mongolia:** Moody's upgraded the sovereign credit rating to B3 with stable outlook.
- **Morocco:** The government relaxed the trading limits for the currency.
- **Nigeria:** The rate of CPI inflation was 15.4% yoy in December versus 15.9% yoy expected. This was the third consecutive month with below 1% mom inflation.
- **Peru:** The real economy returned to positive growth in November with a 0.1% expansion compared to a 0.4% contraction in October.
- **Poland:** CPI inflation rose at a rate of 2.1% yoy in December, while the current account surplus narrowed to EUR 233m in November versus EUR 556m expected.
- **Romania:** The government collapsed after internal political strife. Romania has recently spent too much money and the current account deficit is widening.
- **Russia:** The current account surplus was USD 17.8bn in December versus USD 11bbn expected.
- **Saudi Arabia:** Aramco CEO said that the company is ready for the IPO this year.
- **Singapore:** Non-oil domestic exports increased at a rate of 3.1% yoy in December versus 8.6% yoy expected.
- **South Korea:** The Bank of Korea kept the policy rate unchanged at 1.5%.
- **Thailand:** FX reserves reached USD 206bn as of Friday last week.

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Global backdrop

Despite controlling both houses of Congress and the Presidency, the Republican US Administration failed to prevent a shutdown of the government. The government shutdown will not have major economic implications. Services may be disrupted for a time, but civil servants will eventually get back to work and they will not be deducted pay, so spending will be unaffected. Besides, only Federal Government agencies are impacted. The greater significance of the government shutdown may be what it says about the political climate in Washington at the start of a year of mid-term elections. Trump has likely now delivered the main legislative contribution of his presidency, namely the recently approved tax cut, so there is now much less incentive for Congressmen and women to support him. Besides, he is very unpopular and may become an actual political liability unless he regains popularity before November.

US Treasury yields went higher last week even before the news of the government shutdown. The Dollar also continued to decline. Markets are beginning to wake up to the fact that there is likely to be a doubling of supply of US Treasuries in 2018 following the Trump tax cut, which will cost tax payers USD 1.5trn (8% of GDP) in future debt payments, plus interest. Indeed, this piece of legislation could be the single largest example of fiscal irresponsibility in modern US history. Dagong, the Chinese ratings agency, took note. It downgraded the US credit rating to BBB+ with negative outlook from A- on account of the massive scale of the unfunded tax cuts. The IMF deems that the US public debt was already on an unsustainable path prior to the tax cut.[1]

We note in passing that Alibaba, the Chinese company, has now developed a computer model with artificial intelligence (AI), which scores better than students in Stanford University's reading and comprehension tests. In our view rapid developments in automation, robot technology and AI pose a potential threat to professionals in a number of highly skilled professions. Professionals in finance, law, accounting and other industries hiring highly skilled workers have typically gone to school for at least ten years and then to university for several more years accumulating years of job experience before getting into positions of responsibility. A well-programmed computer may soon be able to reach a similar level of skill at a far lower cost. Perhaps AI, automation and other innovations may eventually pose a greater threat to highly skilled people than to low skilled people. At least lower skilled workers will be in demand to undertake all the bespoke physical jobs that support daily economic activity. If low skilled workers will fare better under new technology, then recent trends in income distribution could begin to reverse, but the process will be noisy because middle class voters tend to be the most troublesome. Two areas remain where human beings are indisputably superior to computers: creativity and irrationality. Make of that what you will.

[1] See Annex II in the latest IMF Article IV report.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	6.42%	6.42%	41.04%	11.90%	5.48%
MSCI EM Small Cap	4.40%	4.40%	35.79%	10.13%	5.71%
MSCI Frontier	6.30%	6.30%	34.28%	8.02%	9.39%
MSCI Asia	5.97%	5.97%	43.78%	12.93%	8.88%
Shanghai Composite	5.46%	5.46%	14.78%	5.79%	11.14%
Hong Kong Hang Seng	12.56%	12.56%	39.98%	8.69%	5.75%
MSCI EMEA	5.13%	5.13%	29.52%	8.65%	0.56%
MSCI Latam	8.73%	8.73%	30.13%	8.42%	-2.02%
GBI EM GD	2.98%	2.98%	18.29%	3.32%	-1.07%
ELMI+	1.92%	1.92%	13.28%	3.26%	-0.32%
EM FX Spot	2.35%	2.35%	8.75%	-3.12%	-6.58%
EMBI GD	-0.04%	-0.04%	8.75%	7.04%	4.55%
EMBI GD IG	-0.51%	-0.51%	7.29%	4.50%	3.17%
EMBI GD HY	0.40%	0.40%	10.23%	10.17%	6.18%
CEMBI BD	0.09%	0.09%	7.02%	6.21%	4.39%
CEMBI BD IG	-0.13%	-0.13%	5.45%	4.05%	3.62%
CEMBI BD Non-IG	0.38%	0.38%	9.31%	9.85%	5.43%

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Benchmark performance

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	5.20%	5.20%	26.63%	13.95%	15.96%
1-3yr UST	-0.23%	-0.23%	0.18%	0.40%	0.52%
3-5yr UST	-0.69%	-0.69%	0.35%	0.62%	0.88%
7-10yr UST	-1.60%	-1.60%	1.04%	0.27%	1.27%
10yr+ UST	-2.81%	-2.81%	4.96%	0.17%	3.17%
10yr+ Germany	-0.96%	-0.96%	-1.13%	0.72%	5.16%
10yr+ Japan	-0.37%	-0.37%	0.89%	2.62%	5.09%
US HY	0.61%	0.61%	6.95%	6.57%	5.58%
European HY	0.51%	0.51%	5.86%	5.68%	6.74%
Barclays Ag	-0.56%	-0.56%	5.09%	3.19%	3.71%
VIX Index*	4.44%	4.44%	-0.09%	-29.70%	-7.24%
DXY Index*	-1.79%	-1.79%	-10.19%	-3.83%	13.27%
CRY Index*	0.85%	0.85%	0.77%	-10.46%	-35.16%
EURUSD	2.07%	2.07%	13.82%	7.80%	-8.02%
USDJPY	-1.78%	-1.78%	-1.80%	-6.59%	24.77%
Brent	2.75%	2.75%	23.82%	41.61%	-38.88%
Gold spot	2.29%	2.29%	9.39%	2.33%	-21.28%

*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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