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WEEKLY INVESTOR RESEARCH

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Intra-EM trade rose significantly despite protectionist policies during the first half of Donald Trump's first term

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Intra-EM trade rising despite protectionist policies. Lebanon's parliament approves confidence vote in PM Diab's cabinet. Argentina rolls dual currency local bond as Minister Guzman speaks to parliament. China focuses on economic growth as new coronavirus cases slow down. Brazilian Central Bank sells USD 2bn via future markets to halt BRL depreciation. South Africa President Ramaphosa highlights the need for economic reform in the State of the Nation Address. Mexico and Russia cut rates by 25bps. Hungarian Central Bank signals early policy tightening as inflation rises above the target. El Salvador political risks increase.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.6	–	1.37%
MSCI EM Small Cap	10.8	–	1.10%
MSCI Frontier	10.7	–	-1.37%
MSCI Asia	12.3	–	1.53%
Shanghai Composite	9.8	–	1.43%
Hong Kong Hang Seng	7.7	–	1.48%
MSCI EMEA	9.3	–	0.48%
MSCI Latam	12.0	–	1.04%
GBI-EM-GD	4.94%	–	0.57%
ELMI+	3.53%	–	0.29%
EM FX spot	–	–	0.29%
EMBI GD	4.72%	310 bps	0.46%
EMBI GD IG	3.26%	161 bps	0.58%
EMBI GD HY	6.72%	512 bps	0.33%
CEMBI BD	4.62%	308 bps	0.29%
CEMBI BD IG	3.39%	185 bps	0.35%
CEMBI BD Non-IG	6.38%	484 bps	0.22%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.5	–	1.65%
1-3yr UST	1.43%	–	0.00%
3-5yr UST	1.42%	–	-0.02%
7-10yr UST	1.59%	–	-0.06%
10yr+ UST	2.04%	–	0.01%
10yr+ Germany	-0.39%	–	0.40%
10yr+ Japan	0.00%	–	-0.07%
US HY	5.11%	344 bps	0.46%
European HY	3.25%	365 bps	0.33%
Barclays Ag	1.28%	-31 bps	-0.15%
VIX Index*	13.68	–	-1.79%
DXY Index*	99.12	–	0.29%
EURUSD	1.0839	–	-0.65%
USDJPY	109.86	–	-0.15%
CRY Index*	172.95	–	2.83%
Brent	57.3	–	7.60%
Gold spot	1579	–	0.17%

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

Emerging Markets

Intra-EM trade under Trump

The sharp rise in protectionist trade policies in the United States during the presidency of Donald Trump has not dented the tendency for Emerging Markets (EM) to trade more and more with themselves. The opposite appears to be true based on data from the International Monetary Fund (IMF). The Direction of Trade Statistics data shows that intra-EM trade accelerated in the first two years of Trump's term. In Dollar terms, intra-EM trade rose by a substantial 33% from USD 5.0trn in 2016 to USD 6.7trn as of the end of 2018 (Figure 1).

Furthermore, intra-EM trade has expanded more quickly than overall EM trade (27%) and much faster than trade growth between developed economies (19%). Global trade expanded by 22% in the past two years. Intra-EM trade now accounts for 44% of all EM trade, up from 42% in 2016 and just 25% in 1990. If the current rate of growth continues for a decade, intra-EM trade will account for 55% of all EM trade by 2028. Less exposure to Developed Markets (DM) is reassuring. After all, the higher the reliance on intra-EM trade, the more insulated EM countries will be from the negative consequences of protectionism in developed markets.

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Emerging Markets

Fig 1: **International trade (USD bn)**

	2016	2018	% change
Intra-EM trade	5,105	6,672	33%
% of EM trade	*42%*	*44%*	*2%*
EM trade with DMs	7,056	8,630	22%
% of EM trade	*58%*	*56%*	*-2%*
Total EM trade	12,071	15,302	27%
% of global trade	*38%*	*39%*	*2%*
Developed markets trade	19,841	23,561	19%
Global trade	31,912	38,863	22%

Source: Ashmore, IMF.

- Lebanon: The Parliament backed the new cabinet and the government's financial plan in a vote of confidence last Tuesday, with 63 out of 84 present MP's (and 128 MP's in total) backing the government. Prime Minister Hassan Diab said the government's priority was to preserve foreign currency which is needed for imports, and all options were on the table about Eurobonds. The views of PM Diab as well as other key players like the Minister of Administrative Development Damianos Kattar and BDL governor Riad Salame have been generally supportive to a gradual, rather than a disruptive approach, corroborating our view on the front end repayment.

- Argentina: Argentina announced a unilateral roll-over of the dual currency AF20 bonds from 13 February to 30 September. The minister stated that investors treated this bond as foreign debt (given the optionality of getting paid the higher of a USD or ARS return) and will be treated the same way as other foreign currency securities, whose maturities will be postponed. Guzman indicated that he would like to see a primary fiscal balance in 2021 and a primary surplus by 2023. International Monetary Fund (IMF) spokesperson Gerry Rice said that negotiations with Argentina were "constructive". In other news, inflation surprised to the downside, rising by 2.3% in the month of January compared to 3.7% in December. The yoy rate of inflation declined to 52.8% in January from 53.8% in December. The decelerating inflation rate motivated the central bank cut the policy rate by 400bps to 44%.

- China: The PBoC Deputy Governor Pan Gongsheng said the coronavirus renders economic growth a priority over leverage ratio, inflation outlook and exchange rate. CPI inflation rose to 5.4% on a yoy basis in January, from 4.5% yoy in December. Core CPI rose to 1.5% on a yoy basis in January from 1.4% yoy in December. The PBoC cut its Medium-Term Lending Facility (MLF) by 10bps to 3.15%, reducing costs for businesses. The number of confirmed coronavirus cases rose to 70.6k in mainland China as of 17 February, a sharp increase from the 39.8k cases from one week before, due to a revision to the methodology on how cases are diagnosed and reported, according to the World Health Organization (WHO). Overall, the number of daily new cases has been slowing down, both inside and outside of China. In other news, the 2019 broad budget hit a 5.6% GDP deficit, lower than the 6.5% GDP deficit target, but higher than the 2018 deficit of 4.6% of GDP.

- Brazil: The Brazilian Central Bank sold USD 2bn in FX swaps last week. The BRL was underperforming EM currencies since December, but after the intervention, the currency rebounded 2% from its 4.38 lowest level to 4.29, or 0.8% stronger during the week. In other news, the GDP proxy IBC-Br Index rose by 1.3% on a yoy basis in December from 0.8% in November, in line with consensus expectations. Retail sales disappointed, rising by 2.6% on a yoy basis in December, lower than the 3.1% yoy figure in November.

- South Africa: The largest trade union COSATU presented a proposal to use part of the ZAR 100bn surplus of its pension plan managed by the Public Investment Corporation (PIC) to bail-out Eskom. The attached conditionalities, including no privatisation or job shedding, go against the core goal of turning Eskom into a stand-alone sustainable business. In the State of the Nation Address (SONA), President Cyril Ramaphosa hinted at austerity by stating that the February budget will "outline a series of measures to reduce spending and improve its composition". The President emphasised that the ultimate solution to public finances were economic reforms that strengthened GDP growth. The diagnosis is correct, but is taking too long to deliver the medicine and could lead to long-lasting after-effects in the patient, in our view. In other news, retail sales declined by 0.4% on a yoy basis in December from a 2.6% yoy expansion in November. Manufacturing production collapsed 5.9% on a yoy basis in December from a 3.2% yoy decline in November. The unemployment rate was unchanged at a stunning 29.1%.

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Emerging Markets

Mexico: The Central Bank of Mexico cut policy rates by 0.25% to 7.0% in a unanimous decision, in line with consensus expectations. The statement suggests a lower likelihood of acceleration in the pace of monetary easing as wage inflation remains robust despite weak economic growth. CPI inflation accelerated to 3.2% on a yoy basis in January, from 2.8% yoy in December. Core CPI rose to 3.7% on a yoy basis in January from 3.6% yoy in December. Investment bounced 1.1% in November following a 1.5% decline in October.

Hungary: CPI inflation rose to 4.7% on a yoy basis in January from 4.0% yoy in December. GDP growth slowed to 4.5% on a yoy basis in Q4 2019, from 5.0% in Q3 2019. The Central Bank has tightened its communication stance with Deputy Governor Marton Nagy highlighting that inflation risks have increased since December and pledging to use all central bank tools to achieve its 3% to 4% inflation target.

Russia: The Central Bank of Russia (CBR) cut its policy rate by 25bps to 6.0%. The forward guidance signalled further cuts ahead. In other news, the CBR has agreed to sell its controlling stake in shares of Sberbank to the Ministry of Finance. The later will utilize USD 39bn in one of the sovereign wealth funds for the purchase. The CBR will reduce its purchase of hard currency in the market by the same amount.

El Salvador: Last weekend, President Nayib Bukelele asked for support from the military in case parliamentarians wouldn't attend an extraordinary Sunday session to approve a loan for a security law. The President stormed parliament with the military, prayed and pledged his party would win a majority a parliament in elections in February 2021. The spectacle has little direct impact over the short term ability or willingness to serve the debt, but it does raise concerns over political stability, undermining investors' confidence.

Snippets:

- Colombia: Economic data surprised on the upside. Retail sales expanded by a yoy rate of 7.1% in December from 4.4% yoy in November while industrial production rebounded to 3.2% on a yoy basis in December from a 1.5% yoy contraction in November.
- Czech Republic: Unemployment rate rose to 3.1% in January, from 2.9% in December, in line with consensus expectations. GDP growth declined to 1.7% on a yoy basis in Q4 2019 from 2.5% yoy in Q3 2019. CPI accelerated to 3.6% on a yoy basis in January from 3.2% yoy in December with prices rising on a widespread basis.
- Egypt: CPI inflation was stable at 7.2% on a yoy basis in January.
- Ghana: CPI inflation inched down to 7.8% on a yoy basis in January from 7.9% yoy in December.
- Kazakhstan: The current account deficit widened to USD 5.5bn (3.3% GDP) in 2019, from USD 0.3bn in 2018. A temporary shutdown of three major oil fields was the main culprit for the deterioration.
- India: WPI inflation rose to 3.1% on a yoy basis in January from 2.6% yoy in December. CPI rose to 7.6% on a yoy basis in January from 7.4% in December. Both indicators surprised on the upside, led by an increase in protein prices. Industrial production declined by 0.3% on a yoy basis in December from 1.8% yoy growth in November.
- Indonesia: The Q4 2019 balance of payments had a USD 4.3bn surplus due to a USD 8.1bn current account deficit and a USD 12.4bn financial account surplus. The 2019 current account deficit was 2.7% GDP, slightly lower than 2.9% in 2018.
- Malaysia: Economic growth softened with Q4 2019 GDP growth slowing to 3.6% on a yoy basis from 4.4% in Q3 2019, disappointing versus consensus expectations. Net exports and temporary supply disruptions in the commodity sector were the main culprits.
- Namibia: CPI inflation slowed to 2.1% on a yoy basis in January from 2.6% yoy in December. The slowdown increases the likelihood of a rate cut in this week's monetary policy committee meeting.
- Nigeria: The Central Bank announced an extension of the onshore futures curve to 5 years at NGN 380 against a spot rate of NGN 364. The futures contract offers investors a foreign exchange hedge at subsidised prices – i.e. lower than the interest rates differential. Foreign Exchange reserves declined to USD 37.2bn on 13th February from USD 47.9bn in May 2018.
- Panama: Fitch revised the country's BBB rating outlook to negative from stable, citing a deterioration in fiscal deficits and a significant increase in government debt due to commitments made by the previous administration.
- Peru: The Central Bank kept policy rates unchanged at 2.25%, in line with consensus expectations.
- Philippines: The trade deficit improved to USD 2.48bn in December, from USD 3.34bn in November. Imports declined due to a sharp drop in iron and steel imports, most likely healing from the impact of two big typhoons. On the other hand, export growth was robust for both primary and manufactured goods.

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- **Poland:** CPI inflation rose to 4.4% on a yoy basis in January from 3.4% in December led by food, alcohol and tobacco prices. GDP growth slowed to 3.1% on a yoy basis in Q4 2019 from 3.9% yoy in Q3 2019.
- **Romania:** CPI inflation declined to 3.6% on a yoy basis in January from 4.0% yoy in December. GDP growth accelerated to 4.3% in Q4 2019 from 3.0% in Q3 2019.
- **South Korea:** Unemployment rate inched higher to 4.0% in January from 3.7% in December. Job creation accelerated to 568k on a yoy basis in January from 516k yoy in December.
- **Turkey:** Industrial production jumped to 8.6% on a yoy basis in December, from 4.9% yoy in December. The current account deficit widened to USD 2.8bn in December from a USD 0.4bn deficit in November.
- **Ukraine:** CPI inflation declined to 3.2% on a yoy basis in January, from 4.1% yoy in December. GDP growth decelerated to 1.5% on a yoy basis in Q4 2019 from 4.1% yoy in Q3 2019 and consensus expectations of 2.1% yoy growth.
- **Zambia:** Finance Minister Bwalya Ng'andu said the country will cancel or downsize USD 5bn in project loans from the USD 7bn of projects in the pipeline which have been contracted, but not yet disbursed. Disbursing less debt than contracted is a necessary but insufficient condition to reduce the risk of debt distress, currently at very high levels.

Global backdrop

Last week, Annegret Kramp-Karrenbauer resigned from her post as leader of the CDU party and frontrunner to replace Chancellor Angela Merkel in the next federal election in Q4-2021. The election of Norbert Walter-Borjans and Saskia Esken as leaders of the SPD, the second-largest party in Germany, and the rise of the far-right AfD party make the new leadership of the CDU all important. Still, the process is likely to be concluded only towards the end of 1H 2020. EU economic data remained weak. Eurozone industrial production contracted at a yoy rate of 4.1% in December, from a 1.7% yoy decline in November. GDP growth inched lower to 0.9% on a yoy basis in Q4 2019, from 1.0% yoy in Q3 2019.

In the UK, Prime Minister Boris Johnson reshuffled the cabinet, replacing Sajid Javid as the Chancellor of the Exchequer with Rishi Sunak. The replacement opens the doors for a more expansionary fiscal policy from the 11th March budget.

In the US, economic data was consistent with late-cycle stages as inflation surprised on the upside and mortgage delinquency reaching all-time lows. CPI inflation rose to 2.5% on a yoy basis in January from 2.3% in December. Core CPI ex-food and energy was stable at 2.3%. Industrial production dropped 0.3% in January after a 0.4% decline in December, and retail sales rose 0.3% in January after a 0.2% increase in December. Capacity utilisation inched lower to 76.8% in January from 77% in December. The University of Michigan Consumer Sentiment Index rose to 100.9 from 99.8, and the NFIB Small Business Optimism Index rose to 104.3 from 102.7. Mortgage delinquency declined to 3.77% in Q4 2019 from 3.97% in Q3 2019, the lowest level since the beginning of the survey in 1979.

Bernie Sanders won the Democratic Party primary in New Hampshire, putting the 78-year-old as the temporary frontrunner in the presidential race against Donald Trump. The betting website predictit.org has the odds of Bernie Sanders winning the nomination at 40% against 30% for Michael Bloomberg and 30% for the remaining candidates. At this stage, the market doesn't seem to price a high likelihood of a Democratic nominee espousing leftist policies winning the election. Bloomberg's economic plans could be classified somewhere between Joe Biden and Bernie Sanders. Higher tax on business and the wealth in contrast with Biden, but lower fiscal spending than Sanders. Furthermore, Bloomberg is committed to increasing the minimum wage to USD 15 per hour.

Higher corporate taxes, higher salaries and less budgetary expenditure are likely to hurt the US equity market, in our view. Long term investors should seek diversification in EM equities while the valuation gap to US equities remains close to a record.

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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	4.17%	-0.69%	-0.69%	9.58%	8.74%	5.18%
MSCI EM Small Cap	2.34%	-1.74%	-1.74%	4.53%	3.27%	2.38%
MSCI Frontier	-1.97%	-2.02%	-2.02%	8.14%	5.90%	2.94%
MSCI Asia	5.03%	0.36%	0.36%	9.84%	10.04%	6.19%
Shanghai Composite	-2.00%	-4.36%	-4.36%	9.88%	-0.97%	0.22%
Hong Kong Hang Seng	6.08%	-2.72%	-2.72%	0.95%	5.99%	1.94%
MSCI EMEA	0.64%	-4.18%	-4.18%	7.59%	4.23%	1.33%
MSCI Latam	1.24%	-4.42%	-4.42%	0.92%	5.65%	4.08%
GBI EM GD	0.51%	-0.78%	-0.78%	9.41%	5.51%	2.68%
ELMI+	0.08%	-1.23%	-1.23%	2.52%	2.88%	1.74%
EM FX Spot	-0.01%	-2.69%	-2.69%	-2.94%	-2.46%	-4.26%
EMBI GD	0.67%	2.20%	2.20%	12.27%	6.47%	6.45%
EMBI GD IG	0.58%	2.88%	2.88%	16.25%	7.60%	5.91%
EMBI GD HY	0.77%	1.42%	1.42%	8.29%	5.26%	7.21%
CEMBI BD	0.62%	2.17%	2.17%	11.88%	6.32%	6.12%
CEMBI BD IG	0.50%	2.10%	2.10%	12.20%	6.17%	5.13%
CEMBI BD Non-IG	0.78%	2.27%	2.27%	11.42%	6.57%	7.78%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	4.91%	4.86%	4.86%	25.55%	15.33%	12.27%
1-3yr UST	-0.11%	0.45%	0.45%	3.74%	1.97%	1.44%
3-5yr UST	-0.29%	1.13%	1.13%	6.08%	2.91%	2.23%
7-10yr UST	-0.50%	2.70%	2.70%	10.73%	4.86%	3.17%
10yr+ UST	-0.43%	6.39%	6.39%	21.24%	9.03%	5.08%
10yr+ Germany	-0.84%	4.00%	4.00%	10.36%	6.51%	3.85%
10yr+ Japan	-0.48%	0.28%	0.28%	3.50%	3.17%	4.10%
US HY	1.09%	1.11%	1.11%	9.83%	6.00%	5.96%
European HY	0.74%	0.84%	0.84%	8.71%	4.08%	4.48%
Barclays Ag	-0.85%	0.42%	0.42%	6.60%	4.31%	2.55%
VIX Index*	-27.39%	-0.73%	-0.73%	-8.25%	19.06%	-13.42%
DXY Index*	1.78%	2.83%	2.83%	2.29%	-1.81%	5.38%
CRY Index*	1.56%	-6.91%	-6.91%	-4.62%	-9.98%	-24.41%
EURUSD	-2.29%	-3.47%	-3.47%	-4.17%	2.10%	-5.07%
USDJPY	-1.37%	-1.17%	-1.17%	0.64%	2.71%	8.41%
Brent	-1.44%	-13.15%	-13.15%	-13.48%	2.71%	-8.33%
Gold spot	-0.63%	3.70%	3.70%	19.03%	27.90%	30.85%

*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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