

Events in the Middle East raise geopolitical concerns, but lower conflict risks in the near future

By Gustavo Medeiros

Argentina's first measures in a positive direction according to the IMF. Oman has a new Sultan facing old challenges. Taiwan president re-elected as economy rebounds. Chile ends FX intervention after a large trade surplus in December. Indonesia raises USD 22.8bn from the UAE to invest in infrastructure. Ecuador oil production increases. China's 2020 inflation target unchanged. Morocco invests to secure water supply. Ethiopia reforms boost human rights in anti-terror legislation reform.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.7	—	0.88%
MSCI EM Small Cap	10.9	—	0.03%
MSCI Frontier	11.0	—	0.32%
MSCI Asia	12.3	—	1.31%
Shanghai Composite	10.1	—	0.28%
Hong Kong Hang Seng	7.9	—	0.13%
MSCI EMEA	9.6	—	0.52%
MSCI Latam	12.3	—	-1.66%
GBI-EM-GD	5.16%	—	0.46%
ELMI+	3.01%	—	0.48%
EM FX spot	—	—	0.15%
EMBI GD	4.88%	302 bps	0.28%
EMBI GD IG	3.50%	162 bps	0.06%
EMBI GD HY	6.73%	490 bps	0.53%
CEMBI BD	4.86%	309 bps	0.42%
CEMBI BD IG	3.60%	183 bps	0.17%
CEMBI BD Non-IG	6.59%	482 bps	0.75%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	16.9	—	0.98%
1-3yr UST	1.58%	—	-0.05%
3-5yr UST	1.64%	—	-0.15%
7-10yr UST	1.83%	—	-0.23%
10yr+ UST	2.29%	—	-0.56%
10yr+ Germany	-0.19%	—	-1.14%
10yr+ Japan	0.00%	—	-0.41%
US HY	5.04%	327 bps	0.23%
European HY	3.38%	352 bps	0.12%
Barclays Ag	1.43%	-40 bps	-0.48%
VIX Index*	12.56	—	-1.46%
DXY Index*	97.40	—	0.73%
EURUSD	1.1126	—	-0.62%
USDJPY	109.63	—	-1.17%
CRY Index*	184.13	—	-2.77%
Brent	65.0	—	-5.65%
Gold spot	1552	—	-0.78%

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

Emerging Markets

- Argentina:** The Treasury borrowed an additional USD 3.2bn from the Central Bank (BCRA), completing the USD 4.6bn outlined by the December emergency economic bill. The foreign exchange will allow for coupon payments during re-profiling discussions with bondholders. Last week, the Finance Secretary Diego Bastourre asked specialised companies to identify bondholders of sovereign debt to begin the re-negotiation process. In other news, the rating agency S&P has raised Argentina's rating to CCC- from CC, citing the administration willingness and commitment to paying the upcoming debt. The IMF director Alejandro Werner said the first measures of the Fernandez administration were heading in a "positive direction", but a detailed medium-term plan is needed.
- Oman:** Sultan Qaboos bin Said al Said has died over the weekend following a long illness. Qaboos has been instrumental in dealing with schisms in the region. He brokered the early stages of the Iran-US deal under Obama in 2015 and managed to stay away from regional conflicts with Qatar and Yemen. Furthermore, with the country's finances in a precarious state, a leadership vacuum could be problematic. But a swift transition has ensued with Qaboos' cousin Haitham bin Tariq Al Said appointed as the new Sultan. The Oxford-educated former minister has the best chance of delivering a smooth transition, given his ample experience in foreign affairs and cabinet management. Balancing an urgent fiscal consolidation while building his popularity will be the Sultan's first challenge while upholding Oman's doctrine of being an "enemy to no one and friend to all" will be his most important test, over the medium term. In his first speech, the Sultan pledged to keep promoting peaceful solutions to regional and global crises.
- Taiwan:** The incumbent President Tsai Ing-wen secured re-election with more than 50% of votes in an election dominated by the relations with Beijing after concerns over the unrest in Hong Kong. In economic news, exports rose by 4.0% on a yoy basis in December, from 3.3% yoy in November. Imports increased by 13.9% on a yoy basis in December led by a surge of 158% on a yoy basis on imports of semiconductor equipment, suggesting a robust rebound on the tech cycle and 5G orders.

Emerging Markets

- **Chile:** The Central Bank of Chile (BCCh) stopped FX sales in both spot and forward markets last week and will only roll outstanding FX forwards in the future. FX reserves rose to USD 40.6bn in December from USD 38.8bn in November, in spite of the significant interventions, due to a USD 1.5bn trade surplus, the biggest since 2014. CLP will be under pressure in the short term as the famous online retail consultant Felices y Forrados recommended investors to switch from 100% "fund E", composed mostly of local bonds, to 50% "fund E" and 50% "fund A" which has approximately 2/3 in foreign equities. In other news, CPI inflation rose to a yoy rate of 3.0% in December, from 2.7% yoy in November, closing the year at the mid-point of the BCCh target.
- **Indonesia:** President Joko Widodo secured a USD 22.8bn investment from the UAE in his Sovereign Wealth Fund project to develop infrastructure, energy and telecommunications projects in Indonesia. The deal was announced alongside other private agreements during Jokowi's visit to Abu Dhabi.
- **Ecuador:** The state-owned Petroamazonas raised oil production from 407k barrels per day to 424k, a 4% increase in 2019. Overall, the country produced 529k barrels of oil per day, on average, in the first eleven months of 2019 up from 515k in the same period of 2018. The country's 2020 budget conservatively forecasts a 534k production for 2020, with an average price of USD 51.3. In other news, CPI inflation was flat in December after declining by -0.7% in November as the economy remained weak after the protests in October.
- **China:** The PBOC kept a 3% inflation target for 2020, in spite of high pork prices, favouring a prudent monetary policy framework. CPI inflation rose at a yoy rate of 4.5% in December, unchanged from the previous month, and lower than the consensus forecast. In contrast, PPI deflation increased to -0.5% yoy in December from -1.4% yoy in November. China announced it would fully open the oil and gas exploration industry to private and foreign firms, in a market previously dominated by state-owned firms.
- **Morocco:** Local state news said Morocco budgeted USD 12bn between 2020 and 2027 to secure water supply with measures including building a dam, reducing water consumption, preserving water resources and increasing availability in rural areas. Pro-active investment is the only way for Emerging Markets countries to hedge against environmental challenges until developed countries agree on a comprehensive framework, such as an enforceable carbon credit mechanism, to tackle climate change sustainably.
- **Ethiopia:** The Parliament replaced an old anti-terror legislation with a far less repressive new law which prohibits police searches without an order, bans detentions for more than two days without charges and allows the suspects to have access to formal legal process. In other news, inflation declined to a yoy rate of 19.5% in December, from 20.8% yoy in November, surprising relative to expectations.
- **Philippines:** CPI inflation accelerated to a yoy rate of 2.5% in December from 1.3% yoy in November. The main culprit was a sharp increase in the price of agricultural products due to the impact of two typhoons in December. Core inflation rose to a yoy rate of 3.1% in December. In other news, November trade deficit was stable at USD 3.3bn in November, in line with consensus expectations, as both exports and imports declined.

Snippets:

- **Angola:** The Central Bank released rules for the partial opening of its capital account, easing rules for inward FDI and portfolio flows.
- **Brazil:** CPI inflation closed 2019 at 4.3% a marked increase from a 3.3% yoy rate in November as food, transportation and personal expenses surprised on the upside. Core inflation was flat at 3.2% in 2019. The inflation expectation for 2020 remains at 3.6%, below the 4.0% inflation target. In other news, industrial production contracted 1.2% in November, after three consecutive months of expansion.
- **Colombia:** CPI inflation was broadly stable at a yoy rate of 3.8% in December, inside the Central Bank target range.
- **Czech Republic:** Economic data deteriorated in November as industrial output declined by 1.1% and exports contracted 2.3%. Salaries grew at a yoy rate of 3.6% in November, from 5.3% yoy in October.
- **Egypt:** CPI inflation accelerated to 7.1% on a yoy basis in December from 3.6% yoy in November, in line with consensus expectations as base effects explained the surge in inflation. Monthly inflation declined by 0.3% in December after a 0.2% drop in November, allowing the Central Bank to cut policy rates further, in our view.
- **Gabon:** The Indian company Coalsale signed a production sharing deal to develop a mine producing up to one million tons of manganese annually, increasing the country's output to 5m tons.
- **Ghana:** CPI inflation declined to 7.9% on a yoy basis in December, from 8.2% yoy in November. The downside surprise opens the possibility for rate cuts by the Bank of Ghana, in our view.
- **Hong Kong:** China has replaced its liaison officer in Hong Kong. The new representative, Mr Luo Huining, expressed hopes that the semi-autonomous city can return to its right path in 2020.
- **Hungary:** Retail sales rose at a yoy rate of 7.3% in November, from 6.2% yoy in October led by double-digit wage growth and seasonal sales (Black Friday).

Emerging Markets

- **India:** The composite PMI rose to 53.7 in December from 52.7 in November with both manufacturing and services components increasing.
- **Malaysia:** Industrial production rose at 2.0% on a yoy basis in November after a 0.3% yoy gain in October, beating consensus forecasts on the back of a rebound in mining output.
- **Mexico:** CPI inflation declined to a yoy rate of 2.8% in December from 3.0% yoy in November. The approval rate of President Andrés Manuel López Obrador rose to 72% in December from 68% in November as most people interviewed held favourable views on his handling of economic matters and the fight against corruption and poverty.
- **Nigeria:** The attorney general withdrew a USD 2bn case against South Africa telecom company MTN Group, a case closely followed by investors. Nigeria is MTN's largest market with close to 60 million customers.
- **Peru:** The Central Bank kept policy rates unchanged at 2.25%, in line with market expectations. Inflation expectations for 2020 declined to 2.2%, allowing the authority to keep monetary policy accommodative.
- **Poland:** CPI inflation increased to a yoy rate of 3.4% in December from 2.6% yoy in November, buoyed by a 7.0% yoy rise in food prices. In spite of high inflation, the Central Bank kept its policy rate unchanged at 1.5%.
- **Romania:** Retail sales rose at a yoy rate of 6.0% in November, only marginally weaker than 6.4% yoy in October. Economic activity is likely to remain robust in 2020 buoyed by a tight labour market and a 40% increase in pensions in September.
- **South Africa:** Eskom chairman Jabu Mabuza tendered his resignation after the company imposed a new round of blackouts on the country last week. Finance Minister Tito Mboweni said South Africa faced downgrade to junk by Moody's if it fails to execute broad structural reforms soon. In other news, industrial production disappointed, declining 1.2% in November after a 0.8% increase in October.

Global backdrop

Oil prices declined by 5% with Brent trading at USD 65 per barrel. Geopolitical concerns declined after Iran's underwhelming retaliation in response to Qassem Soleimani's assassination. Iran fired a series of rockets at two US airbases last week; but only after informing key US allies including Finnish troops based on the stations about the attack. The weak response suggests that Iran's primary concern is regime stability. If that hypothesis is valid, Tehran will most likely wait for the result of presidential elections in the US before any direct response. The ability of Iran to retaliate via proxies in the region will depend on how the population in Iran, Iraq and Lebanon absorb the recent events. Before Soleimani's death, the majority of the people across these three countries were protesting against corruption and inefficient governments, regardless of their sectarian lines. The prevailing anti-US sentiment amongst the people mourning Soleimani's death suggested sympathy for the Iranian regime could increase, but Tehran subsequently suffered a new blow when forced to admit responsibility for shooting a civilian aircraft departing from Tehran to Kyiv. The bottom line is that geopolitical concerns are likely to remain high, but the threat of an open confrontation has declined in the short term.

Good news on the trade front as China's Vice Premier Liu He and US Trade Representative Robert Lighthizer agreed to sign phase one of the trade deal on 15 January in Washington, DC. The text will be unveiled after the agreement is signed and is likely to include a 50% reduction in September's tariffs by mid-February and will have an enforcement provision lasting for 90 days to monitor China's implementations of the agreement. Trump pledged to start negotiating phase two straight away, even if he believes a deal will only be reached after presidential elections. In the meantime, the French finance minister Bruno Le Maire said he was working closely with his US counterpart Steve Mnuchin on a deal to avoid retaliation from a technology tax imposed in French territory affecting US tech titans.

Mixed economic data in the US. The US trade deficit narrowed to USD 43.1bn in November from USD 46.9bn in October as exports rose 0.7% and imports dropped 1.0% with imports from China leading the decline. ISM non-manufacturing increased to 55 in December, from 53.9 in November. In the labour market, the ADP survey surprised on the upside but non-farm payrolls registered 145k new jobs in December, close to consensus expectations, while hourly wage growth was lower than expected coming down to 2.9% on a yoy basis, from 3.1% in November.

In Europe, German industrial production rose 1.1% in November, from a 0.6% increase in October, buoyed by construction and energy. On the other hand, exports declined by 2.3% in December. In the UK, Parliament has voted for a bill allowing Britain to leave the EU on the 31 January, ending more than three years of disagreements. The same law fixed the transition period to no longer than 31 December 2020, making a very tight deadline for a comprehensive trade deal with the EU.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	1.72%	1.72%	1.72%	16.67%	11.53%	6.22%
MSCI EM Small Cap	0.24%	0.24%	0.24%	9.44%	6.38%	3.07%
MSCI Frontier	0.25%	0.25%	0.25%	14.83%	7.94%	3.37%
MSCI Asia	2.21%	2.21%	2.21%	18.25%	12.55%	7.19%
Shanghai Composite	1.38%	1.38%	1.38%	24.96%	1.57%	0.89%
Hong Kong Hang Seng	0.89%	0.89%	0.89%	12.52%	9.42%	2.42%
MSCI EMEA	0.77%	0.77%	0.77%	11.54%	6.85%	3.43%
MSCI Latam	0.09%	0.09%	0.09%	6.75%	10.30%	4.86%
GBI EM GD	0.22%	0.22%	0.22%	10.87%	7.08%	2.66%
ELMI+	0.19%	0.19%	0.19%	3.84%	4.33%	1.86%
EM FX Spot	-0.26%	-0.26%	-0.26%	-1.46%	-0.97%	-4.22%
EMBI GD	0.50%	0.50%	0.50%	13.73%	6.40%	6.41%
EMBI GD IG	0.32%	0.32%	0.32%	15.43%	7.13%	5.69%
EMBI GD HY	0.71%	0.71%	0.71%	12.09%	5.64%	7.38%
CEMBI BD	0.72%	0.72%	0.72%	12.76%	6.25%	6.08%
CEMBI BD IG	0.52%	0.52%	0.52%	12.45%	5.91%	5.02%
CEMBI BD Non-IG	0.97%	0.97%	0.97%	13.15%	6.80%	7.86%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.13%	1.13%	1.13%	28.29%	15.16%	12.07%
1-3yr UST	0.04%	0.04%	0.04%	3.70%	1.85%	1.35%
3-5yr UST	0.18%	0.18%	0.18%	5.61%	2.56%	1.97%
7-10yr UST	0.72%	0.72%	0.72%	9.48%	3.99%	2.64%
10yr+ UST	1.71%	1.71%	1.71%	17.31%	6.92%	3.73%
10yr+ Germany	0.60%	0.60%	0.60%	9.32%	4.90%	4.11%
10yr+ Japan	-0.40%	-0.40%	-0.40%	4.09%	2.38%	3.15%
US HY	0.43%	0.43%	0.43%	11.40%	6.12%	6.17%
European HY	0.29%	0.29%	0.29%	10.43%	4.10%	4.73%
Barclays Ag	-0.14%	-0.14%	-0.14%	6.06%	4.13%	2.28%
VIX Index*	-8.85%	-8.85%	-8.85%	-30.95%	11.84%	-38.91%
DXY Index*	1.05%	1.05%	1.05%	1.81%	-3.74%	5.51%
CRY Index*	-0.89%	-0.89%	-0.89%	3.40%	-5.35%	-16.19%
EURUSD	-0.92%	-0.92%	-0.92%	-3.06%	4.54%	-5.59%
USDJPY	-0.96%	-0.96%	-0.96%	-1.32%	4.43%	7.60%
Brent	-1.48%	-1.48%	-1.48%	7.51%	17.26%	39.56%
Gold spot	1.94%	1.94%	1.94%	20.17%	29.65%	25.49%

*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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