Issued: 22 June 2015

WEEKLY INVESTOR RESEARCH

Ashmore

Presidential race takes shape in Argentina

By Jan Dehn

The leading contenders in Argentina's upcoming presidential election pick running mates. Colombia's economy shows resilience. Russia's economy adjusts, allowing the central bank to cut rates. The labour market catches up with the rest of the economy in Brazil as business heads are drawn into the Petrobras scandal. India's central bank proposes measures to increase foreign participation in the domestic fixed income markets. Malaysia's inflation may have peaked following the adoption of GST in April and Indonesia's central bank leaves rates unchanged, but eases credit conditions. A dovish Fed shunts expectations for the first hike from September towards December 2015, while the standoff over Greece continues to epitomise the inability of politicians in developed markets to grapple with the underlying economic issues.

Emerging Markets	PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	14.2	–	-0.43%
MSCI EM Small Cap	21.9	–	0.47%
MSCI Frontier	10.9	–	-2.16%
MSCI Asia	12.9	–	-0.97%
MSCI EMEA	13.4	–	1.47%
MSCI Latam	22.9	–	1.17%
GBI-EM-GD	6.80%	–	0.75%
ELMI+	3.86%	–	0.68%
EM FX spot	–	–	0.60%
EMBI GD	5.75%	346 bps	0.28%
EMBI GD IG	4.50%	214 bps	0.62%
EMBI GD HY	7.97%	584 bps	-0.22%
CEMBI BD	5.46%	342 bps	0.09%
CEMBI BD HG	4.37%	233 bps	0.24%
CEMBI BD HY	7.50%	548 bps	-0.20%

Global Backdrop	PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	18.6	–	0.78%
2 year UST	0.65%	–	0.19%
5 year UST	1.62%	–	0.40%
7 year UST	2.32%	–	0.40%
10 year UST	3.11%	–	-0.41%
US HY	6.75%	536	0.12%
European HY	4.77%	471	-0.83%
Barclays Ag	–	446	0.68%
VIX Index*	13.96	–	0.18%
DXY Index*	94.16	–	-0.65%
CRY Index*	222.13	–	-1.40%
EURUSD	1.1338	–	0.50%
USDJPY	123.07	–	0.30%
Brent	63.4	–	1.21%
Gold spot	1196	–	0.61%

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

Emerging Markets

- **Argentina:** Both leading opposition candidates for the upcoming presidential election in Argentina have now chosen their vice-presidential running mates. Daniel Scioli, a Peronist, selected Carlos Zanini, Legal Secretary in the departing administration of Cristina Kirchner. This choice will most likely secure him the support of Kirchner's 20% share of the electorate and thereby make him a strong favourite to become president. The market views Zanini's appointment as indicative of a prolonged standoff with holdout investors. However, it is possible that Zanini, as vice-president, will only have limited powers in a future Scioli administration and his presence is mainly to offer Cristina Kirchner reassurance against potential lawsuits against her from within the current administration after she leaves office. Zanini's appointment does not necessarily mean that 'Kirchnerismo' – a radical populist movement on the fringes of the Peronist party – will be highly influential in a future Scioli administration. Instead, power is likely to be concentrated among the traditional power brokers in Argentina, namely: (a) the presidency; (b) provincial governments and congress; and (c) the unions. Meanwhile, Mauricio Macri, the other leading presidential contender, picked Senator Gabriela Michetti, as his vice-presidential candidate. Michetti has a history of fighting abuse of power in Buenos Aires, so she will appeal to younger, female and more centrist voters, who might find Macri a bit too pro-market. Primaries are in August, the first round presidential election in October and a possible run-off would take place in November. President Kirchner will not be seeking elected office, according to the list of candidates submitted to the election commission by her party on Sunday. For more details on the outlook for Argentina see *"A New Argentina",* The Emerging View, March 2015.

- **Colombia:** Colombia's economy is holding up very well considering the scale of the terms of trade shock inflicted on the oil dependent economy by last year's fall in oil prices. New data for Q1 2015 shows that the economy expanded 2.8% yoy, which was better than expected (2.6% yoy) and also represented a firming in the sequential pace of growth on a seasonally adjusted basis. The sensitivity of Colombia's economy to falling oil prices has been reduced considerably due to deep economic reforms undertaken in the first term of President Juan Manuel Santos.

Continued overleaf

Emerging Markets

- **Russia:** Last year's interest rate increases and weaker RUB – policies adopted in response to last year's fall in oil prices – are now working their way through the Russian economy. The adjustment is pushing down investment spending sharply (-7.6% yoy versus -6% yoy expected), while consumption is also taking a serious hit (retail sales declined 9.2% yoy in May versus -10% yoy expected). Unemployment, however, is holding up well at 5.8%, which suggests that real wages are adjusting rapidly. The central bank cut rates by 100bps to 11.5% in line with expectations. We expect the central bank to continue to cut rates albeit at a moderate pace, balancing the scope for rate cuts with its other objective of re-building reserves (it puts downwards pressure on the RUB and therefore potentially upwards pressure on inflation).

- **Brazil:** The labour market in Brazil is now showing signs of serious weakness. Formal jobs declined by 116,000 in May, nearly twice as bad as expected. The weakness in the formal labour market suggests that the tough medicine dispensed by the current economic team (led by Joaquim Levy) in a bid to rid the economy of the illness inflicted by the previous economic team is beginning to work. We expect inflation to decline sharply over the next twelve months. Services inflation will be adversely impacted by weaker labour market conditions, while the elimination of energy subsidies, which this year pushed up headline inflation will drop out of the IPCA index next year. Meanwhile, it is worth remembering that labour markets typically lag broader economic weakness, so the economic downturn necessitated by irresponsible policies in the past is now likely approaching the deepest part of the trough. In other news, the corruption scandal surrounding Petrobras widened last week with the arrest of senior business leaders, including the CEOs of Odebrecht and Andrade Gutierrez, both major Brazilian conglomerates. By threatening senior members and former members of the government, the Petrobras scandal is currently providing strong incentives for the administration of President Dilma Rousseff to engage in fiscal adjustment.

- **India:** The government continues its incremental easing of access to its domestic fixed income markets. According to government officials, the Reserve Bank of India (RBI) has proposed technical changes to the way quotas for foreign institutional investors are calculated. Specifically, by redefining the currency denomination of the quotas from USD to INR, the available quotas can be increased by up to INR 370bn (equivalent to about USD 5.9bn). If adopted, this would de facto allow foreign investors to increase their holdings of Indian government bonds by about 20%. Having said that, India's stance towards capital account liberalisation continues to be characterised by fear of foreign investment rather than an appreciation of the opportunities greater openness would bring. Oddly, India also continues to be more fearful of flows into its fixed income market than into its equity market. This stance stands in sharp contrast to the approach adopted by China. China appears to have realised that opening markets and pushing aggressively for global reserve currency status for its currency will bring enormous benefits to the country. Such benefits could also accrue to India, but only if policy makers wake up to the opportunities facing them. In other news, it is raining in India. Only a few weeks ago, there were concerns that the monsoon might fall short of expectations with adverse implications for inflation. Those fears have now gone away after fresh meteorological data shows that rains are now higher than normal for this time of year. The RBI recently signalled that it was done cutting rates, barring major economic surprises.

- **Malaysia:** The worst inflationary effects of April's adoption of a more efficient uniform 6% Goods and Services Taxation (GST) tax regime across consumer products may now be over. Both core and headline inflation slowed sequentially in May. Core inflation slowed to 0.3% mom sa from 1.0% mom sa (seasonally adjusted) in April, while headline inflation slowed to 0.2% mom sa from 1.0% mom sa. In year on year terms, inflation is still high and will continue to remain high until next year, when the one-off effects of GST drop out. The adoption of a modern, efficient and non-distortionary tax regime such as GST is likely to have substantial but difficult to quantify positive effects on growth going forward.

- **Indonesia:** Bank Indonesia (BI), the central bank, kept rates unchanged at 7.5% in its June meeting. Inflation has recently been ticking higher amidst marginally softer growth. BI eased credit conditions for the private sector by relaxing loan to value limits for property lending and removing constraints on lending to small and medium sized enterprises. Meanwhile, finance ministry officials say that President Joko Widodo will propose further cuts in electricity subsidies. In their place, the government wants to invest more in infrastructure and target income support more directly at the most needy.

Snippets:

- **China:** Property prices rose in April. This coincided with falling prices in the A-share market, leading to speculation that investors took money from stocks to chase rising real estate prices. We think the welcome correction in the A-share market has more to do with the IPO pipeline, high valuations and expectations of tighter margin.

- **Mexico:** Q1 2015 saw the demand-side of the Mexican economy register its strongest increase, 3.5% yoy, since Q4 2012. Private consumption, construction spending, government spending and exports also increased at a solid pace. Imports softened in a sign that the strong USD versus MXN is having clear positive effects on the trade balance in Mexico.

Continued overleaf

Emerging Markets

- **Panama:** The real economy expanded 5.9% yoy in Q1 2015. Growth was strong despite a sizeable reduction in activity related to the expansion of the Panama Canal.

- **Uruguay:** The first quarter of 2015 saw Uruguay's economy clock up a 4.0% expansion relative to the same period last year. Part of the reason for the strong growth rate was the opening of a major pulp plant. Uruguay is generally a well-managed economy, but the government has found it difficult to invest in infrastructure and its neighbours – Brazil and Argentina – can at times be challenging.

- **Venezuela:** President Nicholas Maduro's approval rating declined to 25.8% in May from 28.2% in March, according to a poll conducted by Datanalisis (Venezuela's most credible pollster). The government is trying to postpone macroeconomic adjustment ahead of upcoming congressional elections to protect its standing among voters, but this does not appear to be working very well. Henrique Capriles, an opposition leader, says that congressional elections will be held on 27 September, but this has not been confirmed. Early elections would be positive, because the government would be able to get on with much needed adjustment sooner.

Global backdrop

The Fed was marginally more dovish than expected last week and its first hike is now expected slightly later – sometime between September and December. This tendency for rate hikes to be postponed reflects recurrent disappointment on the growth front. The first predictions of 'exit velocity' for the US economy can be traced back to 2011. Now, four years later, 'exit velocity' remains elusive, despite stronger data in Q2 following the miserable negative growth print in Q1. The Atlanta Fed's Q2 GDP tracking estimate now sits at 1.9% for Q2, which is an unexciting number given super-easy monetary conditions. Investors should be asking themselves why developed countries are growing so slowly despite so many tailwinds from central banks. There are two reasons, in our view. One is that the easy monetary policies have had a far greater impact on asset prices than the underlying economy. The other is that governments have failed to do enough to deal with the underlying economic problems, such as debt overhangs, falling productivity, medium term fiscal issues, banks, regulation, etc. This poisonous combination of sclerotic growth and inflated asset prices suggests that tighter monetary policies could be very painful, because they will quickly hurt the unproductive economy and, at the same time, cause potentially large losses in financial markets that have grown so dependent on cheap and abundant money. Indeed, asset prices have now reached levels that seem distinctly at odds with the economic fundamentals. The rising USD is hurting exporters in the US, while low bond yields in Europe cannot be justified given the level of debt and the institutional issues afflicting that part of the world.

Greece continues to epitomise what is wrong in developed countries. There is a surreal quality to the Greek crisis. Greece is clearly labouring under a debt burden that it cannot handle. Yet, no one wants to accept the political cost of recognising this fact. Realistically, Greece needs a debt to GDP ratio about 100% of GDP lower than today. The only way to achieve this is to inflict a haircut upon those who have lent Greece money, mainly other European countries, the ECB and the IMF. But in accepting the haircut, they will run into trouble with voters in their own countries. This week will see further top level talks to find a solution. Without one, Greece defaults to the IMF in late June and then defaults to the ECB in late July. There are two conceivable solutions. Firstly, either Greece and her creditors reach a compromise where by Greece gets more money in exchange for accepting more reforms, creditors take greater NPV losses and the ECB continues to finance Greek banks, or secondly, talks fall apart – in which case Greece eventually defaults to the ECB, loses access to bank funding and spins out of the Eurozone. Capital controls may be employed to buy time, but will not in themselves prevent one of these two outcomes. Note that even if the first outcome – a compromise – occurs it will not actually solve the problem, merely postpone the final reckoning. Indeed, it is this failure to address the fundamental causes of the crisis that is now once again holding investor sentiment hostage to the Greek debacle. A compromise will bring us back to where we are today in a few years' time, just as the compromise around the bailout in 2011 took us to where we are today.

Continued overleaf

Ashmore

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	-2.72%	2.84%	-4.82%	3.78%	3.21%
MSCI EM Small Cap	-2.83%	10.26%	3.09%	9.28%	5.41%
MSCI Frontier	-0.47%	-3.82%	-13.13%	12.71%	6.75%
MSCI Asia	-3.59%	5.57%	5.36%	9.81%	7.48%
MSCI EMEA	-0.68%	2.94%	-15.69%	-1.51%	0.64%
MSCI Latam	2.73%	-4.65%	-23.13%	-7.49%	-5.20%
GBI EM GD	-0.56%	-4.25%	-14.40%	-3.21%	0.84%
ELMI+	0.32%	-0.43%	-9.04%	-1.73%	-0.13%
EM FX Spot	0.17%	-6.05%	-18.37%	N/A	N/A
EMBI GD	-1.41%	1.83%	1.24%	4.49%	6.84%
EMBI GD IG	-1.49%	0.91%	3.07%	3.43%	6.04%
EMBI GD HY	-1.28%	2.98%	-2.50%	6.18%	8.00%
CEMBI BD	-0.80%	3.81%	2.85%	5.46%	6.35%
CEMBI BD HG	-0.80%	2.40%	3.59%	5.00%	6.21%
CEMBI BD HY	-0.81%	6.45%	0.97%	6.64%	6.80%

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	0.24%	3.48%	9.89%	18.31%	15.95%
2 year UST	-0.07%	0.77%	1.23%	0.60%	0.80%
5 year UST	-0.59%	1.19%	2.75%	0.89%	2.64%
7 year UST	-1.43%	0.29%	3.43%	0.95%	3.96%
10 year UST	-3.79%	-5.45%	2.86%	-0.29%	5.17%
US HY	-0.75%	3.39%	0.00%	7.50%	9.11%
European HY	-1.80%	2.29%	1.82%	11.88%	11.37%
Barclays Ag	0.27%	-2.39%	-5.76%	-0.58%	2.38%
VIX Index*	0.87%	-27.29%	28.66%	-22.92%	-48.39%
DXY Index*	-2.83%	4.31%	17.16%	14.47%	9.36%
CRY Index*	-0.47%	-3.41%	-29.02%	-17.11%	-15.44%
EURUSD	3.20%	-6.30%	-16.61%	-9.80%	-7.87%
USDJPY	0.88%	-2.62%	-17.19%	-34.65%	-26.41%
Brent	-3.34%	10.54%	-44.80%	-30.35%	-18.80%
Gold spot	0.42%	0.64%	-9.26%	-23.97%	-3.68%

*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

Beijing
T: +86 10 5764 2601

Bogota
T: +57 1 347 0649

Jakarta
T: +6221 2953 9000

Istanbul
T: +90 212 349 40 00

Mumbai
T: +91 22 6608 0000

New York
T: +1 212 661 0061

Sao Paulo
T: +55 11 3556 8900

Riyadh
T: +966 11 483 9100

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

Washington
T: +1 703 243 8800

Other locations
Shanghai

Bloomberg page
Ashmore <GO>

Fund prices
www.ashmoregroup.com
Bloomberg
FT.com
Reuters
S&P
Lipper