IMF to decide on RMB's SDR inclusion today

By Jan Dehn

The IMF Executive Board will meet today to decide whether to include the Chinese renminbi as part of the Special Drawing Right. In Turkey, Mehmet Simsek replaces Ali Babacan as Deputy Prime Minister with special responsibility for economic affairs. In Brazil, the PT party's Senate leader and a prominent investment bank CEO are arrested as part of the judiciary's ongoing investigation into illegal campaign funding. In Argentina, President-elect Mauricio Macri appoints a highly credible economic team. The Central Bank of Russia re-introduces 1 year FX repos at Libor+300 and Nigeria's central bank cuts rates by 200bps to 11%. Global markets are likely to focus on important meetings at the ECB and OPEC, non-farm payrolls and Fed Chairwoman Janet Yellen's testimony to the US Congress on Thursday.

Emerging Markets	PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.8	–	-2.02%
MSCI EM Small Cap	12.1	–	-1.02%
MSCI Frontier	9.1	–	-2.64%
MSCI Asia	11.3	–	-1.38%
Shanghai Composite	13.3	–	-5.35%
Hong Kong Hang Seng	7.1	–	-4.33%
MSCI EMEA	9.5	–	-4.47%
MSCI Latam	12.9	–	-3.86%
GBI-EM-GD	6.88%	–	-1.47%
ELMI+	4.47%	–	-0.62%
EM FX spot	–	–	-1.20%
EMBI GD	6.04%	380 bps	-0.13%
EMBI GD IG	4.83%	252 bps	-0.14%
EMBI GD HY	7.98%	587 bps	-0.11%
CEMBI BD	6.07%	403 bps	-0.14%
CEMBI BD HG	4.62%	258 bps	0.00%
CEMBI BD HY	8.59%	655 bps	-0.38%

Global Backdrop	PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	16.2	–	0.48%
1-3 year UST	0.95%	–	0.07%
3-5 year UST	1.68%	–	0.20%
7-10 year UST	2.24%	–	0.39%
10+ years UST	3.01%	–	0.50%
US HY	8.52%	694 bps	-0.07%
European HY	4.89%	508 bps	-0.25%
Barclays Ag	–	227 bps	0.20%
VIX Index*	15.12	–	-1.87%
DXY Index*	100.21	–	0.41%
EURUSD	1.0576	–	-0.41%
USDJPY	123.03	–	0.11%
CRY Index*	183.24	–	-0.88%
Brent	45.1	–	0.49%
Gold spot	1056	–	-1.28%

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

Emerging Markets

- China: The IMF Executive Board will meet today to decide whether to include the Renminbi as part of the Special Drawing Right. China's share of global trade and financial flows has steadily risen relative to other countries and President Obama recently acknowledged that SDR inclusion for the Renminbi was now only a technical matter. It remains to be seen what weighting the Renminbi will have in the SDR basket with estimates ranging from 10% to 16%. China is destined to become the world's largest economy. Once living standards in China catch up with those in the West, China will be four times bigger than the United States. Hence, China's currency and her domestic government bond market are likely to eventually replace the US dollar and the US Treasury bond markets as the world's principal benchmark currency and fixed income benchmarks.
- Turkey: Mehmet Simsek, Finance Minister from 2011-2015, replaced Ali Babacan as Deputy Prime Minister with special responsibility for economic affairs. His presence in the Turkish Cabinet will be key to defending the Central Bank's operational independence. He will also be responsible for pushing forward the economic reform agenda. This agenda will compete with the political reform agenda for President Erdogan's political capital. We think Erdogan wants to allocate his political capital primarily towards passing a set of political reforms that would entrench more power in the Presidency.

The central bank left the one-week repo rate (policy rate) unchanged at 7.25%, while the overnight borrowing rate was maintained at 7.25% and the overnight lending rate at 10.75%. This constitutes a relatively tight monetary policy stance as far as the Central Bank is concerned. The Central Bank issued no indicators that it intends to change its stance anytime soon.

Turkish military shot down a Russian military aircraft, which upset President Putin, so much that he promised retaliation. Businesses and ordinary people are likely to pay a modest price for these tensions. Some 2.5% of Turkish exports go to Russia. Exports in turn are about 29% of GDP, so a complete cessation of Turkish exports to Russia (unlikely, in our view) would reduce Turkish GDP by 0.7%. On the other hand, Turkey would also look to import less from Russia, so the impact on GDP would be lower as the impact on net exports would be smaller than the impact on exports. Turkey imports about 55% of its natural gas from Russia, making Turkey Russia's second largest gas client.

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Emerging Markets

- **Brazil:** Delcidio Amaral and Andre Esteves, respectively the PT party's Senate leader and investment bank CEO, were arrested as part of the ongoing investigation into illegal campaign funding by the judiciary. Esteves was quickly replaced by Persio Arida, a former Central Bank governor. As for Amaral's arrest, the crisis has now reached a point where its marginal impact is rising faster for everyone else due to the perception that the whole political class is rotten, than for President Dilma Rousseff, whose reputation is already at rock bottom. This means that incentives for fixing the problem are beginning to improve. The political response to this latest news may therefore turn out to be less negative than expected. The rise of the judiciary and the demise of corrupt officials is positive for Brazil.

The public finances continue to worsen as the economy shrinks without compensating cuts in government spending. October's central government primary deficit was BRL 12.3bn, taking the ytd deficit to BRL 33.1bn, or 0.67% of GDP. The public finances are likely, however, to get a major one-off boost from a successful auction of hydro-energy concessions, which raised BRL 17bn of which BRL 11bn could reach the public finances this year or early next year.

The slowdown in the economy and the weaker currency are radically transforming Brazil's external balances. The three month moving average current account deficit declined to just USD 3.3bn in October compared to USD 10.9bn in January and USD 8.2bn in October last year. The trade balance is now in surplus, the services balance deficit has halved. The deficit on the income balance is also lower and the interest balance is unchanged (not as affected by the domestic economic cycle). Finally, the current account deficit has now declined so much this year that the deficit is now fully covered by Foreign Direct Investment alone.

The monetary policy committee, COPOM, was surprisingly hawkish in its November communique. Two members voted in favour of a 50bps hike and the reference to maintaining a stable policy SELIC rate for a prolonged period was removed. BRL has rallied 10% since its weakest point in September.

- **Argentina:** President-elect Mauricio Macri appointed Alfonso Prat-Gay as Finance Minister. Federico Sturzenegger has been put forward for the post of Central Bank governor. Prat-Gay is a former Central Bank governor with excellent economic credentials. Sturzenegger is a distinguished academic economist and member of parliament. Both are highly credible individuals and they need to be, in our view. Their remit will be to restore equilibrium to a seriously mismanaged economy, resolve a dispute with holdout investors and handle a parliament without the backing of a majority.

- **Russia:** The Central Bank of Russia re-introduced 1 year FX repos at Libor+300. The 2030 US dollar denominated sovereign bonds trade just over 3.1% yield, so this time the facility is not to drive down the sovereign bond yield (unlike the facility put in place in late 2014). The new facility will (a) provide Dollar liquidity for quasi sovereigns with upcoming Dollar repayments, (b) provide Dollar liquidity in general over the upcoming holiday period and (c) facilitate rolls of last year's repos.

- **Nigeria:** The central bank cut rates by 200bps to 11%. Nigeria maintains a de facto currency peg with rationed access to US dollars. The shortage of Dollars reflects an overvalued exchange rate and the rate cut will encourage more domestic demand and result in an ever more overvalued exchange rate. This is bad policy which will keep investors out of Nigeria for the foreseeable future, in our view. Reserves are USD 30bn and falling. Encouraging domestic demand will worsen the excess demand for US dollars and put further downwards pressure on reserves.

Snippets:

- **Colombia:** The central bank hiked the policy rate by 25bps to 5.50% with a hint that more hikes may be coming.
- **Philippines:** Real GDP growth accelerated to 6.0% yoy in Q3 2015 from 5.8% yoy in Q2. Last year the economy grew only 5.5% yoy in the same quarter. Domestic demand is strong due to both private consumption and government spending.
- **Mexico:** Unemployment rose marginally to 4.37% in October from 4.26% in September. The rise was caused by an increase in the participation rate, which is generally a sign of greater confidence in the labour market. Retail sales slowed in September and recent CPI inflation has been softer than expected. Mexico's trade deficit was USD 1.4bn compared to USD 1.8bn expected (October).
- **Singapore:** The economy accelerated at a rate of 1.9% qoq saar in Q3, up from -2.6% qoq saar in Q2.
- **Thailand:** The current account surplus massively beat expectations. The surplus increased to USD 5.2bn in October versus USD 2.8bn expected.
- **Zambia:** Inflation spiked to 19.5% yoy in November from 14.3% yoy in October.

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Global backdrop

Last week the global backdrop for Emerging Markets was moderately negative for several reasons. Firstly, liquidity dropped sharply due to the holiday shortened week in the US. Second, geopolitical tensions rose as markets focused on the spat between Russia and Turkey. Thirdly, markets are increasingly focused on the very big week of data and policy ahead of us. The ECB is deciding on new QE and interest rates on 3 December. OPEC members meet on 4 December. And the US government will release non-farm payroll and ISM data that will go a long way towards cementing market expectations about a possible hike in the US policy interest rate at the FOMC meeting on 16 December. In addition, Fed Chairwoman Janet Yellen is testifying to the US Congress on Thursday.

In the backdrop, we also note the sharp drop in the participation rate in the Japanese labour market, which explains why unemployment fell from 3.4% in September to 3.1% in October. Household spending also declined 2.4% yoy in October, while disposable income was lower. CPI fell 0.1% mom – the third monthly decline and industrial production, while positive, significantly undershot expectations. These are disappointing outcomes that ultimately raise questions about the limitations of the monetary and fiscal stimuli as the sole routes to a healthy economy. Japan, of course, is well ahead of both Europe and the United States on that particular path.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	-2.48%	-11.47%	-16.13%	-3.43%	-2.53%
MSCI EM Small Cap	-1.76%	-5.99%	-9.11%	0.72%	-1.56%
MSCI Frontier	-3.44%	-13.53%	-17.87%	6.13%	1.31%
MSCI Asia	-2.47%	-7.71%	-9.69%	1.58%	1.52%
Shanghai Composite	1.60%	7.91%	32.70%	23.14%	6.22%
Hong Kong Hang Seng	-5.20%	-15.23%	-7.74%	1.59%	-1.56%
MSCI EMEA	-5.03%	-12.43%	-22.08%	-8.20%	-5.32%
MSCI Latam	-0.54%	-25.07%	-33.58%	-15.04%	-11.81%
GBI EM GD	-1.51%	-12.40%	-18.34%	-8.32%	-2.45%
ELMI+	-1.13%	-6.35%	-9.54%	-4.84%	-2.40%
EM FX Spot	-1.69%	-15.78%	-20.63%	-12.20%	-8.67%
EMBI GD	0.10%	2.78%	0.40%	1.92%	5.32%
EMBI GD IG	-0.17%	0.26%	-0.76%	0.74%	4.55%
EMBI GD HY	0.46%	6.21%	1.30%	3.65%	6.47%
CEMBI BD	-0.32%	2.76%	0.78%	2.77%	4.73%
CEMBI BD HG	-0.46%	2.07%	1.07%	2.78%	4.92%
CEMBI BD HY	-0.09%	3.85%	-0.17%	2.82%	4.46%

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	0.76%	3.48%	2.96%	16.75%	14.31%
1-3 year UST	-0.33%	0.45%	0.27%	0.38%	0.62%
3-5 year UST	-0.38%	1.76%	1.53%	1.21%	1.70%
7-10 year UST	-0.44%	2.34%	2.96%	1.39%	4.30%
10+ years UST	-1.23%	-1.29%	2.52%	1.77%	8.05%
US HY	-2.38%	-2.20%	-4.10%	3.32%	6.26%
European HY	0.53%	3.59%	3.32%	8.15%	10.09%
Barclays Ag	0.10%	0.43%	0.77%	2.79%	4.59%
VIX Index*	0.33%	-21.25%	13.43%	-4.73%	-35.77%
DXY Index*	3.37%	11.01%	13.42%	25.02%	23.42%
CRY Index*	-6.32%	-20.32%	-27.96%	-38.71%	-39.21%
EURUSD	-3.91%	-12.60%	-15.35%	-18.56%	-18.88%
USDJPY	2.00%	2.66%	4.05%	49.16%	47.15%
Brent	-9.10%	-21.42%	-35.78%	-59.50%	-47.57%
Gold spot	-7.51%	-11.08%	-13.10%	-38.41%	-23.93%

*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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