

# It's not only in DM: Big fiscal expansion from the Andeans

By Gustavo Medeiros

The three largest Andean countries (Colombia, Chile and Peru) announced steps to increase fiscal expansion. Argentina postponed the deadline for the debt restructuring offer until 24 July. Bloomberg reported that India is actively seeking inclusion in the GBI-EM index as the government increased fuel prices to alleviate the fiscal deficit. The Central Bank of Brazil cut policy rates to 2.25% and left the door open for further easing. Bank of Indonesia cut policy rates to 4.25% and said the rupiah remains undervalued. The Central Bank of Poland is concerned over an overvalued Zloty. China's president expressed strong support for African countries.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.5	–	1.55%
MSCI EM Small Cap	11.0	–	1.27%
MSCI Frontier	12.3	–	0.04%
MSCI Asia	13.1	–	1.82%
Shanghai Composite	10.6	–	1.83%
Hong Kong Hang Seng	7.7	–	1.60%
MSCI EMEA	10.1	–	0.43%
MSCI Latam	12.2	–	-0.98%
GBI-EM-GD	4.55%	–	-0.49%
ELMI+	1.87%	–	-0.44%
EM FX spot	–	–	-0.86%
EMBI GD	5.52%	475 bps	0.95%
EMBI GD IG	3.14%	232 bps	0.86%
EMBI GD HY	8.88%	815 bps	1.06%
CEMBI BD	4.99%	440 bps	0.53%
CEMBI BD IG	3.41%	282 bps	0.30%
CEMBI BD Non-IG	7.30%	671 bps	0.84%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.2	–	1.88%
1-3yr UST	0.19%	–	0.01%
3-5yr UST	0.33%	–	0.01%
7-10yr UST	0.70%	–	0.06%
10yr+ UST	1.46%	–	-0.27%
10yr+ Germany	-0.41%	–	0.33%
10yr+ Japan	0.00%	–	-0.36%
US HY	6.44%	578 bps	0.87%
European HY	5.44%	590 bps	0.72%
Barclays Ag	0.98%	28 bps	-0.03%
VIX Index*	35.12	–	-0.97%
DXY Index*	97.49	–	0.79%
EURUSD	1.1199	–	-0.76%
USDJPY	106.89	–	0.33%
CRY Index*	137.97	–	3.65%
Brent	42.0	–	5.84%
Gold spot	1753	–	1.82%

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

## Emerging Markets

- Chile:** President Pinera announced a deal with the opposition that includes up to USD 12bn (c. 5% of GDP) of extra-budgetary fiscal expansion over the next 24 months to enhance economic recovery. The plan will be funded by the issuance of additional debt, redemptions from the sovereign wealth fund and USD 2bn from estimated non-executed budgetary items. The deal includes a commitment to fiscal consolidation after 2022. A constitutional amendment granting the Central Bank the right to purchase bonds on the secondary market was also submitted to parliament.
- Peru:** President Martin Vizcarra announced a PEN 4.0bn (USD 1.1bn) investment plan in highway maintenance creating 500k jobs and a PEN 7.0bn (USD 2.0bn) reconstruction plan for the northern region impacted by floods. The reconstruction will be overseen by the United Kingdom.<sup>1</sup> In other news, GDP growth surprised on the downside, declining by 40.5% on a yoy basis in April from a 16.3% decline in March.
- Colombia:** The fiscal committee agreed to suspend the fiscal rule for 2020 and 2021, allowing for a more significant response against the coronavirus shock. The committee had previously allowed Colombia to run a 6.1% GDP fiscal deficit in 2020. Parliament is discussing a bill that allows some pensioners reaching retirement age to transfer their assets from the private pension system to the public pay-as-you-go system. If approved, this would represent a potential COP 27tn (USD 7.2bn) in transfers, reducing the government's debt position by similar amount by adding future liability risks. In other news, economic activity plunged by 20.1% on a yoy basis in April from -4.9% yoy in March.

<sup>1</sup> <https://www.peruembassy-uk.com/news/2020/6/15/the-united-kingdom-has-won-the-bid-for-a-government-to-government-agreement-with-peru-for-the-reconstruction-of-the-damaged-infrastructure-of-the-northern-regions-affected-by-floods>

## Emerging Markets

- Argentina:** The government extended the deadline for investors to accept the debt restructuring offer until 24 July. President Alberto Fernandez highlighted his intention to change investor's perception on Argentina to a country that serves its obligations. Argentina also published a new offer via press release, but did not officially update the offer at the SEC. The proposal has a higher average coupon and interest payment starting in 2021, reduced nominal haircut to 3% as well as recognised the unpaid interest on existing instruments.
- India:** Bloomberg reported<sup>2</sup> the Indian government is actively seeking to include their local government bonds in the JP Morgan GBI-EM index. Currently eight bonds with a total outstanding amount of INR 6tn (USD 78.7bn) are eligible for 100% ownership by foreign investors, the so called 'fully accessible route' (FAR). Other bonds have a maximum foreign ownership quota of 10%. HSBC estimates potential inflows of USD 14bn into local government bonds based on a full inclusion of the FAR bonds. The process of inclusion is unlikely to be imminent due to operational issues, including settlement of FAR bonds in euroclear. In other news, Fitch kept India's sovereign credit rating at BBB-, but cut its outlook to negative, citing weak growth forecast for 2020 and uncertainty on whether the previously expected growth rates of 6% to 7% per year are achievable given the impact of the coronavirus slowdown on the financial sector. The government increased gasoline prices to INR 5.2 per litre and diesel to INR 5.4 per litre last week, a result of an increase in excise duties and higher international oil price. The government is on track to collect as much as 1.0% of GDP of extra revenues if it keeps the current fuel policy, taking advantage of the oil price decline to cut subsidies and increase taxes on fuel.
- Brazil:** The central bank lowered the selic policy rate by 75bps to 2.25% and kept the door open for further policy cuts depending on the evolution of economic activity and inflation. Retail sales plunged 17.5% in April after a 13.7% decline in March and the economic activity declined by 15.1% on a yoy basis in April, from 1.5% yoy in March. Finance Minister Paulo Guedes pledged to increase economic reforms over the next two to three months after the coronavirus emergency programs are finalised. In other news, the Federal Police arrested Fabricio Queiroz, a former policeman who worked as bodyguard and driver of Senator Flavio Bolsonaro, President Jair Bolsonaro's eldest son. The Senator has been investigated for demanding a salary kickback from his employees, which included Queiroz's wife and two daughters, in the past.
- Indonesia:** The Bank of Indonesia (BI) cut the policy rate by 25bps to 4.25%, in line with consensus expectations. The BI signalled it will continue to strengthen the coordination between monetary and fiscal policy to help the government fund the state budget via purchases of bonds. BI also believes the rupiah remains undervalued, despite the fact that the currency has recovered most of the year-to-date losses against the USD.
- Poland:** Industrial production (IP) declined by 17.0% on a yoy basis in May, an improvement from a -24.6% yoy April and better than -18.0% consensus expectations. Retail sales also surprised on the upside, declining 8.6% on a yoy basis in May from -22.6% yoy in April. The yoy rate of CPI inflation was stable at 2.9%. In other news, the central bank kept interest rates unchanged at 0.1% and voiced concerns over a "visibly strong" PLN rate.
- China:** President Xi Jinping expressed a strong willingness to work with the global community in support of African countries hit by the coronavirus, including the possibility of extending the suspension of debt service beyond 2020 for the worst impacted countries. The PBoC lowered the 14-day reverse repo policy rate to 2.35% from 2.55% as the State Council committee urged banks to lower lending cost to support companies and stabilise the economy.

### Snippets:

- Angola:** Oil production declined to 1,220 thousand barrels of oil per day (mbod) in May from 1,350 mbod in April as the county cut production to comply with the OPEC quota.
- Costa Rica:** The central bank cut the policy rate by 50bps to 0.75% in line with consensus expectations.
- Ecuador:** President Lenin Moreno submitted amendments to the public finance law including a cap on debt to GDP of 57% in 2025, 45% in 2030 and 40% after 2030.
- Egypt:** Egypt requested the United Nations Security Council to mediate negotiations with Ethiopia over the hydroelectric dam on the Blue Nile River after the latest round of direct talks ended without a deal.
- Ethiopia:** The World Bank approved a USD 250m credit line to the country.
- Ghana:** The yoy rate of GDP growth slowed to 4.9% in Q1 2020 from 7.9% yoy in Q4 2020 mostly due to a slowdown in the construction and industrial sectors. The producer price index (PPI) inflation increased to 8.4% on a yoy basis in May from 7.4 yoy% in April.
- Honduras:** President Juan Orlando Hernandez was hospitalised with coronavirus. Doctors said he is in good health despite being diagnosed with pneumonia.

<sup>2</sup> <https://www.bloomberg.com/news/articles/2020-06-16/india-is-said-to-seek-inclusion-in-jpmorgan-global-bond-indexes>

## Emerging Markets

- **Hong Kong:** The government's health official Sophia Chan said public gatherings of up to 50 people would be allowed as the coronavirus remains under control.
- **Kenya:** The country won a UN Security Council seat after defeating Djibouti last Thursday. The seat holder enjoys important influence including the use of sanctions and force to preserve peace as well as allowing voting for the election of judges for the International Court of Justice (ICJ).
- **Mexico:** Unemployed workers withdrew MXN 6.7bn (USD 0.3bn) from pension funds from January to May 2020, a 43% increase on a yoy basis. The congress is debating whether to allow larger redemptions from unemployed workers.
- **Mongolia:** The IMF reviewed the fiscal deficit forecast to 5.1% of GDP and economic growth to contract by 1%.
- **Morocco:** The Central Bank cut policy rates by 50bps to 1.5% as inflation declined to 0.9% on a yoy basis in April. Policymakers expect GDP to contract by 5.2% in 2020 and rebound by 4.2% in 2021.
- **Mozambique:** The central bank cut policy rates by 100bps to 10.25% citing uncertainties over the impact on the economy from the military instability in the north<sup>3</sup> and the coronavirus pandemic.
- **Namibia:** The central bank cut policy rates by 25bps to 4.00%, less than the 50bps cut expected by consensus survey.
- **Nigeria:** Oil production declined to 1,550 mbod in May from 1,790 mbod in April as the country cut production to comply with the OPEC quota.
- **Oman:** The budget deficit narrowed to only OMR 27m (USD 70m) in Q1 2020, a strong improvement when compared to the OMR 307m (USD 797m) deficit in Q1 2019 due to a sharp cut in military expenditures and capex.
- **Pakistan:** The Asian Infrastructure Investment Bank (AIIB) approved a USD 0.5bn loan to assist the country's effort against the pandemic. Foreign direct investment declined 53% to USD 120m in May, accumulating a USD 2.4bn during the first 11 months of the 2019-20 fiscal year ending in June 20, against USD 1.3bn in the same period of the 2018-19 fiscal year.
- **Romania:** The current account deficit narrowed to EUR 0.9bn in April from EUR 1.1bn in the same month of 2019.
- **Russia:** The Central Bank of Russia (CBR) cut its repo policy rate by 100bps to 4.5%, in line with consensus expectations. The CBR signalled further cuts ahead pointing out that inflation may not return to the 4% target even in 2021.
- **Saudi Arabia:** The government announced businesses will be allowed to re-open from 21 June, after three months of lockdowns to slow the coronavirus. Restrictions for religious pilgrimages, international flights and gatherings of more than 50 people will remain in place.
- **Sri Lanka:** The central bank cut the statutory reserve ratio by 200bps to 2%, injecting LKR 115bn (USD 0.6bn) of additional liquidity to money market. The cut came a day after President Gotabaya Rajapaksa criticised the authority for ineffective support to the economy.
- **South Korea:** Exports declined by 7.5% on a yoy basis in the first 20 days of June, but declined by 16.2% yoy on a daily average basis.
- **Taiwan:** The central bank kept policy rate unchanged at 1.125% surprising consensus expectations for a 12.5bps cut, reflecting expectation for an economic recovery in 2H 2020 supported by external demand and a consumption rebound.
- **Ukraine:** In a victory for the government against Ihor Kolomoyskyi and the Surkis' brothers, the Supreme Court ruled that the case related to the 2016 takeover of Privatbank should be heard from the beginning. The ruling allows Privatbank to keep deposit from the Surkis' brothers which were confiscated as compensation for a USD 5.5bn fraud that led to the bank's nationalisation.
- **Uruguay:** The yoy rate of GDP growth dropped by 1.4% on a yoy basis in Q1 2020 after a 0.2% yoy expansion in Q4 2019. A strong performance by domestic consumption and investment partially compensated for a strong contraction in net exports.
- **Venezuela:** Oil production declined to a historic low 570 mbod in May from 624 mbod in April according to the Organization of Petroleum Exporting Countries (OPEC) monthly oil report.
- **Vietnam:** The Asian Development Bank (ADB) estimates that the Vietnamese economy will grow by 4.1% in 2020, the fastest in Southeast Asia. The foreign ministry is considering the possibility of resuming international travel with China, Japan and South Korea.

<sup>3</sup> <https://mg.co.za/africa/2020-05-04-making-sense-of-mozambiques-brutal-insurgency/>

## Global backdrop

- Coronavirus:** The number of daily new cases are increasing in US states where economic activity has normalised such as Arizona, Georgia, Texas and others. In EM, Brazil remains in the spotlight with the number of new daily cases and deaths stabilising at a high plateau last week as total deaths exceeded 50k, only behind the US. The daily case count is accelerating in India, Russia, Pakistan, Mexico, South Africa, Colombia, Egypt and Indonesia. Beijing adopted social mobility restrictions after a one-off spike in cases concentrated in a market. However, the higher number of cases contrasts with a stabilisation in the global daily death count as well as promising announcements on more effective treatment methods and continuous progress in multiple fronts towards a vaccine. The University of Oxford announced the cheap and broadly available steroid dexamethasone cut the risk of death for patients in ventilators by one-third and for patients on oxygen by one-fifth.<sup>4</sup> Furthermore, there seems to be widespread discontent about lockdown policies as the normalisation of economic activity became a priority in most societies. Better treatments, lower political willingness to impose lockdowns and continuous monetary and fiscal support will sustain the global economic recovery, in our view.
- EU:** German Chancellor Angela Merkel said she was “happy” with the basic structure of the EU Recovery Fund. The EU Council President Charles Michel said an ambitious recovery fund is needed based on “solidarity, investment and reforms” and pledged to do everything to agree on a deal before the summer break as the EUR 750bn proposal moves from the consultation to the negotiation phase. The Prime Ministers of Sweden, Denmark, Netherlands and Austria, the so-called ‘Frugal Four’ wrote an op-ed in the Financial Times<sup>5</sup> saying they “fully support the creation of a time-limited European emergency recovery fund” to lend (instead of grant) money to member states more affected by the coronavirus pandemic. Monetary policy remains accommodative. The ECB increased its targeted long term refinancing operations (TLTRO) by EUR 0.55tn in net terms, taking the total outstanding TLTROs to EUR 1.5tn. The cost of TLTRO funds will decline to -1% for one-year contracts from the 24 June. In other news, the yoy rate of CPI inflation declined to 0.1% in May from 0.3% in April, but core CPI was unchanged at 0.9% over the same period as most of the price declines were concentrated in food and energy. The Euro Area ZEW economic sentiment index jumped to 59 in June from 46 in May, mostly buoyed by expectations over improved economic activity in the future.
- US:** Economic data was mixed over the last week with initial jobless claims rising to 1.5k on the week ending in 13 June as continuing claims for the previous week was stable at 20.5k, both disappointing analysts’ expectations and contrasting with the stronger non-farm payroll report in early June. Retail sales rose by 17.7% in May after a 14.7% decline in April, surprising consensus expectations for an 8.4% increase. Durable goods orders increased by 8% in May after a 17.7% decline in April, lower than consensus expectations. Industrial production rose by a mild 1.4% in May after contracting 12.5% in April. The Markit PMI rose to 47.8 in June from 39.8 in May and the Markit Services PMI increased to 44.8 in June from 37.5 in May. On the monetary policy front, Chairman Jerome Powell said the Fed had started buying US corporate bonds on an individual basis, shifting away from ETF purchases which had been implemented from March.
- UK:** The yoy rate of CPI inflation declined to 0.5% in May from 0.8% yoy in April, in line with consensus expectations. The Bank of England kept policy rates unchanged at 0.1% and announced another GBP 100bn of asset purchases while dismissed negative interest rates in the short term.
- Geopolitics:** The foreign ministers of both China and India aimed at a quick de-escalation of the conflict in the Himalayan border saying that “neither side would take any action to escalate matters and instead, ensue peace and tranquillity”. The Secretary of State Mike Pompeo said China has recommitted to the first stage of the trade deal after a secret meeting with senior Politburo member Yang Jiechi in Hawaii. Mr. Jiechi asked the US to respect China’s sovereignty by not interfering in Hong Kong internal affairs. In other news, the US administration appointed Mauricio Claver-Carone to the presidency of the Inter-American Development Bank (IDB), breaking the convention to appoint a Latin American for the institution, in place since the 1960s. Brazil, Colombia and Ecuador endorsed the appointment.

<sup>4</sup> <http://www.ox.ac.uk/news/2020-06-16-dexamethasone-reduces-death-hospitalised-patients-severe-respiratory-complications>

<sup>5</sup> <https://www.ft.com/content/7c47fa9d-6d54-4bde-a1da-2c407a52e471>

## Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	7.87%	18.70%	-9.27%	-0.78%	2.44%	3.39%
MSCI EM Small Cap	9.25%	27.46%	-12.50%	-6.54%	-2.76%	-1.45%
MSCI Frontier	1.49%	14.63%	-15.89%	-10.21%	-2.07%	-0.06%
MSCI Asia	8.38%	16.74%	-4.68%	4.00%	3.91%	4.71%
Shanghai Composite	4.52%	8.63%	-2.05%	3.88%	0.39%	-5.89%
Hong Kong Hang Seng	5.13%	5.44%	-9.41%	-4.02%	2.42%	-1.62%
MSCI EMEA	5.52%	21.55%	-19.64%	-16.63%	-2.24%	-1.45%
MSCI Latam	9.35%	23.83%	-32.61%	-28.60%	-5.64%	-2.50%
GBI EM GD	1.10%	10.50%	-6.31%	0.02%	1.25%	2.33%
ELMI+	1.10%	3.74%	-5.06%	-2.24%	0.13%	0.68%
EM FX Spot	0.92%	4.76%	-10.23%	-9.56%	-5.92%	-5.12%
EMBI GD	3.38%	12.12%	-2.89%	1.11%	3.34%	5.23%
EMBI GD IG	1.43%	8.65%	2.74%	8.71%	6.23%	5.98%
EMBI GD HY	5.87%	16.76%	-9.44%	-7.30%	0.01%	4.34%
CEMBI BD	2.63%	11.02%	-0.28%	4.47%	4.41%	5.08%
CEMBI BD IG	1.76%	8.16%	1.61%	6.10%	4.98%	4.83%
CEMBI BD Non-IG	3.85%	15.25%	-2.91%	2.14%	3.65%	5.46%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.88%	20.41%	-3.19%	7.97%	10.23%	10.20%
1-3yr UST	-0.04%	0.17%	2.93%	4.14%	2.68%	1.85%
3-5yr UST	-0.08%	0.42%	5.81%	7.15%	4.04%	2.99%
7-10yr UST	-0.29%	0.54%	10.75%	12.64%	6.41%	4.85%
10yr+ UST	-0.98%	-0.86%	19.86%	24.41%	11.27%	8.78%
10yr+ Germany	-0.11%	0.16%	5.26%	4.49%	6.54%	5.76%
10yr+ Japan	-0.67%	-0.99%	-1.82%	-2.60%	1.78%	3.44%
US HY	2.55%	11.89%	-2.30%	2.14%	3.81%	4.97%
European HY	2.83%	12.72%	-5.49%	-1.90%	1.03%	3.06%
Barclays Ag	0.72%	3.15%	2.81%	5.05%	3.72%	3.37%
VIX Index*	27.66%	-34.40%	154.86%	128.05%	235.11%	175.67%
DXY Index*	-0.87%	-1.57%	1.14%	1.32%	-0.10%	3.35%
CRY Index*	4.33%	13.29%	-25.74%	-22.71%	-17.13%	-38.19%
EURUSD	0.88%	2.08%	-0.27%	-1.67%	0.39%	-1.44%
USDJPY	0.88%	0.83%	1.58%	0.42%	4.14%	15.36%
Brent	18.99%	84.87%	-36.30%	-35.52%	-7.03%	-33.63%
Gold spot	1.29%	9.68%	15.09%	23.85%	40.11%	47.84%

\*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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