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Protests in Latin America are generally a positive force for structural improvements

By Gustavo Medeiros

Yields in the US are rising again after the yield curve inversion earlier this year. Emerging Markets (EM) equities outperformed in spite of rising political noise in Latin America. In Bolivia, Evo Morales stepped down after protests against alleged vote-rigging. The Brazilian investment thesis remains sound despite former President Lula's release from prison as the population demands reform of criminal law. Argentina receives positive signals from multilateral lenders. China reforms small banks as foreign investors increase positions in Renminbi (RMB). The central banks in Czech Republic, Serbia, Peru and Thailand each cut policy rates by 25bps. The first round of the presidential election in Romania delivered no outright winner. India's sovereign rating outlook was downgraded by Moody's. Lebanese banks restrict currency withdrawals and overseas transfers. The high level of youth unemployment threatens political stability in Morocco. Kenya scraps the cap on interest rates. Oil theft in Nigeria exposes the fragility of the authority of the Federal Government vis-à-vis local governments.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.1	–	1.50%
MSCI EM Small Cap	11.2	–	0.27%
MSCI Frontier	9.2	–	-0.25%
MSCI Asia	13.0	–	2.18%
Shanghai Composite	10.5	–	0.20%
Hong Kong Hang Seng	7.8	–	2.45%
MSCI EMEA	9.5	–	1.47%
MSCI Latam	12.7	–	-2.85%
GBI-EM-GD	5.18%	–	-0.93%
ELMI+	4.27%	–	-0.18%
EM FX spot	–	–	-0.72%
EMBI GD	5.18%	321 bps	-0.70%
EMBI GD IG	3.67%	167 bps	-1.06%
EMBI GD HY	7.22%	528 bps	-0.27%
CEMBI BD	5.12%	325 bps	-0.19%
CEMBI BD IG	3.76%	189 bps	-0.46%
CEMBI BD Non-IG	7.05%	517 bps	0.17%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.0	–	0.93%
1-3yr UST	1.68%	–	-0.17%
3-5yr UST	1.75%	–	-0.60%
7-10yr UST	1.94%	–	-1.52%
10yr+ UST	2.43%	–	-3.64%
10yr+ Germany	-0.26%	–	-1.93%
10yr+ Japan	-0.06%	–	-1.94%
US HY	5.68%	369 bps	0.07%
European HY	3.81%	411 bps	0.45%
Barclays Ag	1.48%	-46 bps	-1.36%
VIX Index*	12.07	–	-0.23%
DXY Index*	98.32	–	0.81%
EURUSD	1.1029	–	-0.89%
USDJPY	108.98	–	0.38%
CRY Index*	181.28	–	1.00%
Brent	61.8	–	-0.61%
Gold spot	1464	–	-3.06%

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

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- **Bolivia:** New presidential elections will be held after Evo Morales resigned yesterday. Morales' fall started in 2016 when he lost a referendum to change the constitution in order to end term limits. The Constitutional Court ignored the referendum result and abolished term limits. Bolivians took to the streets, but failed to overturn the court ruling. Three years later, Morales tried to rig presidential elections on the 20 October and the population once again took to the streets. The Organisation of American States (OAS) declared the election fraudulent and recommended a new vote. Morales was forced to resign after losing support from the police, the military and former political allies. He denounced a coup against him while asking for an end of violence across the country. The events in Bolivia fly in the face of recent arguments that Latin America is 'turning left'. Rather, in our view, the events in each country are very specific to that country. In Bolivia, the protesters are demanding more accountable government and better economic performance. This can only be delivered by improvements in the justice system, ending corruption, improving public sector management as well as democratic checks and balances.

- **Brazil:** Investor sentiment towards Brazil took hits from two directions last week. First, the auction of pre-salt basin oil fields produced disappointing results. Petrobras was the sole bidder with the exception of the largest oil field, Buzios, which also drew a 10% participation from two Chinese oil firms. Second, former president Luis Ignacio 'Lula' da Silva was released from jail on Friday after the Supreme Court ruled against incarcerating politicians until their final appeals have been exhausted. The Supreme Court decision was narrow with a 6-5 vote

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Emerging Markets

in favour of releasing criminals condemned by only two courts, although they still have recourse to the Supreme Court. We don't believe either event endangers the economic recovery. Finance Minister Paulo Guedes blamed the poor auction result on the production-sharing model, which was put in place by the previous governments. His comments suggest that a review of the model could be pending ahead of upcoming auctions. Furthermore, the auction was a big win for Petrobras, which snapped up a 90% share of its largest and most important asset. The extraction cost in the pre-salt basin is the lowest in Petrobras' portfolio at just USD 6 per barrel. As far as the release of Lula and other criminals arrested during the so-called 'Carwash' scandal, this is clearly bad news in the sense that it exposes a loophole in the country's laws. It also polarises Brazilian politics. However, the President of Congress, Rodrigo Maia, said that a constitutional amendment will be sought to guarantee the imprisonment of criminals after they have been found guilty in the first two stages in the Brazilian court system. Yesterday, large crowds took to the streets in Sao Paulo to request precisely this kind of constitutional change. Importantly, Lula and other politicians remain convicted by Brazilian courts and many face very ample evidence of their crimes. This means that they are unfit and unable to run for public office. In other Brazilian news, CPI inflation dropped from 2.89% on a yoy basis in September to just 2.54% yoy in October.

- China: The People's Republic Bank of China (PBOC) cut the 1-year medium-term facility interest rate from 3.30% to 3.25% and injected RMB 400bn of liquidity. The modest interest rate cut reflects the PBOC's willingness to stimulate the economy, while at the same time ensuring that the ongoing supply-side shock from the African Swine Fever epidemic does not spread to core inflation. Indeed, CPI inflation jumped to a rate of 3.8% yoy in October from 3.0% yoy in September on the back of high pork prices. Producer price inflation rose by 0.1% mom in October, unchanged from September, while deflation increased from -1.2% on a yoy basis in September to -1.6% yoy in October due to base effects. In other economic news, the Caixin Services PMI declined to 51.1 in October from 51.3 in September. The trade balance improved from USD 39.6bn in September to USD 42.8bn in October as both imports and exports surprised to the upside. The government also announced it will reshuffle the management of small state-owned and inject fresh capital in a bid to forestall any potential financial stability risks. MSCI announced that the share of mainland Chinese stocks, A-shares, will rise to 4.1% of the MSCI EM Index on 26 November from 2.55% currently. This changed should attract some USD 40bn inflows as passive and active managers adjust exposures. PBOC Vice-governor Chen Yulu announced that offshore investors increased their holdings of onshore financial assets by RMB 5.86tn (USD 830bn), a 19% yoy increase. The Vice-governor also added that RMB internationalisation will play a larger role in the design of free trade zones and that China will keep opening its financial markets via structural reforms.

- Argentina: International Monetary Fund (IMF) spokesman Gerry Rice stated the IMF is ready to negotiate with President-elect Alberto Fernandez during the transition period, adding that the IMF is open to the idea of restructuring Argentina's debt as long as the restructuring is consistent with IMF's exceptional access policies. Argentina owes USD 57bn to the IMF, but disbursements have been put on hold since September. Inter-American Development Bank (IADB) President Luis Moreno also confirmed IADB's support for Argentina, pledging to adjust planned disbursements of USD 6bn to the new priorities of the Alberto Fernandez Administration. Alberto Fernandez confirmed his intention to maintain a good relationship with the IMF and the US following meetings with Mexican President Antonio Manuel Lopez Obrador (AMLO) and Mexican tycoon Carlos Slim. Fernandez also met with leftist former president of Ecuador Rafael Correa. President-elect Fernandez would do well to replicate AMLO's strategy of using a far-left populist rhetoric, but governing the country's fiscal accounts in an orthodox and pragmatic manner, in our view. In other news, Argentina registered a USD 9.4bn trade surplus in the first nine months of 2019 as exports increased at a yoy rate of 4.9% and imports declined at a rate of 26.2% yoy.

- Romania: The first round of the presidential election on Sunday delivered no clear winner. A run off will now be held on 24 November 2019 between Klaus Iohannis and Viorica Dancila, who received 37.6% and 22.7% of the votes, respectively. The new Prime Minister, Ludvic Orban, said Romania's budget deficit for the year as a whole will be at least 1% GDP wider than the planned 2.6% of GDP deficit budget due to delays in payments of invoices and VAT refunds. The fiscal deficit reached 2.8% GDP in annualised terms in October.

- Czech Republic: The Czech National Bank kept the policy rate unchanged at 2.0% in line with expectations. Two out of seven members of the monetary policy committee voted for a 25bps hike. Economic data surprised on the upside in September with construction rising at a yoy rate of 0.2% following a 2.4% decline (yoy) in August. Industrial production also improved (expanded at a yoy rate of 4.9% in September versus -3.8% yoy in August). The trade balance recorded a CZK 25.1bn (EUR 1bn) surplus in September following a CZK 8.6bn surplus in August.

- India: Moody's moved India's Baa2 credit rating outlook to negative citing a lack of commitment to fiscal consolidation in the context of slowing growth. A rating downgrade to Baa3 would have no major consequences as the country would retain its investment grade status. India has been impacted by a stronger than usual monsoon season, which has disrupted sectors such as mining and transport. Structural issues in the banking system also weigh on GDP growth.

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Emerging Markets

- **Philippines:** CPI inflation increased marginally to a yoy rate of 0.9% in October from 0.8% yoy in September. GDP growth surprised on the upside in Q3 2019, clocking up 6.2% on a yoy basis compared to 5.5% yoy in Q2 1019 (seasonally adjusted). The improvement in growth was mainly due to higher government spending, which also contributed to a widening of the trade deficit to USD 3.1bn in September.
- **Taiwan:** Exports declined at a rate of 1.5% yoy in October. This is a lower rate of decline than expected by the Ministry of Finance. Exports of technology goods and imports of capital goods rose strongly, buoyed by higher demand from iPhone components after Apple cut prices. Non-technology sector trade remained weak. Taiwanese exports are a leading indicator of the manufacturing business cycle. The rebound in technology exports therefore bodes well for the global manufacturing cycle.
- **Morocco:** The rate of unemployment rose to 9.4% in Q3 2019 from 8.5% in Q2 2019. Services and construction sectors hired more workers, while agriculture shed jobs. The rate of unemployment is highest for 15-24 year olds at 26.7% (compared to 15% for 25-34 year olds). High levels of youth unemployment constitute a potential threat to political stability, in our view.
- **Kenya:** President Uhuru Kenyatta confirmed the removal of a cap on interest rate lending rates. The removal of the cap is good news, because the cap discourages banks from lending to small companies. In other news, the current account deficit narrowed to 4.1% GDP in the year to September from 5.0% of GDP in the 2018 calendar year.
- **Nigeria:** The Nigerian Extractive Industries Transparency Initiative (NEITI) estimates that 138,000 barrels of crude oil were stolen from the country between 2009 and 2018, which is equivalent to a loss worth approximately USD 42bn. The main culprits are pipeline vandalism, criminal sabotage, and illegal refining. Oil theft is a well-known issue in Nigeria, but acknowledging the size of the problem is an important first step towards addressing it.

Snippets:

- **Chile:** The yoy rate of CPI inflation increased to 2.5% in October from 2.1% yoy in September due to higher housing, transportation and food prices.
- **Egypt:** CPI inflation declined to 3.1% on a yoy basis in October from 4.8% yoy in September. This marks a nine-year low. Core inflation on yoy basis inched lower from 2.6% to 2.4% over the same period. Inflation is likely to rise going forward due to base effects, but there should be room for further monetary easing this year.
- **Hungary:** CPI inflation rose marginally to 2.9% on yoy basis in October from 2.8% yoy in September. Economic activity remains solid in Hungary. Industrial output surprised to the upside at 9.0% on a yoy basis, while retail sales expanded at a yoy rate of 5.8% in September.
- **Indonesia:** Real GDP growth was stable in Q3 2019 at yoy rate of 5.0%. Expanding at a yoy rate of 5.1%, private consumption was the biggest contributor to growth.
- **Iran:** President Hassan Rouhani announced the discovery of a new oil field with 53 billion barrels of reserves. It is unclear how Iran will be able to take advantage of the discovery under the current sanction regime. Iran's oil production has nearly halved from 3.9m barrels per day to 2.1m bpd as US sanctions have impeded Iran's ability to sell oil abroad.
- **Lebanon:** The head of Lebanon's Banking Association said all depositors' money was safe as banks remained solvent. The country is beginning to face shortages of fuel and basic goods as protests continue.
- **Malaysia:** Bank Negara Malaysia surprised the market by cutting the reserve requirement by 0.5% to 3.0%. The measure should release an estimated MYR 9.4bn of liquidity.
- **Mexico:** The yoy rate of CPI inflation was 3.0% yoy in October, unchanged versus September.
- **Peru:** The Central Bank cut its policy rate by 25bps to 2.25%. This move surprised two-thirds of analysts, who had expected no cut. Growth weakened in September.
- **Poland:** The National Bank of Poland kept the policy interest rate unchanged at 1.5%. Governor Glapinski signalled a high probability that the policy rate will remain at the current level until the end of June 2022.
- **Serbia:** The National Bank of Serbia cut the policy rate by 25bps to 2.25% in a surprise move (markets had expected no change).
- **South Africa:** The country suffered electricity blackouts Thursday and Friday nights as Eskom struggled to stabilise the power-supply system. Manufacturing output declined 2.4% in the month of October. This is the largest contraction recorded since 2015.
- **South Korea:** Foreign Exchange Reserves registered a new high of USD 406.3bn in October 2019. Reserves were buoyed by the current account surplus of USD 19.7bn in Q3 2019, up from USD 10.5bn in Q2 2019.
- **Thailand:** The Bank of Thailand cut the policy rate by 25bps to 1.25%. Five members of the policy committee voted in favour of the cut, while two others called for interest rates to remain unchanged. Bank of Thailand also announced a relaxation on FX regulations to encourage capital outflows.
- **Zambia:** FX reserves declined to USD 1.42bn at the end of August. Reserves have been broadly stable since February in spite of an energy crisis and large repayment of foreign debt.

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Global backdrop

US yields rose last week on the back of a perceived lower likelihood of a hard Brexit in the UK, progress in trade negotiations between US and China and a cyclical rebound in tech components of manufacturing, leading to a broad expectation of more stable growth going forward. Global PMI's posted a third month of recovery, while exports from leading technology countries, such as Taiwan, rebounded. The yield on German 10-year bonds and Japanese bonds rose, while the US 10-year Treasuries bond dropped 1.5%. The yield on the US 10-year Treasury bond hit 1.94%, up from 1.42% in September. EM bonds sold off in sympathy with higher US Treasury yields, but outperformed bonds in G3. EM equities outperformed US equities; MSCI EM was up 1.5% in the week (in spite of a 2.9% decline in Latin America) compared to 0.9% for S&P 500 and 0.8% for MSCI World.

US and China agreed to resolve the trade dispute in stages. In theory, this allows for a positive agenda of tariff cuts to take over time. Phase one of the talks is almost complete with both sides moving towards an agreement that future tariff increases many be cancelled. On the second trade war front with Europe and Japan, the US has warned that tariffs on imports of autos and could be implemented by Wednesday of this week. EU Commission President Jean-Claude Junker said that he does not think the US will impose tariffs on EU auto imports.

Last week, it was announced that the largest trade deal in the world will be signed next year. The deal will form a new Regional Comprehensive Economic Partnership (RCEP) between the Association of Southeast Asian Nations (ASEAN) and China, Japan, South Korea, Australia and New Zealand, encompassing half of the world's population and 40% of the world's GDP.

US data remains mainly weak, but with some exceptions. The October nonmanufacturing ISM rose to 54.7 from 52.6 in September, but the Markit Services PMI slowed from 51 to 50.6 over the same period. Consumer sentiment, as measured by the University of Michigan, was broadly stable at 95.7 in November (95.5 in October). Factory orders declined by 0.6% in September due to poor durable goods orders, particularly aircraft and vehicles. This follows a decline of 0.1% in August. Productivity growth also declined sharply (-0.3% qoq seasonally adjusted) in Q3 2019. The US trade deficit narrowed in September to USD 52.5bn from USD 55bn in August. Weakness in manufacturing, large trade deficits and low productivity are all symptoms of a classic case of real effective exchange rate overvaluation caused by a strong Dollar, shale oil production and overvalued markets. The solution is devaluation, lower prices and higher productivity. We expect US and other investors to diversify away from US home assets over the coming years, thereby solving the real exchange rate overvaluation problem.

Euro area PMIs were revised higher to 50.6 in October, signalling a marginally better outlook for real GDP growth going into year-end. However, German industrial production declined 0.6% in the month of September after rising 0.4% in August. German exports increased 1.3% in September after contracting 0.9% in August. Moody's downgraded the United Kingdom Aa2 credit outlook to negative due to Brexit 'policy paralysis'.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	2.21%	6.53%	13.11%	10.38%	8.63%	4.37%
MSCI EM Small Cap	0.63%	4.51%	6.63%	6.25%	3.95%	1.71%
MSCI Frontier	0.49%	1.30%	12.08%	9.06%	7.42%	0.61%
MSCI Asia	2.78%	7.46%	13.83%	11.91%	9.82%	6.07%
Shanghai Composite	1.20%	2.04%	21.75%	15.23%	0.29%	6.36%
Hong Kong Hang Seng	3.31%	6.69%	11.55%	5.51%	8.17%	4.52%
MSCI EMEA	2.23%	5.10%	11.03%	7.35%	6.61%	0.94%
MSCI Latam	-1.25%	3.15%	9.90%	7.51%	5.06%	1.00%
GBI EM GD	-0.49%	2.39%	10.44%	12.35%	4.13%	1.13%
ELMI+	0.03%	2.08%	3.52%	4.51%	2.65%	0.62%
EM FX Spot	-0.34%	1.65%	-0.88%	-1.40%	-3.00%	-5.66%
EMBI GD	-0.43%	-0.15%	12.82%	13.40%	4.84%	5.47%
EMBI GD IG	-0.98%	-0.66%	14.46%	16.39%	5.32%	5.22%
EMBI GD HY	0.21%	0.45%	11.18%	10.44%	4.34%	5.61%
CEMBI BD	-0.15%	0.70%	11.42%	11.61%	5.31%	5.19%
CEMBI BD IG	-0.42%	-0.07%	11.46%	12.71%	4.83%	4.65%
CEMBI BD Non-IG	0.23%	1.78%	11.33%	10.13%	6.11%	5.95%

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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	1.91%	4.12%	25.52%	12.47%	15.35%	11.00%
1-3yr UST	-0.24%	0.09%	3.17%	4.49%	1.57%	1.29%
3-5yr UST	-0.73%	-0.44%	4.72%	7.51%	1.82%	2.00%
7-10yr UST	-1.79%	-1.63%	8.05%	13.13%	2.34%	3.00%
10yr+ UST	-4.25%	-5.07%	13.70%	22.64%	3.91%	4.94%
10yr+ Germany	-2.53%	-5.45%	10.80%	14.55%	4.08%	5.88%
10yr+ Japan	-1.24%	-1.87%	4.19%	7.03%	1.18%	4.14%
US HY	0.19%	0.46%	11.92%	7.86%	6.23%	5.24%
European HY	0.47%	0.31%	9.04%	5.20%	4.04%	4.36%
Barclays Ag	-1.40%	-0.74%	5.53%	7.90%	2.19%	1.99%
VIX Index*	-8.70%	-25.68%	-52.52%	-30.47%	-18.11%	-4.74%
DXY Index*	0.99%	-1.07%	2.23%	1.46%	-0.75%	12.32%
CRY Index*	2.48%	4.22%	6.76%	-3.81%	-1.12%	-32.32%
EURUSD	-1.10%	1.18%	-3.84%	-1.68%	1.59%	-11.59%
USDJPY	0.88%	0.83%	-0.66%	-4.28%	2.18%	-5.87%
Brent	2.52%	1.60%	14.78%	-12.01%	37.99%	-24.39%
Gold spot	-3.26%	-0.60%	14.12%	21.93%	19.20%	25.71%

*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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