Issued: 22 March 2021

WEEKLY INVESTOR RESEARCH

Ashmore

Orthodox vs. heterodox policies and unintended consequences

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Emerging Markets' (EM) central banks adopted a more orthodox monetary policy stance with Brazil, Russia and Turkey hiking interest rates by a larger magnitude than expected by the consensus. The G7 agreed to boost special drawing rights (SDR) reserves available to IMF members by USD 650bn, supporting EM. After taking a step towards orthodoxy, Turkey subsequently took two steps back as President Erdogan fired the central bank governor. Egypt kept its policy rate unchanged. The Mexican president threatened to change the constitution after the Supreme Court blocked a misguided energy reform. In Colombia, the tax committee in the parliament unveiled a tax reform proposal.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.6	–	-0.80%
MSCI EM Small Cap	10.9	–	0.49%
MSCI Frontier	10.4	–	0.60%
MSCI Asia	14.9	–	-0.73%
Shanghai Composite	11.5	–	-1.40%
Hong Kong Hang Seng	11.6	–	0.99%
MSCI EMEA	9.8	–	-1.16%
MSCI Latam	11.5	–	1.78%
GBI-EM-GD	4.94%	–	0.05%
China GBI-EM GD	3.18%	–	0.10%
ELMI+	2.77%	–	0.34%
EM FX spot	–	–	0.33%
EMBI GD	5.21%	340 bps	0.28%
EMBI GD IG	3.40%	153 bps	0.17%
EMBI GD HY	7.52%	576 bps	0.42%
CEMBI BD	4.47%	296 bps	0.07%
CEMBI BD IG	3.23%	173 bps	-0.08%
CEMBI BD HY	6.12%	460 bps	0.26%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.6	–	-0.74%
1-3yr UST	0.14%	–	0.02%
3-5yr UST	0.84%	–	-0.04%
7-10yr UST	1.68%	–	-0.73%
10yr+ UST	2.38%	–	-0.91%
10yr+ Germany	-0.29%	–	-0.60%
10yr+ Japan	0.63%	–	-0.16%
US HY	4.55%	337 bps	-0.53%
European HY	3.24%	372 bps	-0.06%
Bloomberg-Barclays	1.16%	-52 bps	-0.22%
VIX Index*	20.95	–	0.26%
DXY Index*	92.01	–	0.18%
EURUSD	1.189	–	-0.35%
USDJPY	108.78	–	-0.32%
CRY Index*	188.8	–	-5.00%
Brent	64.3	–	-6.71%
Gold	1,731	–	-0.05%
Bitcoin	57,663	–	2.22%

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

Emerging Markets

- **Orthodoxy vs. heterodox policies and unintended consequences:** The central banks in Brazil, Turkey and Russia opted to increase interest rates by more than had been expected in the market. The gradual normalisation of policy interest rates is the correct decision in the face of rising inflation and rising inflation expectations. In particular, tighter policy is likely to help to anchor inflation expectations and indirectly support currency valuations. In the Developed Markets (DMs), the Japanese and Norwegian central banks also opted for hawkish policy stances. Their orthodoxy stands in sharp contrast with the US Federal Reserve's (Fed) highly accommodative monetary policy stance in spite of rising inflation risks. Last week, the Fed revised its growth and inflation forecasts sharply higher, but decided to keep its monetary policy stance unchanged in accordance with its average inflation target, that is, monetary policy will only be tightened after inflation has risen above 2% and inflation expectations have moved higher on a sustainable basis.

The more orthodox stance adopted by EM central banks and some central banks in DM has partly been forced upon them as a result of the large expansion of fiscal and monetary stimulus in the United States (US). The massive combined stimulus of USD 2.8tn approved by the US Congress over the last few months has increased inflation expectations. In order to hedge the associated inflation risks, investors have added exposure to commodities, thereby driving commodity prices higher, which in turn has created a feedback loop to higher inflation expectations across the globe. This dynamic drove the yield on long US Treasury bonds higher and, for a time, EM currencies lower although by far less than in 2013.[1] Prudently, EM central banks opted to tighten

[1] See *'EM unlikely to be at risk of another 'Taper Tantrum' episode'*, Weekly investor research, 22 February 2021.

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Emerging Markets

monetary policy early rather than risk dislodging inflation expectations, but thereby also risking a lower growth outlook. In other words, US's current policy stance of running the economy 'hot' has unintended and negative consequences for the rest of the world, which is possibly leading to cautious monetary policy decisions elsewhere.

Unfortunately, the US stimulus has so far only supported consumption, while doing nothing to increase the productivity of the economy. Faster growth in the near term may therefore come at the expense of slower growth in the longer term. As for the Fed, it faces two options. It can either maintain the current pro-cyclical stimulative monetary policy regime with larger puchases of long Treasury bonds, as the private sector hedge rising fiscal and inflation risks, or return to more orthodox counter-cyclical monetary policies, which would negatively impact risk sentiment and growth in the short term, but anchor the long end of the US yield curve. A return to more orthodox fiscal policies, including tax increases and/or spending cuts to reduce the large fiscal deficit, would also help to anchor inflation expectations and contain term yields. In both scenarios, however, the US dollar would likely act as an 'escape valve' for the imbalances already generated by the large fiscal and monetary stimuli in recent years. Dollar depreciation would likely be more gradual if ortodoxy was restored via tax increases and potentially much faster if the Fed continues on its current path for too long.

- **SDRs:** The G7 agreed last week to boost the reserves of the International Monetary Fund (IMF) by USD 650bn via the creation of SDRs. The increase in SDRs is USD 150bn higher than initially proposed by the G-20 finance ministers.[2] If approved the SDR increase would boost EM reserves by USD 256.5bn. The top 20 EM beneficiaries of the increased in SDRs would be the countries shown in Figure 1. In reality, most of these countries are unlikely to draw upon their allocations, but poorer EM countries and those without deep local bond markets are likely to benefit significantly, in our view.

Fig 1: **Top 20 EM beneficiaries of an increased in SDRs to USD 650bn**

Country	Total SDR	% of total SDRs	SDR allocation (USD bn)
India	13,114.4	2.8%	17.9
Russia	12,903.7	2.7%	17.6
Brazil	11,042.0	2.3%	15.1
Saudi Arabia	9,992.6	2.1%	13.7
Mexico	8,912.7	1.9%	12.2
Korea, Republic of	8,582.7	1.8%	11.7
Turkey	4,658.6	1.0%	6.4
Indonesia	4,648.4	1.0%	6.4
Poland	4,095.4	0.9%	5.6
Singapore	3,891.9	0.8%	5.3
Venezuela	3,722.7	0.8%	5.1
Malaysia	3,633.8	0.8%	5.0
Iran	3,567.1	0.7%	4.9
Thailand	3,211.9	0.7%	4.4
Argentina	3,187.3	0.7%	4.4
South Africa	3,051.2	0.6%	4.2
Nigeria	2,454.5	0.5%	3.4
United Arab Emirates	2,311.2	0.5%	3.2
Czech Republic	2,180.2	0.5%	3.0
Colombia	2,044.5	0.4%	2.8

Source: Ashmore, IMF.

- **Brazil:** The Brazilian Central Bank (BCB) increased its policy rate by 75bps to 2.75%, surprising consensus expectations for a 50bps hike. BCB's statement after the meeting signalled a desire to front load the hiking cycle in order to rein in inflation expectations. In political news, cardiologist Marcelo Queiroga was nominated as Brazil's new Health Minister. Queiroga has defended the use of masks and advocated in favour of mass vaccinations, but said he will execute the government's policy. The Health Minister replacement was a key request from congress after approving important landmark reforms such as BCB independence and budgetary reforms. President Jair Bolsonaro's rejection rate rose to 54% last week from 48% in January with some 43% of respondents blaming the president for the dismal state of the Covid-19 crisis, which has seen deaths per million in Brazil to

[2] See *'The G-20 proposal to boost IMF's capital is EM supportive'*, Weekly investor research, 1 March 2021.

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Emerging Markets

1,377, which is the 25th worst in the world.[3] Economic data improved with economic activity rising 1.0% in January compared to 0.6% in December. Formal job creation rose 260k over the same period, surprising consensus expectations to the upside. However downside risks to economic activity are likely to be high since mobility restrictions have been imposed by several states where the recent surge in coronavirus cases threaten to overburden the healthcare system. In corporate news, the Chief Executive Officer (CEO) of Banco do Brasil Andre Brandão tended his resignation. Brandão has been at loggerheads with Bolsonaro since announcing initiatives to reduce costs and boost efficiency. Nevertheless, the hawkish stance of BCB, improving prospects of reforms in Congress and the likelihood that the third wave of coronavirus outbreak is nearing a peak should provide support for generally undervalued Brazilian assets, in our view.

- Turkey: The Central Bank of Turkey (CBT) hiked its policy rates by 200bps to 19.0%, 100bps more than consensus expectations, due to concerns over the inflation outlook. The Turkish Lira (TRY) initially reacted well to the decision by rallying 4.7% during the week and 18.3% since Governor Naci Agbal was appointed on 7 November. However, President Recep Tayyip Erdogan, an avid critic of orthodox monetary policy, replaced Agbal over the weekend with Sahap Kavcioglu, an academic from the Marmara University in Istanbul. Mr. Kavcioglu has been an outspoken critic of Agbal's policies. The change in leadership at CBT comes at a time when Turkey's external balances are in a precarious state, which makes this return to heterodox policy particularly dangerous. Net foreign reserves adjusted for reserve requirements and foreign exchange swaps declined to minus USD 61.3bn as of 12 March from minus USD 57.6bn as of the end of October. The decline in the net reserve position is due to deterioration worsening of the current account deficit, which rose to USD 36.8bn (5.1% of GDP) in 2020 compared to a surplus of USD 6.8bn (0.9% of GDP) in 2019. The risk of contagion to other EM countries is negligible, in our view, because Turkey's heterodox policy stance is not replicated in many other EM countries. Besides, Turkey is now a relatively small market within EM. Turkish local currency bonds have steadily declined as a share of the JP Morgan GBI-EM GD, a local currency bond index, as the government has been unable to issue long bonds due to unanchored inflation expectations. Thus, the index weight is now only 2.3%. Turkey makes up just 0.4% of the main EM stock market index, the MSCI EM. Turkey makes up 3.7% of the sovereign Dollar bond index (JP Morgan's EMBI GD) and 3.8% of the main corporate bond index (JP Morgan's CEMBI BD).

- Egypt: The Central Bank of Egypt (CBE) kept its overnight deposit and lending policy rates unchanged at 8.25% and 9.25% respectively, in line with consensus expectations. CBE noted that economic activity indicators are gradually recovering to pre-pandemic levels at the same time that commodity prices have risen to post-pandemic highs, thereby creating greater uncertainty about the future evolution of prices. The yoy rate of urban consumer prices index (CPI) inflation rose to 4.5% in February from 4.3% yoy in January, which is nevertheless still comfortably below the 7% centre of the inflation target. In other news, remittances from foreign workers rose to USD 29.5bn in 2020 from USD 26.8bn in 2019, providing an important backstop for Egypt's external accounts during the coronavirus-induced shock to tourism.

- Mexico: President Andrez Manuel Lopez Obrador attacked federal judges and the judiciary after his electricity bill granting more powers to the state-owned company CFE was suspended. Obrador said he would propose a constitutional reform if judicial system blocks his energy reform, thereby increasing the importance of midterm elections scheduled for 6 June. In other news, the government said it would take care of USD 6bn of 2021 debt service obligations of state oil company Pemex. The company owed USD 113bn at the end of 2020 and has been receiving constant fiscal injections from the government over the last few years.

- Colombia: The Tax Committee of Colombia's parliament released a report recommending tax increases. In particular, the committee recommended:
  - Cutting the number of items exempt from VAT;
  - Increasing the lower VAT bracket rate from 5% to 10%-12%;
  - Raising the tax on pensions and capital income, and;
  - Eliminating the financial transaction tax.

The fiscal reform is critical to Colombia's ratings outlook, in our view. In economic news, retail sales declined at a yoy rate of 6.4% in January, while manufacturing production was down 1.6% yoy, confirming a slowdown in economic activity in January.

Snippets:

- Czech Republic: The yoy rate of retail sales declined 8.0% in January after rising 0.4% yoy in December. Eastern Europe has recently become the region of the world worst hit by the coronavirus pandemic.
- Hungary: The National Bank of Hungary kept its policy rate unchanged at 0.75%, in line with consensus expectations.
- India: The trade deficit narrowed to USD 12.6bn in February from USD 14.5bn in January.

[3] For comparison, deaths per million are 1,851 in the UK (8th worst) and 1,671 in the US (12th worst). See https://www.worldometers.info/coronavirus/ as at 21 March 2021.

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Global backdrop

- **Indonesia:** Bank Indonesia kept its policy rate unchanged at 3.5% in line with consensus expectations. The trade surplus was stable at USD 2.0bn in February and local auto sales declined to 49.2k in February from 52.9k in January (and 85k on average before covid-19).
- **Mozambique:** The central bank kept the policy rate unchanged at 13.25%, seeing the inflation outlook as 'fairly benign' over the forecast horizon and expecting a stronger currency to anchor prices.
- **Nigeria:** The yoy rate of CPI inflation rose to 17.3% in February from 16.5% yoy in January as food prices rose 21.8% yoy from 20.6% yoy over the same period.
- **Panama:** Moody's downgraded Panama sovereign credit rating to 'Baa2' and changed the ratings outlook to stable, thereby bringing the country's rating in line with S&P at 'BBB' and one notch above Fitch at 'BBB-'.
- **Peru:** The Finance Committee of Congress approved a bill allowing a third pension fund withdrawal and increased access to the severance fund.
- Poland: The yoy rate of CPI inflation declined to 2.4% in February from 2.6% yoy in January, while the core rate of CPI inflation declined to 3.7% yoy from 3.9% yoy. The rate of producer price index (PPI) inflation rose to 2.0% yoy from 1.0% yoy. Industrial output rose by 2.7% on a yoy basis in February from 0.9% yoy in January, while retail sales declined at a rate of 2.7% yoy compared to -6.0% yoy over the same period.
- **Romania:** The central bank kept the policy rate unchanged at 1.25% in line with consensus expectations.
- **Saudi Arabia:** Saudi Aramco released its key 2020 results showing USD 76bn of cash flow from operations and USD 27bn capex resulting in USD 49bn free cash flow. The capex guidance for 2021 was upped only USD 35bn suggesting dividend payment remains a top priority.
- **South Africa:** The yoy rate of retail sales declined 3.5% in January from -1.2% yoy in December with the ban of alcohol sales explaining a large portion of the drop.
- **South Korea:** Exports rose on a yoy rate of 12.5% in the first 20 days of March, or 16.1% yoy after adjusting for fewer business days while imports rose 16.3% yoy over the same period, led by machinery imports.
- **Taiwan:** The central bank kept its policy rate unchanged at 1.125% in line with consensus expectations, while revising the 2021 GDP growth forecast to 4.5% (from 3.7%) and inflation to 1.1% (from 0.9%).
- **Tanzania:** President John Magufuli died of an undisclosed disease last week. Magufuli denied the presence of the Covid-19 virus in the country. He will be replaced by Samia Suluhu Hassan, a Zanzibari. She is Tanzania's first female president. Zanzibar merged with Tanganyika only in 1964 after a bloody revolution.
- **Vietnam:** Ratings agency Moody's affirmed Vietnam's credit rating at 'Ba3' and changed the sovereign credit outlook to positive from negative due to "signs of improvements in fiscal strength and potential improvements in economic strength".

Global backdrop

- **United States:** The Fed maintained a very accommodative monetary policy stance last week, pledging to keep the pace of bond purchases at USD 120bn (USD 80bn of US Treasuries and USD 40bn of mortgage-backed securities) per month for the foreseeable future. The dovish stance contrasts with the Fed's own updated economic projections, which point to stronger real GDP growth (6.5% in 2021 versus 4.2% in the previous projection) and higher core personal consumption expenditure (PCE) inflation of 2.4% in 2021 (from 1.8% in the previous forecast). Fed Chairman Jerome Powell said the Fed believes higher inflation to be a transient phenomenon not warranting higher interest rates. Powell did not confirm, nor deny, that the Fed will engage in yield curve control in order to rein long yields, saying rising yields are not a concern as long as financial conditions remain simulative. In fiscal policy news, the Biden administration is said to be planning the first major federal tax hike since 1993 in order to finance infrastructure spending. The tax hike would target companies and those earning more than USD 400K per year.

US economic data was softer than expected with the Citibank Surprise Index dropping to 41.0 from 78.5 in the previous week. Initial jobless claims rose to 770k in the week ending on 13 March from 725k in the previous week, but continuing claims were unchanged at 4.1m in the week ending on 6 March. Retail sales declined 3.0% in February after growing 7.6% January, disappointing consensus expectations. Industrial production was also weaker, contracting 2.2% in February after rising 1.1% in January. Housing market data deteriorated with housing starts down to 1.4m houses in February from 1.6m in January, while mortgage applications declined 2.2% in the week of 12 March compared to -1.3% in the previous week. Surveys capturing expectations of future economic activity remain strong, however. The Empire Manufacturing Index rose to 17.4 in March from 12.1 in February, while the Philadelphia Fed Business Outlook rose to 51.8 from 23.1 over the same period. This is the highest level since 1973.

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Benchmark performance

- **United Kingdom:** The Bank of England (BOE) kept its monetary policy rate and pace of government bond purchase unchanged at 0.1% and GBP 875bn, respectively. BOE noted inflation expectations remain well anchored and pledged not to tighten policy prior to evidence of good progress on inflation, while saying it stands ready to take action in case inflation expectations deteriorate from here.
- **European Union:** Norges Bank, the central bank of Norway, kept its policy rate unchanged at 0%, but indicate that there is a 50% chance of a hike starting in September and 100% from December onwards.
- **Japan:** Bank of Japan (BOJ) widened the range of its 10-year yield target to +/- 25bps from +/- 20bps, while scrapping the JPY 6tn target for equity ETF purchases. ETF purchases will now be restricted to the narrower TOPIX Index (i.e. excluding ETF purchases of the Nikkei 255 and the JPX 400). The decisions amount to a marginal reduction in stimulus. Meanwhile, BOJ announced a scheme that allows interest rebates for banks in case rates move further into negative territory. This measure should increase the flexibility for BOJ to cut rates further if needed.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-0.04%	3.73%	3.73%	78.71%	6.42%	13.10%
MSCI EM Small Cap	1.76%	7.91%	7.91%	109.88%	5.23%	10.18%
MSCI Frontier	0.72%	1.24%	1.24%	43.11%	-0.97%	6.84%
MSCI Asia	-0.84%	4.40%	4.40%	78.80%	8.64%	14.80%
Shanghai Composite	-2.97%	-1.96%	-1.96%	28.97%	3.70%	5.21%
Hong Kong Hang Seng	0.33%	5.08%	5.08%	37.06%	0.04%	9.12%
MSCI EMEA	3.89%	7.05%	7.05%	63.10%	-1.15%	5.90%
MSCI Latam	6.58%	-3.54%	-3.54%	61.92%	-5.01%	4.93%
GBI-EM-GD	-1.28%	-4.95%	-4.95%	20.13%	0.28%	3.82%
China GBI-EM GD	-0.43%	0.80%	0.80%	9.37%	na	na
ELMI+	-0.20%	-1.36%	-1.36%	11.29%	0.05%	2.50%
EM FX spot	-0.28%	-2.19%	-2.19%	8.92%	-5.70%	-2.79%
EMBI GD	-0.58%	-4.17%	-4.17%	24.40%	4.36%	5.19%
EMBI GD IG	-0.88%	-5.54%	-5.54%	17.37%	6.38%	5.37%
EMBI GD HY	-0.25%	-2.58%	-2.58%	33.46%	2.10%	4.93%
CEMBI BD	-0.57%	-0.73%	-0.73%	20.50%	6.12%	6.30%
CEMBI BD IG	-0.86%	-1.81%	-1.81%	13.11%	6.20%	5.30%
CEMBI BD HY	-0.19%	0.72%	0.72%	31.85%	6.02%	7.86%

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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	2.78%	4.54%	4.54%	65.23%	15.13%	16.03%
1-3yr UST	-0.03%	-0.05%	-0.05%	0.89%	2.85%	1.76%
3-5yr UST	-0.43%	-1.27%	-1.27%	0.86%	4.22%	2.37%
7-10yr UST	-2.36%	-5.67%	-5.67%	-2.13%	5.29%	2.53%
10yr+ UST	-5.64%	-14.10%	-14.10%	-9.40%	6.31%	3.20%
10yr+ Germany	-0.95%	-6.59%	-6.59%	-0.97%	5.58%	2.90%
10yr+ Japan	1.13%	-1.15%	-1.15%	-1.67%	0.89%	0.22%
US HY	-0.75%	-0.05%	-0.05%	29.94%	6.46%	7.77%
European HY	0.34%	1.57%	1.57%	29.79%	3.44%	4.75%
Bloomberg-Barclays Agg	-1.42%	-3.97%	-3.97%	9.12%	3.08%	2.84%
VIX Index*	-25.04%	-7.91%	-7.91%	-68.28%	-10.24%	47.85%
DXY Index*	1.25%	2.31%	2.31%	-10.51%	2.40%	-3.80%
CRY Index*	-0.86%	12.51%	12.51%	52.39%	-3.30%	6.59%
EURUSD	-1.56%	-2.70%	-2.70%	10.81%	-3.37%	5.97%
USDJPY	2.07%	5.36%	5.36%	-2.20%	3.32%	-3.19%
Brent	-2.83%	24.05%	24.05%	138.18%	-6.75%	53.77%
Gold	-0.19%	-8.83%	-8.83%	11.43%	30.23%	38.65%
Bitcoin	26.25%	98.86%	98.86%	798.94%	570.59%	13,733.35%

*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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