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Ashmore

Venezuelan developments

By Jan Dehn

The Weekly provides an update on developments in Venezuela. It also covers economic and political developments in Brazil, Peru, India, China and El Salvador. Events in developed economies continue to provide most of the risk and volatility in global markets. The latest commotion comes from shifts in US monetary policy, noisy US data and US-China trade talks. The UK's attempt to renegotiate the Irish backstop with the EU appears to be failing, while Russia and the US now both seem hell bent on restarting a nuclear arms race.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.6	–	1.73%
MSCI EM Small Cap	9.5	–	1.67%
MSCI Frontier	8.5	–	0.47%
MSCI Asia	11.3	–	1.53%
Shanghai Composite	8.8	–	0.63%
Hong Kong Hang Seng	7.4	–	1.75%
MSCI EMEA	8.7	–	1.24%
MSCI Latam	11.5	–	2.51%
GBI-EM-GD	6.24%	–	1.87%
ELMI+	5.34%	–	0.65%
EM FX spot	–	–	1.08%
EMBI GD	6.24%	354 bps	0.77%
EMBI GD IG	4.58%	186 bps	0.72%
EMBI GD HY	7.98%	530 bps	0.83%
CEMBI BD	5.92%	331 bps	0.58%
CEMBI BD IG	4.77%	216 bps	0.58%
CEMBI BD Non-IG	7.51%	489 bps	0.58%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	14.5	–	1.62%
1-3yr UST	2.52%	–	0.19%
3-5yr UST	2.52%	–	0.34%
7-10yr UST	2.71%	–	0.55%
10yr+ UST	3.05%	–	0.59%
10yr+ Germany	0.18%	–	0.25%
10yr+ Japan	-0.01%	–	0.71%
US HY	6.88%	416 bps	0.79%
European HY	4.91%	513 bps	0.53%
Barclays Ag	1.96%	-75 bps	0.61%
VIX Index*	16.14	–	-2.73%
DXY Index*	95.67	–	-0.07%
EURUSD	1.1448	–	0.17%
USDJPY	109.87	–	0.49%
CRY Index*	180.55	–	-0.13%
Brent	63.3	–	5.59%
Gold spot	1312	–	0.63%

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

Emerging Markets

- **Venezuela:** Regime change is the only game in town as far as Venezuelan bond markets are concerned. As of Friday, the year to date return on the Venezuelan segment of the JP Morgan EMBI GD USD-denominated bond index was 43.3%. However, the situation in Venezuela remains highly uncertain and bond prices are likely to continue to be very volatile until one of two things happen: If President Nicholas Maduro manages to remain in office despite the rising pressure to oust him, then holders of Venezuelan bonds may have to wait a bit longer to get paid. Altenatively, if Maduro leaves office in the next few months, a new Venezuelan government will want to cure the default as quickly as possible in order to be able to raise fresh funding to get the economy going. Investors are therefore paying attention to every little shift in the balance of power between the government and the opposition.

Here is a list of some of the notable developments in the past week:

1. Hundreds of thousands of Venezuelans marched in Caracas in protest against the Maduro government on Saturday.
2. Maduro indicated that he is open to talks with the opposition subject to the participation of international mediators.
3. Maduro proposed to hold early National Assembly elections.
4. Maduro responded to US President Donald Trump's threat that the US could use force in Venezuela by saying he stands ready to defend the country.
5. An Airforce general defected to the opposition, which is under the leadership of National Assembly Speaker Juan Guaidó.
6. Guaidó said he wants to talk to China in the interest of establishing a mutually beneficial relationship. China, a major investor in the Venezuelan oil sector, wants a strategic relationship with Venezuela, regardless of who is in office.

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Emerging Markets

7. Guaidó says he will send large shipments of humanitarian aid to Venezuela in defiance of a government ban.
8. United States has placed restrictions on US persons to trade in both PDVSA and sovereign bonds as well as applying other restrictions on the Venezuelan oil industry, which may result in a decline in oil production and reduce flow of funds to the government.
9. United States stepped up pressure on Turkey on suspicion that Turkey has engaged in commercial transactions with Venezuela in breach of US sanctions.
10. Venezuela is seeking to sell significant amounts of gold overseas as other sources of financing dry up, but the government is finding it difficult to find anyone willing to ship the gold.
11. The European Parliament and several European states have recognised Guaidó as the legitimate leader of Venezuela.
12. The European Union will lead a group of countries, including Latin American nations, tasked with resolving the political crisis in Venezuela. The group has called for a general election; it will also examine the possibility of further sanctions against the Maduro government.

- Brazil: Rodrigo Maia has been re-elected as Speaker of the House in Brazil's parliament. He was elected with a majority of 65%. This is positive news, since the House Speaker decides which bills come to a vote. Maia supports fiscal reform. In another positive development, President Jair Bolsonaro decided to include military personal in the upcoming pension reform. The government also indicated that it wishes to approve full independence for the central bank by March. In economic news, industrial production recovered modestly (0.2% mom) in December and credit conditions improved. The trade surplus in December was USD 1.8bn versus an expected deficit of USD 900m. The full year 2018 current account deficit was just USD 14.5bn, meaning its was dwarfed by annual FDI of USD 88.0bn. The government's 2018 primary deficit of BRL 108.3bn was dramatically smaller than the government's own target of BRL 161.3bn. The re-establishment of central bank credibility with resulting lower inflation, and therefore a lower policy interest rate, has significantly reduced the government's interest rate burden.

- Peru: In a public statement, Fitch, a ratings agency, pointed to Peru's strong fiscal performance. The statement followed much better than expected fiscal numbers in 2018. Peru's fiscal deficit was just 2.1% of GDP in 2018 compared to Fitch's expectation of a deficit of 2.8% of GDP. Fitch affirmed Peru's rating of BBB+ (stable).

- India: India's next general election is just around the corner in Q2 2019, but the government's budget, published last week, did not jeopardise the government's projected fiscal deficit target of 3.4% of GDP. At worst, the Budget signals a pause in fiscal consolidation. The Budget makes some heroic assumptions about GST collections, which may not be realised, but it also raises some new taxes, so the overall fiscal impact is likely to be modest. The proximity of the election means that the scope for serious election-related fiscal damage is now quite limited, in our view. The Budget implies a somewhat larger supply of government bonds, which may crowd out some private investment. However, as long as the overall environment for EM bonds remains strong and Indian bonds offers some of the highest real yields anywhere in the world, we think any pullback in the market in response to the Budget is an opportunity to add at better levels.

- China: At 53.6, the Caixan Services PMI was solid in January, although slightly lower than the strong number recorded in December (53.9). The strength in China's services sector indicates that weakness in the Chinese economy is sector specific, notably in manufacturing, where the Caixin PMI manufacturing index declined to 48.3 from 49.7 in December. However, in a sign that manufacturing may now be stabilising, the official PMI actually increased in January to 49.5 from 49.4 in December. The Chinese government's relatively measured response to the weaker economic data suggests the absence of panic. Meanwhile, investors are not panicking either. 2018 saw a record USD 120bn flow into the Chinese bond and equity markets from abroad. Inflows may easily double in 2019 as Chinese government bonds enter the Barclays/Bloomberg Global Aggregate Indices. 2019 is also likely to see rapid progress in the further inclusion of A-shares in global equity indices. Finally, we note that the daily trading volumes of RMB versus USD has now overtaken GBPEUR trading in London, according to Bank of England. China's financial markets will be multiple times the size of US markets by the middle of this century, in our view.

- El Salvador: Nayib Bukele, former mayor of San Salvador, won 54% of the votes in the presidential election with 88% of the votes counted. Bukele ran on an anti-corruption ticket. Hugo Martinez of the ruling FMLN party has admitted defeat. Bukele is an outsider in El Salvadorian politics, which has traditionally seen power either in the hands of the right-wing ARENA party or the left-wing FMLN party. As middle classes grow and become more influential, anti-corruption politicians have done well in many Emerging Market countries in recent years, including Brazil and Peru.

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Emerging Markets

Snippets:

- **Argentina:** The central bank increased the limit on daily FX purchases to USD 75m per day.
- **Chile:** Unemployment was 6.7% in Q4 2018 in line with expectations. The central bank hiked the policy rate by 25bp to 3.0%.
- **Colombia:** The central bank left the policy rate unchanged at 4.25%.
- **Ecuador:** The government has identified 90% of the financing required in 2019, according to the Finance Minister.
- **Hungary:** The central bank left the policy rate unchanged at 0.9%.
- **Indonesia:** The yoy rate of CPI inflation declined to 2.8% in January from 3.1% yoy in December. The market consensus expectation was 3.1% yoy.
- **Malaysia:** The trade surplus was USD 2.5bn, which is 1.4% lower than last month.
- **Mexico:** Remittances from Mexican workers in the United States rose at a strong 6.0% yoy pace in December. Credit to the private sector expanded at a yoy rate of 4.9% in December. Real GDP growth was 0.3% qoq in Q4 2018 versus 0.2% qoq expected. Ratings agency Fitch downgraded Pemex citing reduced government support.
- **Philippines:** The Philippine stocks exchange will introduce new benchmark indices this year, including a total return index.
- **Poland:** The real economy grew 5.1% in 2018, slightly ahead of expectations and better than in 2017 (4.8%).
- **Qatar:** Reserves recovered further to USD 30.2bn in December.
- **South Africa:** The trade surplus expanded sharply to ZAR 17.7bn in December from ZAR 3.3bn in November.
- **South Korea:** Inflation in January was just 0.8% yoy versus 1.3% yoy expected. Exports in January beat expectations. South Korea exported USD 46.4bn worth of goods and services compared to USD 45.8bn expected).
- **Taiwan:** Manufacturing PMI softened further to 47.5 in January from 47.7 in December. Q4 2018 GDP growth was 1.8% yoy, which was lower than expected (2.1% yoy).
- **Thailand:** CPI inflation declined to 0.3% yoy in January from 0.4% yoy in December.
- **Turkey:** The yoy rate of CPI inflation increased marginally to 20.35% in January from 20.30% in December.

Global backdrop

Three positive developments and two not so positive developments in the global backdrop.

Positive development #1: The FOMC was far more dovish than expected. Less than 10 months ago, the Fed hinted at four hikes in 2019. Now they are signalling patience on hikes and considering an early end to balance sheet normalisation. The Fed made a colossal rooky error in April last year, when it mistook the 'sugar high' from the December 2017 tax cut for higher trend growth. The Fed also appears not to have foreseen that costs would begin to eat into US company earnings by Q3 2018. Costs are rising due to higher wages, tariffs, the strong Dollar and the Fed's own hiking efforts. Barring a major collapse in the Dollar, much higher unemployment, rate cuts or the removal of tariffs, none of which seem imminent, it is unlikely that the cost pressures facing US companies will recede any time soon. This in turn implies a more muted outlook for the US stock market the appreciation of which explains most of the rise in the Dollar over the last eight years.

Positive development #2: US market sentiment also improved last week on the back of stronger economic data, including a better ISM print and the addition of 304,000 new jobs in the American economy in January. However, Q4 GDP tracked lower due to weaker housing and trade. Moreover, the January payroll number is likely to have been distorted heavily by public sector workers, which were forced to take part time jobs during the recently concluded government shutdown. Details in the jobs report showed that about half a million people took part time jobs in January. If so, there is a great likelihood that the strong payroll number in January will give way to a weak one in February.

Positive development #3: Both sides in the US-China trade talks pointed to progress over trade imbalances and protection of intellectual property rights with further talks required in some other areas. Both sides are now hinting at a meeting between Chinese President Xi Jinping and United States President Donald Trump in early March to try to conclude a deal. Our view is that Trump is very keen to strike a deal, because further escalation in the trade war could push the US economy into recession just ahead of the 2020 US presidential election.

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Global backdrop

Negative development #1: The European Union has so far given the United Kingdom a clear 'no' in response to Prime Minister Theresa May's request to consider 'alternative arrangements' for the so-called Irish backstop. The UK parliament had empowered May to re-negotiate with the EU, but failed to specify what it meant by 'alternative arrangements'. No one else, including May, appear to know what it means either. The UK therefore remains firmly on track to crash out of Europe on 29 March, with likely catastrophic economic consequences. In a sign of what is to come, Nissan, a car giant, announced that it is no longer going to build a new model of car in Sunderland, England. It cited Brexit uncertainty as one of its reasons. Sunderland voted 61-39 in favour of leaving the EU, far higher than the UK average of 52-48.

Negative development #2: The world got a little bit less safe last week, when Russia and the United States pulled out of the Intermediate-range Nuclear Forces Treaty (INF). In yet another example of how America under Trump is relinquishing its role as global leader, the United States unilaterally pulled out of the INF, promptly followed by the Russians. Russia withdrew immediately, because it stands to gain a military advantage over Western Europe, which has no plans to deploy new nuclear missiles. The United States and Russia will now likely spend more money on missiles. This will, in Russia, crowd out much needed investment in other parts of the economy, while it will add to the government's already eye-watering stock of debt in the United States. Of course, the resumption of the arms race also means that the risk associated with any future conflict will increase, in much the same way that leverage can increase the fallout from a bad investment decision.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.03%	8.79%	8.79%	-13.59%	15.29%	5.14%
MSCI EM Small Cap	0.10%	5.49%	5.49%	-18.57%	8.55%	2.77%
MSCI Frontier	0.16%	4.92%	4.92%	-16.93%	7.97%	1.41%
MSCI Asia	0.10%	7.41%	7.41%	-13.72%	14.40%	6.86%
Shanghai Composite	1.30%	4.99%	4.99%	-22.19%	1.29%	7.59%
Hong Kong Hang Seng	0.26%	9.28%	9.28%	-14.27%	15.32%	6.44%
MSCI EMEA	-0.69%	10.04%	10.04%	-12.44%	13.83%	1.18%
MSCI Latam	0.10%	15.08%	15.08%	-5.50%	22.49%	3.39%
GBI EM GD	-0.16%	5.29%	5.29%	-5.88%	7.50%	1.02%
ELMI+	-0.29%	2.42%	2.42%	-3.88%	4.97%	0.09%
EM FX Spot	-0.20%	3.43%	3.43%	-9.44%	0.37%	-5.71%
EMBI GD	0.08%	4.50%	4.50%	0.17%	6.82%	5.86%
EMBI GD IG	0.13%	3.01%	3.01%	1.36%	5.28%	4.93%
EMBI GD HY	0.04%	6.06%	6.06%	-1.06%	8.54%	6.80%
CEMBI BD	0.10%	2.81%	2.81%	1.11%	6.29%	4.85%
CEMBI BD IG	0.11%	2.09%	2.09%	1.82%	4.48%	4.23%
CEMBI BD Non-IG	0.08%	3.79%	3.79%	0.27%	9.27%	5.65%

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Benchmark performance

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	0.10%	8.12%	8.12%	-2.18%	14.05%	10.96%
1-3yr UST	-0.09%	0.18%	0.18%	2.09%	0.82%	0.80%
3-5yr UST	-0.25%	0.16%	0.16%	2.78%	0.77%	1.35%
7-10yr UST	-0.45%	0.29%	0.29%	3.83%	0.57%	2.39%
10yr+ UST	-0.54%	0.13%	0.13%	2.67%	0.97%	4.69%
10yr+ Germany	-0.27%	1.89%	1.89%	10.42%	2.90%	6.99%
10yr+ Japan	0.59%	1.67%	1.67%	4.04%	2.56%	4.44%
US HY	0.13%	4.65%	4.65%	1.96%	9.52%	4.63%
European HY	0.03%	2.50%	2.50%	-1.76%	4.89%	4.18%
Barclays Ag	-0.25%	1.27%	1.27%	-0.97%	2.78%	1.12%
VIX Index*	-2.60%	-36.51%	-36.51%	-6.76%	-26.10%	-15.54%
DXY Index*	0.10%	-0.52%	-0.52%	7.26%	-0.83%	17.94%
CRY Index*	0.51%	6.33%	6.33%	-8.56%	10.46%	-36.97%
EURUSD	0.00%	-0.18%	-0.18%	-7.43%	2.14%	-15.32%
USDJPY	0.92%	0.16%	0.16%	0.72%	-5.92%	8.10%
Brent	2.25%	17.62%	17.62%	-7.73%	83.63%	-40.18%
Gold spot	-0.73%	2.27%	2.27%	-2.10%	13.50%	4.53%

*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 1 316 2070

Dubai
T: +971 440 195 86

Jakarta
T: +6221 2953 9000

Mumbai
T: +9122 6269 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

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