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Ashmore

Lazy Days of Summer?

By David Muller

The Beach Boys' Brian Wilson said "Summer means happy times and good sunshine. It means going to the beach, going to Disneyland, having fun." Just as investors appeared to be heading to the beach and hoping for a more benign trade outcome, with some stability returning for the first time in many weeks, renewed tariff threats and friction at the NATO summit reminded us that the appetite for risk assets remains constrained.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.8	–	1.70%
MSCI EM Small Cap	10.7	–	1.66%
MSCI Frontier	10.3	–	0.17%
MSCI Asia	11.4	–	1.85%
Shanghai Composite	9.9	–	3.65%
Hong Kong Hang Seng	6.8	–	1.68%
MSCI EMEA	9.2	–	0.12%
MSCI Latam	11.5	–	2.20%
GBI-EM-GD	6.58%	–	0.20%
ELMI+	5.18%	–	0.06%
EM FX spot	–	–	0.23%
EMBI GD	6.23%	339 bps	0.92%
EMBI GD IG	4.70%	185 bps	0.85%
EMBI GD HY	7.99%	516 bps	1.00%
CEMBI BD	6.00%	319 bps	0.44%
CEMBI BD IG	4.81%	201 bps	0.40%
CEMBI BD Non-IG	7.48%	467 bps	0.49%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.9	–	1.55%
1-3yr UST	2.59%	–	0.00%
3-5yr UST	2.73%	–	0.04%
7-10yr UST	2.83%	–	0.04%
10yr+ UST	2.94%	–	0.19%
10yr+ Germany	0.35%	–	-0.08%
10yr+ Japan	0.04%	–	-0.05%
US HY	6.39%	347 bps	0.49%
European HY	3.52%	429 bps	0.47%
Barclays Ag	1.99%	-84 bps	-0.43%
VIX Index*	12.56	–	-0.13%
DXY Index*	94.55	–	0.47%
EURUSD	1.1708	–	-0.37%
USDJPY	112.40	–	-1.38%
CRY Index*	193.73	–	-4.32%
Brent	73.9	–	-5.35%
Gold spot	1244	–	-1.11%

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

Emerging Markets

As President Trump was heading to Europe for the NATO summit, a round of golf in Scotland and a meeting with President Vladimir Putin in Helsinki, the US Trade Representative published a list of USD 200bn in additional imports from China that would be subject to 10% tariffs. The list of nearly 6,000 items targets products that are part of the "Made in China 2025" programme. While the tariffs would not take effect until September, the announcement marked a significant escalation of trade tensions. The new tariffs are in addition to the USD 16bn of imports on which 25% tariffs are likely to be imposed in August and the USD 34bn on which 25% tariffs were applied last week. In testimony before Congress, Treasury Secretary Steven Mnuchin acknowledged that trade talks with China had "broken down" and said it was now up to China to come to the table with concessions. For their part, the Chinese said that the Trump Administration had "blatantly abandoned the consensuses that two sides have reached and insisted on fighting a trade war with China".

How will China react to this provocative step? Immediately after the announcement, China's Ministry of Commerce vowed to take "countermeasures". Is this really feasible? The newest announcement brings the total amount of goods imported from China that are subject to tariffs to USD 250bn, a figure which is more than the total Chinese imports from the US of USD 130bn. This asymmetric trade relationship could lead to a number of responses including RMB depreciation, a slowdown of approvals of mergers, increased regulation, or even a boycott of American businesses operating in China.

Who gets hurt in the process? American consumers will increasingly feel the impact of retaliatory tariffs as they expand beyond industrial products to impact more consumer products, also American businesses will find their sales to China penalised by new tariffs. Globally, the most likely victims of the increase in trade tensions are the trade-sensitive open Asian economies such as Singapore, Taiwan and South Korea, all of which are part of the Asian supply chain. Any reduction in trade flows would represent a risk for these countries' growth outlook and could trigger a change in the outlook for their respective interest rate policies.

Continued overleaf

Emerging Markets

- **Turkey:** President Recep Erodgan announced the composition of his new Cabinet as Turkey transitioned to an executive presidency in which the president is both head of state and government. Under the new system, ministers report directly to the president rather than to parliament, as was the case under the old system. Confirming the mantra that "elections have consequences", President Erdogan met charges of nepotism as he named his son-in-law Berat Albayrak as the new Minister of Treasury and Finance, merging two Cabinet departments that had previously been separate. Erdogan decreed that he has the sole authority to appoint the central bank governor and deputies. On his way to the NATO summit, Erdogan commented "About the dollar's rise: I am saying with certainty that it will fall". He added that "we will see a decrease in interest rates". The Turkish lira slumped to record lows against the USD over concerns about the new Cabinet and Erdogan's comments on interest rates, surpassing the lows seen in May which prompted emergency rate hikes by the central bank. Meanwhile, Turkey's current account deficit widened from USD 5.5bn in April to USD 5.9bn in May; the year-to-date deficit is at 6.5% of GDP.

- **Poland:** The Monetary Policy Committee (MPC) left the base rate unchanged at 1.5%, stating that "the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability". This comment suggests that interest rates will be on hold for an extended period, a view supported by Governor Glapinski's statement that he sees no reason to move rates until the European Central Bank (ECB) begins its normalisation process. Inflation projections were revised down from 2.1% to 1.8% in 2018, while the projection for 2020 was revised down by 0.2%. The dovish commentary from the MPC is in stark contrast to the more hawkish tilt by both the Czech National Bank (CNB) and the National Bank of Hungary (NBH).

- **Czech Republic:** Inflation figures for June showed a jump to 2.6% yoy from 2.2% yoy in May, largely due to transport price inflation, which incorporates a pass-through of oil price increases and weakness in the Koruna. The June figures confirmed that inflation is and will likely remain above the CNB's 2% inflation target, implying that policy rates could be raised again in 2018 after the 25bps hike to 1% in June.

- **Argentina:** The central bank (BCRA) kept policy rates unchanged at 40% and maintained its hawkish bias in light of the continued challenging inflation environment and continued FX volatility. BCRA also announced changes to the monetary policy framework. Henceforth the central bank will monitor monetary aggregates more closely, augmenting the inflation-targeting regime in acknowledgement that interest rate policy alone will be insufficient to bring stability to markets. The new policy, which will be in place until inflation returns to single digits, will have BCRA monitoring a broader monetary base that includes all its liabilities with banks, including Lebacs and other instruments. BCRA also committed to publication of more transparent statements, including the votes of board members on interest rate policy decisions, and will switch to monthly monetary policy meetings rather than the current bi-weekly schedule.

- **Mexico:** President-elect Lopez Obrador (AMLO) has outlined some of his priorities. On energy, the new government's priority will be to increase domestic production and to reduce imports, which currently average nearly 600,000 barrels per day of gasoline and 230,000 barrels per day of diesel. On the political side, AMLO will look to enact legislation to boost minimum wages. AMLO met with US officials including Secretaries Pompeo, Mnuchin and Nielsen to review NAFTA renegotiation progress, border security and migration.

- **Malaysia:** Bank Negara Malaysia (BNM) kept policy rates on hold at 3.25%, extending the period of rate stability since the bank's 25bps hike in January. The wording of the accompanying statement included some subtle changes in outlook, shifting from a reliance on 'synchronous growth' to "divergence across economies," and also noting an increase risk to growth in Asia due to trade friction and the interest rate outlook in Developed Markets.

- **China:** The State Council released a document targeting steps to improve the management of state-owned financial institutions and outlining forthcoming changes in these institutions' ownership structure that would permit a transition to mixed ownership. The plan calls for development and policy banks to remain state-owned, while the state will retain a dominant stake in financial infrastructure companies. Importantly, the document clarified that these institutions should focus on their main business lines and serve the real economy, an admonition to avoid the expansion into unrelated businesses that has characterised the industry.

Snippets:

- **Colombia:** Alberto Carrasquilla was named Minister of Finance by President-elect Duque. Carrasquilla served in the role from 2003-2007 in the Uribe administration. Central bank governor Echavarria indicated that the bank's easing cycle has ended and that rates would be held steady for "a long time", without clarify how long 'long' is.
- **India:** The June trade deficit widened as imports grew 21% while exports grew 17.6%. Oil imports account for more than half of the increased deficit from the prior month.
- **Kazakhstan:** The National Bank of Kazakhstan (NBK) maintained its base rate at 9%, following the 25bps cut in early June.

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Emerging Markets

- **Korea:** The Bank of Korea (BoK) kept its policy rate unchanged at 1.5% and lowered its GDP forecast for 2018 from 3% to 2.9% as a response to trade policy uncertainty.
- **Peru:** The central bank held interest rates steady at 2.75% while inflation expectations edged upwards, potentially eliminating the possibility of future rate cuts in the near future.
- **Ukraine:** The National Bank of Ukraine (NBU) hiked its policy rate by 50bps to 17.5% with a hawkish bias, while reporting a slowdown in inflation to 9.9% yoy in June from 11.7% yoy in May. The Rada approved an amendment to the anti-corruption law to address IMF concerns which threatened the release of the final USD 2bn tranche.

Global backdrop

UK Prime Minister May continues to face upheaval in her Cabinet and political uncertainty in her Party as Foreign Secretary Boris Johnson and Brexit Secretary David Davis resigned following Cabinet agreement on the government's negotiating position on Brexit. The 'Chequers agreement', named after the PM's country house where the agreement was discussed and agreed, pursues a 'soft Brexit' strategy that would focus on (1) free trade in goods, (2) no free trade in services, (3) withdrawal from the Customs Union and the Single Market, and (4) continued coordination of regulatory and administrative matters. This negotiating position differs from the EU-27 position, and is being criticised as an attempt to cherry pick from among the benefits of EU membership. The two resignations, and hints of further dissatisfaction from within the ruling party, raise the level of political uncertainty and could open the PM to a leadership challenge. With the next round of Brexit negotiations set to start on July 16th, the clock is ticking in advance of the EU Summit to be held in mid-October, where the final agreement on the terms of the UK's withdrawal from the EU are to be announced. The government released a white paper on Thursday that rounds out the Chequers agreement, seeking free movement for workers and students in an apparent contradiction to the policy of ending the free movement of people at the end of the transition period in December 2020. Calling himself a "stable genius", President Trump stated in an interview that PM May had ignored his advice on how to proceed with Brexit and criticised the government's approach to negotiations.

At the NATO Summit in Brussels that can best be described as tumultuous, US President Trump unleashed on alliance members, distorting NATO spending and complaining that Europe has taken advantage of US military support without paying adequately for it. After blasting Germany for being "captive to Russia," Trump proposed a new goal for NATO members of spending 4% of GDP on defence, or double the current target that only a handful of members currently meet. In a further sign of fractiousness, the Turkish foreign minister defended the USD 400m purchase of a Russian-made air defense system. NATO leaders must now be concerned about what Trump will offer to Russian President Putin when they meet in Helsinki on Monday, July 16th.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	1.01%	-5.66%	6.06%	7.40%	5.45%
MSCI EM Small Cap	0.68%	-7.78%	5.16%	4.07%	4.60%
MSCI Frontier	1.94%	-9.19%	2.55%	3.18%	4.31%
MSCI Asia	0.32%	-4.45%	7.59%	8.50%	8.18%
Shanghai Composite	0.10%	-12.82%	-9.88%	-8.78%	9.22%
Hong Kong Hang Seng	-1.16%	-4.99%	4.57%	0.28%	6.66%
MSCI EMEA	1.90%	-9.07%	5.09%	2.61%	0.08%
MSCI Latam	4.17%	-7.29%	-1.34%	4.16%	-0.74%
GBI EM GD	1.12%	-5.39%	-1.46%	2.43%	-1.16%
ELMI+	0.41%	-3.01%	0.50%	1.73%	-0.74%
EM FX Spot	0.82%	-5.67%	-4.68%	-3.60%	-6.94%
EMBI GD	2.29%	-3.48%	0.67%	5.29%	5.54%
EMBI GD IG	1.68%	-2.58%	1.24%	3.93%	4.65%
EMBI GD HY	2.93%	-4.49%	-0.05%	6.85%	6.54%
CEMBI BD	0.64%	-2.25%	0.36%	4.14%	4.79%
CEMBI BD IG	0.67%	-1.44%	0.29%	3.16%	4.23%
CEMBI BD Non-IG	0.60%	-3.23%	0.60%	5.63%	5.56%

Continued overleaf

Benchmark performance

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	3.13%	5.86%	16.67%	12.38%	13.06%
1-3yr UST	0.01%	0.06%	-0.05%	0.43%	0.57%
3-5yr UST	0.08%	-0.67%	-0.96%	0.70%	1.14%
7-10yr UST	0.23%	-1.74%	-1.37%	1.32%	2.07%
10yr+ UST	0.94%	-2.08%	2.07%	4.33%	5.06%
10yr+ Germany	0.22%	4.13%	6.67%	4.99%	6.16%
10yr+ Japan	0.40%	1.95%	3.30%	4.97%	5.13%
US HY	0.51%	0.67%	3.02%	5.68%	5.36%
European HY	1.19%	-0.33%	2.20%	4.49%	6.11%
Barclays Ag	0.05%	-1.41%	1.67%	2.88%	1.44%
VIX Index*	-21.94%	13.77%	32.07%	3.72%	-12.90%
DXY Index*	0.08%	2.63%	-0.64%	-3.19%	14.61%
CRY Index*	-3.32%	-0.07%	9.90%	-10.13%	-32.85%
EURUSD	0.21%	-2.47%	2.00%	7.66%	-11.05%
USDJPY	-1.46%	0.26%	0.20%	10.45%	-11.83%
Brent	-6.99%	10.50%	51.07%	28.48%	-32.46%
Gold spot	-0.70%	-4.53%	0.78%	8.59%	-3.74%

*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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