

EM assets outperformed despite strong correction in US tech

By Gustavo Medeiros

Equity markets declined on the back of a sharp correction in US technology stocks, but EM assets outperformed. Brazil renewed emergency support for poor families and presented an administrative reform to Congress. South Africa's PMI rose sharply in August, but Eskom's problems remain a drag on the economy. Germany confirmed that the Russian politician Alexei Navalny was poisoned with the Novichok nerve agent. Uruguay announced a multi-year budget consolidation and South Korea announced a large fiscal expansion. Argentina's weight in the JP Morgan EMBI GD Index is expected to increase this week. Angola's credit rating was downgraded to CCC. China posted strong export numbers amidst continuing provocation by the US government.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.0	–	-1.95%
MSCI EM Small Cap	12.0	–	0.15%
MSCI Frontier	12.8	–	1.00%
MSCI Asia	11.3	–	-1.99%
Shanghai Composite	12.5	–	-1.42%
Hong Kong Hang Seng	7.6	–	-2.87%
MSCI EMEA	10.3	–	-3.17%
MSCI Latam	12.5	–	0.60%
GBI-EM-GD	4.43%	–	0.04%
ELMI+	2.15%	–	-0.28%
EM FX spot	–	–	-0.27%
EMBI GD	4.94%	415 bps	1.14%
EMBI GD IG	2.81%	196 bps	0.78%
EMBI GD HY	7.95%	721 bps	1.57%
CEMBI BD	4.40%	382 bps	0.43%
CEMBI BD IG	2.96%	237 bps	0.39%
CEMBI BD Non-IG	6.48%	590 bps	0.49%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.7	–	-2.27%
1-3yr UST	0.15%	–	-0.04%
3-5yr UST	0.30%	–	-0.11%
7-10yr UST	0.72%	–	0.05%
10yr+ UST	1.47%	–	0.76%
10yr+ Germany	-0.47%	–	1.63%
10yr+ Japan	0.00%	–	0.29%
US HY	5.51%	488 bps	-0.04%
European HY	4.56%	522 bps	0.44%
Barclays Ag	0.91%	19 bps	-0.16%
VIX Index*	30.75	–	7.79%
DXY Index*	92.88	–	0.73%
EURUSD	1.1834	–	-0.92%
USDJPY	106.24	–	-0.40%
CRY Index*	149.69	–	-3.52%
Brent	42.2	–	-6.74%
Gold spot	1935	–	-1.87%

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

Emerging Markets

- Global Markets:** Global stocks were dragged down at the end of last week by a sharp decline in the prices of US technology stocks. The Nasdaq Index retreated 3.1% last week after posting a 6.4% decline from its peak last Wednesday. The decline, which was worsened by generous valuations and heavy positioning, occurred after it was unveiled that a large player had bought large amounts of single stock options in the market. The MSCI World and the S&P 500 indexes declined 2.3%, while MSCI EM retreated by 2.1%. EM fixed income was resilient. The JP Morgan GBI-EM GD local currency bonds index was flat on the week, while the JP Morgan EMBI GD sovereign debt index ended the week 1.4% higher and the JP Morgan CEMBI BD corporate index rose 0.4%.
- Brazil:** The government renewed its program of emergency support until December with monthly payments of BRL 300 for all unemployed, informal workers, and beneficiaries under the Bolsa Familia program. The measure will cost the public coffers an additional BRL 90bn, which adds to the outlay of BRL 254bn to August. The government also presented an 'administrative reform' aimed at boosting the productivity and flexibility of public sector employees. In terms of the economy, the rate of real GDP growth declined 9.7% in Q2 2020 compared to -1.5% in Q1 2020, which was a surprise to the downside relative to the consensus expectation. However, leading indicators are showing signs of a strong rebound, including a surge in the manufacturing PMI to 64.7 in August from 58.2 in July, the highest level in three years. Industrial production (IP) also rose by 8% in July, which means that IP is now just 6% below the pre-coronavirus crisis level.

Emerging Markets

- **South Africa:** The ABSA manufacturing PMI survey rose to 57.3 in August from 51.2 in July, which was a strong positive surprise relative to the consensus expectation of 50.9. However, consumption remained weak due to the lack of direct stimulus as vehicle sales declined by 26.3% in August following a 29.6% decline in July. In other news, the state owned utility company Eskom said that there is still a high risk of power cuts until the company has completed an 18-month maintenance programme. Low levels of investment, excessive political interference, and poor management practices have saddled Eskom with ZAR 488bn (USD 29bn) of debt.
- **Russia:** The German government confirmed that opposition leader Alexey Navalny was poisoned by Novichok, a nerve agent deployed previously in the English town of Salisbury against former Russian military officer Sergei Skripal and his daughter Yulia. German Premier Angela Merkel said only the Russian government could explain the poisoning and called for a global response to the incident, increasing the risk of sanctions levied against Russia, but potentially enabling Germany to continue to maintain bilateral relations with Russia, particularly with respect to energy imports. In other Russian news, the rate of CPI inflation rose to a yoy rate of 3.6% in August from 3.4% in July.
- **Uruguay:** The government presented the 2020-24 budget law draft to Congress. The Budget envisages a cut in non-interest expenditures from 32% of GDP in 2020 to 28.1% of GDP by 2024. This would stabilise the net debt/GDP ratio at around 64% of GDP by 2022. In other news, the central bank set the monetary policy rate at 4.5%, which is low given inflation expectations one and two years ahead of 7.5%. The centre of the inflation target is 4.5%.
- **South Korea:** The government announced that the 2021 fiscal deficit ex-social security will rise to 5.4% of GDP, where it will remain until 2024. As a result, public debt is now forecast to increase from 43.5% in 2020 to 58.3% by 2024. In other news, the trade surplus was stable at USD 4.1bn in August as exports declined at a yoy rate of 9.9%, while imports were 16.3% lower on a yoy basis. The yoy rate of CPI inflation rose to 0.7% in August from 0.3% in July.
- **Argentina:** Argentina's weight in the JP Morgan EMBI Global Diversified Index is expected to increase by an estimated 18 bps to 49 bps as a result of the recently concluded debt restructuring. The rebalancing could take place as soon as the 10 September. Tax collection declined at a 4.7% yoy rate in August, which is nevertheless a significant improvement from the 12.7% yoy decline recorded in July, although most of the improvement was due to base effects.
- **Angola:** In a severely delayed response to the coronavirus shock and the decline in global oil prices, which took place back in April of this year, the ratings agency Fitch decided to downgrade the sovereign credit rating of Angola to CCC from B-. Fitch forecasts the level of general government debt to increase to 129% of GDP by the end of 2020. In other news, the Paris club announced it will be suspending debt service payments from Angola over the period from 1 May to 31 Dec 2020.
- **China:** Growing at a yoy pace of 9.5%, Chinese exports were stronger than expected in August, while imports fell short of expectations. Hence, the trade surplus was USD 58.9bn versus an expectation of USD 49.7bn. The stronger trade balance number will feed positively into the GDP calculation for Q3 2020. In other economic news, the Caixin manufacturing PMI survey rose to 53.1 in August from 52.8 in July, while the Caixin services PMI declined marginally to 54.0 in August from 54.1 in July. In political news, the US signalled that a number of Chinese state-owned enterprises will be subject to various restrictions as part of the US government's witch hunt on China in the run-up to the US Presidential election in November. The US Pentagon also released a report alleging that China has achieved parity with and in some areas now exceed the US in terms of the modernity of its military. For context, according to data from April 2020 published the Petersen Institute the US spends USD 732bn on its military per year. This is more than the military spending of the next ten largest spenders combined, including China, which spends about USD 250bn per annum.¹

Snippets:

- **Chile:** Economic activity contracted at a yoy rate of 10.7% in July from -12.4% yoy in June. The central bank kept the policy rate unchanged at 0.5% in line with expectations.
- **Colombia:** The manufacturing PMI survey declined to 51.2 in August from 54.2 in July.
- **Costa Rica:** The government formally started negotiations with the IMF for an extended funding facility with the potential to unlock up to USD 1.75bn in funding.
- **Czech Republic:** Real GDP growth contracted at a rate of 8.7% in Q2 2020 from -8.4% in the prior quarter. Markit's PMI survey rose to 49.1 in August from 47.0 in July, which was broadly in line with expectations.
- **Dominican Republic:** The central bank cut the policy rate by 50bps to 3.0% and reduced the rate of interest rates for the permanent liquidity expansion facility by 100bps to 3.5%.
- **Ecuador:** Both S&P and Fitch upgraded Ecuador's sovereign credit rating to B- from 'SD'/'RD' following the completion of the debt exchange. Both ratings agencies left the ratings outlook stable.

¹ See: https://www.pgpf.org/chart-archive/0053_defense-comparison

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- **Ethiopia:** US President Donald Trump suspended USD 130m in aid to Ethiopia citing a lack of progress in negotiations with Egypt and Sudan over the Great Ethiopian Renaissance Dam on the Nile.
- **Hungary:** Real GDP growth declined by 14.5% in Q2 2020, unchanged from the prior quarter. However, in a sign that economic activity is beginning to recover, the manufacturing PMI survey rose to 52.8 in August from 51.1 in July.
- **India:** Leading indicators continued to point to an economic rebound. The manufacturing PMI rose to 51.9 in August from 46.0 in July. Vehicle registrations rose by 16.5% on a yoy basis in August from -8.3% yoy in July and -95% yoy in April. The rate of unemployment also declined to 8.1% in August from 21.1% in April.
- **Kenya:** Treasury Secretary Ukur Yatani said the country is requesting a World Bank loan to provide further budget support.
- **Mexico:** The Markit manufacturing PMI survey inched up to 41.3 in August from 40.4 in July. The INEGI employment survey showed that a further 1.5m jobs were recovered in July following 4.8m in June, thus bringing the unemployment rate down by 0.1% to 5.4%. Overseas remittances were stable at USD 3.5bn in July, but 9.1% higher on a yoy basis.
- **Peru:** The yoy rate of CPI inflation declined to 1.7% in August from 1.9% in July in the city of Lima.
- **Philippines:** CPI inflation declined to 2.4% on a yoy basis in August from 2.7% yoy in July. The decline was mostly due to lower food prices.
- **Poland:** The manufacturing PMI survey declined to 50.6 in August from 52.8 in July, thus surprising consensus expectations to the downside. The yoy rate of CPI inflation inched lower to 2.9% in August from 3.0% yoy in July.
- **Thailand:** The CPI index rose to a lower rate of deflation of 0.5% on a yoy basis in August from -1.0% yoy in July. The yoy rate of core CPI inflation declined marginally to 0.3% in August from 0.4% in July.
- **Turkey:** The Markit/ISO PMI survey declined to 54.2 in August from 56.9 in July. CPI inflation was unchanged at a yoy rate of 11.8% in August.
- **Venezuela:** President Nicolas Maduro issued a decree pardoning more than 100 opponents as a gesture ahead of legislative elections. The move signalled his intention to reignite a dialogue with opposition leader Juan Guaido.

Global backdrop

- **Coronavirus:** Dr. Anthony Fauci, who directs the US National Institute of Allergy and Infectious Diseases, said clinical trials for a coronavirus vaccine may be unveiled ahead of the conclusion of regular clinical trials as the initial data is overwhelmingly positive. When Russia recently did the same it was met with widespread derision. Cases continue to increase in Europe with more than 5k new cases registered per day in France and 12k daily cases in Spain. However, daily deaths are very low despite the ramp up in cases. This likely reflects better treatments and lower transmission rates, including better protection for the elderly and the most vulnerable parts of the population. The UK saw a sharp pickup in case numbers in recent days.
- **US:** The Congressional Budget Office (CBO) said the US Federal Government's fiscal deficit will triple to USD 3.3tn in 2020. This is equivalent to 16% of GDP and constitutes the largest increase in GDP terms since 1945. The larger deficit will raise the debt to GDP ratio above 100% in 2021. In economic news, the Bureau of Statistics' job report surprised to the upside as nonfarm payrolls rose by 1.37m in August, while the Household Survey showed the rate of unemployment falling to 8.4% from 10.2% in July. However, the job market was boosted by the Federal Government's temporary works programs, which added 251k jobs. This means that private payrolls only went up by 1.03m versus an expected improvement of 1.33m. This weak private payroll number is more consistent with recent disappointment in the ADP private payroll numbers and paints a softer picture of the US labour market than the non-farm payroll print. In other economic news, the ISM manufacturing survey rose to 56.0 in August from 54.2 in July and 54.8 expected. New orders surged to 67.6 and prices paid was also strong at 59.5, but the employment component was weak at 46.4. In contrast, the Markit manufacturing PMI recorded a more lukewarm 53.1 in August, down from 53.6 in July, while the ISM non-manufacturing PMI retreated to 56.9 in August from 58.1 in July. Factory good orders rose by 6.4% in July, which was the same expansion as reported in July. Construction spending disappointed by growing only 0.1% in July. Despite evidence of a slowing recovery, the US trade deficit remained wide. The deficit was USD 63.6bn in July compared to USD 53.5bn in June as imports rose by 10.9% and exports increased by a more modest 8.9%. Productivity growth spiked to just over 10%, which is consistent with previous recessions as some workers lose their jobs, while others have to work harder for less pay. Finally, we note that New York mayor Bill de Blasio delayed the reopening of New York schools to 21 September in a compromise to avoid a teachers' strike.
- **EU:** Euro area CPI inflation declined by 0.4% in August, which took the yoy inflation rate to -0.2% from +0.4% yoy in July. The core rate of CPI inflation declined 0.4% on a yoy basis in August from +1.2% in July, with services inflation declining to 0.7% on a yoy basis. The August core inflation reading was the lowest inflation rate recorded since the inception of the series in 1999. The Eurozone unemployment rate rose to 7.9% in July

Global backdrop

from 7.7% in June. Following hawkish remarks from European Central Bank (ECB) board member Isabel Schnabel, the ECB Chief Economist Philip Lane said that the EURUSD exchange rate does matter for calculating the official inflation and growth forecasts. EURUSD upside can be deflationary by pushing down the prices of imports, but a higher EURUSD can also signal capital inflows, which can stimulate domestic demand and thereby help to push up non-tradeable prices. Hence, the impact of exchange rate on inflation is an empirical matter. In terms of Eurozone fiscal policy developments, French President Emmanuel Macron announced a EUR 100bn fiscal stimulus plan. Finally, the UK manufacturing PMI survey was broadly flat in August versus July amidst worsening relations between UK and the European Union over Brexit.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-0.16%	11.27%	0.51%	13.92%	3.26%	9.83%
MSCI EM Small Cap	0.56%	14.46%	-0.05%	10.88%	-0.11%	5.94%
MSCI Frontier	0.22%	7.85%	-9.11%	-4.73%	-1.16%	3.24%
MSCI Asia	-0.49%	11.90%	6.70%	20.35%	5.70%	11.49%
Shanghai Composite	-1.19%	13.62%	12.48%	16.13%	2.16%	3.51%
Hong Kong Hang Seng	-1.01%	2.92%	-8.26%	-0.07%	-0.27%	5.59%
MSCI EMEA	-1.43%	3.12%	-18.81%	-11.40%	-4.89%	1.91%
MSCI Latam	3.82%	8.06%	-29.90%	-20.75%	-8.66%	3.33%
GBI EM GD	-0.06%	2.62%	-4.45%	0.32%	0.62%	4.99%
ELMI+	-0.27%	2.18%	-3.28%	0.85%	-0.17%	2.58%
EM FX Spot	-0.26%	1.65%	-9.47%	-6.85%	-6.38%	-2.94%
EMBI GD	1.00%	5.29%	2.38%	2.91%	4.46%	6.49%
EMBI GD IG	0.63%	3.85%	7.10%	6.52%	7.05%	7.22%
EMBI GD HY	1.47%	7.10%	-3.18%	-1.47%	1.51%	5.59%
CEMBI BD	0.34%	3.59%	3.43%	6.16%	5.11%	6.22%
CEMBI BD IG	0.28%	3.08%	5.07%	5.67%	5.68%	5.69%
CEMBI BD Non-IG	0.42%	4.30%	1.10%	6.75%	4.33%	7.12%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	-2.06%	10.89%	7.47%	18.93%	13.58%	14.55%
1-3yr UST	-0.05%	0.02%	3.04%	3.28%	2.58%	1.84%
3-5yr UST	-0.16%	-0.01%	6.03%	5.28%	3.86%	2.90%
7-10yr UST	-0.20%	-0.17%	10.94%	7.89%	6.19%	4.56%
10yr+ UST	-0.34%	-0.61%	20.47%	12.09%	11.02%	8.17%
10yr+ Germany	1.52%	0.35%	6.24%	-2.35%	7.01%	5.50%
10yr+ Japan	0.09%	-0.15%	-2.26%	-6.45%	1.46%	3.08%
US HY	-0.10%	5.58%	1.57%	4.59%	4.81%	6.39%
European HY	0.45%	3.60%	-2.54%	-0.81%	1.69%	3.66%
Barclays Ag	-0.36%	2.66%	5.72%	4.96%	3.74%	3.97%
VIX Index*	16.43%	1.05%	123.15%	105.00%	166.23%	10.61%
DXY Index*	0.80%	-4.63%	-3.64%	-5.61%	1.32%	-3.48%
CRY Index*	-2.30%	8.50%	-19.43%	-13.28%	-18.14%	-23.90%
EURUSD	-0.92%	5.26%	5.39%	7.00%	-1.29%	5.95%
USDJPY	-0.40%	1.50%	2.20%	0.76%	2.13%	12.33%
Brent	-6.74%	2.62%	-36.02%	-31.38%	-22.50%	-11.34%
Gold spot	-1.87%	8.49%	27.07%	28.71%	44.09%	72.91%

*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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