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WEEKLY INVESTOR RESEARCH

Ashmore

The China hard landing thesis bites the dust – again

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The China hard landing thesis bites the dust again. Slovakia rejects far-right populism. Local elections in Turkey test Erdogan's popularity as economic woes mount. Attention homes in on possible changes to Colombia's fiscal rule. It is election time in Ukraine. Brazilian politics continues to impart noise, but the economy is improving. US introduces yet more sanctions on Russia. The economic data improves in both Argentina and Mexico. Croatia gets investment grade status. Hungary hikes. Pension changes in Poland. Global markets remain jittery as US data continues to weaken.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.1	–	-0.09%
MSCI EM Small Cap	10.2	–	-0.27%
MSCI Frontier	8.6	–	-0.20%
MSCI Asia	12.1	–	-0.09%
Shanghai Composite	10.7	–	-0.43%
Hong Kong Hang Seng	8.1	–	-1.20%
MSCI EMEA	8.5	–	-0.20%
MSCI Latam	11.3	–	1.30%
GBI-EM-GD	6.16%	–	-0.71%
ELMI+	6.04%	–	-0.46%
EM FX spot	–	–	-0.58%
EMBI GD	5.99%	356 bps	0.33%
EMBI GD IG	4.31%	186 bps	0.56%
EMBI GD HY	7.83%	543 bps	0.11%
CEMBI BD	5.70%	336 bps	0.10%
CEMBI BD IG	4.45%	211 bps	0.37%
CEMBI BD Non-IG	7.42%	507 bps	-0.27%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.3	–	1.23%
1-3yr UST	2.30%	–	0.13%
3-5yr UST	2.27%	–	0.16%
7-10yr UST	2.44%	–	0.36%
10yr+ UST	2.84%	–	1.24%
10yr+ Germany	-0.04%	–	0.37%
10yr+ Japan	-0.07%	–	0.43%
US HY	6.43%	391 bps	0.35%
European HY	4.34%	446 bps	0.31%
Barclays Ag	1.77%	-67 bps	-0.13%
VIX Index*	13.71	–	-2.62%
DXY Index*	97.17	–	0.61%
EURUSD	1.1230	–	-0.73%
USDJPY	111.05	–	0.98%
CRY Index*	183.75	–	-0.40%
Brent	68.3	–	1.56%
Gold spot	1289	–	-2.48%

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

Emerging Markets

- **China:** The China hard landing thesis bites the dust – again. China's official Manufacturing Purchasing Managers Index (PMI) surged 1.3 points to 50.5 in March, which was far better than expected (49.6). The recovery was broad-based and included a bounce in new orders as well as production. Caixin PMI, which covers more small and medium-sized enterprises, also bounced to 50.8 from 49.9, the second consecutive increase in the index. Finally, the services PMI also recovered, albeit by less, reflecting the fact that it never weakened as much in the first place. In the last year or so, China's economy has faced twin headwinds from US trade aggression and domestic reforms, but the government's stabilisation measures now appear to be bearing fruit, reducing the odds of a hard landing. It is also noteworthy that other countries, whose industries are often part of the same supply-chain as China, such as South Korea, Vietnam, Taiwan, Thailand and Indonesia, also saw improvements in the PMIs (Figure 1).

In other Chinese economic news, the current account surplus increased by 0.8% of GDP in Q4 2018 to 1.5% of GDP, or USD 54.6bn, driven by a trade surplus, which was 38% higher on the quarter (USD 139.1bn). Also, the government this morning published a list of 197 domestic companies, which have now been registered to provide services based on blockchain technology.

Finally, we note that President Xi Jinping is set to travel to Washington this week following a visit by US Trade Representative Robert Lightizer and US Treasury Secretary Steven Mnuchin to China last week, which was described as 'constructive'.

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Emerging Markets

Fig 1: **PMIs recover in Asia**

Index	March 2019	February 2019	Change
China PMI	50.5	49.9	+0.6
China Services PMI	54.8	54.3	+0.5
China Caixin PMI	50.8	49.9	+0.9
South Korea	48.8	47.2	+1.6
Taiwan	49	46.3	+2.7
Thailand	50.3	49.9	+0.4
Vietnam	51.9	51.2	+0.7
Indonesia	51.2	50.1	+1.1

Source: Ashmore, Bloomberg.

- **Slovakia:** Suzana Caputova, a pro-European centrist, has become Slovakia's first female president after securing 58.3% of the votes with 98.1% of districts counted, an unbeatable lead. In sharp contrast to many of Europe's far-right populist movements, Caputova ran on a pro-environment, pro-gay rights, pro-abortion and anti-corruption platform.
- **Turkey:** President Recep Tayyip Erdogan suffered major defeats in local elections at the weekend, including Ankara, Izmir and possibly Istanbul, where Erdogan's political career was established (the election board said this morning that the opposition is in the lead in Istanbul). Erdogan's defeat increases political uncertainty and will complicate any attempt to pass reforms. Turkey needs economic reform, especially with respect to monetary policy. For many years, Erdogan has pressured the central bank into pursuing excessively loose monetary policies in a misguided bid to drive up growth. All he has achieved is to create imbalance between aggregate demand and aggregate supply. Turkey is now in recession and the Turkish Lira (TRY) has slumped in a repeat of the currency crisis of last year. The central bank has burned through one third of its FX reserves.
- **Colombia:** The Fiscal Rule Advisory Committee has granted the government room to increase the fiscal deficit by 0.3% of GDP in 2019 and 0.1% of GDP in 2020 in order to cope with the upfront costs of integrating upwards of 2 million Venezuelan refugees. The IMF has supported a temporary relaxation of the fiscal rule, but it is unclear if ratings agencies will countenance the measure as well. Moody's in particular may downgrade Colombia from Baa2 to Baa3, that is, still investment grade. S&P and Fitch both have Colombia on investment grade (BBB- and BBB, respectively). A relaxation would put temporary upwards pressure on the debt to GDP ratio. However, it would be myopic of the ratings agencies to downgrade Colombia over a temporary increase in the deficit to manage the Venezuelan refugee problem, because the inflow of Venezuelans to Colombia is ultimately likely to be net positive for the Colombian economy.
- **Ukraine:** Pre-election polls were right in placing Volodymyr Zelensky in pole position ahead of incumbent President Petro Poroshenko and populist former Prime Minister Yulia Tymoshenko in the presidential election at the weekend. Based on one third of the votes counted, Zelenzky has secured just over 30% of the vote, while Poroshenko is in second with about 17% of the cast votes. The two men will now face off in a second round election scheduled for 21 April. Tymoshenko, has only received about 14% of the votes so far. The key issue from an investment perspective is continuity of reforms under the IMF program. Zelensky and Poroshenko are widely expected to keep Ukraine within the IMF arrangement. Full year real GDP growth in 2018 was 3.3%, driven by consumption and investment.
- **Brazil:** Brazilian markets continued to experience volatility last week on the back of developments related to the pension reform. Tensions between the Bolsonaro Administration and Parliament Speaker Rodrigo Maia appeared to rise early in the week resulting in pressure on the currency, bonds and stocks, but by the end of the week the tensions eased and the market recovered. We think the situation will probably remain the same until the reform passes sometime in Q3 2019. Meanwhile, economic data is slowly improving. The current account deficit in February was USD 1.13bn versus USD 1.30bn expected. Bank lending accelerated to 5.5% yoy in February from 5.0% yoy in January, while non-performing loans declined by 10bps to 3.9% (well off the cycle high of 5.9% in 2017). The mid-month IPCA-15 inflation print was 0.54% mom for March compared to 0.43% mom for the full month of February. The number of unemployed Brazilians also declined very marginally to 12.4m in February from 12.6m in January. This translates into a still very high unemployment rate of 12.4%. The high level of unemployment indicates that Brazil is growing well below capacity, so when the pension reform passes there should be room for many years of non-inflationary expansion of the Brazilian economy. As far as the public finances are concerned, there was modestly positive news. The government's primary deficit was BRL 14.9bn in February, while regional governments ran a surplus of BRL 9.4bn. The primary deficit on a 12-month rolling basis remains well within budget limits (BRL 108.3bn versus a target of BRL 132bn). In GDP terms, this is equivalent to 1.5% and well down from 2.9% in October 2017.

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Emerging Markets

- **Russia:** The US government is preparing new sanctions on Russia in response to the alleged nerve-agent attack by Russian agents in UK in 2018. This round of sanctions is not likely to include measures against Russian government bonds, but the US Congress is currently working on other sanctions proposals, which may impede trade in government securities. We see little downside risk for US members of Congress in sanctioning Russia, while sanctions give members of Congress leverage over President Donald Trump. Hence, sanctions are only likely to intensify, in our view.

- **Argentina:** The February 2019 trade surplus was USD 460m versus a deficit of USD 892m in the same month of last year. Exports were up 3.7% yoy, while imports were down 22.9% yoy, indicating the depth of the demand adjustment under the current IMF program. Exports are likely to pick up sharply in the coming quarters as the soy harvest hits the market. As for the decline in imports, the sharp adjustment of domestic demand is necessary following years of excess demand stimulus under the populist Kirchner Administration. Fortunately, things are looking a bit more rosy on the growth side. After returning to positive growth in December (1.0% mom), the Argentinian economy staged yet another month of positive growth in January (0.6% mom).

- **Mexico:** Good economic news from Mexico. The trade surplus was larger than expected (USD 1.22bn versus the USD 0.30bn consensus), while credit to the private sector grew 6.1% yoy in February compared to 5.5% yoy in January. Retail sales were 1.3% higher yoy in January on a seasonally adjusted basis compared to -0.7% yoy in December. The monthly economic activity indicator (IGAE) was also stronger, up 1.3% yoy in January from 0.0% in December. Unfortunately, the political news was not so good. President Donald Trump threatened to close the border with Mexico to stop immigrants from coming into America. Trump also said that he would cut off aid to Honduras, El Salvador and Guatemala as punishment for migration to the US from these countries. In our view, Trump's policies are counterproductive. Closing the border will disrupt business sentiment and hurt the American economy due to the strong supply-chain links between the US and Mexico. Meanwhile, reducing aid to Central America will surely only worsen the economic conditions there, which will encourage even more migration. The Mexican central bank left the policy rate unchanged at 8.25%.

- **Croatia:** Standard & Poor's raised its sovereign credit rating on Croatia to investment grade (BBB- from BB+) citing improvements in fiscal policy. Meanwhile, retail sales surged to a strong pace of 8.7% yoy in February from a solid 4.3% yoy pace in January, beating expectations of 4.1% yoy growth.

- **Hungary:** In a notable shift in policy, the central bank has begun the process of normalising interest rates. The monetary council raised the overnight deposit rate by 10bps to -0.05% from -0.15%. The policy rate and overnight lending rates were left unchanged at 0.9%.

- **Poland:** The government is considering major changes to the pension system. The government may transfer one quarter of assets in the voluntary pension system to the public pension system with the remaining 75% in private hands. The 25% transfer to the public system would reduce the government's funding needs. In other news, CPI inflation was marginally higher than expected in March (1.7% yoy versus 1.6% yoy expected).

Snippets:

- **Chile:** The 3-month rolling average manufacturing gauge accelerate to 1.5% qoq sa in February from 0.9% qoq sa in January. The rate of unemployment declined to 6.7% versus 6.9% expected.
- **Czech Republic:** The central bank left the policy rate unchanged at 1.75%.
- **Egypt:** The central bank left the main policy deposit and lending rates unchanged at 15.75% and 16.75%, respectively.
- **Indonesia:** CPI inflation was 2.48% in March versus 2.51% yoy expected.
- **Nigeria:** The central bank cut the policy rate by 50bps to 13.5%.
- **Singapore:** Industrial production beat expectations in February (0.7% yoy versus a -0.4% yoy consensus estimate).
- **South Africa:** The South African Reserve Bank left the policy rate unchanged at 6.75%.
- **South Korea:** Industrial production surprised sharply to the downside in February (-2.7% yoy versus -0.5% yoy expected). Lunar New Year is partly to blame for the downside surprise. Exports increased 4.5% mom sa following four months of decline.
- **Slovenia:** Inflation was 1.6% yoy in March, in line with expectations.
- **Thailand:** The trade surplus grew to USD 3.5bn in February from USD 0.2bn in January as exports picked up and imports softened. Consumption was stable in February. CPI inflation was 1.2% yoy in March with core inflation sitting at 0.58%. The central bank's target range for inflation is 1-4%.
- **Venezuela:** The country found itself in a blackout for the second time in recent weeks following yet another nationwide power failure. Meanwhile, Russian troops have arrived in Venezuela to support of President Nicholas Maduro.
- **Vietnam:** Exports surged at a yoy pace of 5.4% in March versus expectations of a pace of decline of 4.0% yoy. The real economy expanded at a pace of 6.8% in Q1 2019, just shy of the government's target of 6.9% yoy.

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Global backdrop

Global markets remain extremely jittery. This is partly due to quarter-end, which often leads to some position squaring. However, the bigger story is the dramatic change in economic performance of the United States and the associated impact on financial markets. The facts speak for themselves: the US real GDP growth rate peaked in Q2 2018 at 4.2% qoq saar after Congress' December 2017 tax cut, but has since decelerated to 3.4% in Q3 2018, 2.2% in Q4 2018 (after downwards revisions) and now tracks less than 1% in Q1 2019. The US stock market fell sharply in late 2018, the US yield curve has inverted, the Fed has done the largest U-turn in living memory. White House economic advisor Larry Kudlow is now calling on the Fed to cut rates immediately. Sadly, much of the blame for the US slowdown can be assigned to the US policy makers. The Trump tax cut was inefficient and poorly timed, the Fed was far too hawkish in Q2 2018 and the decision to start a trade war against China was moronic. Now everyone is talking about slower 'global' growth, but the real culprit is clearly the slowdown in the US.

Indeed, the latest economic data suggests that the Chinese and European economies may already be stabilising, even staging a bounce back. As noted above, Chinese PMIs are rising again, which justifies the strong bounce in Chinese equities so far this year. Meanwhile, if German retail sales are anything to go by, the slowdown in Europe may also be coming to an end. German retail sales rose 0.9% mom in February after a 2.8% mom bounce in January, while German car registrations have also picked up. Together, these two indicators point to the strongest bounce in consumption in Germany for nearly ten years. IFO, the German business sentiment indicator also surprised to the upside. Nevertheless, Reuters reported last week that ECB is considering the tiering of interest rates on banks' excess reserves held at the ECB. Tiering would enable the ECB to reduce the incentive for banks to reduce lending in an environment of very low term rates. This may still be necessary, because there is no sign of inflation in Europe despite the improving activity data.

By contrast, the US data is clearly softening. While some sentiment indicators were positive, personal spending increased only by 0.1% mom in January versus a medium forecast of 0.3% mom, while personal income and core prices were both lower than expected. Home prices have now slowed to 3.6% yoy in January from a peak of 6.7% yoy as recently as March last year. Consumer confidence also dropped in March and housing starts, pending home sales and housing permits all weakened, although new homes sales picked up. Despite overall soft domestic demand conditions, the Q4 2018 current account deficit was higher than expected (USD 134.4bn versus USD 130bn expected and USD 126.6bn in Q3 2018). This co-existence of record external deficits and slowing domestic demand illustrates perfectly the US problem: America is either not productive enough, or the Dollar is too strong, or both. Fortunately, there was a silver lining as imminent political risks have abated somewhat. Special Council Robert Mueller was unable to level charges at President Trump for collusion with Russia in election meddling. However, Muller's report was not published, which has many people questioning why. Besides, the key issue of funding of the Trump campaign in 2016 remains unanswered.

In the UK, the original 29 March Brexit deadline came and went. Armed with an extension of the deadline to 12 April courtesy of the EU, the UK parliament proceeded to vote down Prime Minister Theresa May's Brexit bill for a third time, this time by a margin of 58 votes (344 versus 286). May was able to avoid a ban on repeat votes on the same bill by splitting her Brexit bill into two segments, but this was still not enough to secure a majority. Rumour has it that May will now try to get her bill through Parliament a fourth time in the coming week. If she fails, the option of an imminent soft Brexit for the UK dies a death. This will make the outlook more binary but also shifts the balance of probability slightly in favour of the Remainers. After all, only a very small number of MPs have indicated support for a hard Brexit. However, if Parliament ends up having to decide the way forward it is not entirely clear what will happen either. Getting the majority of the 650 members of parliament to agree on anything is a bit like herding cats. Case in point: in indicative votes, Parliamentarians last week rejected all eight alternative proposals for exiting Brexit cul-de-sac. If hard Brexit does not happen, the remaining options revolve around a much longer delay during which the UK may or may not hold fresh elections and/or second referendum or even revoke Article 50. In short, the messy situation remains extremely risky both politically and economically. This was also underlined in a new report from the Centre for Economic Performance at the London School of Economics, which showed that the UK economy has already fallen significantly behind the rest of OECD since the vote to leave EU.[1]

[1] See http://cep.lse.ac.uk/pubs/download/brexit14.pdf

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Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.83%	9.90%	9.90%	-7.11%	11.15%	4.07%
MSCI EM Small Cap	0.96%	7.77%	7.77%	-12.17%	6.21%	1.99%
MSCI Frontier	1.24%	6.91%	6.91%	-15.00%	6.95%	0.56%
MSCI Asia	1.69%	11.39%	11.39%	-5.01%	12.20%	6.74%
Shanghai Composite	5.10%	23.94%	23.94%	-0.08%	3.17%	11.24%
Hong Kong Hang Seng	0.11%	12.40%	12.40%	-1.28%	12.61%	6.51%
MSCI EMEA	-1.31%	5.60%	5.60%	-10.03%	6.05%	-1.28%
MSCI Latam	-2.51%	7.93%	7.93%	-6.36%	11.50%	0.00%
GBI EM GD	-1.33%	2.92%	2.92%	-7.58%	3.28%	-0.76%
ELMI+	-0.72%	1.48%	1.48%	-4.31%	2.42%	-0.65%
EM FX Spot	-1.91%	0.26%	0.26%	-10.72%	-2.86%	-7.02%
EMBI GD	1.42%	6.95%	6.95%	4.22%	5.80%	5.44%
EMBI GD IG	2.42%	5.97%	5.97%	5.98%	4.58%	4.81%
EMBI GD HY	0.49%	8.01%	8.01%	2.43%	7.18%	5.90%
CEMBI BD	1.28%	5.15%	5.15%	4.60%	5.64%	4.84%
CEMBI BD IG	1.77%	4.77%	4.77%	5.56%	4.29%	4.31%
CEMBI BD Non-IG	0.62%	5.65%	5.65%	3.41%	7.86%	5.51%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.94%	13.65%	13.65%	9.48%	13.52%	10.90%
1-3yr UST	0.62%	0.99%	0.99%	2.73%	0.97%	0.98%
3-5yr UST	1.24%	1.59%	1.59%	3.87%	0.95%	1.73%
7-10yr UST	2.51%	2.87%	2.87%	5.77%	0.86%	2.95%
10yr+ UST	5.26%	4.67%	4.67%	6.24%	1.43%	5.38%
10yr+ Germany	4.00%	5.42%	5.42%	10.86%	2.77%	7.46%
10yr+ Japan	1.61%	3.30%	3.30%	4.33%	1.41%	4.84%
US HY	0.94%	7.26%	7.26%	5.93%	8.58%	4.68%
European HY	1.07%	5.63%	5.63%	2.02%	4.92%	4.22%
Barclays Ag	1.25%	2.20%	2.20%	-0.38%	1.49%	1.04%
VIX Index*	0.00%	0.00%	-46.07%	-31.35%	4.66%	4.66%
DXY Index*	-0.12%	-0.12%	1.04%	7.79%	2.70%	21.32%
CRY Index*	0.00%	0.00%	8.22%	-5.94%	9.36%	-39.13%
EURUSD	0.12%	0.12%	-2.08%	-8.71%	-1.39%	-18.58%
USDJPY	0.18%	0.18%	1.23%	4.86%	-0.56%	7.15%
Brent	-0.19%	-0.19%	26.88%	-2.86%	76.52%	-35.37%
Gold spot	-0.25%	-0.25%	0.52%	-3.89%	5.45%	0.79%

*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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