Habemus trade deals

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The signing of the phase one trade deal between the United States (US) and China and the ratification of USMCA by the US Senate reduced tail risks and boosted short term market sentiment. However, the deals leave the US and the rest of the world in a worse position than before the beginning of misguided trade wars three years ago. Russia's Putin reshuffles his cabinet. Argentina's provinces kicks-off debt re-profiling exercises. In China, the economic data and credit numbers surprised to the upside and the government in Chile keep working on pension and tax reforms despite of its low popularity.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.8	–	1.17%
MSCI EM Small Cap	11.1	–	1.92%
MSCI Frontier	11.1	–	1.32%
MSCI Asia	12.4	–	1.47%
Shanghai Composite	10.0	–	-0.54%
Hong Kong Hang Seng	7.8	–	1.35%
MSCI EMEA	9.6	–	0.74%
MSCI Latam	12.4	–	0.24%
GBI-EM-GD	5.16%	–	-0.44%
ELMI+	3.16%	–	-0.06%
EM FX spot	–	–	-0.58%
EMBI GD	4.84%	297 bps	0.40%
EMBI GD IG	3.47%	157 bps	0.36%
EMBI GD HY	6.67%	483 bps	0.45%
CEMBI BD	4.80%	303 bps	0.46%
CEMBI BD IG	3.57%	180 bps	0.29%
CEMBI BD Non-IG	6.49%	472 bps	0.68%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.3	–	1.99%
1-3yr UST	1.56%	–	0.04%
3-5yr UST	1.62%	–	0.06%
7-10yr UST	1.82%	–	-0.02%
10yr+ UST	2.28%	–	-0.35%
10yr+ Germany	-0.21%	–	0.25%
10yr+ Japan	0.00%	–	-0.19%
US HY	5.12%	320 bps	0.28%
European HY	3.33%	349 bps	0.31%
Barclays Ag	1.42%	-40 bps	-0.01%
VIX Index*	12.10	–	-0.46%
DXY Index*	97.66	–	0.32%
EURUSD	1.1091	–	-0.39%
USDJPY	110.16	–	0.19%
CRY Index*	182.89	–	-1.24%
Brent	65.5	–	1.95%
Gold spot	1560	–	0.78%

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

Emerging Markets

- **Russia:** President Vladimir Putin announced a constitutional reform aimed at increasing parliament's powers and changing the division of power between the Executive, Legislative and Judicial branches of government. Parliament will have the right to appoint the Prime Minister (previously presidential prerogative) and the Council of the Federation (i.e. the Russian Senate) will be vested with powers to dismiss the judges of the Constitutional Court. Putin also dissolved his government and appointed Mikhail Mishustin as the new Prime Minister. Mishustin is a previously little-known technocrat, who successfully digitalized the government's tax service. In his new job, he will oversee the implementation of the RUB 500bn (USD 8.2bn or 0.5% GDP) public investment programme aimed at lowering inequality and boosting the quality of life of Russians. The package of reforms follows a decline in Putin's popularity after a difficult pension reform and persistent low rates of economic growth. Russian state-owned enterprises (SOEs) have displayed improved management over the last year, leading to a higher return on equity and dividend payments. It is likely that announced reforms will be positive for consumption, GDP growth and asset prices. In particular, multiples have to potential to re-rate on economic reforms and better management, leading to a normalisation of higher dividend pay-outs.

- **Argentina:** The provinces of Buenos Aires and Chubut announced debt re-profiling exercises. The Province of Buenos Aires sent a consent solicitation to delay the USD 250m principal repayment due on the 26 January 2020 to 1 May 2020. At the same time the province extended a fig leaf by pledging to pay the coupon on time, should the consent to delay of the principal be approved. The proposal will become effective if owners of at least 75% of bonds agree to the extension. As far as sovereign repayments are concerned, Finance Minister Martin Guzman maintained that the resources of the Central Government will not be used to bail out provinces. This is positive for the government's ability to service sovereign debt. There are no cross-default provisions or guarantees between provincial and sovereign instruments. In other news, Sergio Chodos has assumed the role of Director of the Southern Cone at the International Monetary Fund (IMF). Chodos will likely play a key role in the coming renegotiation the IMF's USD 56bn programme with Argentina of which USD 44bn have already

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Emerging Markets

been disbursed. Chodos previously worked with Roberto Lavagna and Guillermo Nielsen during renegotiations with the fund in 2003. In other news, CPI inflation surprised on the downside in December. Prices rose 3.7% in the month compared to 4.3% in November, thus taking the 2019 inflation rate to 53.8%. The Central Bank lowered the floor for its 7-day interest rate actions to 50% from 52%.

- China: The rate of real GDP growth was stable at 6.0% on a yoy basis in Q4 2019. Real GDP growth was by 6.1% for 2019 as a whole compared to 6.8% in 2018. December economic data improved across indicators: fixed asset investment was up 5.4% versus the same time the year before, industrial production was up 6.9% on a yoy basis and retail sales were up 8.0% yoy. All beat consensus expectations. Credit growth increased by CNY 2.1trn in the month of December compared to CNY 2.0trn in November. The volume of local government special bond issues in the first two weeks of January 2020 reached CNY 650bn, which is equivalent to two-thirds of the pre-approved January quota. About three quarters of the proceeds from the bond issues are earmarked for infrastructure investment compared to just over one fifth in the same period last year. China reported USD 46.8bn trade surplus in December, which was an increase relative to November (USD 37.6bn). The stronger trade numbers were mainly attributed to exports to other Asian countries. Imports also surprised on the upside on account of a strong pick up on commodity demand. In other news, the net profits of China SOEs rose by 10.8% in 2019 after 15.7% in 2018 as China's State-owned Assets Supervision and Administration Commission (SASAC) expressed full support for initial public offerings from SOEs in 2020. Finally, we note that the US Treasury dropped the "currency manipulator" label from China.

- Chile: President Sebastian Pinera's approval rate declined to an all-time low of just 6%, but in spite of his low popularity Pinera announced a pension reform proposal, which includes a 3% increase in pension contributions from employers and a 3% increase in government contributions to a government pension fund. The government additional contribution will cost USD 1bn per year. Meanwhile, Chile's Senate unanimously approved a tax reform (37 votes in favour and two abstentions), which will collect USD 2.2bn per year. Some 60% of the expected revenues will come from the wealthiest 1% of the population. The tax reform now goes to the lower house. Approval here will cement the government's ability to implement positive structural reform despite low popularity.

- Mexico: The US Senate approved the USMCA free trade deal. Once President Donald Trump has signed the bill, it will become law. The USMCA is broadly similar to NAFTA, but its approval significantly reduces the risk of a massive one-off disruptions for the Mexican economy. The main difference from NAFTA as far as Mexico is concerned is that the USMCA requires that Mexican employers pay higher minimum wages, which represents a negative supply shock for the Mexican economy as well as the North American supply chain. In other Mexican news, investment declined by 1.5% in October after declining 1.1% in September. Private consumption also surprised to the downside by dropping 0.8% in October after increasing 0.7% in September.

- South Korea: The Bank of Korea kept the policy rate unchanged at 1.25%, in line with consensus expectations. Two members of the monetary policy committee voted to cut the policy rate by 0.25%. There was only one dissenter in November, so a consensus may slowly be building for a rate cut in the future, although the economy is currently undergoing a cyclical recovery. The job market generated 117k new positions in December. The fact that the unemployment rate rose to 3.8% in December from 3.6% in November was due to a higher participation rate as more Koreans entered the job market.

- Brazil: The GDP-proxy indicator IBC-Br surprised on the upside with an expansion of 0.2% in November compared to 0.1% in October. The stronger IBC-Br print contrasted with lower than expected industrial production, retail sales and services activity indicators in November. This suggests that the agricultural sector, a key difference between these indicators, may be doing some of the heavy lifting in the economy at this time.

- India: Trade deficit moderated to USD 11.3bn in December from USD 12.1bn in November. Exports declined at a yoy rate of 1.8%, while imports contracted at a yoy rate of 8.8%. CPI inflation rose at a yoy rate of 7.4% in December, which was a surprise to the upside versus consensus expectations. The inflation print breaches the 6.0% inflation target ceiling of the Reserve Bank of India, although this high print was mainly due to volatile food prices. The rate of core inflation was 3.8% on a yoy basis. In other news, local media outlets reported that trade officials are close to announcing a trade deal with the US.

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Emerging Markets

Snippets:

- **Croatia:** CPI inflation rose to 1.4% on a yoy basis in December from 0.7% yoy in November.
- **Egypt:** The Central Bank kept the policy rate unchanged at 12.25% against a consensus expectation of a 1.0% cut, thus erring on the cautious side after inflation rebounded to 7.0% in December due to base effects.
- **Hungary:** The rate of CPI inflation rose 4.0% on a yoy basis in December from 3.4% yoy in November. This was in line with consensus expectations and due to base effects in fuel prices and food prices.
- **Indonesia:** Trade was in balance in December following a USD 1.3bn deficit in November. Exports recovered at a yoy rate of 1.3% mainly due to higher non-oil export volumes whereas imports declined at a rate of 5.6% yoy.
- **Peru:** The Constitutional Court dismissed a challenge against President Vizcarra's decree, which dissolves the parliament. This means that Parliamentary elections can go ahead as planned on 26 January 2020.
- **Poland:** The rate of CPI inflation was unchanged in December at 3.4% on a yoy basis.
- **Romania:** Industrial production declined at yoy rate 7.7% in November after falling at a yoy rate of 7.6% in October. The Romanian economy is grappling with competitiveness issues due to wage increases and missteps by the previous government as well as the effects of slower economy in Western Europe.
- **Pakistan:** The rating agency Fitch kept Pakistan's credit rating unchanged at B- with a stable outlook, acknowledging good progress in improving the country's external finances and fiscal accounts under the guidance of the IMF.
- **Singapore:** Non-oil domestic exports rose by 2.4% on a yoy basis in December after declining at a yoy rate of 5.9% in November. Non-electronic exports rose at a yoy rate of 11.5% while electronic shipments declined 21.3% yoy in December.
- **South Africa:** The South African Reserve Bank (SARB) cut the policy rate by 0.25% to 6.25%. Market expectations were divided between a 25bps cut and no change. Currency strength, persistently low inflation and high unemployment fully justify the decision, in our view. SARB has been relatively hawkish in recent communications.
- **Sri Lanka:** Fitch kept Sri Lanka's foreign currency rating unchanged at B, but changed the outlook to stable from negative. President Gotabaya Rajapaksa announced sweeping tax cuts after coming to power, adding to an already weak fiscal picture.
- **Suriname:** The rating agency Fitch downgraded the country's credit rating to CCC from B- citing rising government debt.
- **Turkey:** The Central Bank of Turkey cut its benchmark one-week repo rate by 0.75% to 11.25, which was broadly expected by market participants.

Global backdrop

The Phase One trade deal between the US and China was signed. The deal halves the tariff rate on USD 120bn of US imports from China to 7.5% and cancels tariff increases previously scheduled for December. In exchange, China has pledged to purchase an additional USD 200bn of goods from the US by 2021 with specific targets set across four sectors. In practice this means that China will have to increase the volume of products purchased from the US by 129% relative to 2017 levels (USD 155bn).

Achieving the target will pose a challenge in the agriculture and energy sector due to production and logistics bottlenecks. As Figure 1 shows, American energy companies will have to increase their exports to China by USD 52bn, which is the equivalent to 36% of all US energy exports in 2017. Meanwhile, China will have to divert significant purchases from other countries to the US in order to achieve the planned USD 32bn increase in imports by 2021. This is equivalent to 20% of China's total agricultural imports.

The deal includes enforcement mechanisms, which grant a significant degree of discretion to the US, although there are specific timelines for dispute resolution. After signalling the deal, Trump will most likely stand by it, selling its benefits to the population and portraying himself as a tough deal maker. The focus on agriculture and energy is important as it puts direct income in the pocket of Trump's voters and funders. Therefore, as long as China is boosting imports on these sectors, the deal is likely is hold, leading to a window of de-escalation on trade wars, at least until the 2020 elections. Trump has stated his willingness to work on a Phase Two trade deal with China.

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Global backdrop

Fig 1:

The Deal: China to import from US

Sector	2020 (USD bn)	2021 (USD bn)	Total (USD bn)
Manufactured	33	45	78
Agriculture	13	20	32
Energy	19	34	52
Services	13	25	38
Total	**77**	**123**	**200**

% of total China imports by sector

Sector	2020	2021	Total
Manufactured	5.0%	6.8%	11.7%
Agriculture	7.8%	12.2%	20.0%
Energy	5.4%	9.8%	15.2%
Services	2.7%	5.3%	8.0%
Total	**3.8%**	**6.1%**	**9.9%**

% of total US exports by sector

Sector	2020	2021	Total
Manufactured	4.9%	6.6%	11.5%
Agriculture	6.9%	10.7%	17.6%
Energy	12.7%	23.2%	35.9%
Services	1.6%	3.1%	4.7%
Total	**3.3%**	**5.2%**	**8.5%**

2017 China imports by sector

Sector	% Total	USD (bn)
Services	23.3%	473
Minerals	17.0%	344
Electronics	16.7%	338
Machinery	10.9%	222
Chemicals	9.3%	189
Agriculture	7.9%	160
Vehicles	5.0%	102
Metals	4.2%	85
Stone	2.4%	49
Other	1.7%	34
Textiles	1.7%	34
Total	**100.0%**	**2,030**

2017 US exports by sector

Sector	% Total	USD (bn)
Services	34.0%	799
Minerals	13.2%	310
Electronics	10.0%	236
Machinery	8.2%	193
Chemicals	7.7%	182
Agriculture	7.4%	173
Vehicles	6.2%	146
Metals	5.7%	135
Stone	2.9%	67
Other	2.7%	63
Textiles	2.0%	46
Total	**100.0%**	**2,350**

Source: Ashmore, Bloomberg, Atlas of Economic Complexity: http://atlas.cid.harvard.edu/

Despite a favourable market reaction to the trade deal, the fact remain that this trade deal leaves both countries worse off relative to the situation that prevailed prior to Trump's trade war.

First, substantial trade taxes remain in place, including 25% tariffs on some USD 250bn imports of Chinese industrial goods and Chinese retaliatory tariffs worth over USD 100bn.

Second, the new trade framework is far less robust than its predecessor as the agreement replaces general trading rules, which apply in all circumstances, with targets defined in terms of specific Dollar amounts. Such quantitative targets, already challenging in a few sectors, can quickly be rendered unachievable by entirely unpredictable economic shocks, movements in relative prices, commodity price shocks or shifts in exchange rates.

Third, the deal does not in any way fix the large US trade deficit. The US current account deficit is the result of macroeconomic imbalances originating from low levels of saving vis-a-vis investments. China's commitment to buy more US goods amounts to an export subsidy, which, all else constant, appreciates the US Dollar real effective exchange rate by driving up US domestic prices. The higher real effective exchange rate negatively impacts US exports of other products and increases US imports. Indeed, the US trade deficit may even widen if the impact of the deal is to lower uncertainty such that investment increases. Since US savings are very low, any increase in investment would have to be funded from abroad, leading to a widening of the current account deficit.

Finally, the deal distorts global trade by diverting Chinese demand from other countries towards less efficient US producers. Prices should therefore fall in the rest of the world, thereby increasing the competitiveness of America's main competitors in all sectors other than the protected ones.

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Global backdrop

In summary, Trump's Phase One trade deal shares the hallmarks of Trump's other major treaty revamps, such as the Trans-Pacific Partnership (TPP) and NAFTA to USMCA. Each revamp dismantled higher-quality arrangements at a considerable cost only to re-assemble them into inferior agreements. German Chancellor Angela Merkel reflected these concerns, when, in an interview with the Financial Times, she expressed worry that countries are moving away from multilateral arrangements, where win-win solutions lead to better outcomes towards nationalist policies guided by zero-sum bilateral relationships.

In other news, the US House of Representatives sent impeachment charges to the US Senate as an independent congressional watchdog accused the White House of breaching the law by threatening to withdraw USD 214m of military aid to Ukraine. Trump allegedly conditioned the provision of US military support to Kiev on an investigation of Democratic presidential candidate Joe Biden and his son, Hunter Biden, who was on the board of an energy company in Ukraine at the time.

Economic data releases were broadly healthy with retail sales increasing by 0.3% in December, the Philly Fed manufacturing survey rising to 17 in January from 2.4 in December and the NAHB homebuilder survey inching lower to 75, but close to the highest levels since 2005. Housing starts were also strong after rising 16.1% in December, but new building permits disappointed with a 3.9% decline. The rate of CPI inflation was 2.3% yoy in December after a 2.1% yoy increase in November, but core CPI inflation was stable at 2.3% yoy, which was slightly lower than market expectation. One variable, job openings, was very weak, dropping to the lowest level since March 2018.

OPEC released its global oil demand forecast increasing to 101 million barrels per day in 2020 from 99.8 million barrels per day in 2019 due to an improved economic outlook for 2020. Supply disruptions in Iraq and Libya pushed up prices at the weekend.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	2.91%	2.91%	2.91%	16.83%	11.58%	6.55%
MSCI EM Small Cap	2.16%	2.16%	2.16%	11.43%	6.64%	3.51%
MSCI Frontier	1.57%	1.57%	1.57%	16.17%	8.03%	3.62%
MSCI Asia	3.71%	3.71%	3.71%	18.63%	12.79%	7.40%
Shanghai Composite	0.83%	0.83%	0.83%	23.09%	1.95%	0.23%
Hong Kong Hang Seng	2.26%	2.26%	2.26%	12.77%	9.77%	2.70%
MSCI EMEA	1.51%	1.51%	1.51%	11.21%	6.77%	4.07%
MSCI Latam	0.34%	0.34%	0.34%	6.93%	9.69%	5.05%
GBI EM GD	-0.22%	-0.22%	-0.22%	10.62%	6.60%	2.61%
ELMI+	0.13%	0.13%	0.13%	4.00%	4.04%	1.94%
EM FX Spot	-0.84%	-0.84%	-0.84%	-1.68%	-1.30%	-4.15%
EMBI GD	0.90%	0.90%	0.90%	13.59%	6.27%	6.40%
EMBI GD IG	0.68%	0.68%	0.68%	15.52%	6.98%	5.61%
EMBI GD HY	1.16%	1.16%	1.16%	11.74%	5.55%	7.50%
CEMBI BD	1.17%	1.17%	1.17%	12.72%	6.29%	6.15%
CEMBI BD IG	0.82%	0.82%	0.82%	12.39%	5.92%	4.95%
CEMBI BD Non-IG	1.65%	1.65%	1.65%	13.13%	6.87%	8.18%

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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	3.14%	3.14%	3.14%	28.85%	15.93%	12.79%
1-3yr UST	0.08%	0.08%	0.08%	3.69%	1.83%	1.33%
3-5yr UST	0.24%	0.24%	0.24%	5.68%	2.50%	1.89%
7-10yr UST	0.70%	0.70%	0.70%	9.57%	3.83%	2.46%
10yr+ UST	1.35%	1.35%	1.35%	17.29%	6.58%	3.39%
10yr+ Germany	0.86%	0.86%	0.86%	9.59%	4.99%	3.89%
10yr+ Japan	-0.60%	-0.60%	-0.60%	3.53%	2.24%	2.97%
US HY	0.71%	0.71%	0.71%	11.22%	6.18%	6.29%
European HY	0.60%	0.60%	0.60%	9.84%	4.19%	4.74%
Barclays Ag	-0.15%	-0.15%	-0.15%	6.37%	3.78%	2.27%
VIX Index*	-12.19%	-12.19%	-12.19%	-32.02%	4.85%	-39.17%
DXY Index*	1.32%	1.32%	1.32%	1.38%	-3.06%	4.96%
CRY Index*	-1.56%	-1.56%	-1.56%	0.37%	-5.74%	-16.48%
EURUSD	-1.10%	-1.10%	-1.10%	-2.42%	3.63%	-3.97%
USDJPY	1.43%	1.43%	1.43%	0.46%	-3.90%	-7.28%
Brent	-0.83%	-0.83%	-0.83%	4.39%	17.95%	36.38%
Gold spot	2.81%	2.81%	2.81%	22.26%	28.86%	20.42%

*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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