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The G-20 proposal to boost IMF's capital is EM supportive

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The G-20 proposed to increase IMF resources via SDRs. The rise in nominal US Treasury yields should eventually prove supportive for high yield and EM local currency assets. Brazilian assets underperformed following President Bolsonaro's interference in Petrobras. Argentina posted better than expected fiscal and external accounts. The Turkish central bank tightened liquidity. The South African fiscal numbers were better than expected. Chile continued to vaccinate its population at a fast pace. Chinese PMIs moderated due to distortions from the lunar New Year holidays. Mexico recorded solid numbers for the external balances. Leftist candidates gained momentum ahead of the presidential election in Peru.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.5	–	-6.33%
MSCI EM Small Cap	10.6	–	-2.62%
MSCI Frontier	10.4	–	-2.67%
MSCI Asia	14.7	–	-6.17%
Shanghai Composite	12.1	–	-5.06%
Hong Kong Hang Seng	9.7	–	-7.10%
MSCI EMEA	9.7	–	-3.15%
MSCI Latam	10.5	–	-7.80%
GBI-EM-GD	4.71%	–	-2.24%
ELMI+	2.88%	–	-1.25%
EM FX spot	–	–	-1.47%
EMBI GD	5.10%	356 bps	-1.67%
EMBI GD IG	3.29%	169 bps	-2.04%
EMBI GD HY	7.42%	594 bps	-1.26%
CEMBI BD	4.28%	300 bps	-0.54%
CEMBI BD IG	3.05%	176 bps	-0.63%
CEMBI BD Non-IG	5.94%	465 bps	-0.41%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.3	–	-2.41%
1-3yr UST	0.12%	–	-0.05%
3-5yr UST	0.70%	–	-0.39%
7-10yr UST	1.40%	–	-0.62%
10yr+ UST	2.18%	–	-0.16%
10yr+ Germany	-0.26%	–	-0.08%
10yr+ Japan	0.00%	–	-1.06%
US HY	4.25%	326 bps	-0.59%
European HY	3.32%	383 bps	-0.29%
Barclays Ag	1.08%	-32 bps	-0.66%
VIX Index*	27.95	–	5.90%
DXY Index*	90.80	–	0.79%
EURUSD	1.2086	–	-0.58%
USDJPY	106.56	–	1.41%
CRY Index*	190.43	–	1.81%
Brent	65.4	–	0.31%
Gold spot	1755	–	-3.04%

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

Emerging Markets

- **G-20 proposal to boost SDR allocations:** United States (US) Treasury Secretary, Janet Yellen, published a letter urging G-20 finance ministers to maintain fiscal stimulus in a coordinated fashion in order to ensure the continuation of the economic recovery.[1] In the same letter, Yellen supported an allocation of new Special Drawing Rights (SDRs) for the International Monetary Fund (IMF) in order to enhance lending to lower-income countries. Yellen's proposal to boost the capital of the IMF marks a big improvement from the previous US administration's policies towards international financial institutions (IFIs). The return to multilateralism is clearly in the US national interest because by helping to expand the availability of capital across the world via SDRs through the IMF, the US is in effect elevating its own role. The global financial system was not only designed by the US, but also relies disproportionately on institutions that are either controlled directly or heavy influenced by the US government, including the IFIs, the US legal system, and the US banking system.

The Finance Ministers from the G-20 nations granted support of a boost to IMF's resources of USD 500bn via SDRs, which is expected to be finalised in time for April's Annual IMF meetings. However, the proposal is not a done deal. Both US Houses of Congress have to approve the measure. This is a relatively high hurdle considering the Democratic Party's thin majority in the Senate.

If approved, the boost to IMF's capital would be positive for EM. The IMF, along with the World Bank, and other IFIs, are important sources of finance for lower-income countries, particularly in times of crises, when such countries tend to get cut off from market-based financing. By easing their access to finance, lower-income countries will be able to contribute to the coordinated global fiscal response to the ongoing Covid-19 pandemic.

1 See: https://home.treasury.gov/news/press-releases/jy0034

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Emerging Markets

Within EM, Zambia, Bahrain, Belarus, Tajikistan, Ghana and Ukraine – some of whom have limited foreign exchange (FX) reserves and/or balance of payment problems – would all stand to gain through large increases in their FX reserves.

- US Treasury (UST) price action: Last week equities and high yielding EM currencies experienced pull-backs in response to higher nominal UST yields despite the fact that the Fed clearly stated it was not looking to hike rates or taper bond purchases anytime soon. So-called reflation assets (commodities, value stocks, high yield FX) became victim of their own recent success as investors unwound long UST positions. The Australian central bank intervened in a bid to support its cap of 0.1% on the yield on the 3-year bond, while the European Central Bank (ECB) and Bank of Japan said they were monitoring the yield curve.

Most of the rise in US rates was concentrated in the 2-year to 5-year part of the curve. Yields for 5-year UST bond widened 15bps to 0.73%. However, the 5-year real rate rose from -1.90% to -1.60% before closing the week unchanged at -1.75%. The 5-year break-even inflation rate rose from 2.30% to 2.42% - back to the highest level since 2011. The 2-year yield remained anchored rising only 2bps to 0.13%, which is due to the Fed's public commitment not to raising rates until 2023. However, the 2-year forward 1, 2 and 3-year rates are now trading at 0.38%, 0.97% and 1.36%, respectively, which amounts to pricing in approximately two to three hikes per year from 2023 onwards. With the increase in rate volatility last week, the 10-year and 30-year parts of the UST curve retraced 10bps last Friday and the curve bear flattened.

Yields on 30-year mortgage rates rose 0.26% to 3.25% as higher mortgage rates lead to less re-mortgaging, thereby increasing the duration of mortgage portfolios. Importantly, the sell-off did not trigger large widening in credit spreads on US investment grade credit. Our view is that the Fed will start to get seriously concerned when 30-year mortgage rates rise above 3.5% at which point the Fed may extend duration on its holdings of mortgage-backed securities (MBS). The Fed is unlikely to implement or even talk about yield curve control (YCC) until after it has already engaged in control of credit spreads. In a couple of weeks, following the March FOMC meeting, the Fed will release new forecasts, including the so-called dot plot chart for policy rates. This should reinforce Fed Chairman Jerome Powell's dovish message from last week that the Fed is "not even thinking" about removing policy accommodation and push back on the market's pricing of policy hikes between 2023 and 2026.

In light of these considerations, the price action last week suggests that US term nominal rates may continue to rise from here through a combination of higher break-even inflation rates and higher real rates. Alongside progress in re-opening economies, this should be positive for EM high yielding assets both in USD terms and in the local currency segments of the asset class.

- Brazil: Foreign investors sold BRL 9bn of equities during the first two days of last week in response to the sudden dismissal, mainly for political reasons, of the Chief Executive Officer (CEO) of Petrobras, the national oil company. The Central Bank of Brazil was forced to intervene in the currency market and the Bolsonaro Administration tried to calm the nerves of investors by announcing the privatisation of Eletrobras. The Finance Minister sent a draft budgetary reform to Congress in a bid to improve the fiscal accounts of the Federal and sub-national governments. The sacking of Petrobras's CEO coincided with the company's best results in its history, including USD 11bn of earnings in Q4 2020. The company generated USD 22bn of free cash flow in 2020 which is strong when viewed in relation to the company's market cap of USD 52bn. The results highlight the potential upside of a severely undervalued company provided that the new CEO maintains the current corporate governance structure, including maintaining fuel pricing policies. In economic news, Brazil's current account deficit widened to USD 7.3bn in January from USD 5.3bn in December while foreign direct investment increased to USD 1.8bn from 0.7bn over the same period. The yoy rate of consumer prices index (CPI) inflation rose to 4.6% in the first half of February from 4.3% in January, which was in line with consensus expectations. However, the rate of producer prices index (PPI) inflation rose to 28.9% from 25.7% over the same period, which reflects the continuing price pressure coming from tradable goods due to the weak BRL. On the other hand, the fiscal surplus was BRL 43.2bn in January compared to a deficit BRL 44.1bn in December. The improvement was largely due to seasonal effects, which drove net debt to GDP down to 61.6% from 63.0% over the same period.

- Argentina: The budget surplus was ARS 24bn in January compared to a deficit of ARS 308bn in December, while the trade surplus was USD 1.1bn compared to a deficit of USD 0.4bn in December. Imports were unchanged at USD 3.9bn, but exports rose to USD 4.9bn from USD 3.6bn. The pace of domestic economic activity improved, but remains at very depressed levels with shopping centre sales down 32.7% on a yoy basis in December (a slight improvement from -46.6% recorded in previous months). Supermarket sales also improved, recording 2.6% yoy expansion compared to a rate of contraction of 1.1% yoy in December.

- Turkey: Last Wednesday the Central Bank of Turkey (CBT) increased reserve requirement rates (RRR) by 200 bps across different loan maturities, thereby taking the weighted average RRR to 7.7%. CBT also cut the maximum amount of FX and gold banks can deposit as part of the RRR. FX holdings were reduced by 10% to 20% and gold was reduced by 5% to 15%. The measures should withdraw approximately TRY25bn from the system, which compares with total CBT funding prior to the new measures at TRY162bn.

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Emerging Markets

- South Africa: The National Treasury unveiled a more fiscally conservative budget than the market had expected. The fiscal deficit is forecast to improve from 14.0% of GDP in 2021/22 fiscal year (FY) to 6.3% of GDP in the 2023/24 FY. This should ensure that the debt to GDP ratio peaks at 89% by FY 2025/26. The lower fiscal deficit means that domestic bond issuance should decline to ZAR 380bn in FY 2021/22 from ZAR 518.5bn in FY 2020/21.

- Chile: Chile's Covid-19 vaccination campaign accelerated. Some 17.6% of the population has now been vaccinated as of 27 February compared to 0.35% at the beginning of the month. Copper production declined to 465k tons in January from 507k tons in December, in line with seasonal patterns since 2016. The yoy rate of retail sales declined to 5.8% in January from 10.4% yoy in December as the pace of manufacturing production slowed to 4.4% yoy in January.

- China: The manufacturing purchasing manager's index (PMI) moderated to 50.6 in February from 51.3 in January, while non-manufacturing PMI slowed to 51.4 from 52.4 over the same period. Both prints were slightly lower than consensus expectations. The slowdown is attributed to interruptions in production arising from the Chinese New Year, so should have no lasting implications. Within services, the retail, catering and entertainment segments rose partially to offset softness in hotels and business segments. The input price component remained high at 66.7 compared to 67.1 in January, reflecting cost pressures in industry. President Xi Jinping said China has won the battle to eradicate absolute poverty as 99m rural residents have been lifted above the poverty line.

- Mexico: The trade deficit was USD 1.2bn January. This is the best trade balance for some time (the average January trade deficit in the last 5 years has been USD 3.7bn). The deficit follows a large trade surplus of USD 6.3bn in December. The current account surplus was USD 17.4bn in Q4 2020 compared to USD 17.1bn in Q3 2020, buoyed by large remittances of foreign earnings from Mexicans working abroad. The yoy rate of retail sales declined 5.9% in December compared to -5.1% in November, while the rate of CPI inflation rose to 3.8% in the first two weeks of February from 3.7% in January.

- Peru: The rate of real GDP growth declined 1.7% in Q4 2020 (less than consensus expectations) after a 9.0% drop in Q3 2020. In political news, a poll conducted by IEP showed Accion Popular's candidate Yohnny Lescano leading with 11.3% of voting intentions ahead of the presidential election scheduled for 11 April. Lescano is followed by Veronica Mendoza, George Forsyth and Keiko Fujimori with 8.9%, 8.1% and 8.1% of voting intentions, respectively. Some 31% of Peruvian voters have not yet indicated a preference for a candidate. Lescano and Mendoza are both populists on the left in Peruvian politics, so the latest polls imply a higher risk of bad government. In the meantime, centrist candidate Forsyth had its candidacy challenged by Lima's Special Electoral Jury (JNE) which excluded him from the presidential race alleging the candidate omitted relevant information in his *resume*.

Snippets:

- Hungary: The National Bank of Hungary kept its policy rate unchanged at 0.6% in line with consensus expectations.
- India: Economic activity bounced back to pre-pandemic levels on the back of real GDP growth of 0.4% on a yoy basis in Q4 2020. This follows a yoy contraction of 7.3% in Q3 2020. The yoy rate of growth of the private sector was 1% in Q4 2020, up from -7.3% yoy in Q3 2020.
- Malaysia: FX reserves rose by USD 1.1bn to USD 109.7bn in the first half of February, according to data from Bank Negara Malaysia. The yoy rate of CPI inflation rose to -0.2% in January from -1.4% in December, surprising consensus expectations to the upside and the trade balance posted a surplus of MYR 16.6bn compared to MYR 20.7bn over the same period.
- Poland: The yoy rate of real GDP growth declined 2.8% in Q4 2020, unchanged from previous quarter. The unemployment rate rose to 6.5% in January from 6.2% in December.
- South Korea: Bank of Korea kept its 7-day repo rate policy rate unchanged at 0.5%, in line with consensus expectations.

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Global backdrop

- **United States (US):** The US House of Representatives approved a USD 1.9trn fiscal stimulus proposed by President Joe Biden, including USD 1.4k aid cheques to each American, fresh aid for vaccines, and local government support. The bill passed with 219 votes in favour and 212 against. No Republicans voted for the bill and two Democrats voted against. Meanwhile, US economic data was mixed to positive. Initial jobless claims declined to 730k in the week ending in 20 February from 841k in the previous week, although continuing claims declined only marginally to 4.4m in the week ending in 13 February from 4.5m in the previous week. Durable goods rose 3.4% in January from 1.2% in December, but durable goods ex-transportation declined to 1.4% from 1.7% over the same period. New home sales rose to 923k in January from 885k in December, but pending home sales weakened. Personal income rose at a yoy rate of 10% in January, which was higher than expected, while personal spending rose 2.4% yoy, which was lower than expected. Lastly, the core personal consumption expenditures (PCE) deflator index rose to 1.5% from 1.4%, which was slightly above consensus expectations.

- **European Union (EU):** A number of European economists called for the EUR 2.5trn of debt of sovereign member states held by the ECB to be cancelled in order to ease debt service costs at a time of rising real rates in bond markets.[2] The proposal is dangerous and misguided, in our view. The ECB holds government bonds of EU member's states worth 62.2% of European GDP. Cancelling these bonds would generate a loss to the institution, which would have to be recapitalised in one of three ways: (a) direct equity injection by EU member states; (b) by the banking system via negative interest rates on reserves; or (c) via the printing of money to cover the liabilities to the banking sector. In (a), as all European countries are running fiscal deficits they would have to borrow resources to recapitalise the ECB, so in aggregate the Eurozone debt to GDP ratio would remain the same. In (b) the European banking system, which is already the weakest link in the European economy, would weaken further and thus lead to even slower growth in Europe. Finally, in (c) the risk of inflationary pressures would rise and investment would collapse as banks and well-informed investors would shun EUR in favour of real assets and other currencies. In other European economic news, the German IFO Business climate survey rose to 92.4 in February from 90.3 in January, led by improving expectation about the future. Meanwhile, the Italian manufacturing confidence index rose to 99.0 from 95.1 over the same period. The yoy rates of headline and core CPI inflation were stable at 0.9% and 1.4%, respectively.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.77%	3.78%	3.78%	36.45%	6.72%	15.68%
MSCI EM Small Cap	5.95%	6.04%	6.04%	42.07%	4.49%	11.63%
MSCI Frontier	0.14%	0.52%	0.52%	8.59%	-1.11%	7.20%
MSCI Asia	1.25%	5.29%	5.29%	42.33%	9.56%	17.20%
Shanghai Composite	0.75%	1.04%	1.04%	24.70%	4.97%	7.88%
Hong Kong Hang Seng	0.34%	4.74%	4.74%	13.50%	0.68%	11.61%
MSCI EMEA	1.90%	3.04%	3.04%	14.89%	-3.23%	7.87%
MSCI Latam	-2.98%	-9.49%	-9.49%	-5.80%	-7.48%	7.33%
GBI EM GD	-2.68%	-3.72%	-3.72%	3.70%	0.59%	5.54%
ELMI+	-0.59%	-1.16%	-1.16%	4.17%	0.15%	3.50%
EM FX Spot	-0.95%	-1.92%	-1.92%	-1.12%	-5.78%	-1.80%
EMBI GD	-2.55%	-3.61%	-3.61%	0.91%	4.49%	5.94%
EMBI GD IG	-3.51%	-4.71%	-4.71%	0.90%	6.65%	6.11%
EMBI GD HY	-1.44%	-2.34%	-2.34%	0.61%	2.08%	5.70%
CEMBI BD	-0.10%	-0.17%	-0.17%	5.35%	6.30%	6.95%
CEMBI BD IG	-0.82%	-0.96%	-0.96%	3.84%	6.49%	5.85%
CEMBI BD Non-IG	0.88%	0.92%	0.92%	7.32%	6.04%	8.72%

[2] See: https://annulation-dette-publique-bce.com/

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Benchmark performance

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	2.76%	1.71%	1.71%	31.27%	14.14%	16.82%
1-3yr UST	-0.06%	-0.03%	-0.03%	1.66%	2.88%	1.75%
3-5yr UST	-0.74%	-0.85%	-0.85%	2.07%	4.43%	2.40%
7-10yr UST	-2.34%	-3.40%	-3.40%	-0.22%	6.27%	2.84%
10yr+ UST	-5.57%	-8.97%	-8.97%	-6.02%	8.77%	4.19%
10yr+ Germany	-4.45%	-5.69%	-5.69%	-5.52%	6.48%	2.88%
10yr+ Japan	-1.70%	-2.25%	-2.25%	-6.09%	0.62%	0.80%
US HY	0.37%	0.70%	0.70%	9.38%	6.58%	8.97%
European HY	0.68%	1.22%	1.22%	5.32%	3.37%	5.34%
Barclays Ag	-1.72%	-2.59%	-2.59%	4.33%	3.84%	3.61%
VIX Index*	0.00%	22.86%	22.86%	-30.32%	24.39%	57.91%
DXY Index*	-0.09%	0.96%	0.96%	-7.48%	0.52%	-7.68%
CRY Index*	0.00%	13.49%	13.49%	19.43%	-1.81%	16.21%
EURUSD	0.09%	-1.07%	-1.07%	8.55%	-1.47%	11.21%
USDJPY	-0.01%	3.21%	3.21%	-1.62%	0.30%	-6.53%
Brent	-1.04%	26.33%	26.33%	29.53%	2.52%	77.78%
Gold spot	1.18%	-7.57%	-7.57%	10.39%	33.23%	42.41%

*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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