

China reaches landmark investment deal with EU, isolating the US

By Gustavo Medeiros

China reached an investment deal with the EU in spite of warnings from the incoming US administration against rushing into a deal. Brazil's fiscal accounts deteriorated less than expected. South Korea registered stronger than expected economic data. The Central Bank of Turkey hiked its main policy rate by 200bps in a bid to anchor TRY. Argentina's budget deficit was narrower than expected. Russian President Vladimir Putin approved a bill allowing presidents to become senators for life.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.3	–	2.65%
MSCI EM Small Cap	11.0	–	3.20%
MSCI Frontier	10.1	–	1.63%
MSCI Asia	14.3	–	3.08%
Shanghai Composite	11.9	–	3.27%
Hong Kong Hang Seng	8.5	–	2.44%
MSCI EMEA	9.7	–	0.52%
MSCI Latam	12.3	–	1.30%
GBI-EM-GD	4.22%	–	0.35%
ELMI+	1.56%	–	0.41%
EM FX spot	–	–	0.26%
EMBI GD	4.55%	356 bps	0.34%
EMBI GD IG	2.72%	167 bps	0.16%
EMBI GD HY	6.95%	601 bps	0.55%
CEMBI BD	4.04%	328 bps	0.17%
CEMBI BD IG	2.79%	202 bps	0.12%
CEMBI BD Non-IG	5.82%	506 bps	0.24%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	22.1	–	1.82%
1-3yr UST	0.13%	–	0.00%
3-5yr UST	0.37%	–	0.08%
7-10yr UST	0.94%	–	0.34%
10yr+ UST	1.67%	–	1.03%
10yr+ Germany	-0.57%	–	-0.43%
10yr+ Japan	0.00%	–	-0.31%
US HY	4.18%	360 bps	0.56%
European HY	3.40%	406 bps	0.09%
Barclays Ag	0.83%	-11 bps	0.50%
VIX Index*	22.75	–	-0.56%
DXI Index*	89.77	–	-0.56%
EURUSD	1.2251	–	0.29%
USDJPY	103.02	–	-0.76%
CRY Index*	167.80	–	2.51%
Brent	52.9	–	3.14%
Gold spot	1925	–	2.72%

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

Emerging Markets

- China:** China reached an investment deal with the European Union (EU) despite warnings from the incoming US administration over rushing into a deal.¹ The agreement is similar to the recently implemented Regional Comprehensive Economic Partnership (RCEP)² with Asian countries and will improve access for European companies in Chinese markets, while further enhancing China's international influence. The deal highlights the challenges facing the US in maintaining its global economic hegemony and signals a further shift towards a multipolar global system as the balance of power slowly shifts from Washington to Beijing. In other Chinese news, a Caixin article written by Ren Zeping highlighted the growing divide between north and south China since 2014 in terms of economic development. This stands in sharp contrast to the narrowing in differences in living standards within China, which took place in the 1970s.³ The article proposes a number of reforms to improve inequality, including market oriented reforms and free movement of people, most of which Beijing is already pursuing. In economic news, the yoy rate of growth of industrial profits declined to 15.5% in November from 28.2% in October, which is nevertheless still a very solid rate of growth considering the higher base in November. We expect industrial profit to remain solid into 2021 as the economic recovery continues. Finally, the Caixin PMI declined to 53.0 in December from 54.9 in November, surprising consensus expectations to the downside.

Brazil: The primary fiscal balance moved to a BRL 18.2bn deficit in November from a BRL 3.0bn surplus in October, taking the cumulative primary deficit to 8.9% of GDP, which was slightly better than consensus expectations. The ratio of debt to GDP declined 0.7% to 88.1%, while net debt to GDP rose 1.4% to 61.4% due the impact of a stronger BRL on GDP (higher in USD terms). FX reserves correspondingly declined in BRL terms during the month.

¹ See: <https://www.globaltimes.cn/page/202012/1211479.shtml>

² See: *'Asia forms the world's largest trading block, centred on China'*, Weekly investor research, 16 November 2020.

³ See: <https://www.caixinglobal.com/2021-01-02/weekend-long-read-why-chinas-north-south-economic-gap-keeps-getting-bigger-101645586.html>

Emerging Markets

The yoy rate of consumer prices index (CPI) inflation reached 4.2% in the first 15 days of December, constituting a downside surprise relative to consensus expectations. The Governor of Sao Paulo Joao Doria said he will start a programme of vaccinations against the coronavirus for 46m people on 25 January.

- **South Korea:** Industrial production rose 0.3% in November after declining 1.1% in October. The recovery was led by semiconductors. December exports rose 12.6% on a yoy basis, which was twice as fast as consensus expectations, while imports rose 1.8% yoy (versus a -2.8% yoy consensus expectation). Markit's Manufacturing PMI was stable at 52.9, which is the highest level in three years.
- **Turkey:** The Central Bank of Turkey (CBT) hiked its one-week policy rate by 200bps to 17.0% and reiterated its intention to maintain a tight monetary policy stance until inflation has been brought down to target and price stability objectives have been met. The decision brings the ex-ante real policy rate (adjusted by 12m forward inflation expectations) to 6.0%, which is a level that provides a strong incentive for locals to convert their highly dollarised cash balances into TRY. In other news, the yoy rate of CPI inflation rose to 14.6% in December from 14.0% yoy in November, while PPI inflation rose to 25.2% from 23.1%. Both inflation indices surprised consensus expectations to the upside. Markit's Manufacturing PMI declined to 50.8 in December from 51.4 in November.
- **Argentina:** The primary budget deficit narrowed to ARS 59bn, or 0.2% of GDP in November, which is the lowest level since the beginning of the coronavirus pandemic. The improvement was partly due to seasonally lower expenditures alongside some subsidy cuts undertaken in the previous months. Finance Minister Martin Guzman estimates that the primary budget deficit will be 7.0% of GDP at the end of 2020 before narrowing to 4.5% of GDP in 2021. In other news, Argentina's parliament passed a bill to allow abortion.
- **Russia:** President Vladimir Putin signed a bill that grants former Russian presidents broad immunity against prosecution by allowing them to be senators for life. A second bill has also been signed, which allows the president to appoint 30 senators to the Upper House of Parliament, which currently has 170 elected members.

Snippets:

- **Czech Republic:** Markit's Manufacturing PMI rose to 57 in December from 53.9 in November, the fastest acceleration across the region.
- **Hungary:** Manufacturing PMI declined to 51.1 in December from 51.9 in November.
- **India:** Markit's Manufacturing PMI rose to 56.4 in December from 56.3 in November. The current account surplus moderated to USD 15.5bn (2.4% of GDP) in Q3 2020 from USD 19.2bn (3.8% of GDP) in Q2 2020.
- **Indonesia:** Markit's Manufacturing PMI rose to 51.3 in December from 50.6 in November. The yoy rate of CPI inflation rose to 1.7% in December from 1.6% yoy in November.
- **Malaysia:** Markit's Manufacturing PMI rose to 49.1 in December from 48.4 in November. The trade surplus declined to USD 4.1bn, but the cumulative 12-months surplus rose to USD 42.1bn as exports increased 4.3% on a yoy basis and imports declined 9.0% yoy. The yoy rate of CPI inflation declined 1.7% in November from -1.5% yoy in October due to lower fuel, transportation, and housing costs. The rate of core CPI inflation declined to 0.7% on a yoy basis in November from 0.8% yoy in October.
- **Mexico:** The yoy rate of CPI inflation was stable at 3.2% in the first 15 days of December, which is slightly lower than consensus expectations, while the rate of core CPI inflation rose to 3.8% yoy in December from 3.6% yoy in November.
- **Philippines:** Markit's Manufacturing PMI declined to 49.2 in December from 49.9 in November.
- **Poland:** The Manufacturing PMI from Markit rose to 51.7 in December from 50.8 in November.
- **Singapore:** The yoy rate of CPI inflation declined 0.1% in November from -0.2% yoy in October. Industrial production grew at a yoy rate of 17.9% in November after declining 0.8% yoy in October. The recovery was aided by base effects in the electronics and biomedical industries.
- **Thailand:** The trade surplus declined to USD 50m in November from USD 2.2bn in October, driven by an increase in imports and a lesser rise in exports. The Bank of Thailand kept the policy rate unchanged at 0.5%, in line with consensus expectations. In other news, Markit's Manufacturing PMI rose to 50.8 in December from 50.4 in November.

Global backdrop

- United States (US):** The ability of the incoming Biden Administration to effect policy change hinges, to a large extent, on the outcome of the two run-off races for Senate seats in the state of Georgia tomorrow. The odds that the Democrats take control of the Senate have increased from 17% on the 12 November to 43% on 2 January 2021, according to PredictIt, a pollster. This poll is consistent with a poll of polls, which shows both Democratic Party candidates with small leads over Republican candidates, albeit well within margins of error.⁴ In one of the races, incumbent Republican Senator David Perdue has been forced into quarantine one week ahead of the ballot after coming into close contact with someone exposed to the coronavirus. Over the weekend, a recording of the US President Donald Trump on a phone call asking a Georgian election official to 'find' votes in order to overturn president-elect Joe Biden's victory in the state was released.⁵ This could further catalyse participation by pro-Democratic Party voters, tilting the result further in favour of the Democratic Party candidates. If Democrats take both seats in Georgia they will have the same number of Senators as the Republicans. This will grant them a de-facto majority via the Vice Presidential tie-break vote. In the House of Representatives, Nancy Pelosi was re-elected as Speaker for another term. The Democrats plan to reintroduce nine key bills that were rejected by the Trump administration, including an anti-corruption package and expanding the Affordable Care Act ('Obama-Care'). Plans for additional coronavirus relief and a bipartisan infrastructure package are also in the pipeline. Approval of these bills hinges on Democratic Party control of the Senate.

In US fiscal policy news, Trump signed into law a USD 900bn coronavirus stimulus and a USD 1.4trn budgetary bill.⁶ Days later, the Senate overrode Trump's veto of the USD 740bn National Defence Authorization Act, which includes increased pay for troops. Senate leader Mitch McConnell rejected USD 2,000 one-off stimulus checks in spite of demands from Trump and the Democratic Party. This signals that Republicans, no longer in power, will now assume a stance of opposition to greater fiscal spending.

US economic news was mixed. The Conference Board consumer confidence index declined to 88.6 in December from 92.9 in November, while the University of Michigan consumer confidence survey rose to 81.1 from 80.7 over the same period. Manufacturing confidence increased as the Richmond Fed Manufacturing index rose to 19 in December from 11 in November, while Chicago PMI rose to 59.5 from 56.3 over the same period. Labour data was better than expected with initial jobless claims declining to 803k in the week ending on 19 December from 885k in the previous week, while continuing claims were 5.3m in the week ending on 26 December compared to 5.5m the prior week. November housing data was worse than expected with existing home sales down 2.5% and new home sales down 11%. Meanwhile, durable goods orders increased 0.9% in November, while personal income and personal spending declined 1.1% and 0.4%, respectively. The US trade deficit widened by USD 4.5bn to USD 84.8bn in November, exceeding consensus expectations for a USD 81.5bn deficit.

- Coronavirus:** The coronavirus has evolved new variants in the UK and South Africa. The new variants have faster contagion rates, leading many countries in Europe to impose tougher mobility restrictions. In the UK, the return of some pupils to school has been postponed from 4 January to 18 January. The new, more contagious, variants may have lower mortality rates, but they put stress on already heavily utilised healthcare systems, forcing governments to impose lockdowns to prevent deaths. Europe and North America registered 6.0 deaths per million people on a 7-day moving average basis as of 2 January compared to 2.2 back on 25 October. The pace of deterioration is therefore rapid. By contrast, Asian countries are seeing deaths per million below 0.3, including India (0.2 deaths per million). In South America, deaths per million people increased to 2.9 as of 2 January, which is the same level as on 25 October.

Markets continue to discount the coronavirus news due to the recently approved US fiscal package, which provides hope that the economy will remain supported until vaccines can be administered. However, the vaccine campaigns have so far been disappointing in the US, which suggests that it could take longer than expected for full mobility to be restored.

- United Kingdom (UK):** A new trade agreement was reached just days before the 31 December deadline when the UK left the EU, allowing Britain to keep trading goods free of tariffs and quotas. The agreement had few details in key areas beyond goods trade, setting the scene for many negotiations over the next years. The important financial services sector, for example, remains subject to the UK and EU's bespoke regulatory regimes with the EU yet to define equivalence-type provisions in most areas. All considered, the bulk of the economic and political fallout is still to materialise and will be concealed in the short term by the effects of the coronavirus in the economy.

⁴ See: <https://projects.fivethirtyeight.com/georgia-senate-polls/?cid=rrpromo>

⁵ See: <https://news.sky.com/story/trump-recorded-pleading-with-georgia-election-official-to-find-votes-to-overturn-biden-win-12178739>

⁶ See: '[New virus strain risks more stringent lockdowns ahead of vaccines](#)', Weekly investor research, 21 December 2020.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	7.25%	19.61%	18.50%	18.50%	6.45%	13.18%
MSCI EM Small Cap	7.60%	22.10%	19.39%	19.39%	2.90%	8.41%
MSCI Frontier	5.72%	11.22%	1.61%	1.61%	0.07%	6.30%
MSCI Asia	6.68%	18.48%	25.16%	25.16%	8.34%	13.87%
Shanghai Composite	2.41%	7.97%	16.55%	16.55%	4.09%	1.89%
Hong Kong Hang Seng	1.84%	14.33%	-0.03%	-0.03%	0.99%	6.25%
MSCI EMEA	6.50%	16.45%	-6.58%	-6.58%	-2.84%	6.72%
MSCI Latam	11.95%	34.90%	-13.58%	-13.58%	-1.52%	9.27%
GBI EM GD	0.00%	0.00%	0.00%	2.69%	3.00%	6.71%
ELMI+	0.00%	0.00%	0.00%	1.73%	1.13%	3.62%
EM FX Spot	0.00%	0.00%	0.00%	-5.24%	-4.53%	-1.54%
EMBI GD	1.90%	5.80%	5.26%	5.26%	5.04%	7.07%
EMBI GD IG	0.77%	2.96%	8.92%	8.92%	7.38%	7.67%
EMBI GD HY	3.24%	9.33%	0.80%	0.80%	2.38%	6.31%
CEMBI BD	1.47%	4.44%	7.13%	7.13%	6.00%	7.11%
CEMBI BD IG	0.82%	2.71%	7.45%	7.45%	6.34%	6.23%
CEMBI BD Non-IG	2.38%	6.88%	6.61%	6.61%	5.54%	8.56%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	3.84%	12.14%	18.39%	18.39%	14.13%	15.19%
1-3yr UST	0.05%	0.05%	0.00%	3.16%	2.76%	1.91%
3-5yr UST	0.10%	-0.05%	0.00%	6.17%	4.28%	3.01%
7-10yr UST	-0.28%	-1.31%	0.00%	9.98%	6.37%	4.48%
10yr+ UST	-1.18%	-3.00%	0.00%	17.70%	9.85%	7.81%
10yr+ Germany	0.14%	1.15%	0.00%	8.59%	8.02%	6.10%
10yr+ Japan	0.06%	-0.01%	0.00%	-1.87%	1.57%	2.60%
US HY	1.88%	6.45%	7.11%	7.11%	6.22%	8.58%
European HY	0.85%	5.51%	1.92%	1.92%	2.81%	4.81%
Barclays Ag	1.34%	3.28%	9.20%	9.20%	4.84%	4.79%
VIX Index*	0.00%	0.00%	0.00%	65.09%	106.07%	24.93%
DXY Index*	-0.19%	-0.19%	-0.19%	-7.30%	-2.27%	-9.21%
CRY Index*	0.00%	0.00%	0.00%	-9.68%	-13.45%	-4.74%
EURUSD	0.28%	0.28%	0.28%	9.41%	1.52%	13.11%
USDJPY	-0.22%	-0.22%	-0.22%	-4.94%	-8.63%	-13.75%
Brent	2.12%	2.12%	2.12%	-22.89%	-22.29%	42.13%
Gold spot	1.39%	1.39%	1.39%	22.92%	45.51%	79.12%

*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, DX Y and CRY which are shown as percentage change.

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