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WEEKLY INVESTOR RESEARCH

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US-China tensions increase

By Gustavo Medeiros

China's National People's Congress approved new security legislation for Hong Kong. NPC's proposal may have been China's way to pre-empt US interference in Hong Kong, given the recent escalation in anti-Chinese rhetoric by the US Administration and a long line of attacks on Chinese interests in recent times. Argentina unveiled a new debt restructuring offer. The Association of Banks in Lebanon proposed a debt re-profiling without a principal haircut. Colombia cut the policy rate by 50bps to 2.75%. Brazil's current account balance posted the highest monthly surplus since 1995. Thailand's balance of payments posted a large surplus driven by capital repatriation. The IMF approved sizeable precautionary flexible credit lines to Peru and Chile. El Salvador's finance minister urged parliament to approve the disbursement of USD 1.1bn in IFI loans. Costa Rica's finance minister resigned calling for tighter fiscal rules.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.5	–	2.86%
MSCI EM Small Cap	10.2	–	2.56%
MSCI Frontier	11.4	–	2.67%
MSCI Asia	11.9	–	2.44%
Shanghai Composite	10.4	–	1.46%
Hong Kong Hang Seng	7.6	–	1.73%
MSCI EMEA	9.7	–	1.17%
MSCI Latam	11.4	–	6.40%
GBI-EM-GD	4.54%	–	1.99%
ELMI+	2.66%	–	1.20%
EM FX spot	–	–	1.61%
EMBI GD	6.01%	524 bps	0.15%
EMBI GD IG	3.52%	270 bps	0.33%
EMBI GD HY	9.84%	912 bps	-0.08%
CEMBI BD	5.47%	487 bps	0.71%
CEMBI BD IG	3.65%	305 bps	0.49%
CEMBI BD Non-IG	8.21%	761 bps	1.03%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	18.9	–	3.30%
1-3yr UST	0.16%	–	0.02%
3-5yr UST	0.30%	–	0.13%
7-10yr UST	0.65%	–	0.27%
10yr+ UST	1.42%	–	-0.23%
10yr+ Germany	-0.45%	–	-0.97%
10yr+ Japan	0.00%	–	-0.49%
US HY	7.02%	637 bps	1.95%
European HY	6.47%	657 bps	2.52%
Barclays Ag	1.01%	36 bps	0.80%
VIX Index*	27.51	–	-2.02%
DXY Index*	98.04	–	-1.83%
EURUSD	1.1138	–	2.20%
USDJPY	107.55	–	-0.15%
CRY Index*	132.24	–	1.73%
Brent	37.5	–	5.57%
Gold spot	1743	–	0.61%

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

Emerging Markets

- **China:** The National People's Congress (NPC) approved a proposal for new security legislation in Hong Kong. NPC's proposal may have been China's way to pre-empt US interference in Hong Kong, given the recent escalation of anti-Chinese rhetoric by the US government and a long line of attacks on Chinese interests, including:
  - The trade war instigated by the Trump Administration in 2018
  - Restrictions on US public sector pension funds' holdings of Chinese investments
  - Delisting of Chinese stocks from US stock exchanges
  - Bills targeting Huawei and banks dealing with Chinese officials that the US deems to be interfering with Hong Kong
  - Provocation of China over Taiwan
  - Restrictions on entry of Chinese journalists in the US
  - A Senate ban on use of US inputs for +30 Chinese companies
  - Sanctions on Chinese officials for alleged abuses against Uyghurs
  - Expulsion of Chinese students with links to military schools

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Emerging Markets

The new security laws lead to fears over greater Chinese interference in Hong Kong, which has semi-autonomous status under the 'one country, two systems' arrangement. This remains to be seen, however Chinese officials will now take several months to work out the details of the new laws, which are designed to curb subversion, secession, terrorism, and foreign interference. The Legislative Council in Hong Kong will then vote on the bill. Hong Kong's pro-China government said all the rights and freedoms enjoyed by Hong Kong individuals and international investors will remain unchanged. However, US Secretary of State Michael Pompeo said that Hong Kong could no longer be considered autonomous from China, thereby implicitly threatening to remove the city's special status under US law. This could have wide-ranging implications for Hong Kong, but would probably not have a major impact on China per se. The EU adopted a softer stance, expressing concern over the importance of preserving Hong Kong's higher degree of autonomy, but acknowledging that sanctions against China are unlikely to be a solution. German Chancellor Angela Merkel repeated she would still like to achieve a landmark investment agreement between China and the EU. In other news, a Canadian court denied Huawei's Chief Financial Officer Meng Wanzhou's request to avoid extradition to the US. China's embassy in Canada said Canada is an "accomplice to US efforts to bring down Huawei and Chinese high-tech companies".

In economic news, Tencent, the Chinese technology company, announced RMB 500bn (USD 70bn) in fresh investment over the next five years covering cloud computing, artificial intelligence, cyber security, and key infrastructure, such as advanced servers and 5G mobile networks. China's preference, when it comes to countercyclical policy during the coronavirus crisis, is to invest for the long-term in technology. This should help to smooth the economic impact in 2020 and 2021, but also increase China's long-term potential GDP growth. The NBS manufacturing PMI survey inched down to 50.6 in May from 50.8 in April, whereas services PMI rose to 53.6 from 53.2. Industrial profits declined by 4.3% on a yoy basis in April, which was a sharp recovery -34.9% recorded in March. Private sector profits rebounded to positive levels for the first time this year. Last week, the People's Bank of China (PBOC) issued a strong signal that the front end of the government yield curve was pricing too much easing, thereby reducing the likelihood that China's policy interest rate will hit the lower bound of 0%.

Finally, we note that China's soybean imports from the US declined by 62% on a yoy basis in April, leading to fears over the fulfilment of the terms of a recently agreed trade deal with the United States. However, Director of the United States National Economic Council Larry Kudlow played down the risk to the trade deal with reference to the unusual circumstances caused by the coronavirus outbreak.

- Argentina: Argentina unveiled a new debt restricting offer with improved terms. The new debt offer reduced the grace period by one year, increased the coupon payments, and brought forward the principal repayments, spreading them out more evenly. Finance Minister Martin Guzman noted that important progress had been made in shortening the distance between the bondholders and Argentina's offer.[1]

- Lebanon: The Association of Banks in Lebanon (ABL) unveiled a proposal to re-profile Lebanon's domestic government debt and Eurobonds by lowering coupons payments, but not imposing a haircut on principal payments. The plan also introduces a proposal to use state assets to reduce the government's debt stock.

- Colombia: The Central Bank of Colombia cut the policy rate by 50bps to 2.75% in line with consensus expectations. Remittances of income to Colombia from workers living abroad declined by 38.4% on a yoy basis in April following a yoy rate of increase of 32.8% in March. The data suggests Colombians closely monitor currency movements, timing transfers to maximise the benefits of the lowest-ever nominal COP exchange rate in March.

- Brazil: The current account recorded a USD 3.8bn surplus in April following a USD 0.4bn surplus in March. This was the highest surplus since the start of the series in 1995. On the other hand, foreign direct investment disappointed by declining to USD 0.2bn in April from USD 6.2bn in March. CPI inflation declined to 2.0% on a yoy basis in the first half of May from 2.9% yoy in the same period in April. The Labour Ministry registered 1.14m jobs lost between January and April with 0.86m in April alone. The unemployment rate rose only modestly to 12% in April from 11.5% in March due to a large decline in the labour force participation rate. The real rate of GDP growth declined by 0.3% on a yoy basis in Q1 2020 from +0.4% yoy in Q4 2019. In other news, President Jair Bolsonaro vetoed a pay rise for civil servants in line with his pledge to maintain fiscal discipline.

- Thailand: Private consumption declined by 15.1% on a yoy basis in April from -2.7% yoy in March. Manufacturing production declined by 17.2% on a yoy basis from -10.5% yoy over the same period. International tourist arrivals declined to zero in April after a 75% drop on a yoy basis in March as a result of international travel restrictions. Lower tourism revenues pushed the current account balance to a small USD 0.7bn deficit in April, but the balance of payments still posted a USD 8.0bn surplus due to repatriation of cross-border deposits.

- Peru: The IMF has approved an USD 11bn precautionary flexible credit line for Peru. The credit line is not linked to any specific policy targets on account of the strong state of Peru's public finances. In other news, the government announced that social distancing measures will remain in place until 30 June albeit with a partial reopening of some sectors. Congress approved a vote of confidence in Prime Minister Vicente Zeballos' cabinet.

[1] https://www.argentina.gob.ar/noticias/martin-guzman-nos-hemos-acercado-pero-aun-hay-un-camino-importante-por-recorrer

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Emerging Market

• **Chile:** The IMF approved a two-year USD 24bn flexible credit line for crisis prevention purposes. In other news, retail sales declined by 31.3% on a yoy basis in April from -14.9% yoy in March. Manufacturing and industrial production declined at modest single-digit rates on a yoy basis.

• **El Salvador:** Finance Minister Nelson Fuertes urged congress to approve USD 1.1bn of loans from international financial institutions (IFIs) to avert a potential liquidity crisis in June. El Salvador's stock of short term debt is close to the 30% limit imposed by the 2020 Budget. President Bukele and Congress clashed over the extending the shutdown with the president advocating for a longer extension.

• **Costa Rica:** Finance Minister Rodrigo Chaves has stepped down saying the government would need to approve more aggressive fiscal measures in order to avoid default. Last week Mr. Chaves published a letter opposing a bill to create a carve-out from the fiscal rule to allow greater spending by municipal governments.

Snippets:

- **Dominican Republic:** The central bank sold USD 2.1bn in the past three months. FX reserves declined to USD 8.6bn in April from 10.4bn in January. However, they remain adequate. FX reserves stood at USD 7.3bn level in April last year.
- **Hungary:** The National Bank of Hungary kept the policy rate unchanged at 0.9% as expected.
- **India:** Real GDP growth decelerated to a 3.1% rate of a yoy basis in Q1 2020 from 4.1% yoy in Q4 2019. This was better than the consensus expectation of 1.6% yoy growth. The Manufacturing PMI inched higher to 30.8 in May from 27.4 in April.
- **Kenya:** The Central Bank of Kenya kept the policy interest rate unchanged at 7.0% in line with expectations. The authority stated that the growth rate in 2020 is likely to be 2.3% after Kenya recorded a growth rate of 5.4% in 2019.
- **Mexico:** Real GDP growth declined by 1.2% in Q1 2020, which was better than the -1.6% consensus forecast. GDP growth was revised up to -1.2% in Q4 2019 from -1.6% in the previous data release.
- **Nigeria:** The Central Bank of Nigeria cut the policy rate by 100bps to 12.5%, which was a surprise relative to the consensus expectation of no change.
- **Poland:** The National Bank of Poland cut the policy rate by 40bps to 0.1%, which was surprising relative to the consensus expectation of no change. The rate of real GDP growth declined to 2.0% on a yoy basis in Q4 2020 from 3.2% yoy in Q4 2019, while the rate of CPI inflation declined to 2.9% on a yoy basis in May from 3.4% in April.
- **South Korea:** Bank of Korea cut the policy rate by 25bps to 0.5%, in line with consensus expectations. Industrial production declined by 6.0% in April after rising 4.7% in March with lower exports and inventory overhang explaining the decline. Exports remained subdued in May, contracting 23.7% on a yoy basis after -25.1% in April. China was the only destination recording higher export volumes during the month.
- **Turkey:** The yoy rate of real GDP growth declined to 4.5% in Q1 2020 from 6.0% in Q4 2019. This was worse than the 4.9% yoy consensus expectation.
- **Taiwan:** Manufacturing PMI inched lower to 41.9 in May from 42.2 in April, the lowest reading since 2009, with new export orders declining the most.

Global backdrop

• **EU:** The EU Commission President Ursula von der Leyen announced a EUR 750bn EU-wide public investment plan to reduce the impact of the coronavirus comprising of EUR 250bn of subsidised loans and EUR 500bn of grants. Under the plan, originally put forward by Angela Merkel and French President Emmanuel Macron, the ten countries with above average per-capita GDP will receive 24.5% of allocation. Another twelve countries with below-average income, but low levels of debt, will receive 25% of the allocation. Finally, countries with below-average GDP per capita and high debt will receive 50.5% of the allocation.[2] Denmark and Sweden indicated that they are ready to negotiate the recovery fund proposal. They had previously objected to any transfer mechanism funded by borrowed money from within the EU budget. The EU budget commissioner Johannes Hahn proposed new taxes, including an annual levy on 70k large companies with global turnover exceeding EUR 750m targeting EUR 15-20bn per year.

In other news, loans from non-financial corporations declined to EUR 73bn in April from USD 121bn in March. However, loans are still much higher than the 3-month moving average of around EUR 25bn prior to the coronavirus shock, highlighting the challenges in the real economy. The rate of CPI inflation at EU level declined to 0.1% on a yoy basis in May from 0.4% in April in line with consensus expectations. The rate of Italian real GDP growth contracted by 20% in Q1 2020 as a result of the lockdown, mostly driven by weakness in domestic consumption.

[2] High-income group: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, Netherlands and Sweden.
Low-income and high-debt group: Portugal, Italy, Greece, Spain and Cyprus.
Low-income and low-debt group: Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Malta, Poland, Romania, Slovenia, Slovakia.

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Global backdrop

- **US:** Several cities imposed curfews over the weekend due to widespread protests against the killing of George Floyd by a police officer last Monday. The protests were mostly peaceful, but some turned violent at night. Attorney General William Barr described the violence as "domestic terrorism". The turmoil adds to an already unstable social situation as thousands of lives and millions of jobs have been lost during the coronavirus crisis. The virus has impacted the vulnerable lower income segments of the population the most, thereby exacerbating already elevated levels of inequality in the United States.

In other news, US economic data mainly beat expectations last week. New home sales rose by 0.6% in April after a 13.7% decline in March and a 7.4% contraction in February. The consumer confidence index also stabilised, inching up to 86.6 in May from 85.7 in April, mostly driven by the expectations index, which rose to 96.4 from 94.3 over the same period. The improvement likely reflected optimism over the reopening of parts of the US economy. Initial jobless claims rose by 2.1m in the week ending in 23 May, which was down from 2.4m during the previous week, while continuing claims declined to 21m from 25m in the previous week. The decline in continuing claims probably reflects less people receiving jobless insurance through regular state programmes rather than a decline in the rate of unemployment per se. The one notable negative data surprise was durable goods spending, which declined by 17.2% in April following a 16.6% decline in March.

- **Fiscal policy:** The Japanese government approved a record fiscal support package of JPY 117.1tn (21% of GDP) of which 3.7% of GDP will be direct spending. The San Francisco Federal Reserve released a paper estimating that "the fiscal multiplier on government spending when monetary policy is by the zero lower bound is around 1.5".[3] Given the generally high propensity to spend out of fiscal transfers during periods of high unemployment, this suggests that fiscal policy is likely to have a strong effect on growth. Senate Republican leader Mitch McConnell said on Tuesday last week that a fifth bill to provide relief funds to the coronavirus recession is likely.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.79%	10.04%	-15.89%	-4.05%	0.20%	1.27%
MSCI EM Small Cap	2.38%	16.67%	-19.90%	-12.80%	-5.21%	-3.73%
MSCI Frontier	5.84%	12.95%	-17.13%	-10.50%	-2.09%	-0.45%
MSCI Asia	-1.15%	7.72%	-12.05%	0.29%	1.67%	2.29%
Shanghai Composite	-0.07%	3.93%	-6.28%	0.70%	-0.66%	-7.22%
Hong Kong Hang Seng	-4.16%	0.30%	-13.83%	-4.79%	0.59%	-3.82%
MSCI EMEA	3.83%	15.19%	-23.84%	-17.33%	-4.52%	-2.63%
MSCI Latam	6.50%	13.24%	-38.38%	-31.67%	-8.29%	-3.71%
GBI EM GD	5.18%	9.30%	-7.33%	2.05%	1.13%	1.99%
ELMI+	1.47%	2.61%	-6.09%	-2.07%	-0.20%	0.53%
EM FX Spot	2.66%	3.81%	-11.05%	-9.32%	-6.19%	-5.26%
EMBI GD	6.25%	8.64%	-5.90%	0.61%	2.44%	4.28%
EMBI GD IG	4.76%	7.19%	1.36%	9.84%	6.08%	5.37%
EMBI GD HY	8.31%	10.63%	-14.20%	-9.55%	-1.72%	2.97%
CEMBI BD	3.77%	8.02%	-2.97%	3.11%	3.63%	4.33%
CEMBI BD IG	2.64%	6.19%	-0.24%	5.67%	4.51%	4.28%
CEMBI BD Non-IG	5.41%	10.74%	-6.71%	-0.46%	2.42%	4.44%

[3] https://www.frbsf.org/economic-research/publications/economic-letter/2020/may/covid-19-fiscal-multiplier-lessons-from-great-recession/

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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	4.76%	18.19%	-4.98%	12.82%	10.23%	9.84%
1-3yr UST	0.08%	0.21%	2.98%	4.64%	2.67%	1.86%
3-5yr UST	0.26%	0.50%	5.90%	8.03%	4.03%	2.97%
7-10yr UST	0.19%	0.84%	11.07%	14.24%	6.60%	4.72%
10yr+ UST	-1.87%	0.12%	21.05%	26.91%	12.15%	8.50%
10yr+ Germany	-2.93%	0.28%	5.38%	6.83%	6.75%	4.72%
10yr+ Japan	-0.86%	-0.32%	-1.16%	-0.66%	2.06%	3.61%
US HY	4.41%	9.11%	-4.73%	1.32%	3.05%	4.27%
European HY	3.06%	9.61%	-8.09%	-3.07%	0.21%	2.12%
Barclays Ag	0.44%	2.41%	2.08%	5.59%	3.46%	3.28%
VIX Index*	0.00%	-48.62%	99.64%	47.03%	178.16%	96.92%
DXY Index*	-0.31%	-1.02%	1.71%	0.29%	0.86%	0.66%
CRY Index*	0.00%	8.59%	-28.82%	-24.59%	-26.16%	-40.82%
EURUSD	0.32%	0.97%	-0.68%	-0.92%	-0.67%	1.93%
USDJPY	-0.26%	0.01%	-0.98%	-0.48%	-3.42%	-13.80%
Brent	6.17%	64.95%	-43.17%	-41.84%	-25.91%	-42.19%
Gold spot	0.71%	10.49%	14.85%	31.49%	37.65%	46.55%

*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.

Contact

Head office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE
T: +44 (0)20 3077 6000
@AshmoreEM
www.ashmoregroup.com

Bogota
T: +57 1 316 2070

Dubai
T: +971 440 195 86

Dublin
T: +353 1588 1300

Jakarta
T: +6221 2953 9000

Mumbai
T: +9122 6269 0000

New York
T: +1 212 661 0061

Riyadh
T: +966 11 483 9100

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

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