China and India lead global greening

By Jan Dehn

Between them, China and India account for 30% of the improvement in global greening over the past twenty years. This conclusion is based on the evidence of 20 years of daily satellite data collected by NASA. Saudi Arabia turns to her local markets. Speculation mounts about bond market access in India. Brazil's pension reform passes an important constitutional hurdle. PDVSA prepares to pay the 2020 bond coupon late. South Korea can look forward to a strong growth bounce-back in Q2 2019. Argentina's trade balance improves. Early indications suggest that Ukraine's Zelensky will maintain some of the economic and foreign policies of his predecessor. US growth was strong in Q1, but for all the wrong reasons.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.2	–	-1.30%
MSCI EM Small Cap	10.0	–	-1.86%
MSCI Frontier	8.9	–	-1.51%
MSCI Asia	12.1	–	-1.42%
Shanghai Composite	10.5	–	-5.63%
Hong Kong Hang Seng	8.2	–	-2.84%
MSCI EMEA	8.9	–	-1.02%
MSCI Latam	11.4	–	0.70%
GBI-EM-GD	6.23%	–	-1.27%
ELMI+	5.81%	–	-0.88%
EM FX spot	–	–	-0.96%
EMBI GD	6.04%	351 bps	-0.02%
EMBI GD IG	4.30%	175 bps	0.56%
EMBI GD HY	7.97%	547 bps	-0.57%
CEMBI BD	5.69%	326 bps	0.14%
CEMBI BD IG	4.41%	199 bps	0.30%
CEMBI BD Non-IG	7.43%	500 bps	-0.09%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.9	–	1.21%
1-3yr UST	2.29%	–	0.21%
3-5yr UST	2.29%	–	0.35%
7-10yr UST	2.51%	–	0.50%
10yr+ UST	2.94%	–	0.64%
10yr+ Germany	-0.01%	–	1.81%
10yr+ Japan	-0.04%	–	0.30%
US HY	6.15%	359 bps	0.20%
European HY	4.06%	423 bps	-0.20%
Barclays Ag	1.81%	-70 bps	0.06%
VIX Index*	13.16	–	0.74%
DXY Index*	98.06	–	0.77%
EURUSD	1.1157	–	-0.89%
USDJPY	111.73	–	-0.19%
CRY Index*	184.26	–	-3.66%
Brent	72.0	–	-2.78%
Gold spot	1284	–	0.71%

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

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As environmental considerations rightly gain greater prominence in the world of investment, it is noteworthy – and probably surprising to many – that China and India have established themselves as the world's leaders in global greening. 'Greening' refers to the change in average leaf area per year, i.e. it measures to what extent countries expand or shrink areas under vegetation. Greening is measured using satellite data. Specifically, two NASA satellites have been circulating the planet for the past twenty years taking four pictures of almost every place on earth each single day. This rich data set has now been analysed and the results published in a recent article in *Nature*.[1] The article draws two surprising conclusions. First, the world is 5% greener today than twenty years ago. Second, China and India have contributed one third of the increase in global greening over the period with China alone accounting for 25% of improvement. The *Nature* article shows that government programs to conserve and expand forests explain 42% of China's contribution to global greening, while 32% of China's contribution is due to intense cultivation of food crops. In India, food crop cultivation accounts for 82% of the greening. Other large net positive contributors to global greening include EU, Canada, Russia and Australia, while the largest net detractors from global greening are Argentina, Brazil, Democratic Republic of Congo and Indonesia. It is noteworthy that several of the detractors are low-income countries with large forests. Such countries have high a prevalence of severe poverty, so they will find it difficult to preserve forest cover without compensation. Compensation is justified, because forest cover is a public good. However, as long as the US remains unwilling to participate in global environmental accords, it seems sensible to expect poor countries with large forests to continue to chop down trees. This is exactly what wealthy countries did during the early stages of their industrialisation.

- **Saudi Arabia:** The government raised USD 2.5bn from the sale of a 30-year Sukuk Local Currency bond. While nascent compared to the equity market in Saudi Arabia, the development of the local bond market is extremely important for two reasons. First, the establishment of a local institutional investor base and local

[1] See: https://www.nature.com/articles/s41893-019-0220-7

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yield curves are key to achieving self-sufficiency in funding, which is still highly desirable in EM countries on account of the fickle nature of external funding for EM countries. Second, the growth of local bond markets have positive externalities for external debt markets. On average, EM countries now obtain nearly 90% of total financing from local markets. As this percentage rises, the incentive to default on external debt declines, since external debt defaults reduce debt service costs progressively less over time.

- India: As India progresses through a lengthy election process, speculation is mounting that a Modi victory could result in further easing of foreigner's access to the Indian bond market. The slow reduction in the fiscal deficit, combined with regulatory changes to enable Indian banks to lend to the private sector, may pose challenges for the government to place the required amount of bonds, unless regulators grant new buyers – foreign investors – greater access to the market. Capital controls, quotas and lack of index participation currently pose major hurdles to foreign investors wishing to participate in the local fixed income market. The government can easily lift these constraints provided it has the required ambition. From a fixed income perspective, India remains one of the least open economies in the world, which seems at odds with the Modi Administration's slogan of 'Make in India'. China is entering global bond indices, leaving India behind.

- Brazil: The all-important pension reform passed its first major hurdle, when the Constitutional Committee of the parliament approved the reform by a 48-18 margin. This means that the reform is deemed constitutional, wherefore it can proceed to formal approval, first in 'special committee', secondly in the Lower House and finally in the Senate. The Chairman and Rapporteur in the 'special committee' are both from reform-friendly parties, so this bodes well for the odds of approval at committee stage. The remaining process of passage of this reform will probably take at least three months. Meanwhile, the government has provided further detail on the expected fiscal savings under the reform, which will be BRL 1.24trn compared to BRL 1.07trn previously. This is clearly positive, but we expect significant dilution, which could reduce the final savings to somewhere around BRL 700bn. In other Brazilian news, inflation drifted up to 4.7% yoy in the mid-month April IPCA CPI index from 4.2% in mid-March. At 3.5% yoy, core inflation remains comfortably below the central bank's target of 4.25%. Brazil's current account deficit narrowed to USD 494m in March from USD 1,134m in February.

- Venezuela: The board of PDVSA, the Finance Commission of the National Assembly approved the upcoming coupon payment on the PDVSA 2020 bond, which is the only bond not to default, because it is over-collaterised by shares in CITGO. The coupon payment deadline was 27th April 2019, payable 29 April 2019, but plenary of the National Assembly will vote on the payment tomorrow. We expect the National Assembly to approve the payment and the payment to be made within the grace period. Neither the Maduro Adminstration nor the Guaido Administration (Venezuela currently has two recognised governments) want to be blamed for surrendering ownership of CITGO to bond holders. A new academic study from the US-based Center for Economic Policy Research estimates that US sanctions on Venezuela have caused more than 40,000 deaths in 2017 and 2018.[2]

- South Korea: South Korean GDP growth is likely to bounce back sharply in Q2 following a lower than expected contraction of read GDP in Q1 2019, in our view. The economy contracted by 0.3% qoq sa in Q1 2019. This was far worse than expected (+0.3% qoq sa). However, as is often the case in Korea, volatile government expenditure accounted for more than the total miss, namely -0.7%. This follows an unusually strong government contribution of 1.2% in Q4 2019. Moreover, the government has announced a fiscal stimulus, which may be passed next month, which should significantly boost growth. In other words, while the headline looks frightening there is every expectation that Korean growth is merely volatile around a steady trend. Higher frequency indicators, such as PMIs, also point to stable growth rates. Encouragingly, exports made a modest but positive contribution to growth, which is consistent with stronger recent Chinese data.

- Argentina: The silver-lining in the continuing crisis of confidence racking Argentina is that the combination of high inflation, currency weakness, a recent descent into heterodox policies and fears about a possible return of Cristina Kirchner to the presidency in upcoming elections is seriously undermining domestic demand. While painful, this is required in order to bring demand into line with supply after decades of excess demand stimulus. Thus, the trade surplus hit a much higher than expected USD 1.2bn in March on the back of a 34% yoy decline in imports. Polls currently put President Macri's support among voters on par with the support for Cristina Kirchner. Simulations show that Cristina Kirchner would now defeat Macri in a run-off.

- Ukraine: A week after winning the presidential election, Volodymyr Zelensky appears to be following the economic policies of his predecessor, market-friendly Petro Poroshenko. Zelensky indicated that he regards Russian presence in Eastern Ukraine as an invasion and he is continuing with plans to cut gas tariffs on 1st May, as agreed with the IMF.

[2] See: http://cepr.net/publications/reports/economic-sanctions-as-collective-punishment-the-case-of-venezuela

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Snippets:

- **Benin:** The Election Commission last week excluded all opposition parties from participating in legislative elections scheduled for yesterday on the ground that the parties failed to meet the criterion of minimum net worth of roughly USD 430,000.
- **China:** Industrial profits surged at a yoy rate of 13.9% in March, thereby reversing the decline over the previous two months.
- **Colombia:** The central bank left the policy rate unchanged at 4.25%.
- **Egypt:** President Abdel Fattah el-Sisi could remain in power until 2030 after Egyptians overwhelmingly backed constitutional changes to that effect.
- **Indonesia:** Bank Indonesia left the policy rate unchanged at 6.00%, while continuing to ease liquidity conditions.
- **Malaysia:** CPI inflation was softer than expected in March (0.2% yoy versus 0.3% yoy expected).
- **Mexico:** Retail sales beat expectations handsomely in February (1.8% yoy versus 0.6% yoy expected). Real GDP expanded 1.1% yoy in February, which was slightly softer than in January (1.25% yoy). Consumer prices declined 0.03% in the first half of April, but inflation increased to 4.38% on a yoy basis, up from 4.06% yoy a fortnight ago.
- **Poland:** Retail sales were 3.1% higher yoy versus 4.1% yoy expected, most likely due to the effect of Easter, which Catholic poles observe with considerable fervor.
- **Russia:** The central bank left the policy rate unchanged at 7.75% and shifted towards more dovish rhetoric.
- **Turkey:** The central bank left the one-week repo rate unchanged at 24%, while removing its previous hawkish guidance.
- **Ukraine:** The National Bank of Ukraine raised the policy rate by 50bps to 17.5%.

Global backdrop

Over the past week, sentiment towards EM has worsened for a combination of reasons, which include idiosyncratic EM events (discussed in the previous sections) as well as mounting global concerns. Among the latter, we note that asset prices have staged a strong recovery since the sell-off in Q4 last year, but this now raises questions about where returns will come from going forward. Technicals are also playing a part; many investors put money to work in Q1, but as Q2 gets underway they begin to take profits ahead of summer. Finally, the growth prospects in developed markets remain uncertain. Take the US GDP number. No matter how much you try, you can't make a silk purse out of a sow's ear. Thus, the headline US Q1 GDP print was clearly silk purselike, but the details were distinctly hog-like: imports declined, prices were softer than expected, business investment weakened, inventories increased and government spending drove much of the expansion. Personal consumer spending more than halved relative to previous quarter. Moreover, the recent sharp drop in initial claims for unemployment benefit appears to be have been a headline fake as initial claims rose surged back up to 230,000, thus undoing the entire decline in claims observed since early February. US capex momentum is also mixed, judging by the March durable goods report.

In the UK, the governing Conservative Party attempted to find ways to replace Prime Minister Theresa May as pro-Brexit populist Nigel Farage's new Brexit Party takes chunks out of Tory support ahead of the European Parliamentary election scheduled for 23 Mary. Rules in the Tory party prevent more than one leadership challenge each year. By putting an equally aggressive pro-Brexiteer in charge, such as Boris Johnson, the Conservatives hope that they can win some support back from Farage before the election in May. Any travel in this direction clearly increases the odds of hard Brexit for the UK.

In other news, oil prices briefly spiked last week on news that US President Donald Trump supports a renegade general in Libya, Khalifa Haftar, who is trying to unseat the UN-backed government in Tripoli. Europe supports Tripoli, which has been helpful in stemming the flow of refugees from Africa to Europe.

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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	2.00%	2.00%	12.10%	-3.17%	11.56%	4.46%
MSCI EM Small Cap	0.39%	0.39%	8.19%	-10.39%	5.86%	2.00%
MSCI Frontier	0.03%	0.03%	6.94%	-11.36%	6.21%	-0.73%
MSCI Asia	1.52%	1.52%	13.08%	-2.04%	12.56%	6.84%
Shanghai Composite	-0.11%	-0.11%	23.80%	2.83%	3.57%	11.16%
Hong Kong Hang Seng	1.17%	1.17%	13.71%	0.28%	12.97%	7.34%
MSCI EMEA	5.86%	5.86%	11.78%	-1.68%	7.16%	0.47%
MSCI Latam	1.27%	1.27%	9.31%	-3.90%	10.89%	-0.12%
GBI EM GD	0.03%	0.03%	2.95%	-4.61%	2.96%	-0.78%
ELMI+	0.05%	0.05%	1.52%	-2.29%	2.48%	-0.61%
EM FX Spot	-0.11%	-0.11%	0.15%	-8.28%	-2.82%	-6.95%
EMBI GD	0.11%	0.11%	7.07%	5.73%	5.47%	5.30%
EMBI GD IG	0.47%	0.47%	6.47%	7.99%	4.47%	4.73%
EMBI GD HY	-0.23%	-0.23%	7.76%	3.50%	6.61%	5.71%
CEMBI BD	0.64%	0.64%	5.82%	5.86%	5.43%	4.82%
CEMBI BD IG	0.62%	0.62%	5.42%	7.02%	4.27%	4.26%
CEMBI BD Non-IG	0.67%	0.67%	6.36%	4.45%	7.32%	5.53%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	3.83%	3.83%	18.00%	12.45%	14.30%	11.80%
1-3yr UST	0.15%	0.15%	1.14%	3.09%	1.07%	0.99%
3-5yr UST	0.00%	0.00%	1.59%	4.64%	1.14%	1.69%
7-10yr UST	-0.44%	-0.44%	2.41%	7.06%	1.06%	2.75%
10yr+ UST	-1.64%	-1.64%	2.96%	8.04%	1.61%	4.60%
10yr+ Germany	-0.83%	-0.83%	4.55%	11.46%	3.36%	6.94%
10yr+ Japan	-0.66%	-0.66%	2.62%	3.88%	0.29%	4.62%
US HY	1.30%	1.30%	8.66%	6.69%	7.90%	4.84%
European HY	1.29%	1.29%	7.00%	2.71%	4.75%	4.30%
Barclays Ag	-0.44%	-0.44%	1.75%	0.90%	1.36%	0.76%
VIX Index*	-4.01%	-4.01%	-48.23%	-14.60%	-16.18%	-4.01%
DXY Index*	0.79%	0.79%	1.96%	7.12%	5.34%	22.87%
CRY Index*	0.28%	0.28%	8.52%	-8.50%	-0.19%	-40.91%
EURUSD	-0.54%	-0.54%	-2.70%	-7.63%	-2.57%	-19.22%
USDJPY	0.78%	0.78%	1.86%	2.19%	4.91%	8.86%
Brent	5.25%	5.25%	33.79%	-3.56%	49.55%	-33.95%
Gold spot	-0.65%	-0.65%	0.12%	-2.38%	-0.73%	-0.92%

*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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