

A new balance of power after the botched withdrawal of US troops from Afghanistan

By Gustavo Medeiros

The botched withdrawal of Afghanistan marks the end of NATO's Nation-Building efforts in the Middle East and Central Asia. Mixed political news in Peru. Indonesia's Q2 2021 current account deficit deteriorated, but July's trade surplus improved. India's central bank minutes showed hawkish members dissenting from consensus. The Malaysian parliament appointed a new Prime Minister. Korean exports remained solid during the first 20 days of August. Economic data was better than consensus expectations in Argentina and mixed in Poland. Real GDP growth surprised to the upside in Thailand, Hungary and Chile, but was below consensus in Romania and Colombia.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.0	–	-4.62%
MSCI EM Small Cap	11.3	–	-3.80%
MSCI Frontier	11.6	–	-0.64%
MSCI Asia	13.1	–	-4.58%
Shanghai Composite	11.4	–	-2.48%
Hong Kong Hang Seng	8.6	–	-6.78%
MSCI EMEA	9.6	–	-3.04%
MSCI Latam	9.4	–	-4.68%
GBI-EM-GD	5.02%	–	-1.27%
China GBI-EM GD	2.95%	–	-0.05%
ELMI+	3.07%	–	-0.91%
EM FX spot	–	–	-1.31%
EMBI GD	4.89%	357 bps	0.23%
EMBI GD IG	3.03%	165 bps	0.54%
EMBI GD HY	7.08%	580 bps	-0.08%
CEMBI BD	4.24%	310 bps	0.21%
CEMBI BD IG	2.89%	177 bps	0.31%
CEMBI BD HY	5.86%	471 bps	0.08%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.3	–	-0.55%
1-3yr UST	0.23%	–	-0.01%
3-5yr UST	0.80%	–	0.00%
7-10yr UST	1.27%	–	0.26%
10yr+ UST	1.88%	–	1.27%
10yr+ Germany	-0.50%	–	0.58%
10yr+ Japan	0.65%	–	0.09%
US HY	4.16%	312 bps	-0.06%
European HY	3.08%	354 bps	-0.06%
Bloomberg-Barclays	1.00%	-27 bps	-0.32%
VIX Index*	18.56	–	3.11%
DXI Index*	93.31	–	0.68%
EURUSD	1.172	–	-0.48%
USDJPY	109.93	–	-0.63%
CRY Index*	207.0	–	-10.01%
Brent	66.5	–	-4.39%
Gold	1,786	–	-0.03%
Bitcoin	50,373	–	9.74%

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

Geopolitics

The impact of the Afghanistan fallout: Whilst it remains too soon for a comprehensive assessment of the impact of the humiliating United States (US) retreat from Afghanistan, the event may prove to be an important geopolitical development, in our view. In the short term, the main risk is related to the thousands of Western citizens and allies that remain stranded in Afghanistan, with the worst-case scenario being a repeat of a 1979-81 Iran hostage crisis. Such crisis would increase the length and depth of negative press coverage, affecting the Democratic Party in the mid-term elections. Not surprisingly, Biden announced a public commitment to remove everyone from Afghanistan. A few conclusions can be drawn:

- The US has resolutely ended the Nation-Building efforts of the North Atlantic Treaty Organisation (NATO) from 2001 to 2021.
- Instead, the US will now focus on a multilateral foreign policy, aligning its positions with Europe and other allies and seeking a new balance of power across different regions.
- Furthermore, the disastrous exit from Afghanistan may well represent the end of the post-1945 "Pax Americana" era, in our view.
- The US remains the main global military powerhouse, but the poorly-executed interventions in Iraq, Libya and Syria, the way Americans have abandoned their Kurdish and now Afghan allies, and the US indifference to Hong Kong anti-democratic policies already resonate across geopolitical fault-lines.

Geopolitics

- It is unclear if Biden wants to continue Obama's "pivot to Asia" guidance. Therefore, China is further flexing its muscles in the Taiwanese Strait, taking advantage of the US unwillingness to support its allies.¹ Japan, the Philippines and South Korea will also take note.
- Biden's foreign policy so far has been closer to Trump's "America first" doctrine than previous presidents.
- Biden is at the beginning of his administration, when presidents tend to focus on local policies and mostly ignore foreign politics – hence, the US is unlikely to provoke any of the above fault-lines. The nomination of Nicolas Burns – a career diplomat with ample experience in US-China relations – as the new US ambassador to China suggests Biden will seek to de-escalate tensions with China over the following months.
- The vacuum opened by the US abandonment of Afghanistan will expand the role China and Russia play in the Middle East and Central Asia. China's Belt & Road initiative will become even more strategically important while Russia's military position looms larger in the region. China is likely to directly support Pakistan, Tajikistan and Iran to avoid immigration and tensions flaring up in Xinjiang, in our view.
- Moreover, the Afghan withdrawal will have direct consequences for Pakistan, India, Iran and Turkey. It may give Iran a bargaining chip (i.e. holding immigrants from crossing to Turkey and supporting anti-Taliban forces) to try another nuclear deal in exchange for the lifting of sanctions. It may allow Turkey to get more cash from the EU in order to hold Afghan immigrants from crossing to Europe. India, already a key US ally, will have an oversized importance, particularly if Pakistan deepen its (informal) ties with the Taliban government.
- The weaker NATO support means Ukraine, Belarus and the Baltic countries will find it harder to confront Russia in local geopolitical matters. The overwhelming American support to Saudi Arabia may also be at risk, as the Middle East finds a new balance of power.
- The greater influence of China and Russia in Central Asia, the Middle East and Africa should be supportive for Chinese and Russian assets over the medium term. Rising tensions in the Middle East after the potential end of the *Pax Americana* would motivate further instability in the region, which should translate into higher oil prices. Gold may benefit from higher geopolitical tensions, especially now that we know that governments can and will seize crypto currencies from illegal sources. Lastly, China is in a good position to monetise Afghanistan's large reserves of rare earth minerals.²
- The salient long-term question for the US and global stability is whether the disastrous end of the Afghanistan intervention will become the equivalent of the Suez crisis of 1956, which marked the end of the British and French empires and established the polarisation between the US and the USSR.
- The event may lead to the end of the US hegemony and the beginning of a multilateral geopolitical era, with the US, Europe, Russia and China playing important roles across regions.

Emerging Markets

Peru: Prime Minister Guido Bellindo announced a new direct fiscal transfer of PEN 700 (c. USD 170) for 13.5 million people at a cost of 1.1% of GDP, which is higher than the 0.5% of GDP expected. Over the weekend President Pedro Castillo said there would be surprises with prices of gas and food next week, suggesting the government may announce subsidies or price controls to the sectors. In other political news, the Minister of Foreign Affairs Hector Bejar resigned after he was caught in a video criticising the US Central Intelligence Unit (CIA) and was replaced by Oscar Murtua, a moderate who served as Foreign Minister for President Alejandro Toledo. In economic news, the yoy rate of economic activity slowed to 23.5% in June from 48.3% yoy in May while the unemployment rate in Lima declined to 9.4% in July from 10.3% in June.

Indonesia: The trade surplus doubled to USD 2.6bn in July from USD 1.3bn in June as both imports and exports decelerated. On the other hand, the current account deficit widened to USD 2.2bn (0.8% of GDP) in Q2 2021 from USD 1.1bn (0.4% of GDP) in Q1 2021, against consensus expectations for a USD 0.3bn surplus, mostly due to a seasonal pickup in dividend payments. The balance of payments registered a USD 0.4bn deficit as capital and financial account inflows slowed to USD 1.9bn in July from USD 5.6bn in June while portfolio investments moderated USD 0.5bn to USD 4.4bn over the same period. In other news, Bank Indonesia kept its policy rate unchanged at 3.5%, in line with consensus.

India: The minutes of the July monetary policy committee showed Jayanth R. Varma dissenting on the decision to increase the policy rate while two other policymakers (out of six) favoured to start tightening liquidity conditions whilst keeping overall policy accommodative. The monsoon season has rainfall 8% below the normal from 1 June to 22 August as 10 out of 36 regions (mostly in the north) received lower than expected rains.

Malaysia: Ismail Sabri Yaakob was sworn in as the new Prime Minister (PM) on 21 August securing the backing of 114 (out of 220) members of parliament. Yaakob was the former Deputy PM responsible for Covid-19 security protocols. His confirmation points to policy continuity and should reduce political risks in the short term.

¹ See <https://www.globaltimes.cn/page/202108/1231691.shtml> and <https://www.globaltimes.cn/page/202108/1231667.shtml>

² See <https://www.reuters.com/world/asia-pacific/what-are-afghanistans-untapped-minerals-resources-2021-08-19/>

Emerging Markets

South Korea: The yoy rate of export growth accelerated to 40.9% in the first 20 days of August from 32.6% yoy in the previous month, with better momentum in the last 10 days of the period. Imports rose to 52.1% yoy from 44.6% yoy over the same period. On a business day-adjusted basis, exports were down marginally to 31.5% yoy from 32.6% yoy.

Argentina: An online poll by Synopsis, a pollster, showed 71% of Argentines have a negative view of President Alberto Fernandez (from 63% in July) after a video of the president hosting a birthday party during the government imposed lockdown in 2020, whilst 59% of Argentines said they would vote for another political movement. Economic activity rose 2.5% in June after declining 2.0% in May. The trade surplus rose to USD 1.5bn in July from 1.1bn in June, 0.4bn above consensus while the fiscal deficit improved to ARS 98.5bn from 153.2bn over the same period. Wholesale price inflation (WPI) index rose 2.2% in July, the lowest level since May 2020, while the yoy rate of WPI rose to 63%.

Poland: Sold industrial output rose by a yoy rate of 9.8% in July from 18.4% yoy in June, 0.5% below consensus as retail sales moderated to 8.9% yoy from 13.0% yoy, 0.8% above consensus. Construction output rose by a yoy rate of 3.3% in July from 4.4% in June, 3.5% below consensus. The yoy rate of core CPI inflation rose 0.2% to 3.7% in July as PPI inflation rose 1.0% to 8.2% in July. Average wage inflation declined 0.9% to 8.9% yoy in July.

Thailand: Real GDP growth rose 0.4% in Q2 2021, 1.5% above consensus after rising 0.2% in Q1 2021. The trade surplus narrowed to USD 0.2bn in July from USD 0.9bn in June as the yoy rate of export growth decelerated to 20.3% (from 43.9% yoy) while imports slowed marginally to 45.9% yoy (from 53.8% yoy).

Hungary: Real GDP growth rose 2.7% in Q2 2021 from 2.0% in Q1 2021, 1.3% above consensus.

Chile: Real GDP growth rose 1.0% in Q2 2021 from 3.4% in Q1 2021, 0.3% above consensus. The current account deficit widened to USD 2.6bn in July from USD 1.6bn in June

Romania: Real GDP growth slowed to 1.8% in Q2 2021 from 2.5% in Q1 2021, 0.2% below consensus.

Colombia: Real GDP growth contracted 2.4% in Q2 2021 after expanding 2.9% in Q1 2021, 1.2% below consensus mostly due to the impact of street protests in economic activity. Industrial confidence rose to 16.3 in July from 5.8 in June while retail confidence declined 1.4 to 35.8 over the same period.

Snippets:

- **Brazil:** The trade surplus rose to USD 1.98bn in the 15 August week from USD 1.64bn in the previous week. Tensions between President Jair Bolsonaro, Parliament and the Supreme Court remained elevated, leading to fears of lack of reforms and no fiscal consolidation.
- **Ecuador:** The Trade surplus rose to USD 1.8bn in 1H 2021, USD 0.5bn higher than in 1H 2020 as oil products surplus more than doubled to USD 3.2bn.
- **Egypt:** The trade deficit narrowed to USD 2.9bn in June from USD 3.3bn in May. In other news, the sovereign wealth fund is coordinating with the private sector in a USD 2.5bn investment to build 17 desalination plants to be completed by 2025 in order to reduce water shortage risks.
- **Morocco:** The yoy rate of CPI inflation rose to 2.2% in July from 1.5% yoy in June due to higher food prices.
- **Nigeria:** The yoy rate of CPI inflation declined to 17.4% in July from 17.8% yoy in June, 0.1% below consensus.
- **Russia:** The yoy rate of CPI inflation was unchanged at 4.5% in the second week of August, while the yoy rate of PPI inflation declined to 28.1% in July from 31.1% yoy in June
- **South Africa:** The yoy rate of CPI inflation declined to 4.6% in July from 4.9% yoy in June while core CPI moderated 0.2% to 3.0% over the same period, both indices were below consensus. Retail sales rose 0.6% in June from 2.3% in May, 1.1% above consensus.
- **Sri Lanka:** The central bank hiked its deposit and lending policy rates by 50bps to 5.0% and 6.0% respectively. Local media reported Sri Lanka is seeking IMF assistance on top of the SDR facility. This would represent a welcome shift in policy towards more sustainable public finances, however the IMF is also likely to demand a debt restructuring before engaging in a programme.
- **Taiwan:** Export orders moderated to a yoy rate of 21.4% in July from 31.1% yoy in June, but the current account surplus improved to USD 28.0bn in Q2 2021 from USD 26.1bn in Q1 2021.
- **Tunisia:** The government relaxed a curfew after Covid-19 cases declined from 669 cases per million people on the 13 July to 191 cases per million on 21 August. As much as 30% of the population was vaccinated with at least one shot.

Emerging Markets

- **Turkey:** The fiscal deficit widened to TRY 45.8bn in July from TRY 25bn in June. House prices rose by a yoy rate of 29.2% in June, 0.1% higher than in the previous month.
- **Venezuela:** The United Nations (UN) said Venezuela received USD 280m for humanitarian support from 131 local and international non-government organisations (NGOs). The UN plans to raise further USD 708m for the remainder of the year to implement the humanitarian response plan.

Global backdrop

Covid-19: Fears over rising Covid-19 cases and the higher transmissibility of the delta variant weighed on risky assets last week. In the US, cases per million people rose to 445 on 21 August from 40 on 4 July while UK cases per million rebounded to 465 on 21 August from 379 on 3 August.

United States: Treasury Secretary Janet Yellen told senior White House advisers that she supports reappointing Jerome Powell as the Chairman of the Federal Reserve (Fed) after his term ends in February 2022, according to Bloomberg News. Last week the Fed released the minutes of the July Federal Open Market Committee (FOMC) showing most policymakers agreed they could start slowing the pace of bond purchases later this year as enough progress will have been made towards their employment objective. Boston Fed President Eric Rosengreen said he supported reducing bond purchases later this autumn and halting them by mid-2022. However, Dallas Fed Robert Kaplan said he might adjust his pro-tapering stance in case the Covid-19 delta variants persist, curbing economic expansion. Kaplan also mentioned 3 million people retired from the workforce after the pandemic leading to "persistent" supply-demand imbalances. Furthermore, the Fed announced its annual Jackson Hole symposium from 26 August to 28 August would be held remotely, dampening expectations of hawkish announcements next week.

In economic news, the Citibank Economic Surprise Index declined to -36.8 last week from -29.1 in the previous week. Retail sales declined 1.2% in July from 0.7% in June, but IP rose 0.9% from 0.2% over the same period. Housing starts declined 7.0% to 1.53m in July from 1.65m in June and mortgage applications declined 3.9% in the week of 13 August after rising 2.8% in the previous week. The Empire Manufacturing survey dropped to 18.3 in August from 43.0 in July while the Philadelphia Fed Business outlook survey declined to 19.4 from 21.9 over the same period, both significantly below consensus.

Eurozone: The Eurozone preliminary manufacturing PMI dropped 1.3 to 61.5 from in August, 0.5 below consensus, while the services PMI was virtually unchanged at 59.7. Real GDP growth rose 2.0% in Q2 2021, in line with consensus and Q1 2021. The current account surplus rose to EUR 21.8bn in June from EUR 13.9bn in May.

Japan: Real GDP growth rose 0.3% in Q2 2021 from -0.9% in Q1 2021, 0.1% above consensus. The yoy rate of CPI inflation declined to -0.3% (deflation) in July from 0.2% yoy in June, or 0.1% above consensus. Core machine orders rose 18.6% in June from 12.2% in May, 3.0% above consensus.

United Kingdom: The manufacturing PMI was 0.3 lower at 60.1 in August but the services PMI dropped 4.1 to 55.3 over the same period. The yoy rate of CPI inflation declined to 2.0% in July from 2.5% yoy in June, 0.3% lower than consensus. The yoy rate of average weekly earnings rose to 8.8% in the 17 July from 7.4% yoy in the previous week. Retail sales declined 2.5% in July from 0.2% in June, 2.7% below consensus.

Australia: The unemployment rate declined to 4.6% in July from 4.9% in June, 0.4% lower than consensus as 2.2k new jobs were created in July (-43.5k consensus) from 29.1k in June.

Canada: The yoy rate of CPI inflation rose to 3.7% in July from 3.1% yoy in June, 0.3% higher than consensus. Core CPI was unchanged at 1.7% yoy while the median core PCI rose 0.2% to 2.6%.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-4.30%	-10.71%	-4.04%	15.48%	8.46%	8.83%
MSCI EM Small Cap	-5.09%	-6.31%	12.31%	39.73%	11.24%	9.15%
MSCI Frontier	1.73%	1.47%	16.68%	34.62%	9.51%	9.53%
MSCI Asia	-4.46%	-11.60%	-5.94%	13.02%	8.86%	10.10%
Shanghai Composite	0.98%	-3.63%	0.65%	4.06%	10.82%	4.30%
Hong Kong Hang Seng	-5.26%	-17.37%	-16.82%	-11.55%	-3.05%	1.71%
MSCI EMEA	-1.08%	-0.96%	15.07%	30.59%	8.04%	5.36%
MSCI Latam	-5.18%	-9.01%	-0.78%	26.27%	1.48%	2.29%
GBI-EM-GD	-1.99%	-2.41%	-5.71%	2.35%	4.60%	2.03%
China GBI-EM GD	-0.56%	1.11%	4.24%	10.99%	-	-
ELMI+	-1.27%	-1.77%	-2.37%	3.33%	2.09%	1.61%
EM FX spot	-1.77%	-2.90%	-4.43%	0.87%	-2.87%	-3.75%
EMBI GD	0.17%	0.59%	-0.08%	3.65%	6.59%	4.21%
EMBI GD IG	0.65%	1.13%	-1.35%	0.28%	7.76%	4.67%
EMBI GD HY	-0.31%	0.04%	1.46%	7.79%	5.20%	3.64%
CEMBI BD	0.44%	0.66%	1.94%	6.08%	7.61%	5.32%
CEMBI BD IG	0.35%	0.90%	0.76%	3.27%	6.99%	4.63%
CEMBI BD HY	0.55%	0.33%	3.54%	10.04%	8.37%	6.37%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.16%	3.56%	19.35%	33.18%	17.95%	17.43%
1-3yr UST	-0.09%	0.09%	-0.01%	0.09%	2.65%	1.66%
3-5yr UST	-0.31%	0.41%	-0.64%	-0.62%	4.17%	2.23%
7-10yr UST	-0.11%	1.89%	-1.55%	-2.86%	6.30%	2.81%
10yr+ UST	0.75%	4.43%	-3.84%	-7.60%	9.38%	4.02%
10yr+ Germany	1.16%	5.86%	-1.32%	0.22%	5.81%	2.64%
10yr+ Japan	-0.07%	0.96%	0.65%	1.02%	1.82%	0.23%
US HY	-0.41%	-0.03%	3.59%	10.06%	6.90%	6.52%
European HY	0.28%	0.69%	4.19%	9.82%	4.18%	4.14%
Bloomberg-Barclays Agg	-0.63%	0.69%	-2.53%	0.42%	4.59%	2.21%
VIX Index*	1.75%	17.25%	-18.42%	-17.66%	49.56%	49.92%
DXY Index*	1.23%	0.94%	3.75%	0.06%	-2.47%	-1.30%
CRY Index*	-5.10%	-3.01%	23.34%	38.01%	8.64%	9.87%
EURUSD	-1.28%	-1.11%	-4.15%	-0.69%	1.41%	3.53%
USDJPY	-0.19%	1.06%	-6.03%	-3.68%	1.21%	-8.83%
Brent	-12.93%	-11.54%	28.30%	49.85%	-11.07%	33.03%
Gold	-1.54%	0.78%	-5.71%	-7.53%	50.35%	33.17%
Bitcoin	21.94%	47.57%	76.21%	332.68%	680.40%	8,582.60%

*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, DX Y and CRY which are shown as percentage change.

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