

## Inflows to China hit a new record

By Gustavo Medeiros and Jan Dehn

Inflows to China hit a new record. Brazil's Butantan Institute gives the all-clear for distribution of the Coronavac vaccine. South Africa's ANC dismisses talk of a country wide economic lockdown. Indonesia's 2020 fiscal deficit was marginally smaller than expected. Ghana's President Akufo Addo was sworn in, but faces challenges in parliament. EM reported strong inflows in the first week of 2021. In the global backdrop, the political unrest in the United States reflects social division and discontent, which will not disappear with the change of president.

| Emerging Markets    | Next year forward PE/Yield | Spread over UST | P&L (5 business days) | Global Backdrop | Next year forward PE/Yield/Price | Spread over UST | P&L (5 business days) |
|---------------------|----------------------------|-----------------|-----------------------|-----------------|----------------------------------|-----------------|-----------------------|
| MSCI EM             | 13.9                       | –               | 4.83%                 | S&P 500         | 19.9                             | –               | 1.87%                 |
| MSCI EM Small Cap   | 11.3                       | –               | 3.04%                 | 1-3yr UST       | 0.13%                            | –               | -0.04%                |
| MSCI Frontier       | 10.4                       | –               | 2.32%                 | 3-5yr UST       | 0.48%                            | –               | -0.35%                |
| MSCI Asia           | 14.9                       | –               | 5.22%                 | 7-10yr UST      | 1.11%                            | –               | -1.40%                |
| Shanghai Composite  | 12.0                       | –               | 2.79%                 | 10yr+ UST       | 1.86%                            | –               | -3.94%                |
| Hong Kong Hang Seng | 8.8                        | –               | 2.03%                 | 10yr+ Germany   | -0.53%                           | –               | -0.64%                |
| MSCI EMEA           | 9.9                        | –               | 2.36%                 | 10yr+ Japan     | 0.00%                            | –               | -0.20%                |
| MSCI Latam          | 12.8                       | –               | 3.59%                 | US HY           | 4.16%                            | 348 bps         | 0.23%                 |
| GBI-EM-GD           | 4.28%                      | –               | -0.70%                | European HY     | 3.29%                            | 392 bps         | 0.43%                 |
| ELMI+               | 1.77%                      | –               | -0.01%                | Barclays Ag     | 0.87%                            | -24 bps         | -0.46%                |
| EM FX spot          | –                          | –               | -0.43%                | VIX Index*      | 21.56                            | –               | -1.19%                |
| EMBI GD             | 4.68%                      | 348 bps         | -0.81%                | DXI Index*      | 90.37                            | –               | 0.50%                 |
| EMBI GD IG          | 2.87%                      | 161 bps         | -1.31%                | EURUSD          | 1.2192                           | –               | -0.46%                |
| EMBI GD HY          | 7.02%                      | 588 bps         | -0.22%                | USDJPY          | 104.13                           | –               | 0.97%                 |
| CEMBI BD            | 4.14%                      | 320 bps         | -0.26%                | CRY Index*      | 173.35                           | –               | 5.55%                 |
| CEMBI BD IG         | 2.90%                      | 195 bps         | -0.48%                | Brent           | 55.4                             | –               | 8.38%                 |
| CEMBI BD Non-IG     | 5.91%                      | 496 bps         | 0.03%                 | Gold spot       | 1853                             | –               | -4.64%                |

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

### Emerging Markets

- China:** Foreign investors' flows into Chinese bonds climbed to a record high CNY 1tn (USD 148bn) in 2020, taking the cumulative foreign ownership of Chinese bonds to CNY 3.1tn (USD 475bn). Two-thirds of foreign ownership of Chinese fixed income is concentrated in government bonds. In economic news, the yoy rate of CPI inflation rose to 0.2% in December from -0.5% in November led by higher food prices, while the rate of PPI deflation declined to -0.4% yoy from -1.5% yoy over the same period. With a reading of 56.3 in December, the Caixin services PMI remained within expansionary territory level although slightly down from November (57.8). In other news, the US government continued its campaign of unilateral attacks on China. President Donald Trump signed an executive order banning transactions with eight Chinese apps, including Alipay and WeChat Pay. After some back and forth, the New York Stock Exchange also decided to comply with a US government executive order to delist three Chinese telecommunication companies. Finally, the Trump Administration announced that it will step up ties with Taiwan. In our view, the delisting of Chinese companies from US exchanges is unlikely to have any meaningful impact on Chinese companies' access to capital which is primarily sourced from local banks. Rather, the US campaign against China is more likely to hurt American investors, who will find it more difficult to gain exposure to the most important growth story in the world.
- Brazil:** The Butantan Institute in Brazil announced that the Coronavac vaccine – developed by the Chinese biopharmaceutical firm Sinovac – achieved efficiency ratings of 78% in protecting against the covid-19 coronavirus and 100% in protecting patients in very serious cases. Brazil's Minister of Health said the government will buy 100m doses of Coronavac of which 46m will be received by the end of April. In economic news, the yoy rate of industrial production rose to 2.8% in November from 0.3% in October while the December manufacturing PMI remained at expansionary levels at 61.5 in December (compared to 64.0 in November).

## Emerging Markets

- **South Africa:** Last Friday, the governing African National Congress (ANC) Party dismissed speculation of an imminent hard lockdown of the South African economy in response to the coronavirus outbreak due to concerns over the likely economic and fiscal fallout. Nevertheless the situation remains fluid as President Cyril Ramaphosa is expected to announce mobility restriction measures this week. ANC says vaccines will arrive by early April and that ZAR 20.6bn will be spent to inoculate two-thirds of the population of 58m. In economic news, the ABSA Manufacturing PMI weakened to 50.3 in December from 52.6 in November. This is the lowest level since July.
- **Indonesia:** Finance Minister Sri Mulyani Indrawati said the government's fiscal deficit was IDR 946trn in 2020, which is equivalent to 6.1% of Gross Domestic Product (GDP). This compares to a fiscal deficit of 2.2% of GDP in 2019, but the outturn is better than the government's own target for 2020 of 6.3%, due mainly to lower than anticipated expenditure.
- **Ghana:** President Akufo Addo was sworn-in for a second term but an opposition member of the parliament was elected the speaker of the House of Representatives, potentially complicating the passage of legislation. The closely fought election resulted in a split parliament.
- **Proxy flows and issuance:** Emerging Markets (EM) received USD 3.0bn of inflows based on report of proxy flows by mutual funds publishing daily dealing numbers. Some USD 1.3bn flowed to Dollar-denominated bonds, USD 1.5bn to local currency bonds, and USD 0.2bn to blended debt funds. The strong demand was matched by USD 26bn of net issuance in the first three business days of 2021. Daily flow statistics are only approximate indicators of actual flows, because they miss allocations by investors based in many EM countries as well as institutions flows within segregated mandates (which accounts for the bulk of the flow by larger institutional investors).

### Snippets:

- **Chile:** The yoy rate of consumer prices index (CPI) inflation rose by 0.3% to 3.0% in December driven by clothing, furniture, and home articles, while the rate of core CPI rose by 0.2% to 2.6% yoy as services inflation declined to 1.7% yoy.
- **Colombia:** The yoy rate of CPI inflation rose to 1.6% in December from 1.5% in November, surprising consensus expectations to the upside.
- **Ecuador:** International reserves rose to USD 7.2bn in December from USD 5.1bn in November due to disbursements from multilateral organisations. This is the highest level of reserves in 20 years. The yoy rate of CPI inflation was unchanged at -0.9% in December.
- **Egypt:** The yoy rate of CPI inflation declined to 5.4% in December from 5.7% in November due to lower inflation data.
- **Hong Kong:** The composite PMI declined to 43.5 in December from 50.1 in November, the lowest level since April. In other news, more than fifty former opposition lawmakers and activists were arrested for violating the new national security laws.
- **India:** Services PMI recorded a fourth consecutive month in expansion territory in December (52.3), but declined relative to November (53.7). In other news, tax revenues expanded at a very strong yoy rate of 20% in the October-November period.
- **Mexico:** The yoy rate of CPI inflation declined to 3.2% in December from 3.3% yoy in November, whereas the rate of core CPI inflation rose to 3.8% yoy from 3.7% yoy over the same period.
- **Peru:** The yoy rate of CPI inflation declined to 2.0% in December from 2.1% yoy in November.
- **Philippines:** The yoy rate of CPI inflation rose to 3.5% in December from 3.2% yoy in November, which is the highest level since March 2019. The increase was due to a rise in volatile food prices. The trade deficit was unchanged at USD 1.7bn in November.
- **Poland:** The yoy rate of CPI inflation declined to 2.3% in December from 3.0% yoy in November.
- **Sri Lanka:** The government announced that airports will re-open for foreign tourists from 21 January and that the government hopes to receive 1.5m tourists in 2021. This would represent a tripling of inbound tourists compared to 2020, but fall shy of the 1.9m people who visited Sri Lanka as tourists in 2019.
- **Taiwan:** Exports rose at a yoy rate of 12% in December, unchanged from November. Meanwhile, the yoy rate of import growth softened. The trade surplus increased USD 5.8bn from USD 5.3bn over the same period.
- **Turkey:** The current account deficit widened to USD 4.1bn in November from USD 0.3bn in October, slightly wider than consensus expectations. The unemployment rate was unchanged at 12.7% in October.
- **Thailand:** The yoy rate of CPI deflation declined to -0.3% in December from -0.4% yoy in November.
- **Uruguay:** The yoy rate of CPI inflation declined to 9.4% in December from 9.6% yoy in November.
- **Venezuela:** The EU issued a statement denouncing the lack of plurality of parties, credibility and transparency. In the statement, the EU refers to Juan Guaido as part of the opposition member from the outgoing 2015 elected National Assembly.<sup>1</sup>

<sup>1</sup> See <https://www.consilium.europa.eu/en/press/press-releases/2021/01/06/venezuela-declaration-by-the-high-representative-on-behalf-of-the-european-union-on-the-situation/>

## Global backdrop

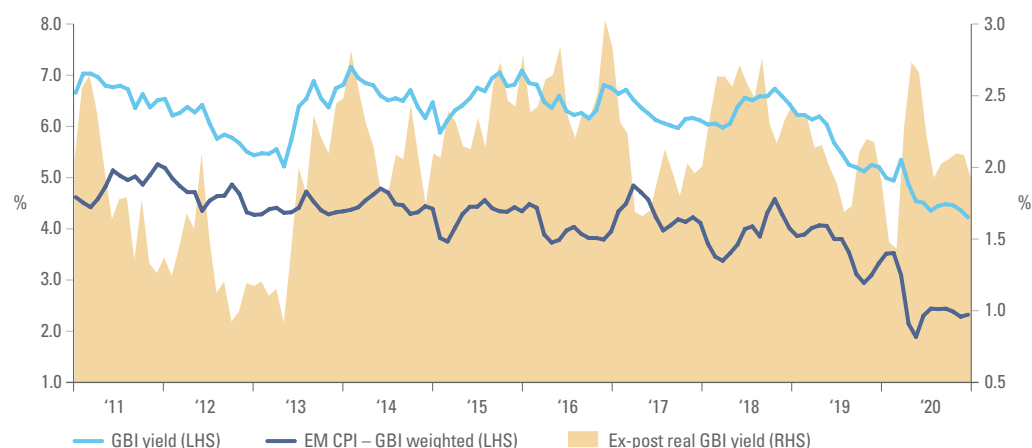
- United States (US):** President Donald Trump's overt encouragement of far-right insurgents, who briefly occupied the Capitol Building appears to have back-fired with mounting pressure on the President to resign or face a second impeachment attempt. Trump has only 9 days left in office, so a second attempt at impeachment is a strategy to force Republican Congressman to 'take blame' for Trump's mistakes and disqualify Trump from future public office, in our view. The change of president does not remove some of the underlying causes that led to the violent in Capitol Hill on 6 January, including high unemployment, excessive levels of debt, rising income inequality and lack of competitiveness due to the strong Dollar. The incoming Biden Administration will inherit a country divided and deeply discontented. On the Right in American politics, politicians are already vying to become the Republican Party's next leader in a bid to take over the 74.2m votes that were cast in support of Trump in November.

The Democratic Party won de facto control of the Senate after securing the remaining two Senate seats in the Georgia Senate race. The Upper House is now split 50-50, but Vice President elect Kamala Harris will have the deciding vote. The control of both Houses of Congress by the Democratic Party should ease the way for confirmation on key appointments and passage of legislation. The Biden Administration faces a tough challenge as it officially takes over the reins on power on 20 January. The coronavirus situation is extremely severe – with deaths equivalent to the total loss of US military personal in the entire Vietnam War every two weeks. Bringing the pandemic under control will undoubtedly have economic consequences, but at the same time the Biden Administration must deliver recovery and confidence that things will improve by the November 2022 mid-term election or risk losing the narrow majority in Congress (and with it the ability to govern effectively). This constellation of circumstances suggests that the Biden Administration will spend heavily. Indeed, Democratic Party Senate Leader Chuck Schumer said that Congress will prioritise USD 2k stimulus cheques to the US population to help them cope with the impact of the coronavirus outbreak. A large infrastructure plan is also being discussed.

US economic data was mixed with weaker than expected labour market data and stronger PMI surveys. The payroll print of -140K suggests a sharp loss of momentum in the US economy following a strong print of +336K in November. Since most of the job losses were concentrated among low paid bar and restaurant workers the average hourly earnings increased to 5.1% from 4.4%. The US trade deficit widened to USD 68.1bn in November from USD 63.1bn in October. The ISM Manufacturing PMI survey rose to 60.7 in December from 57.5 in November with new orders rising to 67.9 from 65.1 over the same period. ISM services rose to 57.2 in December from 55.9 in November.

On the monetary policy front, there were conflicting messages from Fed speakers about future asset purchases. Chicago Fed Chairman Charles Evans and the Atlanta Fed's Chairman Raphael Bostic said they could support a reduction in the pace of the Fed's monthly bond purchase programme (currently USD 120bn per month) before the end of 2021, provided that the economy bounces back strongly. On the other hand, Cleveland Fed Chairwoman Loretta Mester said more fiscal stimulus does not justify a change in the Fed's asset purchase policy, while Federal Reserve Vice Chairman Richard Clarida said that the Fed will maintain the size of its bond purchase programme throughout 2021 and only slow the pace of bond buying 'well down the road'. Clarida said that he is not worried that the 10-year US Treasuries bond yield has moved above 1.0%, suggesting that the Fed is nowhere close to yield curve control to bring down term yields. Yields are rising in response to higher break-even inflation, which hit 2.3% last week (based on 2-year bonds). This indicates that market participants expect US CPI inflation could go well above 2%. This would be permitted by the Fed, whose target is 2.0% on average. On Friday, the 10-year Treasury yield closed at 1.12%, or -0.97% in real terms. To put US yields into EM perspective, Figure 1 shows EM inflation and government bond yields at month-end December 2020. Both are weighted by JP Morgan GBI-EM GD, the most commonly used benchmark index for EM local bonds. Duration is about 5 years. The nominal yield is 4.2%, while inflation is running on an ex-post basis at 2.3%, which means that the real 5-year yield is 1.9% which is close to the average of the last 10 years. In comparison, the real yield on the US 5-year bond was -0.7% on an ex-post basis or -1.65% on an ex-ante basis measured by the US inflation linked government bond.

Fig 1: Index weighted EM local bond yields and CPI inflation



Source: Ashmore, Bloomberg, JP Morgan. Data as at 31 December 2020.

**Global backdrop**

- **European Union (EU) and the United Kingdom (UK):** The UK entered a third national lockdown in a bid to control the more contagious covid-19 strain, which has brought the National Health Service to the brink of collapse. Several EU countries have also imposed new lockdowns. However, vaccination programmes are now underway. Governments are prioritising the oldest and most vulnerable groups, therefore death rates can be expected to start to decline over the coming months as the younger and healthier segments of the population are far less likely to die of coronavirus.
- **Commodities:** The OPEC+ group of oil exporting nations said it would maintain current production, while Saudi Arabia said it would voluntarily cut its own oil production by 1m barrels per day in the months of February and March. Russia and Kazakhstan announced small increases in production over the same period. Oil prices responded positively to the announcement.

**Benchmark performance**

| Emerging Markets    | Month to date | Quarter to date | Year to date | 1 year  | 3 years | 5 years |
|---------------------|---------------|-----------------|--------------|---------|---------|---------|
| MSCI EM             | 4.83%         | 4.83%           | 4.83%        | 24.57%  | 6.68%   | 15.87%  |
| MSCI EM Small Cap   | 3.04%         | 3.04%           | 3.04%        | 25.41%  | 2.86%   | 10.10%  |
| MSCI Frontier       | 2.32%         | 2.32%           | 2.32%        | 5.20%   | 0.09%   | 7.47%   |
| MSCI Asia           | 5.22%         | 5.22%           | 5.22%        | 31.90%  | 8.76%   | 16.53%  |
| Shanghai Composite  | 2.79%         | 2.79%           | 2.79%        | 19.15%  | 4.00%   | 4.62%   |
| Hong Kong Hang Seng | 2.03%         | 2.03%           | 2.03%        | 2.80%   | 0.20%   | 8.57%   |
| MSCI EMEA           | 2.36%         | 2.36%           | 2.36%        | -3.72%  | -2.80%  | 8.84%   |
| MSCI Latam          | 3.59%         | 3.59%           | 3.59%        | -10.79% | -2.11%  | 11.99%  |
| GBI EM GD           | -0.70%        | -0.70%          | -0.70%       | 2.28%   | 2.23%   | 6.95%   |
| ELMI+               | -0.01%        | -0.01%          | -0.01%       | 2.00%   | 0.86%   | 3.98%   |
| EM FX Spot          | -0.43%        | -0.43%          | -0.43%       | -5.15%  | -5.00%  | -1.22%  |
| EMBI GD             | -0.81%        | -0.81%          | -0.81%       | 4.02%   | 4.59%   | 6.95%   |
| EMBI GD IG          | -1.31%        | -1.31%          | -1.31%       | 7.18%   | 6.88%   | 7.36%   |
| EMBI GD HY          | -0.22%        | -0.22%          | -0.22%       | 0.11%   | 2.03%   | 6.41%   |
| CEMBI BD            | -0.26%        | -0.26%          | -0.26%       | 6.34%   | 5.83%   | 7.04%   |
| CEMBI BD IG         | -0.48%        | -0.48%          | -0.48%       | 6.50%   | 6.16%   | 6.10%   |
| CEMBI BD Non-IG     | 0.03%         | 0.03%           | 0.03%        | 6.04%   | 5.40%   | 8.58%   |

| Global Backdrop | Month to date | Quarter to date | Year to date | 1 year  | 3 years | 5 years |
|-----------------|---------------|-----------------|--------------|---------|---------|---------|
| S&P 500         | 1.87%         | 1.87%           | 1.87%        | 19.74%  | 13.81%  | 17.03%  |
| 1-3yr UST       | -0.04%        | -0.04%          | -0.04%       | 3.11%   | 2.78%   | 1.86%   |
| 3-5yr UST       | -0.35%        | -0.35%          | -0.35%       | 5.73%   | 4.25%   | 2.79%   |
| 7-10yr UST      | -1.40%        | -1.40%          | -1.40%       | 8.04%   | 6.05%   | 3.91%   |
| 10yr+ UST       | -3.94%        | -3.94%          | -3.94%       | 12.63%  | 8.83%   | 6.53%   |
| 10yr+ Germany   | -0.64%        | -0.64%          | -0.64%       | 6.71%   | 7.79%   | 5.63%   |
| 10yr+ Japan     | -0.20%        | -0.20%          | -0.20%       | -1.99%  | 1.53%   | 2.37%   |
| US HY           | 0.23%         | 0.23%           | 0.23%        | 7.02%   | 6.02%   | 8.69%   |
| European HY     | 0.43%         | 0.43%           | 0.43%        | 2.29%   | 2.76%   | 4.95%   |
| Barclays Ag     | -0.46%        | -0.46%          | -0.46%       | 8.84%   | 4.74%   | 4.53%   |
| VIX Index*      | -5.23%        | -5.23%          | -5.23%       | 71.66%  | 118.22% | -11.28% |
| DXY Index*      | 0.48%         | 0.48%           | 0.48%        | -7.18%  | -1.61%  | -8.46%  |
| CRY Index*      | 3.31%         | 3.31%           | 3.31%        | -5.86%  | -11.18% | 5.55%   |
| EURUSD          | -0.20%        | -0.20%          | -0.20%       | 9.50%   | 1.33%   | 12.28%  |
| USDJPY          | 0.85%         | 0.85%           | 0.85%        | -5.29%  | -6.41%  | -11.57% |
| Brent           | 6.89%         | 6.89%           | 6.89%        | -14.79% | -20.05% | 75.50%  |
| Gold spot       | -2.40%        | -2.40%          | -2.40%       | 19.70%  | 40.11%  | 69.33%  |

\*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](http://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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