Issued: 12 October 2020

WEEKLY INVESTOR RESEARCH

Ashmore

Indonesia approves a busload of reforms

By Gustavo Medeiros

Indonesia approved the 900-page omnibus law aimed at creating jobs and attracting investment. The Chinese renminbi rose sharply after markets reopened following a week-long bank holiday. Ecuador appointed a new finance minister, but maintains the same policies. The economic data continued to surprise to the upside in Brazil and India. Gazprom was fined over Nordstream 2 by Poland. Kyrgyzstanis took to the streets to protest against rigged elections. Turkey issued new debt at expensive levels. The Mexican central bank's monetary policy committee was divided over further cuts. Fighting re-erupted in Nagorno-Karabach.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.7	–	3.78%
MSCI EM Small Cap	12.1	–	2.97%
MSCI Frontier	12.8	–	3.10%
MSCI Asia	14.7	–	3.77%
Shanghai Composite	12.8	–	1.52%
Hong Kong Hang Seng	8.5	–	2.35%
MSCI EMEA	10.3	–	1.62%
MSCI Latam	12.3	–	5.88%
GBI-EM-GD	4.46%	–	1.58%
ELMI+	1.47%	–	1.26%
EM FX spot	–	–	1.36%
EMBI GD	4.98%	412 bps	1.45%
EMBI GD IG	2.85%	194 bps	0.99%
EMBI GD HY	7.90%	710 bps	2.02%
CEMBI BD	4.51%	388 bps	0.65%
CEMBI BD IG	3.00%	237 bps	0.49%
CEMBI BD Non-IG	6.63%	600 bps	0.88%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.6	–	3.89%
1-3yr UST	0.16%	–	-0.04%
3-5yr UST	0.34%	–	-0.16%
7-10yr UST	0.78%	–	-0.57%
10yr+ UST	1.58%	–	-1.63%
10yr+ Germany	-0.53%	–	0.06%
10yr+ Japan	0.00%	–	-0.23%
US HY	5.32%	469 bps	1.20%
European HY	4.41%	525 bps	0.77%
Barclays Ag	0.91%	13 bps	0.34%
VIX Index*	25.00	–	-2.63%
DXY Index*	93.02	–	-0.49%
EURUSD	1.1819	–	0.31%
USDJPY	105.49	–	-0.25%
CRY Index*	151.74	–	7.62%
Brent	42.5	–	2.98%
Gold spot	1930	–	0.85%

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

Emerging Markets

- Indonesia: Parliament approved a 900-page multifaceted omnibus bill aimed at creating jobs and attracting investment by boosting competitiveness across the economy. The law aims to improve the flexibility of labour markets, cut red tape, simplify business licensing, and provide a regulatory framework for investment in new industries. The bill also centralises regulatory power at the federal government level, thus reducing uncertainty for long-term investors. In other news, Jakarta announced that social distancing rules will be relaxed starting on 12 October following a 'flattening' of the number of confirmed cases in the city. Restaurants will be reopen with a 50% maximum capacity, whereas gyms and cinemas may utilise 25% of their capacity.

- China: The Renminbi (RMB) strengthened by 1.4% against the Dollar last week on pent up demand after markets reopened following China's one-week Golden Week holiday. RMB is 3.7% stronger against the USD ytd thanks to a combination of continuing inflows to both equity and bond markets[1] as well as fewer outflows associated with Chinese tourism abroad. China's trade surplus has also increased and the Dollar has weakened independently of anything happening in China. RMB strength enabled the People's Bank of China (PBOC) to cut the reserve ratio for financial institutions with long Dollar positions in the FX forward market to 0% from 20%, thus effectively cutting the cost of hedging against currency weakness, but in so doing also discouraging further rapid RMB appreciation. In other news, the Korea Institute for Industrial Economics and Trade said that only 80 companies (out of thousands) moved their operations in China back to South Korea in response to a bill, which was introduced in 2013 to stem increased levels of Korean production in China. In economic news, the Caixin services purchasing managers index (PMI) rose to 54.8 in September from 54.0 in August. Also, China launched a pilot scheme to test the potential for broader utilisation of digital currency in retail. The pilot scheme revolves around RMB 10m of gift cards, which can be redeemed in 3,389 designated shops.

[1] See: *'Chinese Government Bonds: Temporary domestic technical headwinds offer springboard for greater foreign participation'*, Market Commentary, 15 September 2020.

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Emerging Markets

- Ecuador: Richard Martinez resigned from his position as Finance Minister shortly after closing a USD 6.6bn deal with the IMF. During his time in office, Martinez oversaw an innovative and extremely successful sovereign debt restructuring. However, Martinez has been the subject of political attacks from members of parliament despite his outstanding job during an exceptionally challenging period. Ecuador's new Finance Minister is Mauricio Pozo, who is market-friendly and highly experienced economist. He will continue the policies of his predecessor. Pozo is in favour of Ecuador's system of dollarisation. He served as Finance Minister from 2003 to 2005. His main job will be to implement the reforms and fiscal adjustments required under the IMF agreement. Martinez is taking up a post at the Inter-American Development Bank.

- Brazil: Retail sales rose 4.6% in August after rising 7.1% in July, buoyed by strong growth in apparel and vehicle sales. Retails sales are now running about 2% above pre-pandemic levels. Vehicle production rose 12% in September after a 21% expansion in August. Vehicle exports rose 28% in September after contracting 14% in August. The yoy rate of consumer prices index (CPI) inflation rose to 3.1% in September from 2.4% yoy in August.

- India: Services PMI rose to 49.8 in September from 46.0 in August. On the policy front, the government appointed Ashima Goyal, Jayanth Varma, and Shashanka Bhide as external members of the Reserve Bank of India (RBI)'s monetary policy committee (MPC) for 4-year terms. Goyal and Varma have publicly advocated for more pro-active monetary accommodation. External MPC members have limited direct influence over policy rates, but can influence broader monetary policy matters within the MPC. Last week, the MPC left the policy rate unchanged at 4.0% in a unanimous decision, which was also in line with consensus expectations.

- Russia: The Polish antitrust watchdog announced a USD 7.6bn fine on Gazprom over the construction of the Nordstream 2 gas pipeline, which links Russia directly with Germany. The fine is not binding as it is not a European Court of Justice final decision. Russia will appeal the fine. Germany is under intense political pressure to cancel Nordstream 2 following the poisoning of Russia opposition politician Alexei Navalny. Nordstream 2 is unlikely to lead to increased gas supplies to Germany, because existing pipelines reaching Germany via the Baltics and Ukraine already have excess capacity. However, Nordstream 2 is useful for Germany as a way of reducing the risks surrounding Russian export to the country, including dependence on gas supplies via Ukraine. In other news, the yoy rate of CPI inflation rose modestly to 3.7% in September from 3.6% yoy in August.

- Kyrgyzstan: Kyrgyzstan has been plunged into political uncertainty following a disputed election. Former President Almazbek Atambayev was arrested last Saturday as the incumbent President Sooronbay Jeenbekov attempts to consolidate power. Parliament named Sadyr Zhaparov, a nationalist politician, as the country's new prime minister. Zhaparov has been in jail since 2013. He was only freed last week after demonstrators stormed government buildings in the capital Bishkek. The president declared a state of emergency after protesters took to the streets to dispute the result of the recently held presidential election.

- Turkey: The government issued USD 2.5bn of new 5-year Eurobonds at a yield of 6.4%. The sale attracted demand of about USD 6.0bn, which is not a lot compared to normal levels of demand for Emerging Markets (EM) high yield bond issues. The yield implies a 600bps spread over US Treasuries, which is twice the spread compared to a similar bond issued in January 2014. Turkey's wide sovereign credit spread is justified by the deep macroeconomic imbalances in the country.[2] Turkey's local currency government bond market has gradually dried up as locals and foreigners shun local currency exposure due to high levels of inflation and elevated risk of currency weakness. Consistent excessive credit creation has led to overheating, while neglect of reforms has increased the cost of doing business. The tendency towards ever more authoritarian government in Turkey suggests that the economic imbalances will continue to deteriorate.

- Mexico: The minutes from the most recent monetary policy committee meeting of the Bank of Mexico revealed broad disagreement about the direction of future monetary policy. Two voting members favoured cutting rates further, while another two members were against further cuts. A fifth member insisted on data-dependent decisions. In other news, the popularity of President Andres Manuel Lopez increased as his approval rate rose to 62% in September from 59% in August.

- Armenia-Azerbaijan conflict: Renewed fighting erupted over the weekend in the Nagorno-Karabach conflict with both sides accusing each other of breaching a temporary cease-fire brokered by Russia. The ceasefire was put in place to allow the Red Cross to collect bodies and provide humanitarian assistance to displaced people.

Snippets:

- Argentina: Tax collection rose 5.5% on a yoy basis in real terms in September after declining 11% yoy in August. Tax revenues from sales of personal goods and high income tax collection compensated for overall lower VAT revenues.
- Belarus: Protests continue in Minsk and other cities in Belarus. President Alexander Lukachenko met with jailed opposition leaders in an attempt to win support for proposed constitutional reforms.
- Chile: The yoy rate of CPI inflation rose to 3.1% in September from 2.4% yoy in August.

[2] See: *'The Earth is still turning'*, Weekly investor research, 6 April 2020.

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Emerging Markets

- **Colombia:** CPI inflation rose at a yoy rate of 2.0% in September from 1.9% yoy in August.
- **Costa Rica:** President Carlos Alvarado announced he will not go ahead with the reforms envisaged in an initial proposal to the IMF following street demonstrations and congressional opposition to the measures.[3] Alvarado said that he intends instead to present a new plan centred on expenditure cuts rather than tax increases.
- **Dominican Republic:** The government submitted its 2021 budget proposal to Congress targeting a fiscal deficit of 3.0% of GDP next year compared to 9.3% of GDP in 2020. The adjustment implies an expenditure cut of 4.7% of GDP and increases in taxes of 1.6% of GDP.
- **Egypt:** The yoy rate of CPI inflation rose to 3.3% in September from 0.8% yoy in August.
- **Ghana:** Bank of Ghana Deputy Governor Maxwell Opoku-Afari discussed the problems associated with a debt cancellation proposal put forward by the World Bank in a public seminar, arguing that it would have negative repercussions for market access.
- **Malaysia:** Industrial production slowed to a yoy rate of 0.3% in August from 1.2% yoy in July.
- **Nigeria:** The current account deficit narrowed to USD 3.2bn in Q2 2020 from USD 5.6bn in Q1 2020 as the financial account received a USD 4bn inflow due to a USD 3.4bn IMF short-term loan. Net reserves increased by USD 2.0bn.
- **Philippines:** CPI inflation declined to 2.3% on a yoy basis in September from 2.4% yoy in August. The trade deficit widened to USD 2.1bn in August from USD 1.9bn in July.
- **Poland:** The Central Bank of Poland kept its monetary policy rate unchanged at 0.1% in line with consensus expectations.
- **South Korea:** The yoy rate of CPI inflation rose to 1.0% in September from 0.7% in August led by an increase in food prices. The core CPI inflation index rose 0.9% on a yoy basis in September from 0.8% yoy in August.
- **Taiwan:** Exports rose by 9.4% on a yoy basis in September and imports contracted 5.4% yoy. This resulted in a record trade surplus of USD 7.1bn. However, exports declined by 5.6% yoy after adjusting for the number of business days.
- **Uruguay:** CPI inflation rose at a yoy rate of 9.9% in September from 9.8% yoy in August.

Global backdrop

- **Negative real yields:** JP Morgan estimates 76% of all sovereign bonds issued in developed economies now offer a negative real yield. Owning these bonds over the long term impairs the purchasing power of pension funds, insurance companies, and other investors. In sharp contrast, negative real yielding bonds are rare in EM with JP Morgan reporting that 84% of all EM sovereign bonds have positive real yields. Two-thirds of the countries with negative real yields in EM are in Eastern Europe, where low rates are necessary to avoid an overvaluation of their local currencies versus EUR.

- **US:** The past week was marked by constant negotiations over a new fiscal stimulus bill. The talks pit Nancy Pelosi, Leader of the House of Representatives, against Treasury Secretary Steve Mnunchin. Republicans offered a USD 1.8 trillion stimulus package, according to press reports. This is close to the USD 2.2 trillion stimulus already approved by the Democrats in the House of Representatives. President Donald Trump urged Congress to extend payroll assistance worth USD 25bn to US airline companies following news that American Airlines has begun to lay off 32k employees. American Airlines pledged that it may reverse the planned layoffs if government assistance is forthcoming. The US Travel Association says that 1.3m additional jobs (equivalent to 50% of all travel-support staff jobs) could be lost without immediate aid. Boston Fed Eric Rosengren said "it´s tragic that it has not been employed already" in reference to the stimulus bill as Dallas Federal Reserve President Robert Kaplan acknowledged that "the Fed can ease financial conditions but we can´t replace lost income, that´s uniquely suited to fiscal policy". Members of the Federal Reserve's Monetary Policy Committee are overwhelmingly in favour of achieving a higher rate of inflation with Chicago Fed President Charles Evans saying that he would welcome 2.5% inflation for a time, stating "we have to cross over, beyond 2%, with some momentum".
In other economic matters, the US trade deficit widened to USD 67.1bn in August from USD 63.4bn in July. This is the widest deficit since 2006 and points to real exchange rate overvaluation in the US. Such overvaluation is likely to reverse[4] as the US embarks on simulative fiscal and monetary policies which historically led to currency weakness.

- **EU:** German car production rose by 25% in the month of September, but remains 15% below the level at the beginning of Q1 2020.

[3] See: *'China's vaccine to be distributed to EM countries'*, Weekly investor research, 28 September 2020.
[4] See: *'US elections and EM'*, The Emerging View, 9 October 2020.

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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	3.80%	3.80%	2.81%	15.92%	3.44%	8.39%
MSCI EM Small Cap	3.40%	3.40%	1.10%	11.05%	-0.10%	4.49%
MSCI Frontier	3.22%	3.22%	-5.70%	1.13%	-1.09%	4.12%
MSCI Asia	3.85%	3.85%	9.66%	23.52%	5.73%	10.18%
Shanghai Composite	1.68%	1.68%	9.76%	14.48%	1.36%	2.84%
Hong Kong Hang Seng	2.35%	2.35%	-10.51%	-1.70%	-1.75%	2.39%
MSCI EMEA	1.87%	1.87%	-18.29%	-8.71%	-3.60%	0.19%
MSCI Latam	5.27%	5.27%	-32.56%	-24.48%	-10.14%	1.05%
GBI EM GD	1.78%	1.78%	-4.65%	-0.62%	1.31%	3.82%
ELMI+	1.47%	1.47%	-2.59%	0.67%	0.56%	2.01%
EM FX Spot	1.55%	1.55%	-9.79%	-6.98%	-5.70%	-3.70%
EMBI GD	1.55%	1.55%	1.03%	2.66%	3.99%	6.00%
EMBI GD IG	1.11%	1.11%	6.97%	7.64%	7.14%	6.91%
EMBI GD HY	2.09%	2.09%	-5.87%	-3.25%	0.42%	4.88%
CEMBI BD	0.74%	0.74%	3.34%	5.23%	4.94%	6.17%
CEMBI BD IG	0.53%	0.53%	5.16%	5.82%	5.70%	5.67%
CEMBI BD Non-IG	1.03%	1.03%	0.77%	4.29%	3.90%	7.05%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	3.46%	3.46%	9.22%	21.38%	13.13%	13.78%
1-3yr UST	-0.06%	-0.06%	3.05%	3.24%	2.64%	1.80%
3-5yr UST	-0.21%	-0.21%	6.00%	5.47%	4.06%	2.79%
7-10yr UST	-0.71%	-0.71%	10.66%	8.41%	6.58%	4.36%
10yr+ UST	-2.10%	-2.10%	18.80%	12.96%	11.32%	7.82%
10yr+ Germany	0.14%	0.14%	7.51%	0.81%	7.82%	5.67%
10yr+ Japan	-0.24%	-0.24%	-2.09%	-3.21%	1.77%	2.90%
US HY	1.36%	1.36%	1.99%	5.12%	4.60%	6.62%
European HY	1.13%	1.13%	-2.32%	0.52%	1.52%	3.87%
Barclays Ag	0.35%	0.35%	6.10%	6.21%	4.35%	3.84%
VIX Index*	-5.20%	-5.20%	81.42%	60.46%	152.27%	46.37%
DXY Index*	-0.92%	-0.92%	-3.50%	-5.37%	-0.04%	-1.92%
CRY Index*	2.18%	2.18%	-18.33%	-13.80%	-17.21%	-25.14%
EURUSD	0.84%	0.84%	5.40%	7.20%	-0.09%	4.05%
USDJPY	0.01%	0.01%	-2.87%	-2.68%	-6.06%	-12.12%
Brent	3.83%	3.83%	-35.58%	-29.73%	-24.41%	-14.72%
Gold spot	2.33%	2.33%	27.18%	29.23%	49.16%	65.81%

*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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