Issued: 20 April 2020

Merits and issues of the G-20 proposal; Ecuador shows how to get it done

By Gustavo Medeiros

The G-20 stepped in to help the least developed countries to cope with the 'sudden stop' financial shock caused by the coronavirus outbreak. This is generally good news because it shores up the economies of vulnerable countries whose domestic market valuations have reached dislocated levels and where buying often proves rewarding, in our view. The government of Argentina announced its initial restructuring offer. Ecuador received overwhelming support to postpone coupon payments until August under its market-friendly policy framework. The IMF provided a reminder why Brazil can have high debt levels but no debt crisis. China's March data disappointed. Moon won by a landslide in the parliamentary election in South Korea. The Reserve Bank of India announced more targeted liquidity injections as inflation declined. Caribbean countries were downgraded by rating agencies.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.8	–	1.51%
MSCI EM Small Cap	9.1	–	2.39%
MSCI Frontier	9.8	–	2.62%
MSCI Asia	11.5	–	2.83%
Shanghai Composite	9.8	–	1.50%
Hong Kong Hang Seng	7.5	–	1.38%
MSCI EMEA	8.6	–	-4.81%
MSCI Latam	10.2	–	-2.42%
GBI-EM-GD	5.05%	–	0.35%
ELMI+	3.46%	–	-0.50%
EM FX spot	–	–	-1.27%
EMBI GD	6.76%	607 bps	0.72%
EMBI GD IG	4.03%	330 bps	0.75%
EMBI GD HY	10.96%	1,031 bps	0.69%
CEMBI BD	6.07%	551 bps	2.35%
CEMBI BD IG	4.16%	359 bps	1.82%
CEMBI BD Non-IG	9.15%	859 bps	3.15%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.2	–	3.06%
1-3yr UST	0.20%	–	0.05%
3-5yr UST	0.35%	–	0.15%
7-10yr UST	0.63%	–	0.57%
10yr+ UST	1.25%	–	1.14%
10yr+ Germany	-0.47%	–	2.63%
10yr+ Japan	0.00%	–	-0.48%
US HY	7.66%	705 bps	2.60%
European HY	7.79%	748 bps	1.96%
Barclays Ag	1.11%	48 bps	0.55%
VIX Index*	38.15	–	-3.52%
DXY Index*	99.88	–	0.53%
EURUSD	1.0864	–	-0.46%
USDJPY	107.82	–	0.05%
CRY Index*	123.80	–	-4.02%
Brent	27.6	–	-13.17%
Gold spot	1682	–	-1.94%

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

Emerging Markets

- **The response of the G-20 group of countries to the coronavirus 'sudden stop':** The coronavirus has effectively cut off the least developed countries in the world from access to global capital markets. Many do not have local markets of sufficient size to meet their financing needs. Last week, the G-20 group of countries issued a statement asking the International Monetary Fund (IMF) and other International Financial Institutions (IFIs) to commit more funding to the least developed countries to help them fight the economic fallout from the coronavirus-induced 'sudden stop' financial shock. The IMF temporarily increased access limits under the Rapid Financing Instrument (RFI) and the Rapid Credit Facility (RCF) to USD 100bn, but this is likely to fall short of the needs of the less developed economies. The G-20 also called for a time-bound suspension of bilateral and multilateral debt repayments of all International Development Association (IDA) countries.[1] We believe higher funding from the IFIs is the right approach. The statement also mentioned private creditor participation but without imposing it or providing any details. We expect participation mainly from large bilateral creditors and IFIs, which represent the largest group of creditors to the least developed economies.

In our view, a mechanism that forces private debt into the moratorium would do more harm than good because several countries do not need coupon forbearance and are willing to continue to service debt. We expect coupon suspensions, if any, to be negotiated on a case by case basis. A temporary suspension on coupon repayments implemented in a market-friendly manner, as Ecuador did last week, would be positive for creditworthiness, in our view. By contrast, a blanket restriction on coupon repayments would be detrimental to the countries involved and the asset class.[2]

[1] IDA countries are those with low per capita incomes that lack the financial ability to borrow from the International Bank for Reconstruction and Development (IBRD).

[2] See: *'Rebuttal to Carmen Reinhart and Kenneth Rogoff's proposal that Emerging Markets suspend debt payments'*, The Emeging View, 15 April 2020.

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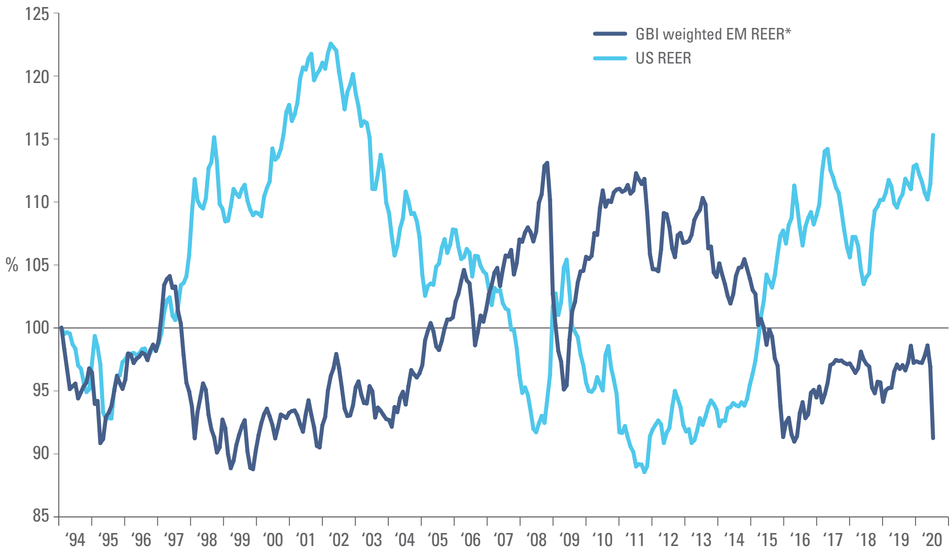
Emerging Markets

- **Local Market valuations:** Valuations in EM local markets now look extremely interesting relative to fundamentals. As of 31 March 2020, the consumer prices index (CPI) inflation weighted by the GBI-EM GD was just 3.2% on a yoy basis, down from 3.6% yoy in February, while yields have increased to 5.6% from 5.1%, thus taking the real interest rate to 2.3% in March from 1.6% in February. For comparison, real yields in US Treasuries and German Bunds of the same duration were -1.7% and -2.1%, respectively. On the FX side, risk aversion due to the coronavirus outbreak has pushed EM currencies to levels that are comparable with the late 1990s and early 2000s (Figure 1). It is worth remembering that at that time EM countries were saddled with severe balance of payments imbalances as a result of the misguided fixed exchange rate regimes, which had precipitated the Asia Crisis of 1997, the Russia Crisis of 1998, and the Latin American crisis in the early 2000s. By contrast, this time there are no large external imbalances in the major EM economies as their currencies have been able to float alongside prudent fiscal policies and successful inflation-targeting regimes by central banks.

Fig 1: **Title: GBI weighted REER vs US REER**



Source: Ashmore, JP Morgan, BIS. Data as at March 2002.
*Weighted by the JP Morgan GBI-EM GD Index starting in December 2002. Prior to that, we use the average weight of the index between 2002 and 2012 to calculate the weights of the period between January 1994 and November 2002.

- **Argentina:** The government announced the terms of its first offer to re-profile the stock of sovereign debt. Under the proposal, the US dollar-denominated bonds issued from 2015 to 2017 will be converted into three different instruments maturing in 2030, 2036, or 2047. The government proposed a 12% haircut for the new 2030 bonds and 5% for the 2036 and 2047 bonds, a grace period until 2022 and coupon payments restarting in 2023. Coupon interest will gradually rise from 0.5% to 4.875% depending on the maturity. Ashmore's views are expressed in the press release attached.[3]

- **Ecuador:** More than 90% of bondholders and 82% of bond in each series accepted Ecuador's consent solicitation to postpone USD 800m in coupon payments until 15 August. The deal provides short term liquidity relief to enable the country to focus on managing a severe coronavirus outbreak in the city of Guyaquil as well as extra time to re-design the programme with the IMF. Most importantly, the approval of Ecuador's proposal removes the risk of default in the near term.[4]

- **Brazil:** The IMF issued a public statement of approval of Brazil's sizeable fiscal expansion in a press conference last week. Almost half of Brazil's debt is in floating rate bonds. At the low policy rate of 3.75%, the government can bear the larger stock of debt without putting serious strain on the public finances. Brazil, like most other countries in JP Morgan's index of local currency bonds, the GBI-EM GD Index, meets almost all its financing needs from its local capital markets. The depth and breadth of capital markets combined with a credible central bank allow such EM countries to sustain a relatively high ratio of debt to Gross Domestic Product (GDP) without incurring distress. In other news, President Jair Bolsonaro sacked Health Minister Henrique Mandetta after a dispute over lockdowns and the use of alternative treatments. Bolsonaro has been vocal on social media about his opposition to social distancing and strongly advocates the use of alternative therapies. This stance puts him on a collision course with his health minister as well as local governors, and Parliament.

[3] https://apnews.com/PR%20Newswire/4691b69d7ec88c3683d544abd6997c2a
[4] See: *'The merits of Ecuador's approach'*, Market Commentary, 9 April 2020.

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Emerging Markets

- China: Real GDP growth contracted by 6.8% on a yoy basis in Q1 2020 versus -6.0% yoy expected. Industrial production declined at a yoy rate of 1.1%, which was nevertheless significantly better than the consensus expectation of -6.2% yoy. However, retail sales declined at -15.8% on a yoy basis versus -10% yoy expected. China's retail sales for the month of March highlight the likely challenges the rest of the world will experience as they re-open their economies, with a reduced level of demand for non-essential items. In other news, SN prime, a mall operator headquartered in the Philippines, said that its China-based malls have seen double-digit week-on-week growth in foot traffic in recent weeks and was now operating at close to 80% of normal levels.

- South Korea: President Moon Jae-in's ruling party Democratic Party of Korea (DPK) scored a landslide victory in the legislative election held last week. The DPK now controls 60% of parliamentary seats for the first time since 1987. Voter turnout was the largest since 1981. The decisive majority will enable DPK to boost the fiscal response to coronavirus and approve structural reforms. Moon's term as president expires in two years. In other news, the unemployment rate rose to 3.8% on a seasonally-adjusted basis in March from 3.3% in February. Employment declined for the first time since 2009.

- India: The Reserve Bank of India (RBI) announced further measures to boost liquidity, while the reverse repo rate was cut by 25bps to 3.75%. RBI mobilised INR 500bn (USD 7bn) to target long term repo operations (TLTROs) for investment-grade bonds, commercial paper and debentures with at least 50% in loans to be allocated to small and mid-sized business. RBI announced another INR 500bn in a special refinance facility to specific sectors. On the regulatory side, RBI allowed banks to extend a debt moratorium to 180 days, restricted bank dividend payments, and temporarily lowered the liquidity coverage ratio to 80% from 100%. Loans to commercial real estate received a one-year extension for delayed projects. In other news, wholesale prices index (WPI) inflation declined to 1.0% on a yoy basis in March from 2.3% yoy in February, while the rate of CPI inflation declined to 5.9% on a yoy basis from 6.6% yoy in the previous month. The decline in inflation is opening the door for RBI to cut rates further, in our view.

- Caribbean: Ratings agency S&P downgraded a slew of Caribbean countries over concerns about the impact of coronavirus on the tourism industry. Belize was downgraded to CCC from B-, Bahamas to BB from BB+ with a negative outlook. S&P also changed the rating outlook to negative[5] for the Dominican Republic (BB-) and Jamaica's (B+). S&P affirmed Barbados' B- rating with stable outlook. We believe the rating agency wants to appear to be pro-active, but this is the wrong approach. Rather, rating agencies should focus on the long term credit fundamentals and not gyrate with market volatility. In our view, the Caribbean is likely to revert to being a top tourist destination as the coronavirus situation normalises. Besides, all countries in question are receiving a boost from lower oil prices, which is a key import across the region.

Snippets:

- Colombia: The Fiscal Council increased the fiscal deficit target to 4.9% of GDP. Colombia's fiscal rule allows countercyclical expenditures to increase if real GDP growth is forecast to drop 2% below the country's expected long term trend growth rate.
- Costa Rica: The Andean Development Fund (CAF) disbursed a loan of USD 500m (0.9% of GDP) to the government. The proceeds are earmarked for social security, unemployment assistance, and medical supplies, including treatments.
- Dominican Republic: The Central Bank applied for a USD 650m RFI line with the IMF and a USD 1-3bn swap line with the Fed.
- Gabon: The IMF approved at staff level the support to Gabon under the RFI last week. IMF staff are now forecasting a fiscal deficit of 2.9% of GDP in 2020 with remaining financing needs for the year of USD 284m (approximately 1.8% of GDP).
- Ghana: The IMF approved a USD 1.0bn RCF facility to Ghana last week. The IMF is forecasting the real GDP growth rate to decline to 1.5% in 2020, which is 6% lower than the previous forecast. The Budget deficit is seen to widen to 6.4% of GDP and debt to peak at 69% of GDP in 2020. In other news, the yoy rate of CPI inflation was unchanged at 7.8% in March, which remains within the central bank's 8% target (+/-2%).
- Kenya: The National Treasury published a supplementary budget for the fiscal year of 2019-2020, which envisages a 7.8% of GDP budget deficit with revenues declining from 20.6% of GDP to 18.2% of GDP. The trade deficit is seen to improve to KES 73bn in February from KES 102bn in January. Overseas remittances expanded at a yoy rate of 10% in February compared to 6% yoy in January.
- Mexico: Fitch downgraded the sovereign credit rating to BBB- with a stable outlook. Another rating agency, Moody's, downgraded the debt rating of the state-owned oil company Pemex to below BBB-. As this was the second rating agency to downgrade Pemex to the high yield category, investment-grade portfolios will now be forced to sell. However, Pemex bonds already trade at distressed levels with a yield close to 11% yield and a cash price of 60 cents, which seems incompatible with the fact that the company receives significant support from the Mexican government. As such, we believe that this downgrade is mostly priced in already.

[5] A negative outlook signals a potential downgrade over the next 6 to 24 months.

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Emerging Markets

- **Mozambique:** The Central Bank cut the policy rate from 12.75% to 11.25%.
- **Namibia:** The Central Bank cut the policy rate from 5.25% to 4.25% in order to maintain interest rate parity with the Reserve Bank of South Africa (SARB). The Namibian Dollar is pegged to the South African Rand.
- **Indonesia:** S&P kept Indonesia's sovereign credit rating at BBB, but downgraded the outlook to negative from stable. Bank Indonesia (BI) kept the policy rate unchanged at 4.5%, but announced a range of policies to improve liquidity. BI cut reserve requirements by 200bps to 3%, which is likely to add some IDR 118trn (0.7% of GDP) in liquidity from 1 May. In other news, the trade surplus narrowed marginally in March USD 0.7bn from an average of USD 0.9bn in January and February.
- **Panama:** The IMF approved a USD 515m RFI line. This credit line covers about 15% of Panama's USD 3.7bn balance of payment gap.
- **Philippines:** The Central Bank cut the policy rate by 50bps to 2.75% in an unscheduled meeting. This takes cumulative easing in 2020 to 125bps.
- **Romania:** Fitch kept Romania's sovereign credit rating at BBB-, but revised the outlook to negative from stable.
- **Russia:** The current account registered a USD 22bn surplus in Q1 2020, which is down from USD 34bn in Q1 2019. The smaller surplus is mainly due to lower energy exports as imports were broadly unchanged. Lower outbound tourism and imports of services due to the weaker RUB have likely compensated in part for lower oil prices to keep Russia's external accounts in surplus, in our view.
- **Senegal:** The IMF board approved a USD 442m disbursement via RCF and RFI, thus using up 100% of the country's IMF quota. The Fund expects growth to decline to 3% in 2020 from 6% in its previous forecast.
- **Sri Lanka:** The government is reported to be in talks with the IMF to borrow money under the RFI. Sri Lanka is trying to improve relations with the IMF after a burst of expansionary fiscal policies earlier this year pushed the deficit target outside of the limits imposed under the IMF programme.
- **Singapore:** Domestic exports ex-oil rose at a yoy rate of 17.6% in March after declining by 0.2% yoy in January and February combined. Exports of pharmaceutical products jumped 48.6% on yoy basis and shipment of non-monetary gold surged at a 242.5% yoy. Electronic exports were 5.8% higher yoy.
- **South Africa:** The government froze public sector wages, thus cancelling a 2018 deal with workers under which wages would increase at the rate of CPI inflation +1%, or 7% in total (with variations depending on pay grade). The state-owned airline South African Airways announced plans to lay off its entire workforce of 4,700 staff after the government denied further financial aid. SARB cut the policy rate by 100bps to 4.25%.
- **Tunisia:** The IMF disbursed USD 745m towards emergency facilities.
- **Turkey:** The budget deficit widened to 2.7% of GDP in March from 2.2% of GDP in February as tax revenues declined by 10% due to a postponement of value added tax (VAT) payments.
- **Uruguay:** The Central Bank reduced Q2 2020 M1 money supply growth target to between 3 to 5% from 6% to 8% in Q1 2020 to reduce inflation. CPI inflation hit 9.2% on a yoy basis in March from 8.8% yoy in December. The target band for CPI inflation is 3% to 7%.

Global backdrop

Equities had another week of rebound due to massive liquidity injections and hopes that lockdown measures could begin to be phased out as coronavirus cases moderate in Europe and the United States (US). MSCI World rose 2.3% as credit spreads declined for high yield and investment grade credit. By contrast, oil prices continue to fall with WTI down by another 20% to USD 18.3 per barrel last Friday. However, the May 2021 WTI future was down only by 1% to USD 35.5 per barrel. Short-dated contracts reflect full storage facilities, whereas longer-dated contracts reflect supply and demand fundamentals more accurately, in our view. OPEC Secretary-General Mohammed Barkindo estimated that the oil market was oversupplied by 14.7 million barrels per day in mid-April with oil in storage now around 1 billion barrels. The depletion of all remaining storage capacity may well coincide with the bottoming of prices for the oil market in 2020, in our view.

- **Coronavirus:** Germany's Chancellor Angela Merkel announced that smaller shops would be allowed to start serving customers this week and schools will gradually re-open in early May. Still, most restrictive measures remain in place. A video from a small trial of severe coronavirus patients treated with Gilead's drug Remdesivir showed promising results. The initial tests were conducted by the University of Chicago with a small sample of 125 patients. Meanwhile, Indian drugmaker Cipla said a few weeks ago it was in early stages of creating a generic copy of Remdesivir. The Lancet reported a coronavirus vaccine test by Oxford University aimed for human testing on 500 volunteers by mid-May. The university is planning to extend the trial to older people before a third phase when testing will be expanded to 5,000 volunteers.

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Global backdrop

In the US, President Donald Trump announced a broad national plan for re-opening the economy in three phases. In phase one, most restrictions will remain in place while public places with large spaces will be open provided people observe strict social distancing policies. In phase two, non-essential travel is allowed to resume and schools open. Lastly, once case numbers are clearly trending lower then full public interaction will resume, albeit with social distancing still maintained in place within restricted spaces, such as bars. Each phase is to last two weeks. States will be given autonomy to determine when to start the process. The risk of this strategy is that, without ample availability of testing alongside aggressive tracing of cases, hotspots that can trigger a second outbreak of coronavirus may re-emerge. A second wave would likely force the US Treasury and Fed to engage in 'intensive care unit' policies with massive additional fiscal stimulus and heavy yield curve intervention for longer.

- Economic data: The data released last week in the US was very bad. The number of people seeking unemployment insurance for the first time increased by 5.25m for the week ending on 11 April. This was only slightly down from 6.62m in the previous week. Continuing claims, which counts the total number of unemployed, jumped to an all-time high of 12m in the week ending in 4 April. This is almost twice as many as the previous all-time high of 6.6m recorded in May 2009. Retail Sales declined by 8.7% in March, which is 7.5 standard deviations below the average. Manufacturing also took a big hit as the US Empire State Manufacturing Survey declined to a record -78.2 compared to a previous low in February 2009 of -34.3. New housing starts declined to 1.2m in March from 1.6m in February.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	6.33%	6.33%	-18.76%	-15.33%	0.57%	-0.12%
MSCI EM Small Cap	9.23%	9.23%	-25.01%	-24.22%	-6.72%	-4.71%
MSCI Frontier	3.94%	3.94%	-23.74%	-17.43%	-3.34%	-2.69%
MSCI Asia	6.75%	6.75%	-12.87%	-10.46%	3.50%	1.52%
Shanghai Composite	3.21%	3.21%	-6.94%	-10.90%	-1.92%	-5.96%
Hong Kong Hang Seng	2.30%	2.30%	-12.11%	-14.01%	2.62%	-3.98%
MSCI EMEA	5.22%	5.22%	-30.43%	-28.59%	-6.63%	-5.10%
MSCI Latam	4.80%	4.80%	-42.97%	-37.87%	-11.77%	-5.96%
GBI EM GD	2.22%	2.22%	-13.33%	-5.89%	-0.39%	0.31%
ELMI+	0.14%	0.14%	-8.35%	-6.05%	-0.51%	-0.05%
EM FX Spot	0.25%	0.25%	-14.09%	-14.44%	-6.99%	-6.17%
EMBI GD	2.31%	2.31%	-11.38%	-4.82%	0.90%	2.97%
EMBI GD IG	1.57%	1.57%	-3.95%	5.91%	4.58%	4.05%
EMBI GD HY	3.33%	3.33%	-19.86%	-16.18%	-3.36%	1.68%
CEMBI BD	3.63%	3.63%	-6.91%	-0.32%	2.56%	3.61%
CEMBI BD IG	2.63%	2.63%	-3.58%	3.47%	3.65%	3.54%
CEMBI BD Non-IG	5.15%	5.15%	-11.42%	-5.43%	1.09%	3.84%

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Benchmark performance

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	11.32%	11.32%	-10.50%	1.09%	9.09%	8.87%
1-3yr UST	0.08%	0.08%	2.84%	5.60%	2.65%	1.83%
3-5yr UST	0.14%	0.14%	5.52%	9.85%	4.00%	2.84%
7-10yr UST	0.45%	0.45%	10.64%	18.12%	6.69%	4.31%
10yr+ UST	1.71%	1.71%	22.98%	38.81%	13.22%	7.59%
10yr+ Germany	1.29%	1.29%	6.44%	13.21%	6.02%	3.07%
10yr+ Japan	-0.61%	-0.61%	-1.45%	0.94%	1.73%	3.15%
US HY	5.85%	5.85%	-7.57%	-2.59%	2.56%	3.73%
European HY	5.97%	5.97%	-11.15%	-7.90%	-0.38%	1.49%
Barclays Ag	1.04%	1.04%	0.71%	5.85%	3.55%	2.69%
VIX Index*	-28.74%	-28.74%	176.85%	215.55%	169.61%	186.84%
DXY Index*	0.83%	0.83%	3.62%	2.46%	0.10%	1.97%
CRY Index*	1.65%	1.65%	-33.37%	-33.84%	-32.37%	-44.42%
EURUSD	-1.51%	-1.51%	-3.12%	-3.49%	1.37%	1.17%
USDJPY	0.26%	0.26%	-0.73%	-3.68%	-1.37%	-9.53%
Brent	21.20%	21.20%	-58.24%	-61.71%	-47.99%	-56.56%
Gold spot	6.65%	6.65%	10.86%	31.93%	31.21%	40.65%

*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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