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Ashmore

China eases monetary and fiscal policy to counterbalance the negative impact of the coronavirus

By Gustavo Medeiros

China unveiled targeted and sizeable monetary and fiscal measures to smooth the impact of the coronavirus. The province of Buenos Aires fully repaid its obligations as the federal government unveiled a timeline for sovereign debt re-profiling. Moody's downgraded Ecuador's credit rating to Caa1. Brazil, Thailand, Philippines and Russia cut their policy rates by 0.25% each. India kept rates stable but improved the monetary transmission channel to the economy. The Czech Republic hiked the policy rate by 0.25%. The Romanian government collapsed, but President Klaus Iohannis reappoints Prime Minister Ludovic Orban.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.5	–	2.76%
MSCI EM Small Cap	10.6	–	1.23%
MSCI Frontier	10.8	–	-0.60%
MSCI Asia	12.0	–	3.45%
Shanghai Composite	9.5	–	-3.38%
Hong Kong Hang Seng	7.5	–	4.54%
MSCI EMEA	9.2	–	0.16%
MSCI Latam	12.4	–	0.20%
GBI-EM-GD	4.97%	–	-0.06%
ELMI+	3.87%	–	-0.21%
EM FX spot	–	–	-0.30%
EMBI GD	4.77%	315 bps	0.20%
EMBI GD IG	3.32%	167 bps	0.00%
EMBI GD HY	6.75%	516 bps	0.44%
CEMBI BD	4.65%	312 bps	0.33%
CEMBI BD IG	3.43%	189 bps	0.15%
CEMBI BD Non-IG	6.39%	486 bps	0.57%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.3	–	3.21%
1-3yr UST	1.38%	–	-0.11%
3-5yr UST	1.38%	–	-0.27%
7-10yr UST	1.56%	–	-0.43%
10yr+ UST	2.02%	–	-0.44%
10yr+ Germany	-0.41%	–	-1.24%
10yr+ Japan	0.00%	–	-0.41%
US HY	5.27%	354 bps	0.62%
European HY	3.32%	372 bps	0.41%
Barclays Ag	1.28%	-28 bps	-0.70%
VIX Index*	15.32	–	-2.65%
DXY Index*	98.85	–	1.05%
EURUSD	1.0912	–	-1.34%
USDJPY	109.78	–	1.00%
CRY Index*	169.61	–	1.55%
Brent	53.8	–	-1.18%
Gold spot	1575	–	-0.13%

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

Emerging Markets

- **Argentina:** The Province of Buenos Aires (PBA) failed to achieve a deal with bondholders, even after pledging to repay 30% of principal and offering to pre-pay the coupon due in May 2020. However, rather than declare a moratorium, Governor Axel Kicillof announced a full repayment of the USD 250m instalment due in late February using PBA's own resources rather than tapping in federal government coffers.

Kicillof is one of the closest allies of Vice President Cristina Fernandez de Kirchner (CFK). PBA's decision to pay its obligations suggests that either Kirchner does not dictate policy or she favours debt repayment, or perhaps, both. Meanwhile, Finance Minister Martin Guzman unveiled a timeline for re-profiling sovereign debt. A debt sustainability analysis will be unveiled around mid-February after which a proposal will be presented by mid-March. The target is to conclude the re-profiling by the end of Q1-2020. This ambitious and tight time schedule does not leave room for a demand for a large haircut, because any attempt to achieve a large haircut would likely precipitate a long and complicated process of negotiation. The local newspaper Clarin published an article last week quoting unnamed sources suggesting a haircut of 15% and four-year maturity extension. Guzman held a "very constructive meeting" with International Monetary Fund (IMF) Chief Kristalina Georgieva in the Rome. In the meantime, President Alberto Fernandez concluded his tour around Europe where he sought to gather support from Germany, France, Spain and other countries for Argentina's economic strategy, which includes a re-profiling of the country's outstanding debt with the IMF. Argentina needs the support of more than 85% of IMF's board members to re-profile the debt. This in turn requires an almost unanimous support from the large European lenders.

In other news, industrial production rose 1.1% on a seasonally adjusted basis in December.

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Emerging Markets

- China: The People's Bank of China (PBOC) has prevented any significant liquidity disruptions during the coronavirus outbreak by announcing CNY 1.2tn of liquidity injections via reverse repos. The PBOC also unveiled a special loan of CNY 300bn for national and regional banks to enable them to provide financing to secure the availability of medical supplies, particularly in the province of Hubei. In addition, the Ministry of Finance unveiled a series of fiscal measures aimed at supporting treatment and containment of coronavirus, including CNY 66.74bn. Lastly, targeted and 'vigorous' tax incentives aimed at preventing the epidemic from spreading were announced. In other news, China announced the halving of USD 75bn of tariffs on US imports starting on 14 February in a "bid to promote a healthy and stable development of Sino-US economic and trade relations". Finally, we note that China's Caixin Services PMI declined to 51.9 in January from 52.5 in December, while consumer prices index (CPI) inflation on a yoy basis increased to 5.4% in January from 4.5% yoy in December, partly due to African swine fever and partly due to the disruptions in supply caused by coronavirus.

- Ecuador: Moody's downgraded Ecuador's sovereign credit rating from B3 to Caa1, citing a large concentration of maturities in 2022 and the challenging environment in which to implement economic reforms. The downgrade was premature and unjustified, in our view. The IMF and other Multilateral institutions are providing financial support for liquidity, infrastructure and poverty-fighting initiatives, which significantly reduces the risk of default over the next two years. Furthermore, Ecuador still has two full years to roll a USD 2.0bn bond, which matures in 2022. Thus, a standard liability management exercise could significantly reduce uncertainty regarding payment of debt. Lastly, the economic reforms promised by the government for 2020 are much less controversial than the reforms in 2019, when the government attempted to cut the bulk of fuel subsidies in one go. We also believe that Moody's is failing to recognise that Ecuador managed to implement a consistent fiscal consolidation over the last three years. In our view, the main risk in Ecuador is the presidential election in 2021. However, both the front-runners for president; Guillermo Lasso and current Vice President Otto Sonnenholzner, would keep the country on a sensible track with respect to economic policy, while Rafael Correa, who could pose a threat to economic stability, is unlikely to be able to return to the country to contest the election, in our view.

- Brazil: The rate of CPI inflation declined to 4.2% on a yoy basis in January from 4.3% yoy in December, which was 0.15% lower than the consensus expectation. The rate of core inflation fell to 3.0% on a yoy basis in January from 3.1% yoy in December. Inflation should decline further due to the reversal of food price increases in December and the decline in oil and energy prices. The Central Bank of Brazil cut policy rates by 0.25% to 4.25%, which was in line with consensus expectations. In the statement, which followed the meeting, the monetary policy committee signalled the end of the easing cycle. Meanwhile, development bank BNDES sold its BRL 22bn (USD 5.2bn) stake in the state-owned oil giant, Petrobras, in a listing on the local stock exchange. Thus, one of the key privatisation targets of the government has now been achieved. In other news, industrial production declined by 1.2% on a yoy basis in December following a 1.7% yoy decline in November on the back of disappointing capital and durable goods numbers.

- India: The Reserve Bank of India (RBI) kept the policy rate unchanged at 5.15%. RBI also announced measures to improve the monetary policy transmission mechanism, including long-term repo operations and exemptions from cash reserve requirements for loans for small and medium enterprises as well as auto loans and mortgages. The measures should lower the cost of funding for the real economy and thereby support economic growth. In other news, manufacturing Purchasing Managers' Index (PMI) accelerated to 55.3 in January from 52.7 in December in a broad-based recovery.

- Romania: The Romanian government collapsed after losing a no-confidence vote, which had been brought by the opposition PSD party. Romania's President Klaus Iohannis reappointed Ludovic Orban as Prime Minister and announced support for early elections. While Orban's PNL party would welcome parliamentary elections, this is only possible with the support of PSD, which commands a majority, but currently opposes an election. Romania looks likely to be stuck in political gridlock for a few more months, but prospects of a snap election increases towards H2 2020 if PSD continues to lose popular support, which may prompt the party to accept an early election in order to avoid losing even more influence than it has already lost.

- Middle East and North Africa (MENA): PMIs for the MENA region declined to 49.3 in January, which is the first decline to below 50 since 2009. Saudi Arabian PMI was strong at 54.9, anchored by solid domestic demand. However, Egyptian PMI disappointed at 46, which was the lowest level since 2017, mainly due to a slump in export orders.

- Botswana: The 2021 fiscal year government budget was announced with a target reduction of the fiscal deficit to 2.4% of Gross Domestic Product (GDP) from an estimated fiscal deficit of 3.9% of GDP in 2020. The lower deficit is to be achieved through expenditure cuts and small tax increases. Many frontier economies exhibit strong fiscal dominance, so fiscal responsibility is essential to macroeconomic stability. Botswana has a long record of fiscal discipline.

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Emerging Markets

Snippets:

- Angola: The Korean Development Agency for Africa (AKEDA) announced a USD 2bn investment to construct a thermal power plant in Benguela, Angola's second largest city.
- Chile: The rate of CPI inflation surprised to the upside, rising to 3.5% on a yoy basis in January from 3.0% yoy in December. The increase in inflation was mainly due to rising food and transportation prices. The economic activity index IMACEC surprised on the upside with a rise of 1.1% on a yoy basis in December, led by a recovery in mining activity.
- Colombia: The rate of CPI inflation declined to 3.6% on a yoy basis in January from 3.8% yoy in December. The government informed that the 2019 budget deficit was 2.5% of GDP with a primary surplus of 0.5% of GDP. This is the first primary surplus since 2012. The government targets 2.2% of GDP fiscal deficit target for 2020, which corresponds to primary surplus of 0.6% of GDP.
- Czech Republic: The Czech National Bank (CNB) hiked the policy rate by 0.25% to 2.25% in a narrow 4-3 vote, which surprised economists and market participants most of whom had expected no change. CNB justified the hike with reference to persistent domestic inflationary pressures, but is unlikely to start a lengthy hiking cycle given the large divergence between Czech and European rates, in our view. In other news, December industrial production and exports declined by 0.9% and 1.8%, respectively. Retail sales expanded at a rate of 0.4% in the month.
- Hong Kong: January's composite PMI rose to 46.8 from 42.1 in December. The recovery matched the decline in the intensity of street protests. Retail sales were still 19.4% lower in December than in the same month the year before and the rate of real GDP growth was -2.9% on a yoy basis in Q4 2020.
- Hungary: Industrial production declined at a rate of 3.7% in yoy terms in December. Retail sales increased at a yoy rate of 6.1% in December, which was a deceleration from 7.3% yoy in November. In other news, the National Bank of Hungary mopped up HUF 130bn (USD 0.42bn) of liquidity in order to contain currency pressures.
- Indonesia: The rate of real GDP growth was unchanged at 5.0% on a yoy basis in Q4 2019.
- Malaysia: Industrial production surprised on the downside with a decline of 1.3% yoy rate in December after rising at a yoy rate of 2.1% in November. Mining output was the main culprit with a 5% yoy drop. Malaysia's trade balance improved, however. The surplus of MYR 12.6bn in December was due to a surge in exports of 2.7% on a yoy basis and a 0.9% yoy growth rate of imports.
- Mexico: The rate of CPI inflation was stable at 0.5% mom in January. On a yoy basis, inflation increased to 3.2% in January from 2.8% yoy in December, mainly due to base effects.
- Philippines: As expected, the Central Bank cut its policy rate by 0.25% to 3.75% in move designed to be preventative, given the perceived threat to the economy posed by coronavirus. The rate of CPI inflation increased to 2.9% on a yoy basis in January from 2.5% yoy in December, which surprised the consensus expectations to the upside. The yoy rate of core inflation was 3.3% in January, slightly down from 3.1% yoy in December.
- Poland: President Andrzej Duda signed a bill to prevent judges from criticising judiciary reforms. The controversial bill is likely to aggravate the already tense rhetorical disputes between Warsaw and the EU, but is unlikely to have any meaningful near-term economic consequences, in our view.
- Russia: The rate of CPI inflation surprised on the downside at 2.4% on a yoy basis in January compared to 3.0% yoy in December. The Central Bank of Russia (CBR) cut the policy rate by 0.25% to 6.0%, which was in line with expectations. CBR kept the door open for further cuts by emphasising a persistent slowdown in CPI inflation to under the 4.0% target.
- Singapore: The government stepped up precautionary measures against the spread of the coronavirus, thereby also increasing downside risks for economic activity. The actions include the cancellation and deferment of large-scale events as well as the introduction of various checks at workplaces and restrictions on visits to pre-school and eldercare premises.
- South Korea: The rate of CPI inflation rose to 1.5% on a yoy basis in January, thus rising above the 1% threshold for the first time in 12 months. The increase is mainly due to higher oil and agricultural prices.
- Taiwan: January exports surprised on the downside, declining 7.6% on a yoy basis after a 4.0% yoy increase in December. The drop may be attributed to the lower number of business days as a result of the Lunar New Year in January, because daily exports actually improved to USD 1.48bn per day from USD 1.35bn per day on average in 2019. Exports to the US and the EU rebounded the most, whereas exports to China were stable relative to December.
- Thailand: The rate of CPI inflation picked up to 1.1% on a yoy basis in January from 0.9% yoy in December, mainly due to food prices. The rate of core inflation was unchanged at 0.5% yoy.
- Turkey: The rate of CPI inflation increased to 12.2% on a yoy basis in January, which was slightly ahead of consensus expectations.

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Global backdrop

The race for the Democratic Party nomination kicked off in Iowa with a big surprise. Former mayor of South Bend, Indiana, Pete Buttigieg narrowly won the race with 26.2% of the delegates versus 26.1% for Bernie Sanders. Joe Biden finished in a distant fourth place with just 15.8% of the votes. Meanwhile, former New York mayor Michael Bloomberg announced that he will double his already numerous campaign ads in an attempt to position himself as the only credible centre-left alternative capable of defeating Trump. The Democratic nomination process was marred with delays, which allowed the Republican Party to capitalise at Democrats's expense just the Senate acquitted President Donald Trump in the impeachment trial. A new Gallup poll showed Trump's approval rate at 49% compared to 39% in October 2019. According to the same poll, the Republican Party's approval rate jumped to 51%, which is the highest level since 2005.

Global economic data generally improved, but coronavirus continues to be more decisive for sentiment. Global manufacturing PMI rose to 50.3 in January from 49.1 in December, which was the first expansionary print since May 2019. The improvement was broad-based as forward-looking new orders rose to 51.1 in January from 49.2 in December. Oil prices rebounded after crude oil inventories increased by much less than expected and US oil production declined more than anticipated. However, the rebound was short-lived, because OPEC members failed to agree on further cuts in addition to the 500m barrels per day reduction announced earlier in the week. The Financial Times newspaper reported that oil traders now estimate that Chinese oil demand has declined by as much as 25%, thereby reducing global oil demand by around 3%.

US economic data surprised on the upside. ISM manufacturing increased to expansion levels at 50.9 in January after five months below 50 (a reading below 50 signals manufacturing contraction). ISM non-manufacturing accelerated to 55.4 in January from 54.9 in December. The Bureau of Labour Statistics reported 225,000 new jobs created in January, which was slightly above the 211,000 average over the last three months. Average hourly earnings also increased by 3.1% on a yoy basis, but the unemployment rate inched up to 3.6%. Industry lost 12,000 jobs in January, while construction added 44,000 jobs, possibly due to unusually warm weather at the start of 2020. Nominal wholesale inventories declined by 0.2% in December, which was weaker than first unveiled in the advance indicators. Productivity increased at a rate of 1.4% in seasonally adjusted terms in Q4 2019. In other news, the head of the Federal Aviation Administration signalled that the Boeing 737 Max could soon return to the skies in spite of the need for further software adjustments.

In fiscal news, the Congressional Budget Office (CBO) unveiled new projections until 2030. CBO forecasts an average of fiscal deficit of 4.8% of GDP over the next ten years, which implies an explosive path for US federal government debt.

In Europe, the data generally disappointed. December industrial production declined by 3.5% in Germany, mostly due to a drop in construction activity. Industrial production fell in yoy terms by 2.8% in France, mainly due to strikes. There were also declines in Spain, Ireland and Netherlands, thus painting a bleak picture for the overall euro area. German factory orders also disappointed with a decline of 2.1% in December. On the other hand, the forward-looking PMI survey pointed to a recovery in manufacturing as output rose to 48.0 in January from 46.2 in December. The composite PMI increased to 51.3 in January from 50.9 in December.

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Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	2.76%	-2.03%	-2.03%	7.82%	8.80%	5.07%
MSCI EM Small Cap	1.23%	-2.80%	-2.80%	3.25%	3.52%	2.25%
MSCI Frontier	-0.60%	-0.66%	-0.66%	11.21%	6.36%	3.17%
MSCI Asia	3.45%	-1.16%	-1.16%	8.89%	9.93%	5.91%
Shanghai Composite	-3.38%	-5.71%	-5.71%	12.53%	-0.77%	0.76%
Hong Kong Hang Seng	4.54%	-4.14%	-4.14%	0.69%	6.91%	2.03%
MSCI EMEA	0.16%	-4.63%	-4.63%	2.88%	4.48%	1.68%
MSCI Latam	0.20%	-5.40%	-5.40%	0.41%	6.41%	4.16%
GBI EM GD	-0.06%	-1.34%	-1.34%	7.01%	5.55%	2.44%
ELMI+	-0.21%	-1.52%	-1.52%	1.50%	2.95%	1.75%
EM FX Spot	-0.30%	-2.97%	-2.97%	-4.55%	-2.45%	-4.36%
EMBI GD	0.20%	1.73%	1.73%	11.82%	6.50%	6.34%
EMBI GD IG	0.00%	2.29%	2.29%	15.52%	7.49%	5.76%
EMBI GD HY	0.44%	1.08%	1.08%	8.11%	5.45%	7.15%
CEMBI BD	0.33%	1.87%	1.87%	11.77%	6.31%	6.08%
CEMBI BD IG	0.15%	1.74%	1.74%	12.06%	6.13%	5.03%
CEMBI BD Non-IG	0.57%	2.05%	2.05%	11.37%	6.62%	7.85%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	3.21%	3.16%	3.16%	25.43%	15.48%	12.37%
1-3yr UST	-0.11%	0.44%	0.44%	3.76%	1.92%	1.45%
3-5yr UST	-0.27%	1.15%	1.15%	6.08%	2.79%	2.21%
7-10yr UST	-0.43%	2.77%	2.77%	10.78%	4.63%	3.06%
10yr+ UST	-0.44%	6.38%	6.38%	21.13%	8.72%	4.70%
10yr+ Germany	-1.24%	3.58%	3.58%	10.19%	6.24%	3.85%
10yr+ Japan	-0.41%	0.36%	0.36%	3.51%	3.28%	3.73%
US HY	0.62%	0.65%	0.65%	9.66%	5.89%	5.92%
European HY	0.41%	0.51%	0.51%	8.46%	4.04%	4.48%
Barclays Ag	-0.70%	0.57%	0.57%	6.37%	4.12%	2.58%
VIX Index*	-18.68%	11.18%	11.18%	-2.54%	41.20%	-11.09%
DXY Index*	1.50%	2.56%	2.56%	2.29%	-1.93%	4.32%
CRY Index*	-0.41%	-8.71%	-8.71%	-4.74%	-12.59%	-24.17%
EURUSD	-1.63%	-2.68%	-2.68%	-3.23%	2.53%	-3.61%
USDJPY	1.32%	1.08%	1.08%	-0.54%	-3.04%	-8.08%
Brent	-7.48%	-18.47%	-18.47%	-13.35%	-5.10%	-4.64%
Gold spot	-0.91%	3.78%	3.78%	20.37%	27.64%	27.65%

*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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