

Another week of hawkish surprises and faster vaccinations in EM

By Gustavo Medeiros

Emerging Markets (EM) countries are now vaccinating their populations at a faster rate than developed markets (DM), strengthening the outlook for economic recovery. At the same time, more EM central banks are turning hawkish quicker than expected. Mexico unexpectedly hiked rates by 25bps and Hungary hiked rates by 30bps as expected, but adopted a more hawkish tone in communications. Similarly, the Chilean central bank signalled rate hikes over the coming meetings. In other EM news, Chinese industrial profits rose to the highest level since 2017 and Brazil's finance minister forwarded a tax reform to Congress. In Peru, President-elect Pedro Castillo said he would like to stick with the current Central Bank Governor, Julio Velarde. Argentina reached a deal with the Paris club to avoid a default. Colombian protest leaders called for a truce due to security and healthcare concerns. Ratings agency Standard & Poor's kept Malaysia's sovereign rating unchanged at 'A-'. Thailand left the policy rate unchanged. China agreed to restructure the debt of the Republic of Congo. Zambia's fiscal accounts improved due to higher copper prices.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.5	–	1.42%
MSCI EM Small Cap	12.2	–	0.57%
MSCI Frontier	12.0	–	0.61%
MSCI Asia	14.8	–	1.28%
Shanghai Composite	11.8	–	2.50%
Hong Kong Hang Seng	10.1	–	2.24%
MSCI EMEA	10.1	–	1.02%
MSCI Latam	10.7	–	2.52%
GBI-EM-GD	5.04%	–	0.83%
China GBI-EM GD	3.16%	–	0.11%
ELMI+	2.61%	–	0.77%
EM FX spot	–	–	0.92%
EMBI GD	4.92%	332 bps	-0.24%
EMBI GD IG	3.19%	154 bps	-0.06%
EMBI GD HY	7.14%	560 bps	-0.44%
CEMBI BD	4.26%	289 bps	0.02%
CEMBI BD IG	3.05%	168 bps	-0.05%
CEMBI BD HY	5.86%	448 bps	0.11%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.3	–	2.76%
1-3yr UST	0.27%	–	0.01%
3-5yr UST	0.92%	–	-0.07%
7-10yr UST	1.53%	–	-0.56%
10yr+ UST	2.15%	–	-2.30%
10yr+ Germany	-0.16%	–	-1.42%
10yr+ Japan	0.69%	–	0.10%
US HY	3.85%	275 bps	0.37%
European HY	2.97%	340 bps	-0.04%
Bloomberg-Barclays	1.15%	-38 bps	-0.04%
VIX Index*	15.62	–	-5.08%
DXY Index*	91.86	–	-0.04%
EURUSD	1.193	–	0.05%
USDJPY	110.63	–	0.33%
CRY Index*	210.4	–	4.56%
Brent	76.1	–	1.63%
Gold	1,784	–	0.02%
Bitcoin	34,495	–	4.34%

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

Emerging Markets

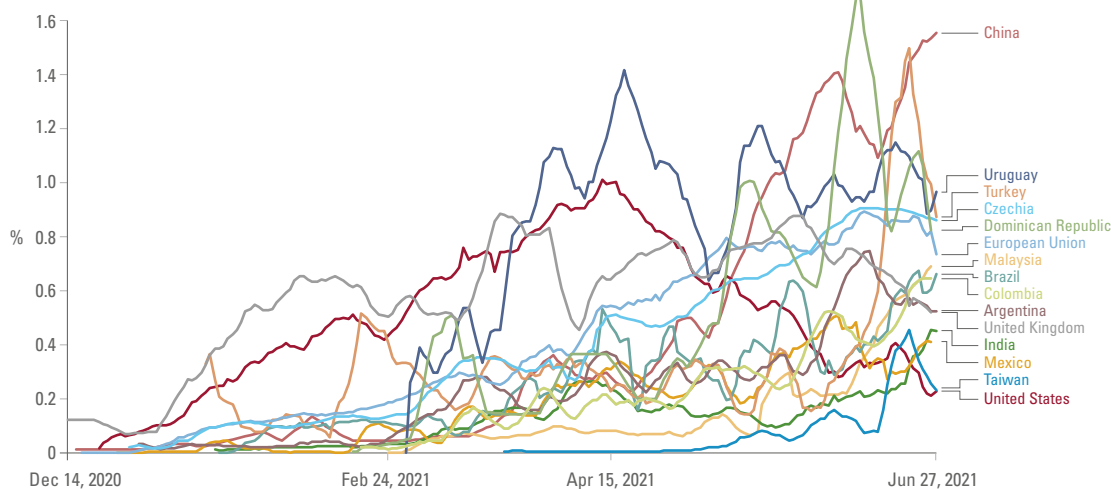
Pace of vaccinations: EM is now vaccinating on average 0.75% of its population per day, which is faster than DM (0.59% per day), according to UBS Research.¹ China vaccinated 21.5 million people per day on average last week (1.5% of population) as India's daily vaccination rate reached 8.6 million on 22 June, or a 7-day moving average rate of 5.0 million (0.4% of population).

Figure 1 shows large improvements in the pace of vaccinations last month in Uruguay, Turkey, Dominican Republic, Czech Republic, Malaysia, Colombia, Brazil, Argentina, Mexico, and Indonesia. All these large EM countries are now vaccinating at a faster pace than the US, which experienced a 2/3 drop in daily vaccinations due to vaccine hesitancy, with a large part of the population saying it wants to "watch and wait" before taking the jab. The US has only vaccinated 53.5% of its population with at least one dose, broadly similar to the European Union (EU) at 49.1%.

¹ See: UBS: Global Vaccination Tracker - EM now vaccinating faster than DM. As at 25-June-2021.

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Fig 1: Daily Covid doses per 100 people



Source: Our World in Data, as at 27 June 2021.

EM vaccinations are improving due to a combination of better supply as vaccine hoarders in DM have stopped purchasing jabs and improving logistics and management. In Indonesia, for example, vaccinations hit a record 1.3 million doses per day last week with the 4-day moving average rising to 0.8 million (0.3% of population) following logistical improvements. Specifically, Indonesians can now register for vaccination in any clinic, regardless of their home address and clinics are no longer required to reserve vaccines for the second shot. These changes mean that Indonesia may be able to reach its daily target of 1 million vaccinations per day from July onwards, which would put the country on track to have vaccinated the majority of its adult population in all major cities by the end of Q3 2021.

In another interesting development, Cuba is now vaccinating more than 1% of its population daily and has already inoculated 50% of the island using its indigenous vaccine called Abdala. This vaccine is 92.3% effective in protecting people against the coronavirus, according to local authorities.

EM central banks turn hawkish: Last week, the Central Bank of Mexico (Banxico) hiked the policy rate by 25bps to 4.25%, surprising all 23 economists surveyed by Bloomberg, who had expected the policy rate to remain unchanged. The central banks of Hungary and Czech Republic also hiked policy rates by 30bps and 25bps respectively, in line with consensus expectations, but the statement from the Hungarian Central Bank was more hawkish than expected. The Chilean central bank also kept rates unchanged, but signalled hikes in the future. Lastly, the minutes of the latest monetary policy committee meeting in Brazil corroborated a high likelihood of an accelerated pace of interest rate hikes over the coming months. The more hawkish stance anchors inflation expectations, which in turn helps to anchor the currency, while higher carry supports inflows into the local market. EM currencies rose 0.9% against the Dollar last week, led by the countries where central banks actions surprised to the hawkish side. Thus, MXN rose 4.2% last week followed by BRL (3.2%), and CLP (2.0%). The Hungarian forint was up 1.9%, while the Polish Zloty rallied 1.5%. On the negative side, currencies with less central bank support weakened. THB sold off by 1.0% while INR, PEN, and MYR were down by 0.4%. Malaysia's central bank may cut the policy rate over the coming weeks, while India and Thailand remain committed to keeping interest rates low for the time being.

Mexico: The Central Bank of Mexico (Banxico) surprised consensus expectations last week as it hiked its policy rate by 25bpt to 4.25%. The committee was split with 3 members voting for the hike and 2 members voting for no change. The statement following the meeting had a more hawkish tone, noting that the monetary policy committee's future decisions will depend on incoming data. The yoy rate of consumer prices index (CPI) inflation was unchanged at 6.0% in the first 15 days of June, while core CPI inflation rose 0.1% to 4.6% yoy. Retail sales declined 0.4% in April after rising 3.6% in March, but increased on a yoy basis to 30.1% from 2.5% over the same period.

Hungary: The National Bank of Hungary (NBH) increased its policy rate by 0.3% to 0.9%, in line with consensus expectations. However, the statement following the decision was more hawkish than expected. NBH revised its real GDP growth forecast to a yoy rate of 6.2% in 2021 from 5.0% yoy three months ago. NBH now sees the yoy rate of CPI inflation remaining slightly above the target ceiling of 4.0% throughout 2021.

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Chile: The minutes of the Central Bank of Chile's monetary policy committee showed its members discussed a policy rate hike in its June meeting, thus increasing the likelihood of a hike at the next meeting in July. In other news, the ministry of finance said it would increase the sale of US Dollars to USD 3.9bn in June from USD 3.0bn in May.

China: Industrial profits rose at a yoy rate of 36.4% in May following 57.0% yoy growth in April. Industrial profits thereby hit their highest level since 2017 and the highest historical result for the month of May. China's current account surplus declined to USD 69.4bn in Q1 2021 from USD 75.1bn in Q4 2020, reflecting a recovery in imports. In other news, ratings agency Standard & Poor's (S&P) kept China's sovereign credit rating unchanged at 'A+' with a stable outlook. In financial regulatory news, the People's Bank of China (PBOC) invited five large banks and the payments company Alipay to a meeting to re-emphasize a ban on transactions using cryptocurrencies. In pandemic related news, the former Deputy Head of the Chinese Centre for Disease Control and Prevention, Feng Zijian said the shift to open borders would largely depend on vaccination rates and a consensus about the acceptable level of deaths to the broader society, thus casting some doubt about the precise timing for China's further reopening of its borders.

Peru: In a market-friendly turn, President-elect Pedro Castillo said he would like to reappoint the orthodox economist Julio Velarde as the head of the Central Bank of Peru (CBP). Velarde has been the Chairman of the CBP since 2006. Castillo said he is "committed to maintain fiscal balance and improve the quality of public spending, promote investments, and respect the independence of the Central Bank." Castillo's statement came after Velarde had earlier signalled he would be leaving his post at the end of his current term.

Brazil: Finance Minister Paulo Guedes handed a tax reform to the President of the Lower House Arthur Lira. The reform would introduce a tax on dividend payments of 20% (currently 0%), while corporate income tax would gradually decline from 25% today to 22.5% in 2022 and 20% in 2023. The tax reform would also raise the floor for individual income tax from BRL 1.9k per month (USD 4.7k per year) to BRL 2.5k per month (USD 6.1k per year), thereby increasing the number of individuals exempt from income tax to 16.3 million from 10.7 million today. Last week, the Lower House approved the privatization of Eletrobras. In other political news, a poll by IPEC showed former President Luis Inacio Lula da Silva leading the 2022 presidential race with 49% of voting intentions versus 23% for President Jair Bolsonaro. In monetary policy news, the minutes of the June monetary policy committee (COPOM) showed its members discussing increasing the Selic policy interest rate by more than 75bps. Central Bank Governor Roberto Campos Neto said the COPOM will use all tools available to achieve the 3.5% inflation target in 2022 as the latest survey shows the median economists forecast for 2022 inflation at 3.8%. The Monetary Council set the 2024 inflation target at 3.0%, which is 25bps lower than the 3.25% target for 2023.² The yoy rate of CPI inflation rose to 8.1% in the first 15-days of June, which was slightly lower than consensus expectations, but higher than the 7.2% yoy rate recorded in May. In other news, the current account surplus hit a record USD 3.8bn in May, taking the last 12 month running current account deficit to only 0.6% of GDP.

Argentina: The Paris Club reached a deal with Argentina to avoid a debt default. Argentina will repay USD 430m instead of the USD 2.4bn due in June and has committed to conclude an agreement with the International Monetary Fund (IMF) by the end of March next year. Economic growth surprised to the upside last month, allowing the central government to post a primary deficit of only 0.1% of GDP for the first five months of 2021 compared to a deficit of 2.4% GDP at the same time last year. In other news, stock market index provider MSCI announced that Argentina will be removed from its main EM index and downgraded to standalone market status in November 2021. The expectation in some quarters was that Argentina would only be downgraded to 'Frontier Market', but capital controls for institutional investors led MSCI to remove Argentina from all its EM indices altogether.

Colombia: Leaders of the recent popular protests against the government have asked people to leave the streets in order to guarantee the safety of the population and stop the spread of coronavirus. Despite protests and mobility restrictions, economic activity recovered to pre-pandemic levels with the main economic activity indicator surging 28.7% on a yoy basis in April from 11.9% yoy in March. Retail confidence rose 6.9 to 32.5 in May, while the industrial confidence survey was up 1.9 to -3.2. The confidence survey oscillates between -100 and 100 with zero indicating neutral.

Malaysia: Ratings agency S&P affirmed Malaysia's sovereign credit rating at 'A-', and kept a negative outlook. The yoy rate of CPI inflation declined to 4.4% in May from 4.7% yoy in April, below consensus expectations, while the yoy rate of core CPI inflation rose 0.1% to 0.8%. Low inflation levels may enable Bank Negara Malaysia to cut the policy rate in upcoming meetings.

² The Monetary Council is formed by the central bank governor, minister of finance and minister of development.

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Thailand: Bank of Thailand (BoT) kept its policy rate unchanged at 0.5% in line with consensus expectations. BoT is likely to keep policy rates low at least until the country starts receiving tourists again. Exports rose at a yoy rate of 41.6% in May and imports rose by 63.4% on a yoy basis leading to a USD 796m trade surplus from USD 182m in April.

Republic of Congo: China agreed to restructure a USD 2.4bn debt owed by the Republic of Congo in a deal that will facilitate further engagement with the IMF. In a call with President Denis Sassou, Chinese President Xi Jinping said the deal would encourage more Chinese companies to invest in the Republic of Congo. Xi also pledged to provide Covid-19 vaccines.

Zambia: The Ministry of Finance said that revenues were 39% higher than budget estimates for the Jan-April period due to higher royalties from mining companies (mostly copper mines). The government cleared arrears and reduced funding from Bank of Zambia, thanks to higher revenues. The yoy rate of CPI inflation in May was 24.6%, up from 23.2% yoy in April.

Snippets:

- **Czech Republic:** The central bank hiked its policy rate by 0.25% to 0.50% in line with consensus expectations.
- **Ecuador:** In a positive measure to attract foreign direct investment (FDI), Ecuador re-joined the International Centre for Settlement of Investment Disputes (ICSID), a World Bank arbitration court that solves disputes with intentional investors.
- **Ivory Coast:** The yoy rate of CPI inflation rose to 4.2% in May from 3.9% yoy in April.
- **Namibia:** The yoy rate of real GDP growth – was -6.5% in Q1 2021 comparead to -5.9% yoy in Q4 2020.
- **Philippines:** The Philippines Central Bank kept its policy rate unchanged at 2.0%, in line with consensus expectations. The Central bank said it expects CPI to settle at 4.0% this year before easing to 3.0% in 2022.
- **Poland:** Construction output rebounded to yoy rate of 4.7% in May from -4.2% yoy in April, while retail sales surged 8.2% mom in May (19.1% yoy) from -7.7% mom (25.7% yoy) in April.
- **South Africa:** The yoy rate of CPI inflation rose to 5.2% in May from 4.4% yoy in April, in line with consensus expectations, while core CPI inflation rose only 0.1% to 3.1% yoy over the same period. A spike in fuel prices was the main factor behind the higher inflation rate. Inflation may have peaked in South Africa last month.
- **Singapore:** The yoy rate of CPI inflation rose to 2.4% in May from 2.1% yoy in April, while core CPI inflation rose to only 0.8% yoy from 0.6% yoy over the same period.
- **South Korea:** Bank of Korea Governor Lee Ju-yeol signalled a more hawkish policy stance. Still, he indicated that monetary policy would remain accommodative even after 25-50bps of rate hikes.
- **Sri Lanka:** The government announced a 1.2% of GDP increase in 2021 spending on top of an already enlarged budgeted deficit of 10.7% of GDP.
- **Taiwan:** The yoy rate of industrial production (IP) rose 16.5% in May from 14.1% yoy in April, surpassing the consensus expectation of 13.1% yoy.
- **Turkey:** Consumer confidence rose to 81.7 in June from 77.3 in May, but remains close to the lowest levels since 2012.

Global backdrop

Commodities: The prices of oil (Brent first future) rose 3.6% to USD 76.2 per barrel. The Energy Information Administration (EIA) reported US stockpiles fell for a fifth week in a row, with a draw of 7.6 million barrels against 3.9 million forecasted, leading to continued tightness in the oil market. Iran and the nuclear global powers agreed to lift 1,040 sanctions imposed on Iran by the Trump administration, but Iran requested the removal of pre-Trump sanctions as well, which has delayed a final deal, which may now have to be negotiated by Iran's new conservative President Ebrahim Raisi. The Organisation of the Petroleum Exporting Countries (OPEC) is reportedly considering easing production curbs by 500k barrels per day in August.

Iron ore prices declined 5.3% on the announcement that China would sell strategic reserves of the metal, but subsequently rebounded 8.0% to USD 222 per metric ton. This followed comments by Glencore CEO Ivan Glassenberg that Chinese selling would only reduce prices temporarily as strong underlying demand continues to support prices. The rise in prices of industrial and precious metals accelerated from Wednesday last week after the China National Food and Strategic Reserves Administration announced that it would sell less than the expected quantities of state stockpiles. The first batch for release next month will include 20,000 tons of copper, 30,000 tons of zinc, and 50,000 tons of aluminium.

Global backdrop

United States: President Joe Biden announced a deal with a group of 10 Senators from both political parties to invest USD 1.2tn in infrastructure in eight years, of which USD 579bn is from new resources.³ The programme focuses on physical infrastructure such as railways, road and bridge maintenance, building a national network of electric vehicle (EV) charging points, and building highways in rural communities. In other news, the Supreme Court rebuffed the third attempt to nullify the Affordable Care Act, otherwise known as Obama-Care. The decision illustrates the independence of the court in which two-thirds of the judges were appointed by Republican presidents with conservative values.

In economic news, initial jobless claims declined to 411k in 19 June from 418k in the previous week, while continuing claims declined to 3.4 million in 12 June from 3.5 million in the previous week. Surveys of economic activity disappointed at the margin as the University of Michigan sentiment survey declined 0.9 to 85.5 in June, while the IHS Markit manufacturing PMI rose 0.5 to 62.6, but services PMI declined 5.6 to 64.8. Unpacking the manufacturing PMI print, input prices rose 5.0 to 83.8 and output prices rose 0.9 to 71.8. Durable goods orders rose 2.3% in May against 2.8% expected and -0.8% in April. The US current account deficit widened to USD 196bn in Q1 2021 from USD 175bn in the previous quarter, while the trade deficit widened USD 2.9bn to USD 88.1bn in May. The housing market was softer than expected as new home sales declined 5.9% in May to 769k from 817k in April and 993k at the peak in January. Mortgage applications rose 2.1% in the first week of June after rising 4.2% in the previous week, but remain 30% below their peak in early January. The yoy rate of PCE price deflator rose 0.4% to 3.9% in May, while core PCE increased 0.5% to 3.4% yoy, in line with consensus expectations. Nominal income declined 2.0% and real consumer spending was down 0.4% in May, both below consensus expectations.

Europe: Germany's incumbent alliance of the CDU and CSU parties published its election manifesto, which rejected any softening of Germany's constitutional debt brake. The programme argued for a return as quickly as possible to a balanced fiscal budget and a debt to GDP ratio below 60%. Eurozone composite PMI rose to 59.2 in June from 57.1 in May, slightly better than consensus expectations. Germany's manufacturing PMI rose to 64.9 in June from 64.4 in May, while the flash services PMI rose to 58.1 from 52.8 over the same period, both ahead of consensus expectations.

United Kingdom: Bank of England kept its policy rate and asset-purchasing programme unchanged. Departing Chief Economist Andy Haldany voted to reduce the pace of asset purchases.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.47%	5.39%	7.75%	40.50%	11.72%	14.35%
MSCI EM Small Cap	1.99%	10.90%	19.43%	62.63%	12.00%	12.90%
MSCI Frontier	1.76%	13.06%	13.97%	36.38%	7.58%	9.26%
MSCI Asia	0.04%	3.79%	6.53%	39.34%	12.34%	15.71%
Shanghai Composite	0.44%	5.70%	4.76%	23.92%	10.60%	7.18%
Hong Kong Hang Seng	0.38%	0.24%	2.43%	12.92%	2.83%	8.96%
MSCI EMEA	-0.16%	8.15%	16.93%	36.85%	7.11%	8.17%
MSCI Latam	4.38%	16.98%	10.82%	43.18%	6.54%	7.86%
GBI-EM-GD	-0.84%	3.93%	-3.01%	6.31%	4.19%	3.91%
China GBI-EM GD	-1.38%	2.88%	3.19%	11.75%	na	na
ELMI+	-0.87%	2.38%	-0.25%	6.78%	2.16%	2.67%
EM FX spot	-0.75%	2.67%	-1.02%	4.56%	-2.82%	-2.40%
EMBI GD	0.66%	3.99%	-0.73%	7.54%	6.62%	5.17%
EMBI GD IG	1.12%	2.71%	-2.73%	2.82%	7.82%	5.39%
EMBI GD HY	0.16%	5.46%	1.60%	13.37%	5.20%	4.85%
CEMBI BD	0.68%	1.94%	1.12%	8.49%	7.41%	5.89%
CEMBI BD IG	0.59%	1.37%	-0.34%	5.17%	7.04%	5.00%
CEMBI BD HY	0.81%	2.69%	3.11%	13.19%	7.88%	7.26%

³ See <https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/24/fact-sheet-president-biden-announces-support-for-the-bipartisan-infrastructure-framework/>

Benchmark performance

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.92%	8.11%	14.78%	40.99%	18.51%	18.23%
1-3yr UST	-0.22%	-0.09%	-0.14%	0.06%	2.71%	1.60%
3-5yr UST	-0.53%	0.17%	-1.17%	-0.89%	4.17%	2.07%
7-10yr UST	0.31%	1.94%	-3.91%	-4.73%	5.75%	2.28%
10yr+ UST	2.03%	4.87%	-9.30%	-11.82%	7.69%	3.19%
10yr+ Germany	0.39%	-1.50%	-7.67%	-5.49%	4.25%	1.38%
10yr+ Japan	0.30%	0.68%	-0.09%	-0.10%	1.02%	-0.41%
US HY	1.07%	2.47%	3.34%	14.28%	7.20%	7.45%
European HY	0.61%	1.63%	3.49%	12.07%	4.30%	4.90%
Bloomberg-Barclays Agg	-0.87%	1.32%	-3.20%	2.65%	4.22%	2.44%
VIX Index*	-6.80%	-19.48%	-31.34%	-55.02%	-7.30%	-16.69%
DXY Index*	2.03%	-1.47%	2.13%	-5.72%	-3.62%	-4.56%
CRY Index*	2.29%	13.76%	25.40%	56.54%	5.80%	9.85%
EURUSD	-2.47%	1.66%	-2.39%	6.08%	3.08%	7.77%
USDJPY	0.96%	-0.08%	7.15%	2.84%	0.13%	7.66%
Brent	9.81%	19.80%	46.95%	85.57%	-2.22%	56.69%
Gold	-6.47%	4.44%	-6.05%	0.61%	42.88%	35.96%
Bitcoin	-5.99%	-41.49%	18.96%	278.66%	470.64%	5,228.29%

*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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