The art of the deal: EM opens up to the World

By Gustavo Medeiros

Emerging Markets are opening up to the World. A temporary ceasefire between Turkey and the Kurdish was agreed in Northern Syria. Large protests erupt in Lebanon and Chile. Brazil auctions oil fields and seeks to increase privatisations. China GDP slowed as expected, but signs of stabilisation abound. Saudi Aramco postpones its IPO. India inflation declines. Bank of Korea cuts rates. Romania shows growing signs of overheat. Kenyatta scraps the cap on interest rates. In the UK, a second Brexit deal has been sealed, but remains unapproved by Parliament. The United States and China signalled a conclusion of 'phase one' of a trade deal is possible by mid-November.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.7	–	1.27%
MSCI EM Small Cap	11.0	–	1.96%
MSCI Frontier	9.1	–	0.76%
MSCI Asia	12.4	–	1.45%
Shanghai Composite	10.5	–	-1.19%
Hong Kong Hang Seng	7.9	–	0.84%
MSCI EMEA	9.2	–	0.94%
MSCI Latam	12.4	–	0.53%
GBI-EM-GD	5.17%	–	0.58%
ELMI+	4.66%	–	0.59%
EM FX spot	–	–	0.45%
EMBI GD	5.17%	339 bps	0.16%
EMBI GD IG	3.52%	171 bps	0.10%
EMBI GD HY	7.40%	565 bps	0.24%
CEMBI BD	5.10%	343 bps	0.19%
CEMBI BD IG	3.67%	200 bps	0.09%
CEMBI BD Non-IG	7.16%	547 bps	0.31%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	16.4	–	0.55%
1-3yr UST	1.58%	–	-0.02%
3-5yr UST	1.57%	–	-0.24%
7-10yr UST	1.75%	–	-0.63%
10yr+ UST	2.25%	–	-1.77%
10yr+ Germany	-0.38%	–	-0.94%
10yr+ Japan	-0.13%	–	-0.26%
US HY	5.67%	383 bps	0.62%
European HY	3.87%	421 bps	0.23%
Barclays Ag	1.37%	-38 bps	0.30%
VIX Index*	14.25	–	-3.32%
DXY Index*	97.35	–	-1.10%
EURUSD	1.1156	–	1.14%
USDJPY	108.46	–	-0.08%
CRY Index*	175.75	–	2.17%
Brent	59.2	–	-0.25%
Gold spot	1492	–	-0.06%

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

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- Emerging Markets (EM) integration deepens as United States (US) shrinks from the world: There are several signs of greater integration between EM economies and between EM and the European Union (EU) as the US becomes more protectionist.

These include the announcement of a single visa arrangement for Chinese tourists visiting Argentina and Brazil, which may also be extended to other countries in South America. Latin America is also deepening trade ties with Europe via the Mercosul trade agreement.

Last week, Germany allowed the Chinese tech giant Huawei to supply its 5G network. It is a strategic choice as Huawei's unique technology will enable Germany to quickly achieve 5G nationwide coverage. China is Germany's third largest market (only marginally behind the US and France) and likely to grow faster. For example, exports from Germany to China doubled from USD 56bn in 2009 to USD 106bn in 2018, while over the same period exports to France only increased from USD 110bn to USD 123bn, and exports to the US rose from USD 73bn to USD 126bn.

Lastly, the Chinese State Council agreed to roll out measures to remove restrictions to foreign businesses and further level the playing field with Chinese companies. The important financial and automobile sectors are included in the regulatory change.

- Turkey: A five-day ceasefire in Syria was announced after a meeting between US Vice President Mike Pence and Turkey's President Erdogan. Under the agreement, Kurdish soldiers are expected to evacuate a 30-kilometre deep and 430-kilometre long strip of land adjacent to the Syrian northern border with Turkey. If the ceasefire holds, President Erdogan will have achieved a major objective at a very low cost. Syria and Russia will also have increased their influence in the region at the expense of the US. Erdogan is scheduled to meet with Russian President Vladimir Putin on the 22 October in Sochi, where the balance

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of power between Syria and Turkey will undoubtedly be discussed. Erdogan will be watching developments in the US Senate, where a sanctions bill against Turkey has been introduced, in spite of the current cease-fire. If passed, the bill would prohibit the purchase of Turkish sovereign debt. The odds of broad sanctions encompassing Sovereign debt taking effect are small, in our view, given the White House opposition to the bill and the cease-fire. In other news, industrial production in Turkey declined at a rate of -3.6% yoy in August, as export-oriented sectors and domestic demand underperformed.

- Lebanon: Protesters hit the streets from Thursday night in protest against a levy on WhatsApp calls. The protests escalated into demands for government resignation with hundreds of thousands of people in the streets Sunday, the largest number since 2005. Four ministers representing the Maronite Christian Lebanese withdrew from the government on Saturday. On Sunday, the leader of Hizbollah Sheikh Nasrallah, opposed a government resignation. Prime Minister Saad al-Hariri cancelled the initial levy and blamed his partners in government for the chaos. Hariri gave an ultimatum for the approval of economic reforms which would unblock potential USD 11bn in international aid support.

- Chile: Violent protests broke out Saturday in Santiago against a 4% increase in subway fares. President Pinera cancelled the increase in order to stabilise the situation, but civil unrest continued in protest against the high cost of living. In other news, the 2020 Budget was unveiled with a 2.0% fiscal deficit, lower than the 2019 deficit of 2.2%. The 2020 Budget includes an increase in public investment of 6.8%, which will be financed through a reduction in non-compulsory recurrent spending.

- Brazil: A number of positive developments in Brazil last week. First, the Senate approved the "transfer of rights" bill, which allows the government to sell the right to explore 12 oil and gas fields with potential to generate 500,000 barrels of oil per day. Auctions for the fields are due to take place on 6 November and the government expects to receive a down payment of approximately BRL 100bn (USD 24bn). Second, Finance Minister Paulo Guedes unveiled a plan to open up Brazil's natural gas market. Breaking up Petrobras' monopoly could reduce gas prices by as much as 40% over the next two years, according to the Minister. Third, preparations for the privatisation of state-owned energy Eletrobras gained momentum as the company's board approved a capital increase of BRL 10bn (USD 2.5bn). The capital increase will give the company cash to implement programmes like the voluntary resignation programme and other restructuring processes in order to cut costs on a more permanent basis. In economic news, the consumer confidence index increased for the fifth consecutive month in September to 89.7 (from 89.1 in August). Business confidence in the services and industrial sectors rose to 93.2 and 97.9 (from 91.1 and 97.7 in August), respectively. Vale, the giant mining company, announced that iron ore production increased by 35.4% in the third quarter of 2019 to 86.7 mt as production normalised following environmental issues.

- China: Real GDP growth slowed to a 6.0% yoy rate in Q3 2019 from 6.2% yoy in the previous quarter. However, higher frequency data points offered some grounds for optimism. First, industrial production (IP) accelerated to a rate of 5.8% yoy in September, 0.9% yoy higher than expected. Higher electricity production was the main contributor to IP growth, but car production remained weak. Second, retail sales rose by a rate of 7.8% yoy in September due to higher mobile phone and car purchases. Third, credit activity picked up as new loans rose to RMB 1,690bn in September from RMB 1,210bn in August. This implies a stabilisation in aggregate financing which increased at a rate of 10.8% yoy in September, the same as in the previous month. The price of newly built commercial and residential properties increased by +0.5% in September to a yoy rate of 8.6% (from 9.1% yoy in August). Consumer prices (CPI) inflation rose by 0.2% mom in September to 3.0% yoy due to rising pork prices (up by 69.3% yoy in September). Core CPI inflation excluding food and energy was stable at a rate of +1.5% yoy. Producer prices inflation (PPI) declined to -1.2% yoy in September (from -0.8% yoy in August) due to lower oil prices.

- Saudi Arabia: Saudi Aramco announced a postponement of its planned Initial Public Offering (IPO) following the recent attacks on its processing infrastructure. The company re-affirmed its intentions to the IPO and indicated that the timing will depend on market conditions.

- India: Wholesale inflation prices (WPI) slowed to a 0.3% yoy rate in September from 1.1% yoy in August. This is the lowest rate of WPI inflation since 2006. Meanwhile, CPI inflation rose by 4.0% yoy in September from 3.3% yoy in August mainly on the back of higher food prices. IP in August declined to a rate of 1.1% yoy from 4.6 yoy in July and the trade deficit narrowed to USD 10.9bn in September due to a faster slowdown in imports than exports. Subdued inflation amid a slowing economy should allow the Reserve Bank of India to cut rates further, in our view. In other news, tensions remained high in Kashmir with shots fired between the Indian and Pakistani armies, which saw four civilians killed and a dozen wounded, according to officials from both sides.

- South Korea: The Bank or Korea (BoK) cut the policy rate by 0.25% to 1.25% with two voters dissenting in favour of a hold. The trade war between US and China was the main culprit for softer export activity, while the economic data suggests the impact of tensions with Japan was limited, so far. BoK is studying unconventional

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monetary policy tools as the zero bound for rates comes closer. Unemployment rose marginally to 3.4% in September from 3.1% in August. An important leading indicator to global growth, Korean exports in the first 20 days of October declined by a rate of 13.5% yoy on a working day adjusted basis. The year over year number was impacted by a high base in October 2018.

- Ecuador: The IMF welcomed the dialogue process aimed at finding a peaceful resolution between the government and indigenous groups, which ended the protests. The fund pledged to keep working with Ecuadorian authorities with technical and financial support to ensure fiscal sustainability and improve economic growth. In order to compensate for the impact of lower subsidy cuts, the government submitted an emergency bill to parliament with tax adjustments increasing revenues by an estimated USD 0.5bn. A labour market reform bill is expected to be submitted to parliament within weeks. In economic news, the unemployment rate rose to 4.9% in September from 4.4% in June and foreign direct investment declined to USD 427 million in the first six months of 2019, 21% lower than in the first half of 2018.

- Colombia: The constitutional court suspended the 2018 financing law – due to a technical error in the course of the approval of the bill. The suspension only takes effect from the start of 2020, so the government will retain an extra 0.7% of GDP of revenues obtained this year, safeguarding the 2.4% GDP fiscal deficit target for 2019. The original bill also projected an ongoing reduction in taxes for companies, so its suspension would boost 2020 revenues. However, we expect the government to reintroduce the bill cutting corporate taxes. The expectation of lower corporate taxation has been one of the tailwinds for the strong cyclical recovery in Colombia this year, so we expect the government to reintroduce the tax cuts in another bill. Timing is uncertain, however, due to local elections scheduled for 27 October.

- Romania: IP declined at a rate of -6.7% yoy in August (from -5% yoy in July). Rising minimum wages are undermining competitiveness in low value add sectors like textiles. The loss of competitiveness was also reflected in the current account balance, where the total year to date deficit widened to EUR 7.1bn in August. This is higher than the EUR 5.8bn year to date deficit at the same time in 2018.

- Argentina: Inflation rose by 5.9% in the month of September, or 53.5% yoy. This marked an acceleration from the monthly inflation print of 4.0% in August, but inflation was lower than the consensus expectation of 7.0% mom. The September inflation figure reflects the pass-through from the drop in ARS in the aftermath of the August primary election result. The fiscal balance was in compliance with the targets of the IMF programme in Q3 2019 as the Argentinian Treasury reported a 0.1% of GDP primary surplus year to date. This compares to a 1.0% of GDP deficit in the same period in 2018.

- Kenya: President Uhuru Kenyatta vetoed a parliamentary bill that would maintain the cap on interest rates on bank loans. Parliament could still push the bill through, but only with a two-third majority to override Kenyatta's veto. The removal of the cap on interest rates, which unintentionally encouraged banks to limit credit to the economy in favour of buying government bonds, would be positive for the economy. In other news, the Treasury unveiled plans to borrow USD 4.1bn from external lenders, including the African Development Bank, China, Japan and the World Bank. The decision to borrow from lower-cost multilateral lenders is good news, although Kenya's external debt burden is likely to reach almost 60% of GDP, which clearly increases the vulnerability of the sovereign to changing economic and financial circumstances.

- Venezuela: The Government of Chile said it would work with allies to shut down Venezuela's air space and implement a naval blockade in case Venezuelan President Nicolas Maduro refuses to hold free elections. A blockade of oil exports from Venezuela would significantly increase the country's economic challenges. Meantime, a media report said that the Jamaican government has decided to repay part of an old debt to Venezuela into an escrow account, which places the resources out of reach of Maduro, thus complying with US sanctions.

Snippets:

- Angola: Finance Minister Vera Daves said the country is planning to issue international bonds to fund 2019 and 2020 budget gaps.
- Bolivia: Early results from on Sunday's presidential election suggests no clear winners. With 83% of the ballots counted, incumbent President Evo Morales received 45% of the vote, compared to 38% from former president Carlos Mesa. This is a much narrower margin than the polls were suggesting. A run-off on 15 December will be held if fourth-term-contender Morales fails to win by a 10% margin.
- Czech Republic: The current account deficit stabilised at EUR 1.5bn in July, taking the year-to-date surplus of EUR 1.1bn, which is slightly better than in the same period in 2018.
- Egypt: the government signed an agreement to settle local currency government bonds in Euro clear. The agreement will make Egyptian local government bonds available to a larger range of investors, paving the way for inclusion on important EM fixed income benchmarks.

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- **Ghana:** CPI inflation slowed to a rate of 7.6% yoy in September, which is 0.2% yoy lower than in August and stands within the central bank's inflation target. Meanwhile, PPI inflation declined from a 10.2% yoy rate in August to 9.7% yoy in September.
- **Indonesia:** The trade balance surprised on the downside with a USD 200m deficit in September due to firmer imports of capital goods.
- **Singapore:** Exports contracted at 8.1% yoy rate in September led by a decline on sales of electronic goods which contracted by a 25% yoy rate.
- **South Africa:** The state-owned utility company Eskom cut energy deliveries for three days last week owing to unexpected grid maintenance in a few of its power plants. The government is expected to unveil a restructuring plan for Eskom prior to the Budget Statement on 30 October.
- **Ukraine:** President Volodymyr Zelensky's approval rate declined to 66% in October from 73% in September following a controversial proposal for peace in Donbas and an unpopular land reform, which allows foreign investors to purchase land in Ukraine.

Global backdrop

The IMF unveiled a more sombre outlook for global growth in 2019 showing Global GDP growth at 3.0%, down from its 3.2% forecast in July and only 0.5% higher than the 2.5% level considered to be a global recession by the IMF. In 2020, the fund expects global growth to pick up to 3.4% due to better performance from Brazil, Mexico, Russia, Saudi Arabia and Turkey.

In the United Kingdom (UK), Prime Minister Boris Johnson reached a new Withdrawal Agreement with the European Union to start the Brexit process. The deal was expected to be voted by the UK Parliament on Saturday. Instead of approving the deal, Parliament approved a provision demanding Mr. Johnson request an extension of the Brexit deadline from the 31 October 2019 to 31 January 2020. This would allow more time to pass the necessary legislation and avoid a 'hard' Brexit in case there is no time to do so before the first deadline. The president of the European Council, Donald Tusk acknowledged the UK's request to extend the deadline. In the meantime, the British Government remains confident they can create the Withdrawal Agreement, and will submit it to Parliament this week. The deal, if approved, sets the first terms and conditions for the separation of the UK from the EU. A custom border between the UK and the island of Ireland will be in place in order to avoid a border between Northern Ireland and the Republic of Ireland. A new free trade agreement between the UK and the EU would be negotiated by 31 December 2020. Until that date, the UK remains part of the EU with the same rights and obligations it has been previously subject to. The Withdrawal Agreement is, therefore, not the end of the process. It is just 'the end of the beginning'.

In other global trade news, the so-called 'phase-one' trade agreement which prevented a further increase in tariffs on Chinese exports to the US was put on hold by China. The country declared its interest in a more comprehensive deal which removes the tariffs scheduled to be raised on 15 December. Trump struck a constructive tone, saying China has already been buying US Agriculture products for months. Leaders of both countries said the stage is set for a broader trade 'truce' to be agreed during the APEC summit in mid-November when Xi Jinping and Donald Trump are scheduled to meet. If confirmed, that would remove a significant source of uncertainty over the global economy.

A number of economic indicators were released in the US. Industrial production declined by a rate of -0.4% mom in September (from 0.8% mom in August), the lowest level since November 2016. Retail sales declined by a rate of 0.3% mom in September. Vehicles, parts and gasoline stations alongside building materials led the decline. Housing starts surprised on the downside, declining- 9.4% in September after a +15.1% rise in August, but the NAHB housing market index rose by 3 points to 71 in October, indicating builders are still confident on the future. In Europe, Industrial production (IP) surprised on the upside, expanding by a rate of 0.4% mom in August, from a -0.4% mom decline in July.

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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	2.41%	2.41%	8.69%	8.59%	6.97%	3.78%
MSCI EM Small Cap	2.38%	2.38%	4.46%	4.85%	2.58%	1.41%
MSCI Frontier	0.60%	0.60%	11.31%	10.67%	7.51%	-0.27%
MSCI Asia	2.43%	2.43%	8.46%	9.28%	7.56%	5.59%
Shanghai Composite	1.14%	1.14%	20.68%	21.08%	0.68%	6.86%
Hong Kong Hang Seng	3.33%	3.33%	8.04%	7.93%	6.81%	4.47%
MSCI EMEA	1.89%	1.89%	7.64%	8.67%	5.80%	0.35%
MSCI Latam	1.91%	1.91%	8.58%	4.22%	5.05%	-0.04%
GBI EM GD	2.29%	2.29%	10.33%	12.67%	4.12%	0.68%
ELMI+	1.64%	1.64%	3.08%	4.47%	2.55%	0.09%
EM FX Spot	1.67%	1.67%	-0.87%	-1.59%	-2.95%	-6.15%
EMBI GD	0.22%	0.22%	13.24%	13.29%	5.02%	5.59%
EMBI GD IG	0.12%	0.12%	15.36%	16.42%	5.52%	5.31%
EMBI GD HY	0.34%	0.34%	11.06%	10.13%	4.52%	5.86%
CEMBI BD	0.47%	0.47%	11.16%	11.40%	5.25%	5.21%
CEMBI BD IG	0.19%	0.19%	11.74%	12.69%	4.88%	4.71%
CEMBI BD Non-IG	0.86%	0.86%	10.33%	9.67%	5.89%	5.96%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	0.41%	0.41%	21.05%	10.07%	14.01%	11.87%
1-3yr UST	0.21%	0.21%	3.28%	4.61%	1.61%	1.28%
3-5yr UST	0.08%	0.08%	5.26%	7.95%	1.93%	2.02%
7-10yr UST	-0.33%	-0.33%	9.48%	14.36%	2.55%	3.13%
10yr+ UST	-2.11%	-2.11%	17.24%	25.19%	4.39%	5.41%
10yr+ Germany	-3.56%	-3.56%	13.01%	16.57%	4.02%	6.38%
10yr+ Japan	-0.85%	-0.85%	5.28%	8.56%	1.65%	4.53%
US HY	0.22%	0.22%	11.65%	7.55%	5.87%	5.38%
European HY	-0.14%	-0.14%	8.55%	4.63%	3.90%	4.61%
Barclays Ag	0.22%	0.22%	6.56%	8.59%	2.37%	1.73%
VIX Index*	-12.25%	-12.25%	-43.94%	-28.36%	6.82%	-11.38%
DXY Index*	-2.04%	-2.04%	1.23%	1.71%	-1.36%	14.13%
CRY Index*	1.04%	1.04%	3.50%	-10.87%	-7.20%	-35.62%
EURUSD	2.32%	2.32%	-2.58%	-2.73%	2.50%	-12.39%
USDJPY	-0.29%	-0.29%	1.11%	3.91%	-4.30%	-1.68%
Brent	-2.60%	-2.60%	10.04%	-25.80%	14.33%	-31.34%
Gold spot	1.49%	1.49%	16.46%	22.11%	17.85%	19.22%

*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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