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WEEKLY INVESTOR RESEARCH

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The IMF gets it: local bond markets are the backbone of financial stability

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The International Monetary Fund published a guidance note in support of developing local currency bond markets across Emerging Markets. China's total social financing surprised to the upside. Brazil's Supreme Court crushed former President Lula's conviction for corruption. The Ecuadorian electoral court dismissed the recount request from Yaku Perez. The vaccination campaign accelerated in Chile. Peruvian copper production poised to increase. Ghana's 2021 fiscal deficit target was wider than expected.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.8	–	0.70%
MSCI EM Small Cap	10.6	–	1.08%
MSCI Frontier	10.4	–	0.78%
MSCI Asia	15.0	–	0.14%
Shanghai Composite	11.5	–	-1.39%
Hong Kong Hang Seng	9.5	–	-1.06%
MSCI EMEA	10.2	–	3.73%
MSCI Latam	11.1	–	2.31%
GBI-EM-GD	4.87%	–	0.47%
ELMI+	2.63%	–	0.38%
EM FX spot	–	–	0.70%
EMBI GD	5.24%	352 bps	-0.04%
EMBI GD IG	3.41%	163 bps	-0.16%
EMBI GD HY	7.57%	591 bps	0.09%
CEMBI BD	4.45%	303 bps	-0.33%
CEMBI BD IG	3.20%	178 bps	-0.46%
CEMBI BD Non-IG	6.12%	469 bps	-0.17%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.8	–	2.69%
1-3yr UST	0.15%	–	-0.01%
3-5yr UST	0.85%	–	-0.16%
7-10yr UST	1.63%	–	-0.46%
10yr+ UST	2.39%	–	-1.96%
10yr+ Germany	-0.31%	–	-0.26%
10yr+ Japan	0.00%	–	-0.22%
US HY	4.39%	326 bps	-0.06%
European HY	3.20%	370 bps	0.26%
Barclays Ag	1.14%	-49 bps	-0.19%
VIX Index*	20.69	–	-3.97%
DXY Index*	91.85	–	-0.46%
EURUSD	1.1933	–	0.73%
USDJPY	109.28	–	0.36%
CRY Index*	193.79	–	0.34%
Brent	69.6	–	1.96%
Gold spot	1724	–	2.41%

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

Emerging Markets

- **Local bond markets:** The International Monetary Fund (IMF) and the World Bank jointly published a guidance note in support of developing local currency bond markets, acknowledging that local capital markets are the best way to secure stable access to funding.[1] Local bond markets are particularly important for Frontier economies, which depend mainly on fickle external markets to finance their budget deficits. We believe the IMF should build on this insight to push for reforms in support of the creation of healthy local bond markets as part of the conditionality for lending to Emerging Markets (EM) and frontier countries.[2]

- **China:** At RMB 1.7tn in February versus RMB 0.9bn expected, total social financing (TSF) expanded at a yoy rate of 13.3% in February compared to 13.0% yoy in January. It is possible that the stronger than expected credit data reflects an earlier resumption of business activity following the travel bans imposed during the Chinese New Year. The yoy rate of consumer prices index (CPI) inflation rose to -0.2% in February from -0.3% yoy in January, while producer prices index (PPI) inflation rose to 1.7% yoy from 0.3% yoy over the same period. Economic data for the cumulative January to February period exceeded consensus expectations with the yoy rate of industrial production (IP), fixed asset investment and retail sales rising 35.1%, 35.0% and 33.8% respectively on base effects. Property sales in tier 1 cities surged 60.8% ahead of 2019 over the same period.

  On the other hand, the unemployment rate rose to 5.5% in February from 5.2% in January, suggesting policy is likely to remain simulative. Bloomberg news reported that regulators are planning to announce stricter rules for Tencent's financial technology ('fintech') business. A new industry with relatively little transparency, fintech is likely to attract more regulatory scrutiny worldwide, including in China, which has taken a lead in this respect.

[1] See https://www.imf.org/en/Publications/analytical-notes/Issues/2021/03/12/guidance-note-for-developing-government-local-currency-bond-markets

[2] See *'Missing the big picture on IMF lending'*, Market Commentary, 2 March 2021.

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Emerging Markets

Putting in place a sound regulatory framework for the fintech industry is good for the long-term development of the industry as it lowers the risks of unintended consequence, including market abuse and bubbles. The clampdown on bad practices in China started with the cancellation of the initial public offering (IPO) of Ant Group in November last year. Most of Ant's expansion had been based on extending on credit to individuals and small companies. Ant has a better basis for credit analysis in the sector due to a large database from its vast payment network. However, Ant group kept very little exposure to the loans, selling as much as 98% of the risk to large Chinese banks, a practice which is unsustainable over the long term. Regulators may fine Alibaba under antitrust legislation.[3] Since markets do not like regulation, its imposition can be a headwind for equities in the short term, but in the medium-term better regulation, which protects investors from excessive greed and provide the basis for more stable capital markets is clearly preferable. In other corporate news, Baidu, an internet services company, is seeking to raise USD 3.6bn by listing the company in the Hong Kong stock exchange.

- Brazil: The Supreme Court ruled that a local court in Curitiba did not have jurisdiction to pass judgement on former President Luiz Inacio Lula da Silva ('Lula'), thereby in effect nullifying Lula's conviction on charges of corruption. The Federal District Court of Brasília will now re-run the trial. If Lula is found not guilty, or if there is no sentence prior to July 2022 then Lula may be allowed to run for President in next year's presidential election. Meanwhile, current President Jair Bolsonaro is trying to move towards the centre after appearing in public wearing a mask and highlighting the importance of vaccines against Covid-19. Brazil has already procured more than 300m shots and an increased pace of deliveries in the coming months should allow for a quick ramp-up of vaccination from the current 11.4m people (5.4% of the population) to around 75% of the population by the end of 2021. In other news, the Lower House voted in favour of an emergency bill that provides BRL 250 cheques to be distributed to the population between March and May this year. The increase in social assistance will be paid for by higher taxes and a freeze on public sector wages across all levels of government, thereby keeping the fiscal ceiling intact. The Central Bank of Brazil intervened in the foreign exchange (FX) market in several auctions leading to a solid rebound in BRL, which ended the week 2.2% stronger at 5.56 versus the Dollar. In economic news, the yoy rate of PPI inflation as measured by the FGV IGP-DI rose to 30.0% in February from 26.6% in January due to higher commodity prices and a weaker BRL previously. The yoy rate of CPI inflation rose to 5.0% in February from 4.6% in January, thereby moving further away from the centre of the central bank's target of 3.75% and close to the 5.25% ceiling of the target range for inflation.

- Ecuador: The Contentious Electoral Tribunal rejected Yaku Perez vote recount appeal and ratified the result from the National Council (CNE) which confirms the runoff between Andrez Arauz and Guillermo Lasso on the 11 April. Mr. Perez asked his supporters to "keep fighting for democracy", but did not directly call them to come to the streets. International reserves declined to USD 5.8bn in February from USD 6.6bn in January.

- Chile: The government announced weekend quarantines in Santiago in order to contain the spread of coronavirus. Chile has vaccinated more than one third of its population and is on track to vaccinate close to 50% of the population by the end of the quarter. This would bring the country on par with the United Arab Emirates and only behind Israel in terms of the pace of vaccinations. The trade surplus moderated to USD 1.5bn in February from USD 1.7bn in January, which was better than consensus expectations as copper exports rose to USD 3.9bn from USD 2.7bn over the same period. The yoy rate of CPI inflation fell to 2.8% in February from 3.1% in January.

- Peru: Energy and Mines Minister Jaime Gálvez said Peru can produce 2.5 million metric tons (mmt) of copper in 2021 compared to 2.15mmt in 2020. Production may rise further to 3.0mmt by 2023, provided that the benign political environment continues after the scheduled presidential and parlimentary elections on 11 April 2021. In economic news, the trade surplus was USD 347m in January compared to a deficit of USD 479m in December. The central bank kept its policy rate unchanged at 0.25%.

- Ghana: The government announced the 2021 fiscal deficit will improve only modestly to 9.5% of GDP from 11.7% of GDP in 2020. The worse than expected deficit figure should push the debt/GDP ratio to around 80% of GDP in 2021 from 76% of GDP in 2020. The yoy rate of CPI inflation rose to 10.3% in February from 9.9% in January, which was higher than consensus expectations of a 9.8% yoy increase.

[3] See https://www.wsj.com/articles/china-regulators-plan-to-tame-tech-giant-alibaba-jack-ma-11615475344

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Emerging Markets

Snippets:

- Argentina: CPI inflation declined to 3.6% in February from 4.0% in January, in line with the median survey of economists on Bloomberg. Core CPI rose to 4.1% in February from 3.9% in January. Industrial capacity utilization declined to 57.2% in January from 58.4% in December.
- Colombia: Consumer confidence improved to -14.6 in February from -20.8 in January, but was worse than the consensus expectation of -10.8.
- Czech Republic: The yoy rate of CPI inflation declined to 2.1% in February from 2.2% in January, but real wage growth rose to 3.8% in Q4 2020 from 1.8% in the previous quarter. The yoy rate of industrial output declined 4.4% in January after rising 8.0% yoy in December.
- Egypt: The yoy rate of CPI inflation rose to 4.5% in February from 4.3% in January. Foreign exchange reserves rose to USD 40.2bn in February from USD 40.1bn in January. GDP growth accelerated to 2% in 4Q20 from 0.7% in 3Q20. Rating agency Fitch kept the sovereign credit rating unchanged at 'B+' with stable outlook.
- Dominican Republic: Rating agency Fitch affirmed the sovereign credit rating of 'BB-' but introduced a negative outlook on account of deteriorating fiscal indicators due to the Covid-19 pandemic. The country's debt/GDP ratio of 58% is slightly worse than the 'BB' median.
- Hungary: The yoy rate of CPI inflation rose to 3.1% in February from 2.7% yoy in January. The trade surplus improved to 830m in January from 398m in December. The cumulative 2021 budget deficit worsened to HUF 540bn in February following a surplus of HUF 199bn in January. The February deficit was the largest since 2011.
- India: The yoy rate of CPI inflation increased to 5.0% in February from 4.1% yoy in January, in line with consensus expectations. Meanwhile, core CPI inflation rose to 5.6% yoy from 5.3% over the same period. IP declined 1.6% on a yoy basis in January from +1.0% growth in Q4 2020 as consumers cut back spending.
- Indonesia: The trade surplus was unchanged at USD 2.0bn in February which represents a 8.6% expansion on a yoy basis from 12.2% yoy in January.
- Kenya: S&P Ratings downgraded Kenya's sovereign credit rating to 'B' from 'B+' in spite of a USD 2.4bn IMF loan conditional on scrapping tax breaks and exemptions equivalent to roughly 6% of GDP and speeding up of the restructuring of state owned companies.
- Lebanon: The Lebanese Pound weakened above LBP 10k to the USD in the black market. The official exchange rate remains pegged to the Dollar at LBP 1.5k.
- Malaysia: IP rose at a 1.2% yoy pace in January compared to 1.7% yoy in December, slightly ahead of consensus expectations.
- Mexico: The yoy rate of core CPI inflation rose to 3.8% in February from 3.5% in January, in line with consensus expectations. IP declined 4.9% in January after a 2.1% contraction in December.
- Paraguay: Protesters took to the streets to oust President Mario Abdo Benítez after coronavirus infections soared amidst a shortage of basic healthcare supplies, including vaccines. Abdo fired his health minister and three other members of his cabinet over the weekend, but has so far failed to appease the public.
- Philippines: The trade deficit widened to USD 2.4bn in January from 2.2bn in December as exports declined at a yoy rate of 5.2% in January after growing 1.7% yoy in December.
- Romania: The yoy rate of CPI inflation rose to 3.2% in February from 3.0% in January. GDP growth declined at a yoy rate of 1.4% in Q4 2020 from -1.5% in Q3 2020, while the unemployment rate rose to 5.6% in January from 5.2% in December.
- Senegal: Former presidential candidate Ousman Sonko was arrested and charged with rape leading to protests across Senegal. The protests soon precipitated the release of Sonko.
- South Africa: Good economic data kept South African assets supported last week. The current account recorded a surplus equivalent to 2.2% of GDP in 2020 (the first full-year surplus in 18 years). This compares to a current account deficit of 3.0% in 2019. Real GDP growth was 6.3% in Q4 2020, which beat the consensus expectation of 5.6%. Mining production rose 4.5% in January after contracting by 1.5% in December.
- Sri Lanka: The Chinese central bank approved a USD 1.5bn swap line with Sri Lanka.
- Taiwan: The yoy rate of export growth declined to 9.7% in February from 36.8% yoy in January, lower than consensus expectations.
- Thailand: Consumer confidence recovered to 49.4 in February from 47.8 in January.
- Turkey: The current account deficit declined to USD 1.9bn in January from USD 3.2bn in December.
- Ukraine: The yoy rate of CPI inflation rose to 7.5% in February from 6.1% in January, higher than the median economists' forecast. The main contributors to higher inflation were higher household heating costs, higher food prices, and the higher minimum wage.

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Global backdrop

- **Coronavirus:** The Novavax vaccine was shown to be 96.4% effective in the third phase trials in the UK, including 86.3% effective against the new strain of the virus circulating in the UK and 55.0% effective against the South African strain. Thailand, Denmark, and other EU countries suspended the use of the Astra Zeneca vaccine over concerns about blood clots. Despite ongoing supply problems, the pace of vaccinations in the EU increased. Some 48.5m people, or 10.9% of the EU population have now been vaccinated (as of 13 March). In the US, the immunologist and chief medical advisor to the US President Anthony Fauci said he expects that mobility should be normalised by the summer. The US has vaccinated 105.7m people, or 31.9% of its population.

- **United States (US):** The US Treasury sold USD 120bn 3-year, 10-year and 30-year bonds. The supply was met with good demand, but on Friday a block seller of US Treasuries pushed up yields. Last week, the yield on 10-year bonds increased by 7bps to 1.63% and the 30-year yield rose by 9bps to 2.39%. This week the Fed updates its economic forecasts and the dot-plot chart, which shows the Federal Open Market Committee (FOMC) members' expectations about the forward evolution of rates. Both real GDP growth and the outlook for inflation have increased significantly since the last FOMC meeting, wherefore some members may call for earlier rate hikes, starting in 2023. If FOMC members' median forecast converges to one hike in 2023 the yield at the front end of the US Treasury curve increase to bear flatten the yield curve. In economic news, the University of Michigan consumer sentiment index rose to 83.0 in the preliminary March report from 76.6 in February, thus beating the consensus expectation, but still not reaching pre-covid levels. Credit card data from Bank of America showed that spending rose 10.7% on a yoy basis on the week ending in 6 March. The yoy rate of PPI rose to 2.8% yoy in February from 2.7% yoy in January, mostly due to higher energy prices, export and intermediate goods. Headline CPI inflation rose to 1.7% yoy from 1.4% yoy over the same period in line with consensus expectations, but the yoy rate of core CPI inflation declined outright to 1.3% from 1.4%.

- **European Union (EU):** The European Central Bank (ECB) kept its policy rate unchanged at -0.5% and maintained the current size of the pandemic emergency purchase program (PEPP) at EUR 1.85tn. However, the ECB will ramp up the pace of PEPP purchases over the next quarter if term bond yields rise too fast in the near-term, according to ECB President Christine Lagarde. The ECB moved its 2021 inflation forecast from 1.0% to 1.5%. In political news, the CDU party from Premier Angela Merkel suffered a harsh defeat in two regional elections.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.76%	4.56%	4.56%	56.47%	6.17%	14.02%
MSCI EM Small Cap	1.27%	7.39%	7.39%	68.97%	4.65%	10.54%
MSCI Frontier	0.12%	0.64%	0.64%	30.30%	-1.27%	6.71%
MSCI Asia	-0.11%	5.17%	5.17%	55.16%	8.63%	15.64%
Shanghai Composite	-1.59%	-0.57%	-0.57%	20.90%	3.69%	6.57%
Hong Kong Hang Seng	-0.66%	4.05%	4.05%	19.44%	-0.38%	9.71%
MSCI EMEA	5.11%	8.31%	8.31%	49.63%	-2.02%	7.12%
MSCI Latam	4.71%	-5.23%	-5.23%	41.28%	-6.70%	5.26%
GBI EM GD	-1.33%	-5.00%	-5.00%	10.20%	0.08%	4.14%
ELMI+	-0.55%	-1.70%	-1.70%	6.38%	-0.19%	2.71%
EM FX Spot	-0.61%	-2.51%	-2.51%	2.79%	-6.00%	-2.65%
EMBI GD	-0.86%	-4.44%	-4.44%	10.54%	4.18%	5.42%
EMBI GD IG	-1.04%	-5.70%	-5.70%	5.30%	6.27%	5.60%
EMBI GD HY	-0.66%	-2.98%	-2.98%	17.10%	1.86%	5.16%
CEMBI BD	-0.64%	-0.80%	-0.80%	10.23%	6.04%	6.47%
CEMBI BD IG	-0.78%	-1.74%	-1.74%	5.84%	6.19%	5.51%
CEMBI BD Non-IG	-0.45%	0.46%	0.46%	16.58%	5.85%	7.98%

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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	3.55%	5.32%	5.32%	61.76%	14.46%	16.52%
1-3yr UST	-0.05%	-0.08%	-0.08%	1.00%	2.84%	1.81%
3-5yr UST	-0.38%	-1.23%	-1.23%	0.86%	4.24%	2.51%
7-10yr UST	-1.64%	-4.98%	-4.98%	-3.40%	5.63%	2.88%
10yr+ UST	-4.77%	-13.32%	-13.32%	-14.20%	6.96%	3.68%
10yr+ Germany	-0.35%	-6.02%	-6.02%	-9.69%	6.17%	3.34%
10yr+ Japan	1.30%	-0.99%	-0.99%	-3.53%	0.99%	0.99%
US HY	-0.22%	0.48%	0.48%	17.97%	6.53%	8.11%
European HY	0.40%	1.63%	1.63%	15.80%	3.40%	4.77%
Barclays Ag	-1.20%	-3.76%	-3.76%	3.48%	3.27%	3.22%
VIX Index*	-25.97%	-9.05%	-9.05%	-64.22%	24.71%	22.86%
DXY Index*	1.07%	2.13%	2.13%	-6.99%	1.90%	-4.95%
CRY Index*	1.76%	15.49%	15.49%	37.60%	-0.05%	13.28%
EURUSD	-1.18%	-2.32%	-2.32%	6.71%	-3.02%	7.42%
USDJPY	2.54%	5.84%	5.84%	3.22%	2.76%	-3.43%
Brent	5.22%	34.32%	34.32%	105.55%	6.85%	79.61%
Gold spot	-0.57%	-9.18%	-9.18%	13.87%	30.98%	39.91%

*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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