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Ashmore

EM central banks maintain course as BRL remains undervalued

By Gustavo Medeiros

All EM central banks left policy rates unchanged last week. However, communications from the central banks in Brazil and Turkey signalled a more hawkish stance, while the South African and Malaysian central banks tilted in a more dovish direction. The Brazilian real (BRL) remains undervalued versus its long term fundamentals. South African inflation declined further. The Chinese government introduced requirements for Covid-19 testing for the people wishing to travel during the Chinese New Year. Thailand's exports rose faster than expected. The unemployment rate declined in Mexico. The International Monetary Fund (IMF) released the fourth review of Angola programme, which highlights strong willingness to service debt. Zambia purchased 90% of the Mopani Mine from Glencore.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	14.3	–	2.57%
MSCI EM Small Cap	11.4	–	1.01%
MSCI Frontier	10.5	–	-0.84%
MSCI Asia	15.5	–	3.37%
Shanghai Composite	12.3	–	1.13%
Hong Kong Hang Seng	9.5	–	3.15%
MSCI EMEA	10.0	–	-0.23%
MSCI Latam	11.7	–	-4.56%
GBI-EM-GD	4.33%	–	-0.29%
ELMI+	2.30%	–	-0.16%
EM FX spot	–	–	-0.32%
EMBI GD	4.75%	358 bps	0.23%
EMBI GD IG	2.88%	165 bps	0.11%
EMBI GD HY	7.20%	608 bps	0.37%
CEMBI BD	4.15%	325 bps	0.15%
CEMBI BD IG	2.88%	198 bps	0.20%
CEMBI BD Non-IG	5.96%	506 bps	0.07%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.9	–	1.23%
1-3yr UST	0.12%	–	0.05%
3-5yr UST	0.44%	–	0.17%
7-10yr UST	1.10%	–	0.37%
10yr+ UST	1.86%	–	0.38%
10yr+ Germany	-0.51%	–	-0.60%
10yr+ Japan	0.00%	–	-0.30%
US HY	4.15%	348 bps	0.17%
European HY	3.31%	391 bps	0.29%
Barclays Ag	0.88%	-22 bps	0.11%
VIX Index*	21.91	–	-1.34%
DXY Index*	90.12	–	-0.64%
EURUSD	1.2180	–	0.85%
USDJPY	103.69	–	0.00%
CRY Index*	172.85	–	-3.92%
Brent	55.5	–	1.30%
Gold spot	1852	–	0.57%

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

Emerging Markets

EM monetary policy stance

EM central banks left their key policy rates unchanged last week amidst more hawkish communications from the monetary authorities in Brazil and Turkey and more dovish stances from South Africa and Malaysia. The Chinese central bank signalled neutrality with respect to the outlook for rates in China. The Brazilian and South African central banks both emphasised the need to implement structural reforms in order to reduce the risk premium implied in the long end of local yield curves and in order to reduce pass-through inflations risks associated with the prices of tradable goods.

In our view, most EM central banks maintain an appropriate monetary stance, given consumer prices index (CPI) inflation rates. The *ex-post* real yield across the term structure in the main local currency government bond index, JP Morgan's GBI-EM GD, remains close to 2.0% owing to low levels of inflation in countries as shown in Figure 1.

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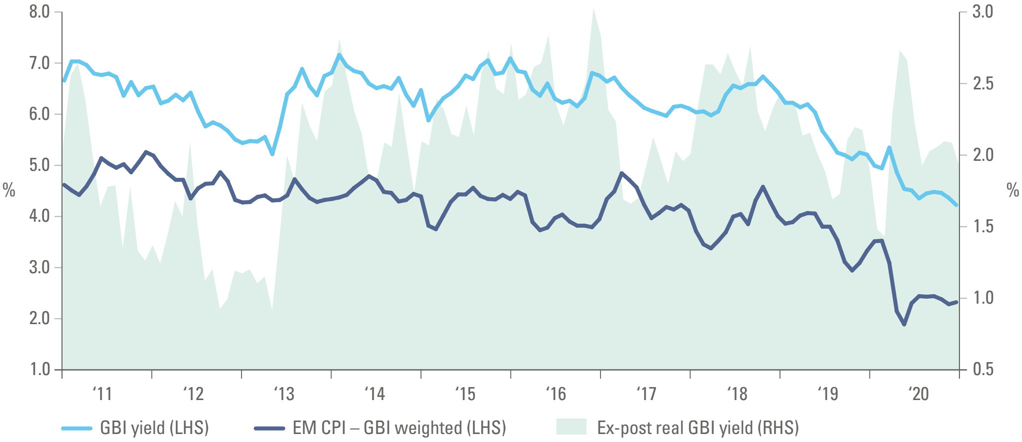
Emerging Markets

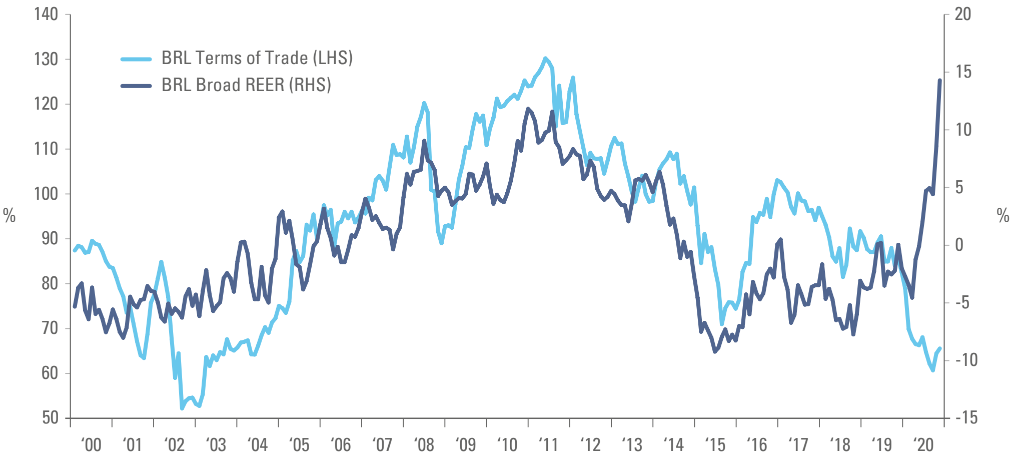
Fig 1: **GBI-EM GD ex-post real yield (adjusted for CPI inflation)**



Source: Bloomberg, Haver, Ashmore. Data as at 30 December 2020.

- **Brazil:** The Brazilian Central Bank (BCB) kept its policy rate (Selic) unchanged at 2.0%, but removed the commitment to keeping interest rates unchanged for the foreseeable future. BCB will work to keep inflation expectations within target for the coming years, something it has mostly achieved in recent years. BCB's baseline inflation scenario is 3.6% in 2021 and 3.4% in 2022. The baseline scenario assumes that BRL will be stable at 5.35 and that Selic will end 2021 at 3.25% and 2022 at 4.75%, thus implying 125bps hikes over 2021 and another 150bps hike over 2022. The BCB highlighted the need to advance structural reforms in order to avoid the secondary effects of higher commodity prices on the broader economy, which could potentially de-anchor inflation expectations.[1] Current higher commodity prices in Dollar (USD) terms have improved Brazil's terms of trade and ought to have strengthened BRL, but political and fiscal uncertainties are keeping the currency at undervalued levels for now, including protests at the weekend against President Jair Bolsonaro over his handling of the coronavirus outbreak. A reduction in the level of political noise following the conclusion of the elections of new leaders of the Senate and Lower House of Congress, which are scheduled for 1 February, could therefore trigger BRL appreciation, in our view. The extent of the currency's undervaluation is highlighted in Figure 2. The disconnect between Brazil's terms of trade (relative export and import prices) which are now at the widest in 20 years to Brazil's real effective exchange rate (REER) (BRL valued against Brazil's main trading partners, adjusted for inflation) is at the lowest level since 2003.

Fig 2: **Broad BRL REER versus BRL terms of trade**



Source: Bloomberg, Citibank, Ashmore. Data as at 31 December 2020.

- **South Africa:** The South Africa Reserve Bank (SARB) kept its policy rate unchanged at 3.5% in line with consensus expectations. Instead of cutting rates and threatening financial stability, the SARB called for structural reforms to boost growth. This is the right message, in our view. At the moment, it is uncertain whether the yield curve would have reacted to further rate cuts. Fiscal reform is necessary for a flatter yield curve which would in turn boost SARB's ability to ease monetary policy. The yoy rate of CPI inflation declined to 3.1% in December from 3.2% yoy in November, while core CPI inflation was unchanged at 3.3%. Mining production declined 11.6% on a yoy basis in November from 5.9% yoy in October, disappointing consensus expectations.

[1] See: https://www.bcb.gov.br/en/pressdetail/2374/nota

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- Turkey: The Central Bank of Turkey (CBT) kept the main policy rate unchanged at 17.0% and pledged to maintain tight monetary policy for an extended period and possibly hike rates further if needed. CBT acknowledged that credit expansion is responsible for the widening of the current account deficit and noted that credit growth has now started to slow.

- Malaysia: The yoy rate of CPI inflation increased to -1.4% in December from -1.7% yoy in November. Bank Negara Malaysia (BNM) kept its policy rate unchanged at 1.75% on the back of a more optimistic scenario for global economic recovery, but remains committed to using its policy levers to sustain the recovery. Most economists surveyed by Bloomberg expected a 25bps rate cut.

- China: The Chinese government asked people to avoid travelling during the Chinese New Year, which occurs between 11 February and 17 February 2021. Travelers will be required to present a test taken within seven days prior to travel. The People's Bank of China (PBOC) said interest rates are at an appropriate level, while the Ministry of Finance pledged to maintain a stable government leverage ratio, while expanding the scope for direct funding from the central government. In the regulatory space, PBOC published a draft directive with the objective of reducing market concentration in the online payment industry, where AliPay controls 55.6% and WeChat Pay has a market share of 38.8% (as of Q2 2020). PBOC advises the State Council's Regulatory Committee on companies that abuse their dominant positions in markets and even has the power to break up non-bank institutions if a company "severely hinders the healthy development of the payment market". Last week, ByteDance, the parent company of TikTok, launched a new online payment company called Douyin Pay. In economic news, China overtook the United States (US) as the largest recipient of inward bound foreign direct investment (FDI) in the world. In 2020, FDI to the US declined by 49% to USD 134bn, while flows to China increased by 4% to USD 163bn. The data on FDI flows is compiled by the United Nations Conference on Trade and Development (UNCTAD).

- Thailand: Exports increased 4.7% on a yoy basis in December from -3.7% yoy in November. This is the strongest expansion of exports in nearly two years. Import growth was also firm at 3.6% yoy. Exports of electronic products, electrical appliances, and rubber products were the main contributors to the expansion, whereas capital goods and raw materials dominated imports. In a bid to stimulate demand, the government approved a cash handout programme of THB 210bn (1.3% of GDP). Beneficiaries receive an e-credit, which can then be spent at retailers that are registered in the programme.

- Mexico: President Andres Manuel Lopez Obrador tested positive for Covid-19. The 67-year old says his symptoms are mild and that he is receiving treatment. The unemployment rate declined to 3.8% in December due to favourable seasonal effects. Some 95k jobs were lost. This was better than previous periods and consensus expectations, suggesting a sequential recovery of the Mexican labour market.

- Angola: The IMF published its fourth review of its programme with Angola.[2] The document describes Angola as a country striving to consolidate its debt burden after the oil price shock and associated recession in 2020. Angola's debt stock remains sustainable thanks to a recent debt re-profiling with bilateral investors and debt relief from the DSSI programme, which will cut USD 6.9bn of debt repayment until 2022. The 2021 Budget estimates that the fiscal surplus will be 0.3% of GDP with the ratio of external debt to GDP peaking at 101% in 2020 before declining sharply to 62% of GDP by 2025.

- Zambia: Glencore, the Anglo-Swiss commodity trading and mining company, said it has sold a 90% stake in Mopani Copper Mines for USD 1.5bn to Zambia's mining investment arm ZCCM which already owned 10% of the mine. The deal will be financed by Glencore at Libor +3% and will be repaid from mining revenues. The de facto nationalisation of the mine is bad news. Zambia's previous experiences with nationalisation of the mining industry in the late 1960s led to a structural decline in production.

Snippets:

- Argentina: The fiscal deficit closed the year at 8.5% of GDP as federal revenues declined by 0.3% of GDP to 17.9%, while spending rose 5.7% of GDP to 24.3% of GDP, mainly due to greater outlays associated with the coronavirus pandemic.
- Ghana: President Nana Akufo-Addo signalled policy stability by reappointing Ken Ofori-Atta as Finance Minister. The President also announced plans to cut the number of ministries from 36 to 29 in order to save money.
- Kenya: The Treasury Secretary Ukur Yatani said that China suspended USD 245m of debt service to the country due until June.
- India: High frequency activity data continues to improve as imports ex-oil and ex-gold for December rose to the highest level in 26-months. This implies a yoy rate of increase of 8.4%.
- Indonesia: Bank Indonesia kept its policy rate unchanged at 3.75% in line with consensus expectations.

[2] See: https://www.imf.org/en/Publications/CR/Issues/2021/01/19/Angola-Fourth-Review-Under-the-Extended-Arrangement-Under-the-Ext ended-Fund-Facility-and-50024

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Emerging Markets

- **Mongolia:** Prime Minister Ukhnaagiin Khürelsükh resigned from his post following a day of protests against the handling of the Covid-19 crisis in Ulaanbaatar. Mongolia has avoided a large coronavirus outbreak, reporting less than 1.6k infections since March 2020.
- **Nigeria:** Ratings agency Fitch said that the Federal Government of Nigeria borrowed NGN 2.8bn or 1.9% of GDP from the central bank to fund the 2020 fiscal deficit, taking total indebtedness to NGN 9.8tn.
- **Panama:** The IMF approved a new two-year USD 2.7bn Precautionary and Liquidity Line (PLL) as an insurance to enable the government to handle potential costs associated with Covid-19 pandemic.
- **Pakistan:** The current account deficit widened to USD 660m in December as imports jumped 32% on a yoy basis to USD 5.0bn. The rise in imports was partially compensated by a 16.2% yoy rise in remittances from foreign workers to USD 2.4bn.
- **Russia:** There were protests in major cities across Russia at the weekend in support of opposition leader Alexey Navalny, who is currently in government custody.
- **Singapore:** The yoy rate of CPI inflation rose to 0.0% in December from -0.1% yoy in January while core CPI declined to a deeper deflation at -0.3% yoy from -0.1% yoy over the same period.
- **South Korea:** Exports rose by 10.6% on a yoy basis on the first 20-days of January from 3.5% yoy in December.
- **Sri Lanka:** The central bank kept its deposit and lending policy rates unchanged at 4.5% and 5.5%, respectively. This represents a highly accommodative policy stance. The Minister of Finance reiterated that the government is not looking to engage with the IMF in the short term.
- **Tunisia:** Protesters took to the street and clashed with the police across several cities due to frustration over poor economy during a four-day national lockdown to stop covid-19

Global backdrop

- **Coronavirus:** Global Covid-19 cases approached 100 million with infections in US alone surpassing 25 million. The US makes up just over 4% of the world's population. However, the 7-day average of cases per million people declined last week across most of the world, including the US, Europe, South America and South Africa. In the UK, 7-day average cases collapsed from 881 per million to 548. Research from the Institute for Health Metrics and Evaluation (IHME)[3] suggests that the number of cases and hospital resource utilisation should decline over the next weeks in most large countries, due to a combination of mobility restrictions and inoculations from vaccines.

- **United States (US):** Janet Yellen expressed her support for a large fiscal expansion, urging lawmakers to "act big" now and worry about the debt later. This is in line with our expectation that the Biden administration will increase public spending significantly early on in order to ensure political support at the mid-term elections scheduled for November 2022.[4] President Joe Biden wasted no time following his inauguration signing 30 executive orders in its first three days in office. Notably, Mr. Biden's executive orders stopped the US withdrawal from the World Health Organisation, re-joined the Paris climate accord, cancelled the Keystone XL oil pipeline from Canada and restored collective bargain power and worker protections for Federal workers while laying the foundations to increase the minimum wage to USD 15 as well as a number of measures to deal with the coronavirus crisis. The US economic data was generally better than expected. The Citibank index of data rose a surprising 36.5% to 78.2, which is the highest level since 27 November 2020. All market surveys surprised significantly to the upside: Markit's January preview of Manufacturing PMI rose to 59.1 from 57.1 in December; Services PMI rose to 57.5 in from 54.8; and the Philadelphia Fed Business Outlook improved to 26.5 from 11.1 over the same period. Housing data was also better than expected. Initial claims for unemployment benefit remained high at 900k, but beat expectations (935k).

- **European Union (EU):** The European Central Bank (ECB) kept its key policy rate unchanged and confirmed the size of its Pandemic Emergency Purchase Programme (PEPP) at EUR 1.85tn. ECB maintained a flexible approach saying it may not use the entire PEPP budget if favourable financing conditions remain in place. Alternatively, it may increase the programme if required. In economic news, the Euro Area consumer confidence index declined 1.6 points to -15.5 in January, but auto registrations rose 10.4% in December after declining 7.2% in November.

- **United Kingdom (UK):** The yoy rate of CPI inflation rose to 0.5% in December from 0.2% yoy in November. In political news, the Scottish Prime Minister Nicola Sturgeon said she would seek to hold a second independence referendum even without government approval. The British government is considering tighter border controls, which may further adversely impact the UK economy.

[3] See https://covid19.healthdata.org/brazil?view=resource-use&tab=trend&resource=all_resources

[4] See: *'EM and the big Biden growth rotation'*, Market Commentary, 20 January 2021.

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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	7.88%	7.88%	7.88%	25.69%	6.78%	17.48%
MSCI EM Small Cap	3.73%	3.73%	3.73%	21.83%	2.44%	11.55%
MSCI Frontier	2.73%	2.73%	2.73%	2.41%	-1.26%	9.05%
MSCI Asia	9.31%	9.31%	9.31%	33.94%	9.36%	18.47%
Shanghai Composite	3.85%	3.85%	3.85%	20.61%	3.43%	6.71%
Hong Kong Hang Seng	8.75%	8.75%	8.75%	8.64%	-0.22%	11.91%
MSCI EMEA	2.93%	2.93%	2.93%	-4.50%	-3.97%	10.10%
MSCI Latam	-3.34%	-3.34%	-3.34%	-16.28%	-5.47%	11.17%
GBI EM GD	-1.21%	-1.21%	-1.21%	1.41%	1.52%	6.93%
ELMI+	-0.46%	-0.46%	-0.46%	1.32%	0.33%	4.01%
EM FX Spot	-0.88%	-0.88%	-0.88%	-5.22%	-5.58%	-1.14%
EMBI GD	-1.24%	-1.24%	-1.24%	2.91%	4.63%	7.06%
EMBI GD IG	-1.35%	-1.35%	-1.35%	6.44%	7.10%	7.46%
EMBI GD HY	-1.11%	-1.11%	-1.11%	-1.40%	1.87%	6.55%
CEMBI BD	-0.16%	-0.16%	-0.16%	5.59%	5.93%	7.32%
CEMBI BD IG	-0.26%	-0.26%	-0.26%	6.09%	6.32%	6.29%
CEMBI BD Non-IG	-0.02%	-0.02%	-0.02%	4.83%	5.41%	9.00%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	2.35%	2.35%	2.35%	17.75%	12.82%	17.32%
1-3yr UST	0.01%	0.01%	0.01%	2.97%	2.85%	1.83%
3-5yr UST	-0.17%	-0.17%	-0.17%	5.49%	4.49%	2.75%
7-10yr UST	-1.17%	-1.17%	-1.17%	7.38%	6.59%	3.83%
10yr+ UST	-3.74%	-3.74%	-3.74%	10.11%	9.60%	6.25%
10yr+ Germany	-1.08%	-1.08%	-1.08%	5.57%	7.93%	5.19%
10yr+ Japan	-0.40%	-0.40%	-0.40%	-1.94%	1.53%	2.31%
US HY	0.48%	0.48%	0.48%	6.92%	6.16%	9.28%
European HY	0.78%	0.78%	0.78%	2.12%	2.90%	5.31%
Barclays Ag	-0.71%	-0.71%	-0.71%	8.25%	4.42%	4.53%
VIX Index*	-3.69%	-3.69%	-3.69%	50.48%	89.21%	-9.28%
DXY Index*	0.21%	0.21%	0.21%	-7.90%	0.82%	-9.30%
CRY Index*	3.01%	3.01%	3.01%	-1.65%	-13.29%	7.72%
EURUSD	-0.30%	-0.30%	-0.30%	10.54%	-1.75%	12.27%
USDJPY	0.43%	0.43%	0.43%	-4.78%	-5.23%	-12.35%
Brent	7.07%	7.07%	7.07%	-8.62%	-21.24%	81.84%
Gold spot	-2.46%	-2.46%	-2.46%	17.04%	37.37%	67.13%

*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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