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The final shock

By Gustavo Medeiros

Lebanon announced a moratorium on its sovereign debt. Argentina's inflation declined as the government prepared its offer to re-profile its debt. Ratings agency Standard and Poor's maintained Ecuador's credit rating at B- with a stable outlook. Economic activity continued to normalise in China as the number of COVID-19 cases declined. Brazil's GDP growth rate increased and the Central Bank sold USD 5bn via swaps. Ukraine appointed a new Prime Minister in a government dominated by technocrats. South Korea announce more fiscal stimulus. Indian manufacturing held up well in February. Bank Indonesia supported the local market. South Africa's current account deficit narrowed sharply. Sri Lanka announced new elections for 25 April.

In the global backdrop, oil prices declined sharply as Russia and Saudi Arabia entered a price war following a failure of OPEC+ meeting to agree on production cuts. The Fed eased policy, but other developed market central banks have less room to act. The latest economic data in the United States held up, but it remains to be seen if this will continue. Joe Biden emerged as the front-runner for nomination for Democratic Party candidate. Finally, the International Monetary Fund (IMF) pledged USD 50bn of funding to Emerging and Frontier economies deemed to be vulnerable to coronavirus.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.9	–	0.69%
MSCI EM Small Cap	9.7	–	-0.04%
MSCI Frontier	8.6	–	-2.03%
MSCI Asia	11.6	–	1.36%
Shanghai Composite	9.6	–	5.35%
Hong Kong Hang Seng	7.0	–	1.50%
MSCI EMEA	8.4	–	-0.02%
MSCI Latam	10.8	–	-5.10%
GBI-EM-GD	4.76%	–	1.62%
ELMI+	3.84%	–	0.72%
EM FX spot	–	–	0.44%
EMBI GD	4.84%	410 bps	1.14%
EMBI GD IG	3.04%	227 bps	2.33%
EMBI GD HY	7.39%	668 bps	-0.29%
CEMBI BD	4.49%	382 bps	0.67%
CEMBI BD IG	3.08%	241 bps	1.19%
CEMBI BD Non-IG	6.61%	594 bps	-0.06%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.4	–	0.65%
1-3yr UST	0.29%	–	0.73%
3-5yr UST	0.33%	–	1.30%
7-10yr UST	0.35%	–	3.05%
10yr+ UST	0.74%	–	8.29%
10yr+ Germany	-0.85%	–	2.64%
10yr+ Japan	0.00%	–	-0.44%
US HY	6.36%	550 bps	-0.44%
European HY	4.24%	530 bps	-1.16%
Barclays Ag	0.90%	55 bps	2.47%
VIX Index*	41.94	–	8.52%
DXY Index*	95.00	–	-2.36%
EURUSD	1.1453	–	2.87%
USDJPY	102.04	–	-5.80%
CRY Index*	155.85	–	-3.60%
Brent	33.8	–	-34.82%
Gold spot	1680	–	5.69%

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

Emerging Markets

- **Lebanon:** Lebanese Prime Minister Hassan Diab announced a moratorium on Eurobond repayments, saying the Government has to prioritise basic needs. The decision puts the Lebanese Government on a collision course with the Lebanese banking sector, which owns the majority of the bonds. The banking sector and Bank du Lebanon (BdL) provide the bulk of funding for the Government. Defaulting on the Eurobonds without a plan to implement structural economic reforms and recapitalise the banks is likely to exacerbate the economic crisis with the population bearing the bulk of the impact as a deepening recession could lead to tighter capital controls and further depreciation of the Lebanese Pound. Lebanon's best option may therefore be to pursue an orderly re-profiling of the debt accompanied by deep macroeconomic reforms.

- **Argentina:** The Central Bank cut the monetary policy rate by 200bps to 38%. Real-time price monitoring suggests that consumer prices index (CPI) inflation was 1.9% in February, which is consistent with an annualised inflation rate below 30%. Finance Minister Martin Guzman appointed financial advisors and distribution agencies ahead of the incoming debt re-profiling. The details of the government's proposal are expected towards the end of March this year.

- **China:** There were further signs of a gradual resumption of economic activity. This supports the view that China will be the first country to rebound from the coronavirus outbreak. Specifically, daily coal consumption increased to 70% of normal levels, while two-thirds of people had returned to Tier 1 and 2 cities after the

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Emerging Markets

Lunar New Year break as of the end of last week. As the number of new cases outside Hubei declines to negligible levels, the Government continued to offer policy support, including sizeable transfers to local governments and a plan to boost investment in 5G technologies. However, backward-looking data was still weak. Export growth year to date plunged to -17.2% on a yoy basis in January and February from +7.9% yoy in December. Imports declined by 4.0% on a yoy basis year to date from +16.5% yoy growth in December. The year to date trade deficit thus increased to USD 7bn. Exports to the United States (US) declined the most, whereas imports of material goods, such as iron ore and oil increased by 1.5% and 5.2% on a yoy basis in volume terms, supported by better economic activity prior to the Lunar New Year and the US-China phase 1 trade deal. The Caixin composite purchasing Managers Index (PMI) declined to 27.5 in February from 51.9 in January, while services PMI was down to 26.5. The official manufacturing PMI fell to 40.3. Numbers below 50 signify economic contraction.

- Brazil: Real Gross Domestic Product (GDP) growth in Q4 2019 was 1.7% on a yoy basis, which was an improvement from the previous quarter (1.2% yoy). For 2019 as a whole, real GDP growth was 1.1%. The Government highlighted that private sector growth is picking up, whereas public sector activity is contracting. This is a more sustainable growth model than in the past, even if slower public sector growth weighs on growth in the short term. Markit's composite PMI slowed to 50.9 in February from 52.2 in January. Brazil's central bank issued a statement signalling more rate cuts to ameliorate the impact of coronavirus on global markets and the Brazilian economy. The trade balance swung to a USD3.1bn surplus in February from a deficit of USD 1.7bn in January due to a combination of higher exports and lower imports. Financial outflows prompted the Central Bank to sell USD 5bn in FX swaps to contain depreciation of the Brazilian Reais. BRL has emerged as a funding currency for investments in other Emerging Markets (EM) currencies with BM&F future contracts showing that foreign investors now hold close to USD 35bn of short BRL positions (as of 08 March 2020).

- Ecuador: Ratings agency Standard and Poor's kept Ecuador's sovereign debt rating at B- with a stable outlook on the view that the country will continue to access private and official lending over the coming years. Foreign exchange reserves dropped by USD 0.2bn to USD 3.3bn in February, taking reserves to slightly below the 15-year average of USD 3.7bn. CPI inflation declined by 0.2% on a yoy basis in February, marking the third consecutive month of deflation. Ecuador is working with the International Monetary Fund (IMF) to schedule the next disbursements under an ongoing IMF program, taking into account lower oil prices and asset price movements triggered by the coronavirus outbreak.

- Ukraine: President Volodymyr Zelensky appointed Denys Shmyhal as the country's new Prime Minister after dissolving the previous government. Shmyhal brings a team of experienced technocrats to critical positions as Zelensky faces challenges in approving land reforms and anti-corruption legislation. Shmygal announced an increase in pensions, which is to be funded by cuts in salaries of government officials.

- South Korea: The South Korean government announced a supplementary budget of KRW 11.7tn (0.6% of GDP) to offset the negative growth consequences of coronavirus. This stimulus will bring the overall fiscal deficit to 4% of GDP. However, the government's debt stock is unlikely to surpass 50% of GDP over the next five years, which is very modest by Korean standards, in our view. Meanwhile, CPI inflation declined to 1.1% on a yoy basis in February from 1.5% yoy in January. Core inflation softened to 0.6% yoy.

- India: The Indian economy expanded at a healthy pace in February according the manufacturing PMI, which inched lower to a still solid 54.5 in February from 55.3 in January. State Bank of India (SBI) announced an injection of INR 24.5bn in Yes Bank as part of a bailout organised by the Reserve Bank of India.

- Indonesia: Bank Indonesia (BI) held an unscheduled press conference to announce a triple intervention, whereby the central bank bought IDR via the spot and forward markets as well as bonds in the local market. BI also lowered the reserve requirement ratio (RRR) for foreign currency deposit by 400bps to 4%, thereby releasing more than USD 3bn in liquidity within the local financial system. Local banks will additionally benefit from 50bps cut in the local currency RRR.

- South Africa: South Africa's current account deficit narrowed sharply to 1.3% of GDP in Q4 2019 from 3.7% of GDP in Q3 2019 due to a combination of declining imports and better terms of trade. The yoy rate of real GDP growth slowed to -0.5% in Q4 2019 from 0.1% yoy in Q3 2019. Manufacturing PMI slowed to 44.3 in February from 45.2 in January.

- Sri Lanka: President Gotabaya Rajapaksa dissolved parliament and called for early elections to be held on the 25 April. The new parliament will reconvene on the 14 May. The Central Bank kept the two policy rates unchanged at 6.5% and 7.5%, respectively. As of end-January 2020, official foreign exchange reserves stood at USD 7.5bn, which is equivalent of 4.5 months of imports.

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Emerging Markets

Snippets:

- **Chile:** The rate of CPI inflation increased to 3.9% on a yoy basis in February from 3.5% yoy in January. Food and transport costs were the main contributors to higher prices. The yoy rate of core CPI increased to 2.7% in February from 2.5% yoy in January.
- **Colombia:** CPI inflation inched up to 3.7% on a yoy basis in February from 3.6% yoy in January. The current account deficit increased to 4.3% of GDP in 2019, which is the widest in four years. Foreign direct investment (FDI) reached 3.5% of GDP in 2019, the highest level since 2012.
- **Hong Kong:** Retail sales declined at a yoy rate of 21.4% in January after contracting at a rate of 19.4% yoy in December. Tourist arrivals declined by 52.7% on a yoy basis in January. The Hong Kong government suspended the individual visitor scheme, which applies to tourists from mainland China, in a bid to limit exposure to coronavirus.
- **Malaysia:** Bank Negara Malaysia cut the policy rate by 25bps to 2.5% as expected. The trade surplus inched lower to MYR 12.0bn in January from MYR 12.5bn in December, beating consensus expectations. Exports declined at a yoy rate of 1.5% in January, while imports declined at a yoy rate of 2.4%.
- **Mexico:** The approval rate of President Andres Manuel Lopez Obrador declined to 63%. Though still solid, this is the lowest approval rate since his election.
- **Oman:** Moody's downgraded the country's sovereign debt rating to Ba2 from Ba1 citing large fiscal deficits leading to a higher debt to GDP ratio.
- **Peru:** The pollster Pulso Peru reported a drop in the approval rate of President Martin Vizcarra to 58% in early March from a high of 82% when he dissolved Congress last October. Vizcarra's disapproval rate rose to 36% from 30%.
- **Philippines:** The yoy rate of CPI inflation increased to 2.6% in February from 2.9% yoy in January. The increase was mostly due to food, tobacco, utilities and transport-related costs. The yoy rate of core inflation was stable at 3.1% with the rate of CPI inflation in Metro Manila slowing to 2.0% yoy from 2.1% yoy in January.
- **Singapore:** Manufacturing PMI declined to 48.7 in February from 50.3 in January.
- **Thailand:** The yoy rate of CPI inflation declined to 0.7% in February from 1.1% yoy in January. Energy prices were a key contributor towards lower inflation, while core CPI inched higher to 0.6% yoy.
- **Turkey:** CPI inflation climbed to 12.4% on a yoy basis in February from 12.2% yoy in January, which was slightly below consensus expectations.
- **Uruguay:** The rate of CPI inflation declined to 8.3% on a yoy basis in February from 8.7% yoy in January. The public sector fiscal deficit was 2.8% of GDP at the end of 2019, or 4.3% of GDP without counting one-off effects.

Global backdrop

- **Oil:** Last week's meeting of OPEC members and Russia ended without a deal after Russian Energy Minister Alexander Novak refused to participate in proposals to reduce global production by 1.5 million barrel per day (mbpd). Brent crude oil prices immediately declined 10% to USD 45.2 last Friday. This was followed by sharply lower prices this morning when Saudi Arabia announced a full-on price war over the weekend, threatening to increase oil production by as much as 2.0 mbpd and offering steep discounts to European and US clients. Saudi and Russia can cope with low oil prices for longer than many other smaller producers due to low break-even lifting costs and high levels of foreign exchange reserves.

The sharp decline in oil prices may challenge some banks with exposure to the oil and gas industry and related sectors. Alongside the negative impact of the coronavirus on economic activity, global economic activity could hit the lowest level since 2009, albeit on a transitory basis.[1]

- **Policy:** The US Federal Reserve announced a 50bps policy rate cut last Tuesday, which took the policy rate to 1.0% and 1.25%. The Federal Reserve also injected liquidity via repo operations. The risk, as we have discussed elsewhere, is that the Federal Reserve will run out of ammunition and thus not be able to cope with a future recession.[2] US equities, leveraged loans and high yield credit looks vulnerable in a slowdown scenario. On Friday, Boston Federal Reserve Bank President Eric Rosengren said that negative interest rates would be ineffective due to the negative impact on banks. Moreover, as 10-year US Treasury yield approaches zero quantitative easing loses its effectiveness. However, the Federal Reserve cannot buy non-government assets unless there is a change in the Federal Reserve Act. US policy may therefore shift towards currency intervention, particularly if fiscal policy is unavailable due to the political business cycle.

[1] See: *'It is here again – the VIX spike!'* Market Commentary, 28 February 2020.

[2] See: *'What goes around comes around: a short note on Dollar risk'* Market Commentary, 17 January 2020.

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Global backdrop

The European Central Bank (ECB) and Bank of Japan (BOJ) do not have room to cut policy rates further. Hence, they may well engage in asset purchases. Indeed, last week the BOJ announced greater open market operations and ETF purchases in order to support liquidity and aid financial stability. Europe, Japan, China and many other EM countries are net importers of oil and will therefore benefit from lower oil prices.

- Economics: The most recent US data looked ok, but it does not reflect the recent shocks. Non-farm payrolls increased by 273,000 jobs in February, unchanged from January. The rate of unemployment inched lower to 3.5% in February from 3.6% in January, while average hourly earnings rose 3.0% on a yoy basis in February compared to 3.1% yoy in January. Markit's manufacturing PMI rose to 57.3 in February after 54.8 in January, while services PMI was stable at 49.4. However, ISM manufacturing PMI inched down to 50.8 in February, which may be an early indication that coronavirus is beginning to weigh on the US economy.

- Politics: Democratic presidential candidate Joe Biden emerged as the new favourite to win the Democratic Party nomination after a strong showing in Super Tuesday. Biden has so far captured 624 delegates compared to Bernie Sanders' 556. Moderate candidates Mike Bloomberg and Amy Klobuchar dropped out of the race and pledged support for Biden. Elizabeth Warren also quit the race, but without granting support for any other candidate. Tomorrow Michigan and five other states that jointly account for 352 delegates will vote. In the White House, President Trump appointed Mark Meadows to replace Mick Mulvaney as his chief of staff.

- Coronavirus: Italy took drastic steps to deal with an increasing number of cases and casualties of coronavirus. Northern Italy closed schools, museums, gyms and theatres. Bars and restaurants will shut at 6pm. The Italian government also closed schools and universities across the country until the 15 March. The consequence is likely to be a severe contraction in growth in the first half of 2020 with growing risk of a more persistent dislocation if the government is not able to normalise activity by March.

The President of the European Council Mario Centeno clarified that the fiscal rule within the Stability and Growth Pact allows for a temporary deviation from fiscal rules to counter exceptional events such as coronavirus, thus opening the possibility of temporary wider deficits in peripheral European economies. The IMF announced that the 2020 IMF-World Bank spring meetings would go ahead, but in virtual format. They jointly pledged USD 50bn towards Emerging and Frontier economies to help them to cope with the impact of coronavirus.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.69%	-9.05%	-9.05%	-1.33%	5.56%	3.66%
MSCI EM Small Cap	-0.04%	-10.80%	-10.80%	-7.45%	-0.10%	0.27%
MSCI Frontier	-2.03%	-7.84%	-7.84%	2.67%	3.72%	1.22%
MSCI Asia	1.36%	-5.92%	-5.92%	0.78%	7.59%	4.76%
Shanghai Composite	5.35%	-0.51%	-0.51%	0.22%	0.17%	0.78%
Hong Kong Hang Seng	1.50%	-6.36%	-6.36%	-6.36%	4.93%	1.71%
MSCI EMEA	-0.02%	-16.23%	-16.23%	-8.48%	-0.24%	-0.43%
MSCI Latam	-5.10%	-21.21%	-21.21%	-14.17%	-1.30%	1.58%
GBI EM GD	1.62%	-3.11%	-3.11%	6.05%	4.49%	3.08%
ELMI+	0.72%	-2.78%	-2.78%	0.43%	2.24%	1.68%
EM FX Spot	0.44%	-5.59%	-5.59%	-6.07%	-3.52%	-4.15%
EMBI GD	1.14%	1.69%	1.69%	11.30%	6.12%	6.36%
EMBI GD IG	2.33%	5.26%	5.26%	18.60%	8.35%	6.52%
EMBI GD HY	-0.29%	-2.43%	-2.43%	3.73%	3.66%	6.19%
CEMBI BD	0.67%	2.20%	2.20%	11.20%	6.19%	5.99%
CEMBI BD IG	1.19%	3.69%	3.69%	13.29%	6.60%	5.39%
CEMBI BD Non-IG	-0.06%	0.19%	0.19%	8.38%	5.67%	7.03%

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Global backdrop

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	0.65%	-7.68%	-7.68%	9.38%	9.89%	9.69%
1-3yr UST	0.73%	2.19%	2.19%	5.46%	2.56%	1.81%
3-5yr UST	1.30%	4.48%	4.48%	9.54%	4.07%	2.97%
7-10yr UST	3.05%	9.72%	9.72%	18.39%	7.21%	4.81%
10yr+ UST	8.29%	23.45%	23.45%	42.02%	14.77%	8.93%
10yr+ Germany	2.64%	11.25%	11.25%	19.27%	8.75%	5.48%
10yr+ Japan	-0.44%	1.69%	1.69%	5.09%	3.26%	4.23%
US HY	-0.44%	-1.82%	-1.82%	5.70%	4.71%	5.19%
European HY	-1.16%	-3.19%	-3.19%	2.66%	2.49%	3.26%
Barclays Ag	2.47%	4.48%	4.48%	10.76%	5.59%	3.81%
VIX Index*	4.56%	204.35%	204.35%	161.31%	240.98%	178.49%
DXY Index*	-3.19%	-1.44%	-1.44%	-2.37%	-6.73%	-2.65%
CRY Index*	-2.26%	-16.12%	-16.12%	-13.74%	-14.94%	-28.94%
EURUSD	3.86%	2.13%	2.13%	1.85%	8.29%	5.54%
USDJPY	-5.32%	-6.05%	-6.05%	-8.25%	-11.23%	-15.77%
Brent	-33.04%	-48.74%	-48.74%	-48.54%	-35.18%	-42.20%
Gold spot	5.93%	10.71%	10.71%	29.87%	39.85%	43.93%

*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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