

## Good news in Latin America amidst challenging politics in US and the UK

By Gustavo Medeiros

In Ecuador, a court of appeals upheld a conviction for bribery for former President Rafael Correa, thus barring him from running in the 2021 election. Argentina completed a debt exchange for local law bonds. The Brazilian economy rebounded faster than expected. Mexico unveiled an austere budget for 2021 with a zero fiscal deficit, which could be challenging to achieve. On the other hand, political noise is rising in Peru ahead of elections scheduled for April 2021. Elsewhere, China posted robust credit numbers as the government positioned itself against the sale of TikTok. South African GDP growth plunged in Q2 2020. Nigeria took one step forward and two steps back on liberalisation of market prices. Zambia started to identify holders of its Eurobond ahead of a possible debt restructuring. Bahrain issued USD 1.5bn despite challenging credit metrics. Malaysia kept the policy rate unchanged. In the global backdrop, the number of coronavirus cases increased in Europe and Pfizer, a pharmaceutical company, said it expected a vaccine to be ready before year-end. In the United States, President Donald Trump was accused of misleading the public as natural disasters and social conflict raged across America, while in Great Britain Prime Minister Boris Johnson returned to brinkmanship in the Brexit negotiations.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.5	–	-0.68%
MSCI EM Small Cap	11.9	–	-0.96%
MSCI Frontier	12.7	–	-0.17%
MSCI Asia	14.4	–	-0.74%
Shanghai Composite	12.4	–	-2.83%
Hong Kong Hang Seng	8.4	–	-1.28%
MSCI EMEA	10.4	–	1.29%
MSCI Latam	12.2	–	-1.94%
GBI-EM-GD	4.45%	–	0.17%
ELMI+	2.04%	–	0.24%
EM FX spot	–	–	0.21%
EMBI GD	4.83%	409 bps	-0.54%
EMBI GD IG	2.84%	205 bps	-0.30%
EMBI GD HY	7.51%	681 bps	-0.82%
CEMBI BD	4.41%	388 bps	-0.01%
CEMBI BD IG	2.96%	243 bps	0.02%
CEMBI BD Non-IG	6.50%	598 bps	-0.04%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.1	–	-3.28%
1-3yr UST	0.13%	–	-0.01%
3-5yr UST	0.25%	–	-0.04%
7-10yr UST	0.66%	–	-0.27%
10yr+ UST	1.41%	–	-1.26%
10yr+ Germany	-0.48%	–	0.05%
10yr+ Japan	0.00%	–	0.40%
US HY	5.56%	496 bps	-0.49%
European HY	4.49%	519 bps	0.17%
Barclays Ag	0.89%	23 bps	0.13%
VIX Index*	26.87	–	-6.73%
DXY Index*	93.19	–	0.47%
EURUSD	1.1851	–	0.29%
USDJPY	106.04	–	-0.22%
CRY Index*	146.41	–	-3.28%
Brent	39.9	–	-4.98%
Gold spot	1948	–	0.72%

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

### Emerging Markets

- Ecuador:** Former President Rafael Correa, a defaulter, will not be able to participate in presidential elections in 2021 after a ruling in the court of appeals of the National Court of Justice denied his request to review his conviction for bribery. Meanwhile, market-friendly candidate Guillermo Lasso invited Vice President Otto Sonnenholzer and attorney Alvaro Noboa to join his electoral campaign after announcing that 43 political organisations have joined his campaign. The weight of Ecuador in JP Morgan's index of sovereign external debt, the EMBI GD, increased by 6bps to 1.35% when the old bonds were replaced with the new bonds on the 10 September. Due to the longer maturity profile of the new bonds, the modified duration of Ecuador in the EMBI GD rose from 2.7 to 8.5 years.
- Argentina:** Finance Minister Martin Guzman announced that 99% of bond holders had accepted the terms of the exchange of old local law bonds for new bonds. Ratings agency Standard & Poor's (S&P) upgraded Argentina's sovereign credit rating to CCC+ from selective default ('SD') with a stable outlook. The weight of Argentina's bonds in the EMBI GD increased by 27 bps to 1.50% after the new securities replaced the old bonds in the index. Like in the case of Ecuador, the duration increased as a result of the longer profile of new bonds (from 3.7 years to 7.9 years).

## Emerging Markets

- Brazil:** Retail sales rose by 7.2% in the month of July, which was a surprised upside relative to consensus expectations. This follows an 11.1% expansion in June. As a result of the better economic data, the median average expectation for GDP growth in 2020 improved from -6.6% in June to -5.2% as of August. The wholesale inflation index (IGP-DI) rose 3.9% in the month of August, or 15.2% on a yoy basis, which is the highest level since November 2002 (mainly due to BRL depreciation). High levels of spare capacity in the economy and generally low levels of FX pass-through, IGP-DI notwithstanding, due to recession has kept inflation at low levels. Thus, consumer prices index (CPI) inflation merely inched higher to 2.4% on a yoy basis in August from 2.3% in July. In corporate news, the telecommunication company Oi approved a debt restructuring involving a 55% haircut on local bank and export credit agencies debt versus a haircut of 60% originally proposed. The company will auction off assets as part of the restructuring plan. The state-owned oil giant Petrobras announced a tender offer to repurchase USD 4bn of Eurobonds across the curve. This is more than 10% of the company's outstanding bonds (USD 36.5bn). Petrobras has reduced its Eurobond debt from USD 51bn three years ago.
- Mexico:** Mexico's parliament raised the (non-binding) gross debt limit by 20% of GDP to 70% of GDP for the next four years of the current presidential term ahead of presenting the government's 2021 Budget to Congress. The Budget itself proposes a very austere fiscal stance, including a primary deficit of 0%. While positive, we believe that the administration of President Andres Manuel Lopez Obrador may struggle to achieve this ambitious target, since the Budget makes somewhat optimistic growth and oil production assumptions. In other Mexican news, industrial production (IP) rose by 6.9% in July after a 17.9% rebound in June, but IP still remains 11.6% lower on a yoy basis. CPI inflation rose to a yoy rate of 4.1% in August from 3.6% in July, thus exceeding the 4.0% ceiling of the inflation target for the first time since May 2019.
- Peru:** The level of political noise in Peru is rising steadily ahead of the April 2021 election. Members of parliament have proposed to impeach President Vizcarra over allegations of graft. Vizcarra has vigorously attacked parliamentarians over corruption in the past few years, so they are now aiming to get their own back. An impeachment vote could take place this week. Vizcarra is not running for re-election next year. If he is ousted, the Head of Congress Manuel Merino will take over the running of the country until the election.
- China:** The yield on 10-year government bond rose to 3.15%, the highest level since December 2019. Higher bond yields reflects the strong ongoing economic rebound in China, greater supply of bonds, and less monetary policy easing going forward. Meanwhile, the Chinese government is focussing on ensuring a more effective credit channel. Total social financing (TSF) rose to RMB 3.6tn in August on the back of heavy government bond supply (RMB 1.4tn, resilient corporate bond financing (RMB 363bn) and steady loan growth (RMB 1.3tn). Encouragingly, corporate medium to long term loans increased to RMB 725bn from RMB 596bn last month. Money supply as measured by M1 expanded at a yoy rate of 8.0% compared to 7.0% yoy in July. As companies are borrowing more using longer term loans, they are now in a position to deploy more resources to investment. Meanwhile, the yoy rate of M2 growth slowed to 10.4% from 10.7% yoy last month reflecting a reasonably tight overall money supply, given China's rate of growth. On the inflation front, CPI inflation dropped to 2.4% on a yoy basis in August from 2.7% yoy in July, while PPI inflation was -2.0% yoy in August compared to -2.4% yoy in July. The decline in the rate of CPI inflation was mostly due to lower food price inflation, whereas the slowdown in PPI deflation reflected increasing oil prices and higher construction-related product prices. As far as Sino-US tensions are concerned, the US Department of Defence indicated that it could add SMIC, a Chinese semiconductor firm, to its restricted list, which would make it more challenging for China to purchase chips from its most advanced chip designers. Last week, Beijing positioned itself against the sale of TikTok operations to a competitor, most likely to avoid selling its successful social media algorithm to a US company.
- South Africa:** The real economy contracted by 51% on qoq annualised basis in Q2 2020, which is a record low for the series. The drop in GDP in Q2 was the fourth consecutive quarter of negative growth. GDP is likely to post a strong rebound from here, in our view, although it will take a long time for the economy to regain pre-coronavirus levels of activity as the government is not in a position to stimulate the economy using countercyclical fiscal policy due to the fiscal excesses of previous administrations. The current account swung to a 2.4% of GDP deficit in Q2 2020 from 1.2% surplus in Q1 2020 with the trade surplus almost halving to 2.1% of GDP on reduced export volumes (mainly due to coronavirus pandemic effects). The services balance moved to the widest deficit in nine years at 1.3% of GDP due to lower tourism revenues, while the income account deficit widened to 2.4% of GDP on lower income receipts.
- Nigeria:** President Muhammadu Buhari publicly defended his policies to deregulate fuel and electricity prices as the government seeks to re-engage with multilateral institutions in a bid to secure additional funding. However, the day after his comments the government imposed tighter restrictions on the use of FX for imports of food and fertiliser, thus, increasing distortions in the markets for these important goods.
- Zambia:** The government has begun to identify holders of its Eurobonds as the first step before an expected debt restructuring. Zambia would thus become the third country in the EM sovereign debt space to engage in debt restructuring in the past 12 months following Argentina and Ecuador. The prices of Eurobonds were little changed around 55c, which is not too far from the levels, where Argentina and Ecuador restructured their bonds.

## Emerging Markets

- **Bahrain:** The Kingdom of Bahrain issued a USD 1.5bn dual tranche 7-year Sukuk bond and a 12-year Eurobond at 3.95% and 5.45% yield, respectively. The country managed to issue the new bonds despite challenging credit metrics and poor external picture as oil prices continued to weaken last week. By the end of the year, we expect that Bahrain's debt to GDP ratio could hit 120% as the fiscal deficit is expected to be around 14% of GDP this year, while the current account deficit should be around 8% of GDP.
- **Malaysia:** Bank Negara Malaysia (BNM) kept its policy rate unchanged at 1.75% in line with consensus expectations. The BNM described the current monetary stance as "appropriate" on the back of a strong economic rebound in Q3 2020 and BNM's expectation of greater fiscal spending after the government raised its debt ceiling to 60% of GDP. In economic news, industrial production rose 1.2% in July after declining 0.4% in June.

### Snippets:

- **Angola:** The IMF confirmed that discussions towards a further loan to Angola will take place on 16 September. The government is due to receive two disbursements of USD 561m under the existing programme, which is currently under review. In other news, Moody's downgraded the country's credit rating to Caa1.
- **Chile:** The yoy rate of CPI inflation was unchanged at 2.4% in August, while yoy core CPI inflation was 1.9% over the same period.
- **Colombia:** CPI inflation surprised to the downside in August at 0.0% mom, thus taking the yoy rate to 1.9% from 2.0% yoy in July. The consumer confidence index rose to -25.4 in August from -32.7 in July. The low of -41.3 was in April.
- **Costa Rica:** CPI inflation was stable at 0% in August, unchanged from July. The yoy rate of CPI inflation is -0.1%.
- **Czech Republic:** Industrial production rose at a yoy rate of 4.9% in July from 5.6% yoy in June, surprising consensus expectations to the downside. The trade surplus was EUR 830m in July compared to EUR 870m in June.
- **Egypt:** The yoy rate of CPI inflation declined to 3.4% in August from 4.2% in July.
- **Hungary:** The yoy rate of CPI inflation rose to 3.9% in August from 3.8% yoy in July, driven by core CPI items.
- **India:** Industrial production rose by 7.8% in the month of July from 25.4% in June.
- **Indonesia:** Jakarta's Governor announced that the city will resume large scale social distancing from 14 September onwards after coronavirus cases increased, thus threatening the city's healthcare system.
- **Israel:** Prime Minister Benjamin Netanyahu announced a three-week lockdown in Israel following a resurgence of coronavirus cases.
- **Kazakhstan:** The central bank kept the policy rate unchanged at 9.0%.
- **Kenya:** The World Bank approved a USD 750m loan for a road and fibre optic cabling project in the northeast of the country.
- **Philippines:** The trade deficit widened to USD 1.8bn in July from USD 1.4bn in June. Exports rose by 3.0%, while imports increased 1.9% (slower pace than in the previous two months). Infrastructure-related imports of capital goods and iron ore picked up, but remained subdued compared to pre-coronavirus levels.
- **Russia:** The yoy rate of CPI inflation rose to 3.6% in August from 3.4% in July. Higher food prices were the main contributor to the pickup in inflation. The rate of GDP growth was -8.0% in Q2 2020 following a decline of 8.0% (revised) in the previous quarter.
- **South Korea:** There were 273k jobs lost in August, which is a similar level of job losses as in July. The rate of unemployment dropped to 3.2% in August from 4.2% in July.
- **Taiwan:** Exports rose by 8.3% on a yoy basis in August in a positive surprise relative to consensus expectations.

## Global backdrop

- **Coronavirus:** Albert Bourla, the Chief Executive Officer of Pfizer, a pharmaceutical giant, said the company will know if its Covid-19 vaccine is effective at the end of October and indicated that the company is already manufacturing hundreds of thousands of ampules in anticipation of FDA approval. Coronavirus cases continued to increase in the European Union (EU) with France and the United Kingdom (UK) respectively registering an average of 8k and 3k new daily cases in the past week. On the other hand, a Spanish second wave appears to be subsiding as the average number of daily cases declined to 3k last week from 6k previously. In EM, India's case count continues to accelerate to 91k new daily cases on average, whereas in Brazil the daily case numbers moderated to 27k last week from 46k at the peak in early August.

- **US:** President Donald Trump threatened to punish US companies that create jobs overseas by increasing import taxes to engineer an aggressive re-shoring of production. With less than two months before presidential election, the more hostile stance has a clear political angle, although Trump's first term has been characterised by significant protectionism. The performance of the US economy in Trump's first term provide clear evidence that trade wars have hurt the US economy. This is not only evident in weak economic growth, but also in the external balances. Despite tariffs and the one-sided trade agreement signed with China last year, the US trade deficit continues to widen, while China's trade surplus continues to grow. This illustrates perfectly the fact that external deficits are due to wider macroeconomic imbalances, notably the imbalance between savings and investment. US consumes and invests in excess of its savings rate, wherefore the excess balance of spending has to be financed by the rest of the World. The US trade deficit will only start to narrow when the unsustainable fiscal balance in the US is addressed. Protectionism is economic illiteracy.

In other news, wildfires continue to rage across the US west coast for the second consecutive year, while Louisiana declared a state of emergency after Tropical Storm Sally formed in the Gulf of Mexico. A rising number of natural disasters is exposing President Trump's poor record on environmental issues. Protests are also raging across America over growing inequalities in American society. Last week, journalist Bob Woodward showed that President Donald Trump may have committed a serious breach of governance when he downplayed the severity of the coronavirus to "avoid panic", thus purposefully misleading the American public in the face of a genuine and serious threat, which has now killed nearly 200,000 people. Meanwhile, brinkmanship continues in the US Congress over a new stimulus package despite the expiry of large elements of The Cares Act economic support package.

On the economic front, initial jobless claims rose by 884k in the week ending on 5 September, unchanged from the previous period, while the number of unemployed claiming insurance on a continuing basis rose to 13.4m from 13.3m in the previous week. Inflation was higher than consensus expectations, rising 1.3% on a yoy basis in August from 1.0% yoy in July. The yoy rate of core CPI inflation went up to 1.7% in August from 1.6% yoy in the previous month. Producer prices index (PPI) inflation also increased at a rate of 0.6% on a yoy basis from 0.3% yoy over the same period.

- **UK:** Prime Minister Boris Johnson threatened to override some of the provisions of the Irish protocol in the UK-EU withdrawal Treaty signed last year unless EU offers better terms in a future trade agreement with the UK. The risk of a no-deal Brexit is thus rising unless the UK changes its position. Bank of England Chief Economist Andy Haldane warned that extending the furlough job protection scheme would prevent a necessary adjustment process.

- **EU:** Euro area GDP slumped 39.4% in Q2 2020 due to poor domestic demand and retrenchment in capital spending. The European Central Bank (ECB) said they are monitoring the recent appreciation of EUR as currency appreciation may have a negative impact on inflation. However, ECB President Christine Lagarde played down prospects of currency intervention. While a stronger currency can push down inflation by lowering import prices, Europe is running a major trade surplus and a stronger currency may also induce capital inflows, which can have a positive impact on inflation by stimulating domestic economic activity.

## Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-0.84%	10.52%	-0.17%	10.15%	2.51%	9.28%
MSCI EM Small Cap	-0.40%	13.36%	-1.01%	8.16%	-0.97%	4.99%
MSCI Frontier	0.06%	7.67%	-9.27%	-2.91%	-1.78%	3.03%
MSCI Asia	-1.22%	11.07%	5.91%	16.31%	4.93%	10.69%
Shanghai Composite	-3.98%	10.40%	9.29%	10.91%	1.22%	2.66%
Hong Kong Hang Seng	-2.27%	1.60%	-9.44%	-4.02%	-0.87%	4.08%
MSCI EMEA	-0.16%	4.45%	-17.76%	-11.54%	-4.58%	2.11%
MSCI Latam	1.81%	5.97%	-31.26%	-24.81%	-10.12%	3.15%
GBI EM GD	0.11%	2.79%	-4.29%	0.41%	0.19%	5.07%
ELMI+	-0.02%	2.43%	-3.04%	0.45%	-0.33%	2.60%
EM FX Spot	-0.04%	1.87%	-9.28%	-7.08%	-6.58%	-2.89%
EMBI GD	0.46%	4.73%	1.84%	3.35%	4.09%	6.34%
EMBI GD IG	0.32%	3.54%	6.78%	7.73%	6.78%	7.17%
EMBI GD HY	0.63%	6.22%	-3.97%	-1.86%	1.03%	5.32%
CEMBI BD	0.33%	3.59%	3.42%	6.08%	5.00%	6.25%
CEMBI BD IG	0.30%	3.10%	5.09%	6.28%	5.60%	5.73%
CEMBI BD Non-IG	0.38%	4.26%	1.06%	5.70%	4.18%	7.13%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	-4.50%	8.13%	4.80%	13.48%	12.49%	13.49%
1-3yr UST	0.00%	0.07%	3.09%	3.77%	2.57%	1.85%
3-5yr UST	0.03%	0.19%	6.23%	6.59%	3.87%	2.95%
7-10yr UST	0.27%	0.29%	11.46%	10.67%	6.25%	4.73%
10yr+ UST	0.81%	0.54%	21.86%	18.54%	11.26%	8.63%
10yr+ Germany	1.57%	0.39%	6.29%	0.20%	6.86%	5.63%
10yr+ Japan	0.49%	0.25%	-1.87%	-3.79%	1.56%	3.17%
US HY	-0.32%	5.34%	1.34%	3.89%	4.68%	6.24%
European HY	0.63%	3.78%	-2.37%	-0.54%	1.70%	3.66%
Barclays Ag	-0.23%	2.79%	5.86%	6.46%	3.59%	3.94%
VIX Index*	1.74%	-11.70%	94.99%	95.56%	157.38%	10.80%
DXY Index*	1.14%	-4.31%	-3.32%	-5.16%	1.16%	-2.16%
CRY Index*	-4.44%	6.12%	-21.19%	-16.24%	-20.13%	-25.22%
EURUSD	-0.71%	5.49%	5.68%	7.71%	-0.57%	4.73%
USDJPY	0.12%	-1.75%	-2.37%	-1.92%	-3.81%	-11.81%
Brent	-11.84%	-2.99%	-39.52%	-33.71%	-28.03%	-13.91%
Gold spot	-1.03%	9.36%	28.36%	29.98%	46.47%	75.60%

\*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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