EM inflation in April declined to the lowest levels since 2002

By Gustavo Medeiros

Index-weighted CPI inflation declined to the lowest level in nearly two decades. Argentina postponed the deadline for debt restructuring. China's exports improved and Huawei received the green light to operate in the US. Brazil's central bank cut the policy rate by more than expected. Nigeria slashed fuel subsidies to zero and pledged that fuel prices will be driven by market forces going forward. The Central Bank of Peru made provisions to smooth pension fund redemptions. GDP growth slowed faster than expected in Indonesia and the Philippines. Colombia increased fiscal support to smooth the coronavirus impact on growth. Saudi Arabia announced it will cut public employee benefits and hike VAT to consolidate the fiscal accounts. Sub-Saharan African PMI's declined by less than in the rest of the World.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.2	–	-0.52%
MSCI EM Small Cap	9.8	–	-0.52%
MSCI Frontier	10.7	–	1.10%
MSCI Asia	11.8	–	-0.59%
Shanghai Composite	10.2	–	3.10%
Hong Kong Hang Seng	7.7	–	-1.56%
MSCI EMEA	9.2	–	-0.33%
MSCI Latam	10.9	–	-0.86%
GBI-EM-GD	4.71%	–	1.44%
ELMI+	3.11%	–	-0.50%
EM FX spot	–	–	0.37%
EMBI GD	6.58%	583 bps	1.52%
EMBI GD IG	3.89%	309 bps	1.04%
EMBI GD HY	10.74%	1,004 bps	2.16%
CEMBI BD	5.92%	533 bps	0.67%
CEMBI BD IG	3.92%	333 bps	0.44%
CEMBI BD Non-IG	8.99%	841 bps	1.00%

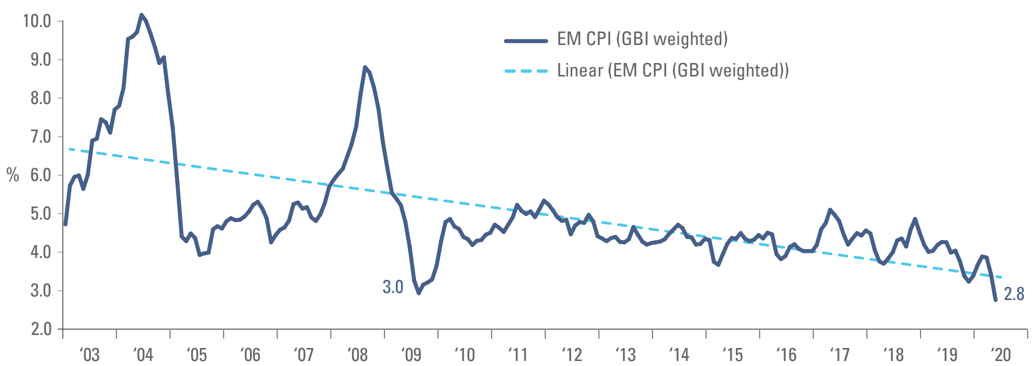
Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	18.0	–	3.56%
1-3yr UST	0.16%	–	0.10%
3-5yr UST	0.34%	–	0.22%
7-10yr UST	0.69%	–	-0.10%
10yr+ UST	1.40%	–	-1.84%
10yr+ Germany	-0.54%	–	-1.47%
10yr+ Japan	0.00%	–	-0.43%
US HY	7.88%	725 bps	0.83%
European HY	7.32%	757 bps	-0.58%
Barclays Ag	1.05%	36 bps	-0.79%
VIX Index*	27.98	–	-9.21%
DXY Index*	99.73	–	0.25%
EURUSD	1.0843	–	-0.59%
USDJPY	106.95	–	0.20%
CRY Index*	124.74	–	7.11%
Brent	30.5	–	12.06%
Gold spot	1704	–	0.14%

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

Emerging Markets

- **Inflation:** Consumer prices index (CPI) inflation in Emerging Markets (EM) declined to the lowest level since the start of the local currency government bond index (GBI-EM GD) in 2002. CPI inflation dropped to 2.8% on a yoy basis in April from 3.5% yoy in March and 4.0% yoy in January (Figure 1). The sharp drop came despite the higher food prices in many countries due to supply disruptions. Lower inflation and the low risk of pass-through to inflation from weaker currencies is allowing central banks to cut policy interest rates to all-time lows. Lower interest rates reduce the cost of funding, which in turn helps EM countries with large domestic bond markets to smooth the economic impact of the coronavirus (Figure 2).

Fig 1: **EM index-weighted CPI inflation**



Source: Ashmore, Bloomberg, JP Morgan. Data as at end-April 2020.

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Emerging Markets

Fig 2: **EM index-weighted policy interest rates**

Source: Ashmore, Bloomberg, JP Morgan, BIS. Data as at April-2020.

- Argentina: The government postponed the deadline for the debt restructuring offer from the 8 May to 22 May as most bondholders rejected the original offer. According to a poll from Poliarquia Consultores, a credible local pollster, 53% of supporters of Alberto Fernandez and 80% of supporters of former president Mauricio Macri want the government to avoid default. Some 61% of all respondents said that the government should improve its offer to bond holders. Meanwhile, Argentina's relationship with multilaterals remains solid. Last week Argentina repaid the USD 320m quarterly interest payment due to the International Monetary Fund (IMF). The Inter-American Development Bank (IDB) announced a record USD 1.8bn in fresh lending to the country in 2020. In other news, tax collection declined by 24% on a yoy basis in April following a 9% yoy decline in March, signalling a rapid decline in economic growth.
- China: Exports fared better than expected in April, rising by 3.5% on a yoy basis following a -6.6% yoy decline in March. Imports declined by 14.2% on a yoy basis in April after declining by 10% yoy in March. The Caixin Services Purchasing Manager's Index (PMI) survey improved mildly to 44.4 in April from 43.0 in March and 26.5 in February. FX reserves rose by USD 30.9bn to USD 3.09tn in April due to better trade numbers during the month as well as lower net capital outflows. China's external accounts are likely to remain resilient due to lower outbound tourism and fewer outflows from local investors. In other news, Reuters reported the US Department of Commerce close to approving new rules allowing US companies to deal with China's Huawei in setting standards for the next generation 5G network. The concession to Huawei contrasts with renewed tensions between the countries due to political reasons and highlights China's dominance in key technological frontier areas.
- Brazil: The central bank (BCB) cut the policy rate by 75bps to 3.0%, a larger cut than expected by most analysts (50bps). A continuous decline in both current and future inflation expectations alongside the ongoing economic slowdown due to coronavirus justified the larger than expected rate cut. The BCB signalled that a final cut of similar magnitude could be made in the next meeting in June and mentioned that structural reforms and fiscal restraint will be needed to stabilise macroeconomic conditions after the coronavirus outbreak is brought under control. The central bank also sold USD 8.4bn in April to avoid disruption in the currency market, so the central bank now holds USD 303.4bn in net FX reserves (including outstanding FX swap contracts). Congress approved an economic bill, which allows the central bank to buy public and private bonds. Meanwhile, industrial production (IP) declined 9.1% in the month of March after rising 0.7% in February as a result of social distancing, which was imposed from mid-March onwards. In other news, Fitch revised the outlook on Brazil's BB- sovereign credit rating to negative from stable due to increased political uncertainty.
- Nigeria: State-owned national oil company Nigerian National Petroleum Corporation (NNPC) announced an end to oil subsidy policies. In the short term, Nigerians will pay around NGN 125 (USD 0.32) per litre of gasoline, which is the lowest level over ten years. Going forward, prices will be allowed to fluctuate with market conditions, according to NNPC. This is good policy making as low oil crude prices allows EM countries to cut subsidies and increase taxation on fuel with little direct impact to the population. The litmus test will be whether politicians are strong enough to avoid re-stating subsidies when oil prices rises. Fuel price subsidies should ultimately be replaced by direct subsidies to the most vulnerable share of the population.
- Peru: Central Bank Governor Julio Velarde said the board has authorised direct US dollar purchases from pension funds after the parliament approved a law, which allows Peruvians to withdraw up to 25% of their pensions. The central bank also offered to open repo lines for the pension funds with short term liquidity available against sovereign bonds collateral. Velarde said that he estimates that fewer than half of eligible individuals will cash in their pension assets, as low levels of asset prices after the sell-off discourages redemptions. In other news, the IMF said it will back a two-year USD 11bn flexible credit line for precautionary purposes.

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Emerging Markets

- Indonesia: Real GDP growth slowed to 3% on a yoy basis in Q1 2020 from 5% yoy on the previous quarter, the weakest quarterly growth since the Asian Financial Crisis in late 1990. The slowdown took place despite of the absence of broad travel restrictions. Indonesia's first official coronavirus case was reported on 3 March. Growth is set to remain weak in Q2 2020 as travel restrictions are set to be in place during the traditional migration during Ramadan.

- Philippines: The yoy rate of real GDP growth was -0.2% in Q1 2020, which was below the consensus expectations of a 2.9% yoy increase. CPI inflation declined to 2.2% on a yoy basis in April from 2.5% yoy in March. The trade deficit widened to USD 2.4bn in March from USD 1.7bn in February with imports and exports both declining by 25% on a yoy basis as the quarantine regime imposed from mid-March led to backlogs in the country's main port in Manilla.

- Colombia: President Ivan Duque Marquez announced a new emergency programme whereby the government will subsidise worker's salaries from companies that lost more than 20% of revenues due to the coronavirus outbreak. The programme was given the go-ahead by the fiscal committee, which has authorised a fiscal deficit of 6.1% of GDP in 2020, about 4% of GDP wider than the planned pre–coronavirus fiscal deficit. At the same time, the committee requested the government to present a fiscal consolidation plan, including cutting subsidies and increasing revenues. In other news, CPI inflation declined by 35bps to 3.5% on a yoy basis, from 3.9% yoy in March.

- Saudi Arabia: Finance Minister Mohammed Al-Jadaan announced a hike in the VAT rate to 15%, from 5% effective from the beginning of July. At the same time, Al-Jadaan will halt living allowances to public servants from June as part of the measures to cut SAR 100bn of expenditures to compensate for the fiscal impact of lower oil prices and reduced activity due to the coronavirus lockdown. Meanwhile, King Salman ordered the distribution of a 'Ramadan Aid' worth SAR 1.85bn to families under social security benefits.

- Sub-Saharan Africa: Composite PMI for the region declined to 35.6 in April from 49.7 in March. Excluding Nigeria, the index dropped by more (to 32.5 from 41.4) as the lockdown in Nigeria has been less severe. This decline is lower than in other regions as the JP Morgan global PMI Composite declined to 26.5 in April, from 39.2 in March. Several factors could explain the lower coronavirus impact in Africa, including: (a) better demographic profiles, (b) a larger share of the population dedicated to agriculture in less densely populated areas, (c) less efficient lockdowns in cities due to large informal sector and (d) better climate characteristics and (e) widespread BCG vaccination.[1]

Snippets:

- Chile: The Central Bank of Chile kept the policy rate unchanged at 0.5%, which was in line with consensus expectations. CPI inflation declined to 3.4% on a yoy basis in April from 3.6% yoy in March.
- Czech Republic: The Central Bank cut the policy rate by 75bps to 0.25% and committed to keeping interest rates at low levels for an extended period. Two out of five members of the monetary policy committee voted for a smaller cut of 50bps. The Board signalled no further need for quantitative easing.
- Egypt: The Central Bank of Egypt reported that FX reserves declined to USD 37bn in April from USD 40.1bn in March due to outflows from local bonds. CPI inflation rose to 5.9% on a yoy basis in April from 5.1% in March, mostly driven by food prices.
- Honduras: The IMF approved the second programme review. This releases USD 222m in additional funding, taking total IMF lending to USD 530m, which is equivalent to 2.2% of GDP.
- Hong Kong: The yoy rate of GDP growth contracted by 8.9% in Q1 2020, which was below consensus expectations. The weak growth print in Q1 2020 followed a 3.0% yoy contraction in Q4 2019.
- India: Services PMI declined to 5.4 in April from 49.3 in March as a result of the nationwide lockdown. The government announced a fuel tax hike to compensate for the higher fiscal deficit. In other news, the government started easing the lockdowns by reopening long distance trains amongst other measures.
- Iraq: The parliament approved Mustafa al-Kadhimi as a new prime minister after six months of impasse.
- Ivory Coast: 19 people including 14 soldiers linked to former congressman and presidential candidate Guillaume Soro were arrested for allegedly plotting a coup. Soro was *convicted in absentia* to a 20-year prison term for embezzlement.
- Kenya: The IMF approved a USD 739m (approximately 0.8% of GDP) emergency credit line.
- Malaysia: Bank Negara Malaysia cut the policy interest rate by 50bps to 2.0%, which was in line with consensus expectations. The monetary policy committee indicated that it expects inflation to remain below zero in 2020.

[1] See: *'Status update: Coronavirus and EM fixed income in 2020'* Market Commentary, 29 April 2020.

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Emerging Markets

- **Mexico:** CPI inflation declined to 2.15% on a yoy basis in April from 3.25% yoy in March. This was slightly higher than expected due to shortages impacting core inflation. Mexicans abroad remitted a record USD 4bn back to Mexico in March as a weaker MXN encouraged inflows.
- **Morocco:** The rate of unemployment increased to 10.5% in Q1 2020 from 9.2% in the previous quarter.
- **Sri Lanka:** The Central Bank of Sri Lanka cut the policy interest rates by 50bps. The rate cuts took the lending facility rate to 6.5% and the deposit facility rate to 5.5%.
- **South Korea:** CPI inflation declined to 0.1% on a yoy basis in April from 1.0% yoy in March.
- **Thailand:** CPI inflation moved to negative 3.0% on a yoy basis in April from minus 0.5% yoy in March. The drop in inflation was mostly due to lower energy prices, which reached the lowest level since 2009. Core CPI inflation declined to 0.4% on a yoy basis in April from 0.5% yoy in March.
- **Uganda:** The IMF approved a USD 491m credit line (equivalent to 1.8% of GDP).
- **Uruguay:** CPI inflation rose to 10.9% on a yoy basis in April from 9.2% yoy in March with food prices contributing a good part of the increase. The core measure of CPI inflation, which excludes food declined during the month.

Global backdrop

- **US:** Initial jobless claims rose by 3.2m during the week ending on 2 May, which was a slight moderation from 3.8m in the previous week. Continuing claims to the week of 25 April jumped to 22.7m from 18.0m in the previous week. Non-farm payrolls registered 20.5m jobs lost in the month of April. Productivity declined by 2.5% in Q1 2020 as layoffs from mid-March proceeded at a slower pace than the decline in total output. The ISM non-manufacturing survey declined to 41.8 in April from 52.5 in March. The trade deficit widened to USD 44.bn in March from USD 39.9bn in February with autos and oil and gas exports declining the most.
- **EU:** The risk of an institutional crisis has marginally increased last week after the German Constitutional Court (GCC) ruled that the European Central Bank (ECB) overstepped the mark in terms of monetary policy intervention. The European Court of Justice criticised the decision from the GCC, claiming the latter has no jurisdiction over broad EU monetary policy. Legal jurisdiction aside, the fundamental problem is that too much is being asked of the ECB as European Union (EU) governments are unable to agree on centralised fiscal policy and structural reforms. As more and more responsibility is placed on the ECB, its interventions are now beginning to trespass the limitations imposed by laws in EU member states. While similar legal issues do not apply in the UK, US or Japan, these countries suffer from the same fundamental problem of relying too much on central banks, especially in relation to the lack of emphasis on economic reforms. As such, the problem highlighted by the German court applies far beyond the Eurozone.

In other European news, retail sales declined 14.4% during Q1 2020, which indicates that the Eurozone was operating at about 30% below capacity in March. German IP declined 9.2% in March after growing 0.3% in February. Construction was the only item with positive growth in Germany as capital goods production suffered the most, led by vehicles. Norges Bank cut the policy interest rate by 25bps to 0% and signalled that further rate cuts are unlikely. The central bank also announced that it has intervened in the currency market, purchasing NOK 3.5bn in March. This was done to support the normal functioning of the FX market. In the UK, Bank of England Governor Andrew Bailey signalled that more quantitative easing is possible to boost economic growth.

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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	-1.40%	7.65%	-17.72%	-10.63%	0.18%	0.25%
MSCI EM Small Cap	-0.90%	12.90%	-22.49%	-18.13%	-6.06%	-3.95%
MSCI Frontier	1.14%	7.93%	-20.81%	-14.49%	-2.50%	-1.86%
MSCI Asia	-1.23%	7.63%	-12.12%	-5.84%	2.70%	2.11%
Shanghai Composite	1.29%	5.34%	-5.01%	2.51%	0.25%	-5.22%
Hong Kong Hang Seng	-1.56%	3.02%	-11.49%	-7.56%	3.62%	-3.19%
MSCI EMEA	-1.71%	9.04%	-27.91%	-22.98%	-5.82%	-4.83%
MSCI Latam	-2.71%	3.44%	-43.71%	-37.88%	-11.77%	-7.18%
GBI EM GD	0.44%	4.37%	-11.50%	-1.81%	0.27%	0.60%
ELMI+	-0.52%	0.61%	-7.92%	-4.35%	-0.31%	-0.13%
EM FX Spot	-0.62%	0.49%	-13.89%	-12.77%	-6.75%	-6.36%
EMBI GD	1.67%	3.95%	-9.96%	-3.41%	1.26%	3.28%
EMBI GD IG	1.06%	3.41%	-2.21%	6.86%	5.14%	4.57%
EMBI GD HY	2.51%	4.70%	-18.80%	-14.55%	-3.20%	1.71%
CEMBI BD	0.65%	4.78%	-5.88%	0.21%	2.72%	3.78%
CEMBI BD IG	0.50%	3.98%	-2.32%	3.99%	4.02%	3.88%
CEMBI BD Non-IG	0.88%	5.98%	-10.72%	-4.95%	0.93%	3.69%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	0.67%	13.58%	-8.69%	3.84%	9.02%	8.92%
1-3yr UST	0.06%	0.19%	2.95%	5.38%	2.73%	1.87%
3-5yr UST	0.12%	0.36%	5.75%	9.47%	4.20%	2.98%
7-10yr UST	-0.22%	0.43%	10.62%	16.93%	6.98%	4.70%
10yr+ UST	-1.90%	0.09%	21.01%	34.00%	13.25%	8.55%
10yr+ Germany	-1.47%	1.78%	6.96%	11.58%	7.55%	5.21%
10yr+ Japan	-0.54%	0.00%	-0.84%	0.73%	2.19%	3.69%
US HY	0.65%	5.18%	-8.16%	-3.29%	2.10%	3.55%
European HY	-0.57%	5.76%	-11.33%	-7.34%	-0.82%	1.49%
Barclays Ag	-0.84%	1.11%	0.78%	5.36%	3.67%	2.75%
VIX Index*	-18.07%	-47.74%	103.05%	74.44%	163.96%	102.02%
DXY Index*	0.73%	0.69%	3.47%	2.47%	0.11%	4.97%
CRY Index*	6.44%	2.42%	-32.86%	-30.30%	-30.87%	-45.35%
EURUSD	-1.02%	-1.70%	-3.31%	-3.38%	-0.17%	-2.80%
USDJPY	-0.21%	-0.55%	-1.53%	-2.15%	-6.07%	-10.93%
Brent	20.62%	34.04%	-53.82%	-56.84%	-39.96%	-53.04%
Gold spot	1.06%	8.07%	12.33%	31.12%	39.13%	43.95%

*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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