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Some ease shutdowns, others extend them: more fiscal and monetary easing ahead

By Gustavo Medeiros

Political uncertainty rises in Brazil after Justice Minister Sergio Moro's resignation. South Africa announces a big fiscal stimulus as the IMF offers funding with no strings attached. Argentina uses grace period on Eurobond coupon payments. China announces mass testing for coronavirus to accelerate economic normalisation. Mexico cuts rates, increases liquidity and announces fiscal measures. South Korea boosts fiscal measures. Ghana ends lockdown. Benin repudiates debt moratorium.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.7	–	-2.39%
MSCI EM Small Cap	9.1	–	-1.48%
MSCI Frontier	9.9	–	-1.36%
MSCI Asia	11.3	–	-2.35%
Shanghai Composite	9.8	–	-1.05%
Hong Kong Hang Seng	7.6	–	-1.62%
MSCI EMEA	8.8	–	0.35%
MSCI Latam	9.9	–	-8.84%
GBI-EM-GD	5.03%	–	-1.31%
ELMI+	3.29%	–	-0.90%
EM FX spot	–	–	-1.38%
EMBI GD	7.03%	639 bps	-1.55%
EMBI GD IG	4.14%	346 bps	-0.74%
EMBI GD HY	11.56%	1,096 bps	-2.65%
CEMBI BD	6.13%	560 bps	-0.22%
CEMBI BD IG	4.15%	361 bps	0.17%
CEMBI BD Non-IG	9.36%	883 bps	-0.80%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.2	–	-1.30%
1-3yr UST	0.23%	–	0.00%
3-5yr UST	0.39%	–	0.01%
7-10yr UST	0.62%	–	0.36%
10yr+ UST	1.20%	–	1.85%
10yr+ Germany	-0.47%	–	0.15%
10yr+ Japan	0.00%	–	1.19%
US HY	8.38%	775 bps	-2.10%
European HY	7.74%	755 bps	-0.23%
Barclays Ag	1.08%	46 bps	-0.03%
VIX Index*	35.93	–	-2.22%
DXY Index*	99.98	–	0.02%
EURUSD	1.0844	–	-0.17%
USDJPY	107.26	–	-0.33%
CRY Index*	112.75	–	-11.04%
Brent	20.9	–	-18.15%
Gold spot	1721	–	1.51%

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

Emerging Markets

- **Brazil:** Justice Minister Sergio Moro resigned after President Jair Bolsonaro replaced the head of the federal police for political reasons. Mr. Moro is one of the most popular figures in Brazil after skilfully dismantling the 'car-wash' corruption scheme, culminating with the imprisonment of former president Luis Inacio Lula da Silva which sent shock waves across Latin America. In an interview, Moro indirectly accused Bolsonaro of interfering with the federal police and five other crimes. Following the recent dismissal of Brazil's popular Minister of Health, this second replacement of a key minister in just two weeks led to a knee jerk reaction in asset prices. This was based on fears that the market-friendly Minister of Finance Paulo Guedes and his team could also be at risk, after an infrastructure plan was unveiled by another minister without the presence of Mr. Guedes last week. In our view, the economic team is committed to the economic project and will only leave if not allowed to implement the plan.

The Supreme Court and the Parliament are likely to thoroughly investigate Moro's allegations, but an impeachment trial is still not the base-case scenario. According to polls from late March, Bolsonaro's disapproval rate is around 35% and approximately 35% of those polled having a neutral view of his administration. For impeachment proceedings to become a reality, the president's disapproval rating typically needs to decline above 70% and two-thirds of the members of congress need to vote in favour of impeachment for the president to be removed from office. Furthermore, it is unlikely that Congress President Rodrigo Maia will open an impeachment process in the middle of the coronavirus pandemic. If Bolsonaro eventually resigns, or is impeached, then Vice President Hamilton Mourao would assume the position of president until the end of 2022. General Mourao is a capable politician with a wide set of skills in geopolitics and economics, and therefore in our opinion would be a good caretaker.

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Emerging Markets

Brazilian asset prices were already undervalued prior to Moro's resignation and overshot last Friday. However, volatility may persist until it becomes clear that the economic team is not at risk. In other news, the current account surprised to the upside with a surplus of USD 868m in March, bringing the cumulative 12-month current account deficit to 2.8% of Gross Domestic Product (GDP) from 2.9% in February. Foreign direct investment also surprised on the upside at USD 7.6bn in March, or 4.5% of GDP on a rolling 12-month basis. Outflows from portfolio investors hit USD 22.2bn in March.

- South Africa: The government announced a fiscal package of ZAR 500bn (approximately 10% of GDP) in a bid to support the economy. Some ZAR 130bn will be re-allocated within the budget. Another ZAR 200bn will be extended as federal government guarantees in the form of bank loans to small companies, while net ZAR 170bn of fresh stimulus funding is required. The fiscal package should temporarily increase the fiscal deficit to more than 10% of GDP. The IMF senior representative for South Africa said USD 4.2bn of emergency funding could be provided with no ex-post conditionality, which could cover nearly half of the net increase in the fiscal deficit. Foreign investors' positions in local currency government bonds declined to 34.0% of the total in March from 37.1% in the previous quarter as local investors and the central bank bought bonds yielding approximately 6% in real terms. The rate of consumer prices index (CPI) inflation declined to 4.1% on a yoy basis in March from 4.6% yoy in February, which was mostly due to declines in services and rental inflation.

- Argentina: The government announced it will use the 30-day grace period on USD 500m coupon payments that were due on the 22 April in a bid to marginally increase its bargain power in the ongoing debt restructuring negotiations. In other news, the fiscal deficit increased to ARS 125bn in March 2020 from ARS 13bn in March 2019. The marked deterioration came from a combination of higher expenditures and lower revenues. Primary spending increased by 70% on a yoy basis due to an increase in pension and social benefits as well as higher subsidies and assistance to provinces. Revenues rose by only 31% yoy mostly due to weak VAT revenues as the lockdown started in 20 March.

- China: The State Council announced that nationwide mass testing for coronavirus will take place to address contagion fears and allow for a wider reopening of the economy. A consumer survey by Morgan Stanley suggests that 94% of China's work force is back to work, while 86% go out for groceries. However, restaurant visits and leisure activity trips remain below 40% of normal levels. At the same time, the government announced less stringent border controls with the rest of the world. In other news, the weight of Chinese government bonds in JP Morgan's index of Emerging Markets (EM) local currency bonds (GBI EM GD) increases to 2% at the end of April from the current 1%. Fiscal revenues declined by 26.1% on a yoy basis in March after declining at a rate of 9.9% yoy in the January- February period.

- Mexico: The central bank cut its policy rate by 50bps to 6.0% and announced MXN 750bn (approximately 2.6% of GDP) in liquidity measures to support the financial system The board of directors believes the economy could contract around 5% in 1H 2020. The yoy rate of CPI inflation declined to 2.1% in the first half of April from 2.8% yoy in the previous period. President Andres Manuel Lopez Obrador announced a MXN 623bn (circa 2.2% of GDP) increase in budget spending on social programs and critical projects in order to counter-act the direct and indirect effects of coronavirus.

- South Korea: Exports declined by 26.9% on a yoy basis in the first 20 days of April with autos and petroleum exports declining the most. Imports declined at a yoy rate of 18.6% mostly due to lower crude oil prices. Real GDP growth contracted 1.4% on a yoy basis in Q1 2020 from a 1.3% yoy expansion in Q4 2020. The slowdown was led by the sharpest drop in demand for traded goods since the Asian Financial Crisis in 1997. In other news, the government held a fifth emergency meeting to address the economic impact of the global shutdown. A total of KRW 85tn (approximately 4% of GDP) of fiscal measures will be implemented to support key industries, such as airlines, shipbuilding, shipping, automobile as well as small businesses and direct support to the population.

- Ghana: President Nana Akufo-Addo announced the end of a lockdown designed to contain the coronavirus. Ghana has 1,042 cases and nine deaths after conducting more than 50k tests. Lockdowns are less effective in the informal sectors in many African cities, where many people live in close quarters. Meanwhile, lockdowns are less necessary in lower density rural areas, where a big part of the population lives. In other news, the rate of real GDP growth increased to 7.9% on a yoy basis in Q4 2019 from 5.6% yoy on Q3 2019. Producer Prices Index (PPI) inflation declined to 6.8% yoy in March, form 10.5% yoy in February. Moody's moved the outlook on the sovereign's 'B3' rating from positive to negative.

- Benin: Finance Minister Romuald Wadagni said a broad debt moratorium across developing economies would do more harm than good as it would complicate pricing credit risk in the future. He issued specific policy recommendations in an open letter, asking multilateral institutions to create a new vehicle to provide funding at concessional rates to countries with sustainable debt and to buy back existing debt instruments at distressed levels of countries with unsustainable debt burdens in order to help them to restore debt sustainability and regain market access. Benin's plan is very similar in scope to the plan we proposed last week.[1]

[1] See: *'The case for a global macro-prudential policy'*, Market Commentary, 20 April 2020.

Emerging Markets

Snippets:

- **Colombia:** The President of the Inter-American Development Bank (IDB) said that a USD 1.15bn loan will be made available for disbursement to Colombia in the course of the next month.
- **Ecuador:** Foreign Exchange (FX) reserves rose by USD 580m to USD 3bn. Fitch downgraded Ecuador's sovereign rating to 'RD' (restricted default) from 'C' after bond holders last week accepted the government's consent solicitation, which led to a postponement of coupon payments until August.
- **Egypt:** The government requested financial assistance from the IMF under the Rapid Financing Instrument (RFI) as well as a Stand-By Agreement (SBA). The SBA credit line is precautionary by nature, and will come with macroeconomic policy guidance from the Fund.
- **Hungary:** Central Bank Governor Tells Figyelo announced the start quantitative easing (QE) policies starting the first week of May.
- **Malaysia:** The yoy rate of CPI inflation fell to -0.2% in March from 1.3% yoy in February. The drop was mostly due to lower fuel costs. The government extended movement restrictions, which began on 18 March by another two weeks to 12 May.
- **Mozambique:** The IMF approved USD 309m in the RFI loan to support the nation's urgent balance of payments needs amidst the coronavirus outbreak.
- **Peru:** President Martin Vizcarra extended the lockdown until the 10 May.
- **Philippines:** President Rodrigo Duterte extended the lockdown of metropolitan Manila and half of the main island of Luzon until the 15 May.
- **Poland:** Industrial production (IP) declined by 2.3% on a yoy basis in March. This was better than the consensus expectations of a 3.3% yoy decline. Retail sales dropped 9.9% on a yoy seasonally adjusted basis in March from 4.2% yoy in February. The reason was the ongoing lockdown.
- **Romania:** Moody's kept Romania's 'Baa3' rating unchanged, but cut the rating outlook to negative from stable due to a structural deterioration in public finances as pension expenditures increase.
- **Russia:** The central bank cut the policy rate by 50bps to 5.5%, which was in line with consensus expectations.
- **Singapore:** The government's lockdown was extended until 1 June with the aim of reducing the commuting workforce from 20% to 15%. Core CPI inflation declined 0.2% on a yoy basis in March after declining at a yoy rate of 0.1% in February. IP surged 21.7% in the month of March, thereby partially reversing a 22.1% decline in February, mostly due to a pick-up in the biomedical industry. IP ex-pharma was up 2.5% in March after a 17.8% contraction in February.
- **Taiwan:** IP rose 10.4% in yoy terms in March following a 20.7% yoy expansion in February. Production and export of technology products, particularly semiconductors lead the faster than expected rebound. Taiwanese industries benefit from the country's effective healthcare system, which has reduced the number of coronavirus cases even sooner than in most other Asian countries.
- **Thailand:** Exports rose by 4.2% on a yoy basis in March after contracting 0.8% yoy in January-February. Imports accelerated by 7.4% on a yoy basis after falling 4.5% yoy in February.
- **Turkey:** The Central Bank cut its one-week policy rate by 100bps to 8.75% saying that the balance of risk for inflation is skewed to the downside. The banking sector regulator changed the formula for calculating capital ratios to incentivise additional loans and Eurobond purchases. Eurobond holdings now bear a zero capital requirement.
- **Ukraine:** Fitch kept Ukraine's 'B' rating unchanged, but cut the rating outlook to stable from positive.

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Global backdrop

- **Oil:** The West Texas Intermediate (WTI) future traded around an incredible – USD 40 (minus forty Dollars) per barrel last Monday on the day of the contract fixing before rebounding to USD 17 per barrel by the end of the week. Traders, who were long the WTI contract that expired at midnight of 20 April were 'cornered' by lack of storage capacity in the landlocked area around Cushing, Oklahoma, which forced them to sell oil at whatever price they could. Large positions by retail investors in WTI Exchanged Traded Funds (ETFs) exacerbated the problem. Last week, we highlighted the possibility of a depletion of storage leading to a sudden collapse in front end prices. The one-year future was down 11% trading at USD 32 per barrel at the end of last week after touching an intra-week low of USD 30 per barrel.

- **US:** Payments made under the CARES Act programme helped to boost consumer spending by 26% on a yoy basis in the third week of April after declining at a yoy rate of 23% in the prior fortnight, according to credit card data from Bank of America Merrill Lynch. Lower income cohorts (with income of less than USD 50,000 per year) increased spending by 49% yoy, whereas higher income groups increased spending by a mere 3% yoy. Most of the incremental spending went towards food and restaurants. The data indicates that direct cash payments are most effective when targeted at the most vulnerable part of the population.

The main risk associated with cash transfers – should they become permanent – is that they distort incentives for people to remain on benefits rather than get jobs, potentially leading to inflationary outcomes due to supply disruptions, which would ultimately hurt the benefit recipients themselves. In some states, the combined transfers from federal and local governments may exceed the minimum wage, which acts as a disincentive for some categories of workers to seek jobs until the programme ends on 31 July. The November 2020 presidential election looms. The Democratic Party will push for a continuation of cash handouts in a bid to place Republican members of Congress, who favour an early end to cash handouts into a precarious political position. We note in passing that 110 members of UK's parliament signed a petition in favour of universal basic income (UBI).

In other news, initial jobless claims went up by another 4.4m in the week ending in 18 April, which was marginally lower that the 5.2m increase in the previous week. In total, 26m claim applications have been filled over the last five weeks. Continuing claims rose to 16m in week ending in 11 April from 12m in the previous week. Markit's preliminary Purchasing Managers Index (PMI) survey for the month of April dropped to 36.9 from 48.5 in the manufacturing sector and to 27.0 from 39.8 in services. Clearly, declining rates of economic activity and rising unemployment are already rippling through the US economy. Existing home sales declined at an annualised pace of 5.3m in March from 5.8m in February, while the share of mortgages in forbearance rose to 6% of the total volume on the week ending in 12 April. This compares to close to 0% last month. The CARES Act allows borrowers of federally-backed mortgages to suspend payments for up to 12 months.

- **Europe:** Several European Central Bank (ECB) policymakers, including Olli Rehn from Finland and Fabio Panetta from Italy spoke in favour of a stronger fiscal union. In their video conference last Thursday, European Union (EU) leaders reached broad agreement on a ballpark EUR 1tn fund to support economic recovery at regional level within Europe. ECB issued a press release to the effect that banks will be allowed to use high yield securities as collateral for funding operations as long as the securities were rated investment grade on 7 April 2020. The measure seeks to provide support to sovereign and corporate bonds that are downgraded below BBB-. S&P affirmed Italy's sovereign credit rating at BBB with a negative outlook.

- **Japan:** The Bank of Japan removed limits for the purchase of government bonds and increased the scope for corporate bonds and commercial paper, more than doubling its JPY 20 tn (USD 187bn).

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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	3.78%	3.78%	-20.70%	-16.47%	-0.55%	-0.95%
MSCI EM Small Cap	7.61%	7.61%	-26.13%	-24.31%	-7.30%	-5.00%
MSCI Frontier	2.52%	2.52%	-24.78%	-17.43%	-3.83%	-3.03%
MSCI Asia	4.25%	4.25%	-14.92%	-11.66%	2.48%	0.84%
Shanghai Composite	2.12%	2.12%	-7.91%	-10.15%	-1.32%	-6.62%
Hong Kong Hang Seng	0.64%	0.64%	-13.53%	-14.06%	2.39%	-4.23%
MSCI EMEA	5.59%	5.59%	-30.19%	-27.48%	-7.21%	-5.46%
MSCI Latam	-4.47%	-4.47%	-48.01%	-43.16%	-14.39%	-8.52%
GBI EM GD	0.89%	0.89%	-14.46%	-5.86%	-1.12%	0.02%
ELMI+	-0.77%	-0.77%	-9.18%	-6.08%	-0.96%	-0.32%
EM FX Spot	-1.13%	-1.13%	-15.28%	-14.62%	-7.58%	-6.52%
EMBI GD	0.72%	0.72%	-12.76%	-6.32%	0.25%	2.52%
EMBI GD IG	0.82%	0.82%	-4.66%	4.62%	4.23%	3.83%
EMBI GD HY	0.59%	0.59%	-21.98%	-18.08%	-4.36%	0.94%
CEMBI BD	3.40%	3.40%	-7.12%	-0.71%	2.39%	3.52%
CEMBI BD IG	2.81%	2.81%	-3.42%	3.31%	3.69%	3.56%
CEMBI BD Non-IG	4.31%	4.31%	-12.13%	-6.16%	0.61%	3.57%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	9.88%	9.88%	-11.66%	-1.14%	8.23%	8.20%
1-3yr UST	0.08%	0.08%	2.84%	5.41%	2.65%	1.83%
3-5yr UST	0.15%	0.15%	5.53%	9.46%	4.02%	2.84%
7-10yr UST	0.81%	0.81%	11.04%	17.81%	6.86%	4.44%
10yr+ UST	3.59%	3.59%	25.25%	40.04%	13.98%	8.30%
10yr+ Germany	1.45%	1.45%	6.60%	11.39%	6.85%	3.48%
10yr+ Japan	0.57%	0.57%	-0.27%	1.68%	2.29%	3.40%
US HY	3.63%	3.63%	-9.52%	-4.79%	1.73%	3.24%
European HY	5.73%	5.73%	-11.35%	-8.24%	-0.59%	1.43%
Barclays Ag	1.01%	1.01%	0.68%	5.74%	3.45%	2.66%
VIX Index*	-32.89%	-32.89%	160.74%	182.25%	246.81%	173.86%
DXY Index*	0.94%	0.94%	3.72%	2.01%	0.91%	3.32%
CRY Index*	-7.42%	-7.42%	-39.31%	-38.94%	-37.53%	-49.66%
EURUSD	-1.70%	-1.70%	-3.30%	-3.06%	-0.27%	-0.44%
USDJPY	-0.26%	-0.26%	-1.24%	-3.93%	-3.60%	-9.90%
Brent	-7.96%	-7.96%	-68.29%	-70.99%	-59.31%	-67.72%
Gold spot	9.14%	9.14%	13.45%	34.49%	36.15%	43.21%

*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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