Ashmore

The Earth is still turning

By Jan Dehn

Economic activity picked up in China in March. Ukraine's Zelensky leads from the front to pass key reforms. India finally looks set to join key fixed income benchmark indices. Turkey's ticking macroeconomic time bomb. Peru goes big in fighting the economic downturn. Indonesia paves the way for counter-cyclical fiscal policy. Hungary turns its back on democracy. Zambia prepares to restructure debt. Mexico activates its Fed swap line.

The global backdrop section discusses the denial surrounding the spike in initial jobless claims in the United States, improving Dollar liquidity and the importance of watching oil prices like a hawk right now.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	9.7	–	-1.22%
MSCI EM Small Cap	7.7	–	-0.74%
MSCI Frontier	6.8	–	-2.06%
MSCI Asia	10.3	–	-1.36%
Shanghai Composite	9.3	–	-0.30%
Hong Kong Hang Seng	7.3	–	-0.15%
MSCI EMEA	7.8	–	2.92%
MSCI Latam	8.7	–	-5.88%
GBI-EM-GD	5.53%	–	-2.99%
ELMI+	4.98%	–	-1.82%
EM FX spot	–	–	-2.39%
EMBI GD	7.13%	647 bps	-0.39%
EMBI GD IG	4.24%	354 bps	-0.16%
EMBI GD HY	11.61%	1,099 bps	-0.71%
CEMBI BD	6.62%	607 bps	-0.02%
CEMBI BD IG	4.47%	392 bps	0.10%
CEMBI BD Non-IG	10.17%	962 bps	-0.21%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	13.9	–	-2.02%
1-3yr UST	0.25%	–	0.10%
3-5yr UST	0.41%	–	0.23%
7-10yr UST	0.64%	–	1.19%
10yr+ UST	1.26%	–	2.46%
10yr+ Germany	-0.44%	–	0.38%
10yr+ Japan	0.00%	–	0.63%
US HY	9.97%	942 bps	-0.59%
European HY	9.29%	895 bps	0.71%
Barclays Ag	1.23%	59 bps	-0.45%
VIX Index*	46.80	–	-18.74%
DXY Index*	100.64	–	1.45%
EURUSD	1.0825	–	-2.02%
USDJPY	109.06	–	1.21%
CRY Index*	127.96	–	4.07%
Brent	34.0	–	49.30%
Gold spot	1621	–	-0.07%

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

Emerging Markets

- **China:** The pace of manufacturing and services activities in China ramped sharply higher in March in a clear sign that economic activity is rebounding following the drop in coronavirus infections. China's services Purchasing Managers Index (PMI) rose from 42.0 in February to 52.3 in March. The bounce in manufacturing activity from 44.0 to 52.0 was also significant. The Caixin services PMI also rose from 26.5 in February to 43.0 in March. The epicentre of the coronavirus outbreak shifted from China to Europe in March. It is now showing signs of peaking in Europe. It will then likely peak in the United Kingdom and finally, in the not so distant future, in the United States. The sharp contraction in economic activity in Europe and the United States due to lockdowns will likely weaken demand for Chinese exports for a time, but China will seek to offset weaker external demand with fiscal stimulus to the tune of about 4% of GDP, mainly focused on tax cuts and infrastructure spending. The People's Bank of China (PBOC) also cut the reserve ratio for rural and smaller town banks by 1%, thereby releasing some USD 56bn of liquidity. Meanwhile, Chinese bonds have lived up to their 'safe haven' credentials this year with stable and positive performance year to date.[1]

Ukraine: President Volodymyr Zelensky led from the front in a monumental night for Ukraine on Monday last week, when he single-handedly snatched victory from what looked like the jaws of certain defeat in parliament (the 'Rada'). Showing up in person and making the case for his reforms directly to the Rada, he secured passage for two critical reforms, which are required for the disbursement of USD 8.0bn under Ukraine's program with the International Monetary Fund (IMF). With his boldness, Zelensky thereby averted a potentially serious economic and financial crisis for the country. The two bills – a banking reform and laws that pave the way for the establishment of a market for land – now face a second reading in the Rada in early April, but should pass. Zelensky was also able to obtain parliamentary approval for his new picks for the posts of finance minister and health minister. The land reform is particularly exciting, because Ukraine's rich endowment of fertile farm land means that the country has the potential to become the bread basket of Europe.

[1] See: *'Chinese bonds challenge Treasuries as 'safe haven' destination'*, Market Commentary, 2 April 2020.

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Emerging Markets

- India: After years of to-ing and fro-ing on the issue of opening its bond markets to foreign investors, the Indian government finally took the step to allow foreign investors unfettered access to a series of government bonds. This decision should in turn pave the way for Indian government bonds to enter all the major global fixed income benchmark indices. It is an important development, because index inclusions grants India access to a more stable institutional investor base. Index inclusion should, over time, lower the term structure of interest rates, which in turn will aid economic activity and broaden credit markets in the country. Index inclusion also at long last extends Prime Minister Modi's "Make in India" pledge – the notion that India should open to the rest of the world – to the world of finance. In practice, access to Indian bonds will be via the Reserve Bank of India's ' Fully Accessible Route', which places no limits on foreign investment in specified securities, including all new 5, 10 and 30-year bonds (a total of USD 57bn worth of securities). The bonds should be eligible for inclusion in the Bloomberg-Barclays Global Aggregate Index (BBGA), JP Morgan's GBI-EM GC index and presumably also FTSE's WGBI. Index inclusion is likely to take place over the next 24 months.

- Turkey: What does a ticking time bomb look like? Try negative net FX reserves. Based on official data released last week, the Central Bank of Turkey (CBT) now appears to have a larger short FX forward position (USD 26bn) than its stock of net FX reserves (USD 21bn). This precarious situation seems to have arisen following a drop in gross FX reserves of USD 15bn so far this year. Additionally, the Turkish government has about USD 12bn in FX deposits at the CBT, which additionally holds about US 20bn in (illiquid) gold reserves. Still, the capacity of CBT to extend Dollars via FX forward depends on its ability to attract Dollar deposits, which could prove ever more difficult as tourism revenues decline (due to coronavirus) and foreign debt obligations mount. On the other hand, lower oil prices offer some respite for Turkey, but, as we argue in the Global Backdrop section, oil prices may rise again once lockdowns are lifted. The real underlying problem in Turkey is that domestic demand is too strong compared to domestic supply. The current account deficit is financed by short-term foreign flows. Instead of trying to bring domestic demand into balance with domestic supply, ideally by stimulating productivity, the government is actively pushing domestic demand even higher by forcing institutional investors to extend ever more credit. This path is unsustainable. In related economic news, the yoy rate of consumer prices index (CPI) inflation was 11.9% in March, just ahead of expectations of 11.8% yoy.

- Peru: Due to its enviable low gross stock of government debt of just 24% of GDP, Peru has announced an economic package worth 12% of GDP to fight the effects of coronavirus at home and on Peru's exports. The package comprises income support for vulnerable groups and government-backed loans for businesses. The government will also seek a contingency line from the IMF worth about USD 18bn and another USD 2.0bn in financing from the World Bank. More controversially, Peru's Congress approved a measure, which allows all Peruvians to withdraw up to 25% of their pension savings to help tie them over during the coronavirus outbreak. President Vizcarra may yet veto this measure, propose amendments, or simply sign it into law. The government's own proposal would only allow the unemployed to tap into their pension pots. If given presidential ascent, the measure could potentially lead to a large sell-off in assets owned by the Peruvian pension system to the extent Peruvians decide to withdraw funds. Due to the likely transitory nature of the coronavirus outbreak, it is only right to borrow to enable consumption and other economic activities to continue as smoothly as possible for the duration of the outbreak, but it is unclear if tapping the pension system is the right way forward, given the government's strong capacity to borrow.

- Indonesia: The government temporarily suspended the budget deficit cap in order to increase fiscal spending by 2.4% of GDP. The cap was lifted to increase health care spending, provide social safety nets and provide tax incentives and other types of support for small business in light of the coronavirus outbreak. The fiscal deficit under the new budget will be just north of 5% of GDP in 2020 and then taper down to eventually return to the mandated cap of 3.0% of GDP by 2023. Counter-cyclical fiscal policy is eminently suited for the current crisis, particularly in poorer countries, where many small businesses cannot access finance, provided that the government's finances can stand the hit and that adequate financing is available. The former requirement is met in that Indonesia's net debt to GDP ratio is less than 30%. The financing situation is less clear in that foreigners already own a relatively large share of local bonds. Apparently aware of this source of vulnerability, Bank Indonesia was given powers to buy government bonds (as a last resort).

- Hungary: Europe may have established its first dictatorship since the death of General Francisco Franco of Spain in 1975 and the collapse of the Soviet Union-sponsored puppet regimes in 1989. As has happened many times in the past, democracy was dismantled through an act of parliament, i.e. seemingly at the will of the people. Specifically, Hungary's parliament last week approved legislation, which grants Prime Minister Viktor Orban powers to rule by decree without a time limit and without restrictions on what he can rule on. Orban's powers therefore extend to any law, not just legislation pertaining to the ongoing coronavirus outbreak. Orban may or may not choose to give up some or all of these extra-ordinary powers at some point, but one wonders why he would do so. One possibility is that pressure from the European Union (EU) eventually convinces him to do so, although EU will find it difficult to exercise real pressure, because Poland and a few other EU member states sympathise with Orban and may have similar plans of their own. EU has to act with unanimity in these

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Emerging Markets

cases. In any case, the EU may want to scale up pressure on Hungary over time instead of provoking a confrontation right now while the EU is busy dealing with the coronavirus pandemic and Brexit. The EU was established to prevent a return to Europe's dark history of authoritarianism. In other news, the National Bank of Hungary introduced a 1-week deposit facility, which pays 0.9%. The new rate is likely to be more attractive as a destination to place money than FX swaps, thus reducing pressure on HUF.

- Zambia: The Zambian government has announced that it wishes to restructure its external debt burden of USD 11.2bn. Roughly one third is Eurobonds, the remainder being bilateral and multilateral debt. Zambia is a major copper producer. The government's revenues have fallen sharply due to lower commodity prices, thereby pushing the country into its current predicament. Bond prices were already trading around 30c, reflecting the fact that markets were already expecting news of this kind.

- Mexico: The Mexican government last week activated a USD 60bn swap line with the US Federal Reserve in a bid to stabilise MXN. The Mexican peso has been weakening as a result of concerns over a US recession, low oil prices and general risk aversion in global financial markets due to coronavirus.

Snippets:

- Brazil: The primary deficit was BRL 20.9bn in February. This was slightly lower than expected (BRL 21.5bn). The running 12-months primary deficit is around 0.8% of GDP.
- Chile: The Central Bank of Chile cut the policy interest rate by 50ps to 0.5%.
- Colombia: The rate of unemployment in February declined to 11.5% compared to 12.4% in the same month of 2019.
- Hong Kong: At 34.9, the March PMI picked up compared to the low print of 33.1 recorded in February.
- Kenya: The yoy rate of CPI inflation declined to 6.1% in March from 6.4% in February.
- Malaysia: The trade surplus increased to USD 3.0bn in February from USD 2.9bn in January, mainly due to lower imports.
- Russia: President Vladimir Putin extended the stay-at-home period until the end of April.
- Singapore: The government closed schools and most places of work to prevent the further spread of coronavirus.
- South Africa: Vehicle sales contracted at a yoy rate of 29.7% in March. This compares to a 43% yoy maximum collapse in vehicle sales in 2008/2009. Fitch downgraded the sovereign to two notches below investment grade with negative outlook on growth and fiscal concerns. This follows recent downgrades by both Moodys' and S&P.
- South Korea: Industrial production surged at a yoy rate of 11.4% in February, which was far ahead of expectations (3.4% yoy). Exports expanded 18.7% in the three months to March compared to the previous three months.
- Thailand: The government announced a stimulus package of 10% of GDP comprising a combination of loans, transfers and spending on public projects.
- Vietnam: The rate of real GDP growth slowed to 3.8% on a yoy basis in Q1 2020. This compares to 7.0% yoy Q4 2019.

Global backdrop

- US economy: Some ten million Americans have lost their jobs in the last two weeks alone, according to the weekly count of new claims for unemployment protection from the United States Department of Labor. There is already no precedent for this scale of deterioration in the US labour market (Figure 1). Nonfarm payrolls were also disastrous: -701K versus -100K expected. Bad as they may seem, the numbers may worsen further yet. The nonfarm payroll print only included data up to and including 14 March, which is before the main lockdowns began. Besides, the US Administration's own officials predict the number of coronavirus-related deaths could rise to 100,000 people or more over the next fortnight, which would be twice as many as the number of Americans killed in the Vietnam War. In this context, the lockdowns could even intensify further, thereby increasing the economic pain even more.

All this, of course, implies recession. Recession may prove difficult to escape from, because the Fed has already cut rates to zero and engaged in 'QE infinity', while the government's debt to GDP ratio should easily reach well above 120% this year, even before any additional fiscal stimulus to deal with the recession. One implication of recession is that much of the USD 10trn of foreign money, which chased stocks, leveraged loans and high yield in the US over the past decade may leave once the panic surrounding coronavirus dissipates. The very low yields

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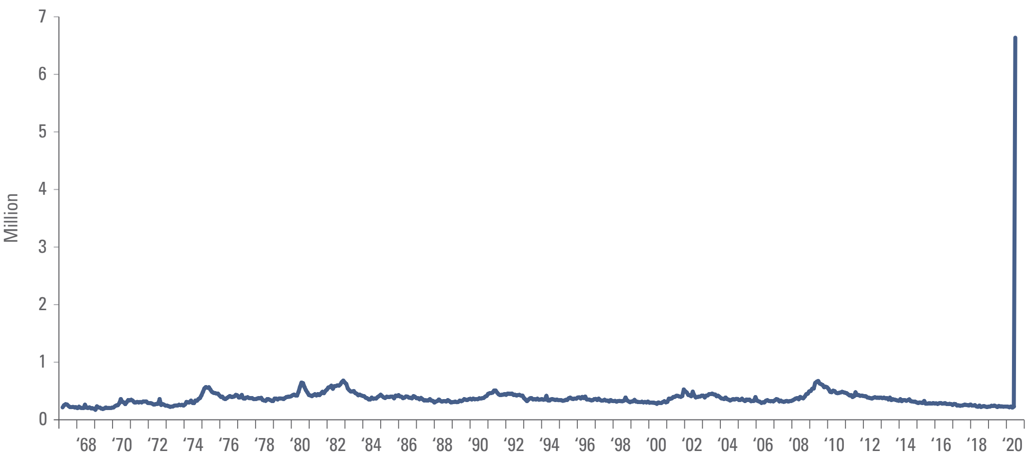
Global backdrop

available on Treasuries means that US government bonds cannot hedge losses in US markets. US recession has special significance for EM, because most EM external debt trades as a spread over the US Treasury curve and most EM currencies trade versus the Dollar, not EUR or JPY or GBP. The fact that EM spreads are still wider than they should be versus the Treasury curve and the Dollar is still too strong versus EM FX shows that markets are still trying to quantify the potential for more coronavirus 'tape bombs', more bad economic data, and more liquidation of assets. However, when the panic subsides – which it will do – investors will soon start to ask how their USD 10trn can make money in a recession-afflicted US economy. The answer, as in past recessions, is "not easily". This is why the Dollar has tended to fall in past US recessions. This, in our view, is the real message behind the spike in initial claims: the Dollar eventually has to fall. A recession pushes the Dollar lower and increases flows to EM sooner and by more than our expectation was just a few months ago. And flows are ultimately the key to growth in EM's finance-constrained economies.[2]

Fig 1: **New claims for unemployment benefit in the United States**



Source: Ashmore, Bloomberg.

- Dollar financing eases up: Demand for Dollars tends to spike temporarily during most global market panics. The kneejerk response to demand Dollars contributes to global instability and can even push some countries and companies, notably those that do not have well developed domestic markets in which they can finance, into trouble. Shortages of Dollar financing can happen regardless of fundamentals, for example if investors panic and, by selling, push borrowing costs to prohibitive levels. In these situations, it is part of the responsibilities of the provider of Dollars – the world's primary reserve assets – to ensure that sufficient funding is available. Last week, the Federal Reserve thus launched a new repo line facility, which can be tapped into by central banks the world over, while the US congress approved a doubling of the resources available to the IMF. This shows that these two US institutions, at least, understand that with power comes responsibility.

- Watch oil prices like a hawk: The most important conclusion from China's ongoing recovery from coronavirus is that this illness is finite both in terms of duration and economic impact. If the outbreaks are handled as well in other parts of the world, they should prove finite in time and economic impact. Oil prices are likely to prove a good indicator of when economic activity begins to pick up in earnest. Granted, the 60% peak-to-trough collapse in oil prices this year was partly due to supply issues (a price war between Russia and Saudi Arabia). However, we believe that demand has been a far more important driver of oil prices, with some estimates that as much as a quarter of the world's demand of roughly 100m barrels per day has fallen away due to lockdowns to contain the spread of coronavirus.

Last week saw oil prices displaying some recovery on the back of an announcement by the United States President Donald Trump to the effect that Russia and Saudi Arabia would cut production by 10m barrels per day. However, it soon became clear that agreement had not actually been established, underlining that most things Trump says have to be taken with a pinch of salt. In any case, production cuts are extremely difficult to achieve. The oil world comprises large and small producers, state and non-state actors, and OPEC and non-OPEC members. Getting them to agree on anything is like herding cats. Perversely, the incentives to cut production only become very strong once prices rise, because then the blow to income from lower production can be offset by the higher prices. Indeed, Russia and Saudi Arabia may be waiting for exactly that, a pick-up in demand, before they mend fences. In other words, curtailing supply could prove difficult.

[2] For a deeper discussion of the risks surrounding the Dollar see: *'What goes around comes around: a short note on Dollar risk'*, Market Commentary, 17 January 2020.

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Global backdrop

More importantly, a sustained rise in prices is likely to require the lockdowns to be lifted. This only happens when there are clear signs that virus infections have peaked. Once it happens, however, it could trigger a sharp surge in demand for oil as people get back to commuting to work, social driving, shopping and visiting friends and family, while industrial activity, services, and air traffic all recover. Granted, lingering recession and large quantities of oil in storage may prevent prices from staging a full recovery, but they should still rise relative to the current very low levels.

This is why the questions of when the virus has fizzled out in the majority of the world's large populations and when the lockdowns can be lifted are so important. These questions are particularly important in countries, which use a disproportionate amount of the world's energy, such as the United States. Relief may not be so far away. As noted earlier, Asia is already past the peak in infections.[3] There are signs that infections in Italy and Spain are levelling out. UK is next to peak and then the United States. Hence, the peak of the outbreak on a global level could be reached within the next few weeks, or months at most. Oil traders are likely to be watching these developments with keen interest.

What does this mean for EM? If, as we expect, the sharp drop in oil prices turns out to be relatively short-lived, it follows that the current troubles facing EM's specialist oil producers too will prove finite in duration. Until relief in the form of higher prices materialises, the support of the IMF and other multilateral financial institutions will obviously be critical in helping these countries to meet their financing needs as financial markets remain closed. The governments in the oil producing countries also help themselves by engaging in liability management operations and approach private investors with proposals for private funding, etc. The smartest governments will exploit the fall in energy prices to slash expensive fuel subsidies, thereby improving the public finances on a forward-looking basis.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-1.95%	-1.95%	-25.08%	-20.67%	-2.16%	-0.77%
MSCI EM Small Cap	-1.83%	-1.83%	-32.60%	-31.20%	-10.13%	-5.74%
MSCI Frontier	-0.39%	-0.39%	-26.92%	-20.03%	-4.60%	-3.33%
MSCI Asia	-1.90%	-1.90%	-19.93%	-16.78%	0.48%	0.99%
Shanghai Composite	0.50%	0.50%	-9.38%	-11.97%	-2.78%	-4.49%
Hong Kong Hang Seng	-1.08%	-1.08%	-15.01%	-15.83%	1.12%	-1.96%
MSCI EMEA	1.02%	1.02%	-33.21%	-28.89%	-7.36%	-5.42%
MSCI Latam	-5.91%	-5.91%	-48.80%	-44.49%	-14.92%	-7.45%
GBI EM GD	-2.48%	-2.48%	-17.31%	-9.68%	-1.70%	-0.53%
ELMI+	-1.45%	-1.45%	-9.81%	-7.10%	-0.96%	-0.14%
EM FX Spot	-1.60%	-1.60%	-15.68%	-15.74%	-7.46%	-6.43%
EMBI GD	-0.57%	-0.57%	-13.87%	-7.45%	0.21%	2.53%
EMBI GD IG	-0.51%	-0.51%	-5.92%	3.81%	4.04%	3.63%
EMBI GD HY	-0.64%	-0.64%	-22.94%	-19.38%	-4.26%	1.22%
CEMBI BD	-0.04%	-0.04%	-10.20%	-3.62%	1.51%	3.10%
CEMBI BD IG	0.17%	0.17%	-5.90%	1.18%	2.98%	3.18%
CEMBI BD Non-IG	-0.34%	-0.34%	-16.05%	-10.13%	-0.52%	3.13%

[3] See: *'The triple shock and EM equities: First-in first-out?'*, The Emerging View, 2 April 2020.

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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	-3.68%	-3.68%	-22.56%	-11.63%	3.84%	5.92%
1-3yr UST	0.04%	0.04%	2.80%	5.53%	2.66%	1.84%
3-5yr UST	0.05%	0.05%	5.43%	9.54%	4.09%	2.87%
7-10yr UST	0.74%	0.74%	10.96%	17.92%	7.02%	4.47%
10yr+ UST	2.91%	2.91%	24.43%	39.07%	13.99%	7.93%
10yr+ Germany	1.10%	1.10%	6.25%	11.49%	6.71%	3.55%
10yr+ Japan	0.67%	0.67%	-0.17%	1.61%	2.68%	3.65%
US HY	-2.05%	-2.05%	-14.48%	-9.15%	0.05%	2.33%
European HY	0.12%	0.12%	-16.05%	-12.37%	-2.20%	0.39%
Barclays Ag	-0.37%	-0.37%	-0.70%	4.24%	3.37%	2.43%
VIX Index*	-12.59%	-12.59%	239.62%	265.05%	277.72%	217.50%
DXY Index*	1.60%	1.60%	4.41%	3.33%	-0.03%	3.99%
CRY Index*	5.07%	5.07%	-31.13%	-31.82%	-31.49%	-41.84%
EURUSD	-1.87%	-1.87%	-3.47%	-3.89%	1.70%	-0.89%
USDJPY	1.41%	1.41%	0.41%	-2.17%	-1.58%	-8.75%
Brent	49.43%	49.43%	-48.52%	-51.69%	-38.09%	-41.53%
Gold spot	2.81%	2.81%	6.87%	24.97%	29.51%	33.47%

*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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