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Further progress in Ecuador economic reforms and Argentina debt renegotiation

By Gustavo Medeiros

Ecuador implemented further economic reforms. China withdrew its GDP growth target, but increased the fiscal deficit. Argentina postponed the deadline for debt renegotiations to 02 June. Indonesia kept policy rate unchanged. Zambia formally requested debt the cancellation of undisbursed commercial debts. The US Supreme Court ruled against Venezuela's appeal to retain control of Citgo. The state of Sao Paulo moved forward public holidays to encourage greater social distancing. The United Nations Economic Commission for Africa (UNECA) said African countries should fulfil its obligations with commercial credit to keep market access.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.2	–	-0.06%
MSCI EM Small Cap	10.0	–	2.52%
MSCI Frontier	11.1	–	2.45%
MSCI Asia	11.6	–	-1.55%
Shanghai Composite	10.1	–	-1.95%
Hong Kong Hang Seng	7.5	–	-2.40%
MSCI EMEA	9.5	–	2.43%
MSCI Latam	11.2	–	6.53%
GBI-EM-GD	4.55%	–	2.46%
ELMI+	2.51%	–	0.86%
EM FX spot	–	–	1.95%
EMBI GD	6.07%	534 bps	3.19%
EMBI GD IG	3.57%	279 bps	2.72%
EMBI GD HY	9.91%	923 bps	3.82%
CEMBI BD	5.57%	533 bps	1.72%
CEMBI BD IG	3.70%	344 bps	1.17%
CEMBI BD Non-IG	8.40%	817 bps	2.51%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	18.3	–	3.27%
1-3yr UST	0.18%	–	-0.03%
3-5yr UST	0.35%	–	-0.06%
7-10yr UST	0.68%	–	-0.13%
10yr+ UST	1.39%	–	-0.79%
10yr+ Germany	-0.49%	–	-0.73%
10yr+ Japan	0.00%	–	-0.01%
US HY	7.47%	680 bps	2.59%
European HY	6.98%	723 bps	1.54%
Barclays Ag	1.04%	36 bps	0.51%
VIX Index*	28.16	–	-3.73%
DXY Index*	99.63	–	0.26%
EURUSD	1.0919	–	-0.04%
USDJPY	107.85	–	0.13%
CRY Index*	129.53	–	4.79%
Brent	36.2	–	4.59%
Gold spot	1733	–	-0.72%

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

Emerging Markets

- Ecuador: President Lenin Moreno announced a USD 4.0bn reduction in public spending, taking advantage of lower oil price levels to cut diesel and gasoline subsidies. Another USD 1.0bn will be shaved from wages of public servants via a two hours reduction in the working day. Lastly, Moreno announced another USD 2.6bn of cuts in capital expenditure and interest payments. The deep fiscal adjustment highlight the willingness of the government of Ecuador to adjust to the changes in external circumstances. The main trade unions organised demonstrations across the country to protest against the measures on Monday 25 May, but the attendance numbers were small with only around 2k people in Quito and only around 4k people nationwide, according to the Interior Minister.

- China: The National People's Congress (NPC) withdrew the growth target for 2020 and widened the central government budget deficit target to at least 3.6% of GDP, taking the wider fiscal deficit, which includes off-budget spending such as local government bonds, to a record 15.2% of GDP. The comparable fiscal expansion in 2009 was 14.2% of GDP. In the property market, the price per square meter increased in 50 out of 70 cities in April, which was an improvement from 38 out of 70 cities in March. The recovery in the property market has been better than expected due to pent-up demand caused by the shutdown and developers have signalled that sales in May and June are likely to be even better. Infrastructure spending and other types of fixed asset investment are also likely to run faster than the rate of real GDP growth as authorities focus on stimulating employment. Auto sales increased by 4.4% on a yoy basis in April, which was mostly driven by sales of commercial vehicles, which rose at a rate of 31.6% yoy, while sales of personal vehicles declined by at a modest rate of 6% yoy.

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Emerging Markets

- **Argentina:** The government defaulted on its sovereign debt after failing to pay interest on bonds falling due last Friday. However, there may not be the usual consequences, such as acceleration of all outstanding payments and immediate commencement of legal procedures, as bondholders have shown willingness to continue to negotiate with the government over a broader restructuring. The deadline for debt renegotiations has so far been extended to 02 June. In other news, the index of economic activity declined by 11.5% on a yoy basis in March from -2.2% yoy in February, led to a slowdown in construction. FX reserves declined by USD 600m to USD 43bn on 19 May, which was mostly due to a decline in USD-denominated bank deposits.

- **Indonesia:** Bank Indonesia (BI) kept the policy rate unchanged at 4.50% against market expectations of a 25bps to 50bps cut. BI cited a desire to keep foreign exchange rates stable as a reason for keeping rates unchanged. On the other hand, BI injected liquidity to the tune of IDR 583.5tn, which is equivalent to USD 39.5bn, or 4% of GDP, via direct purchases of government bonds both in the primary and secondary markets. Meanwhile, the current account (CA) deficit declined to USD 3.9bn in Q1 2020 from USD 8.1bn in Q4 2019 (1.4% and 2.8% of GDP, respectively).

- **Zambia:** Finance Minister Bawalya Ng'Andu formally requested the cancellation of USD 3.1bn of projects, which were contracted but payments had not been made. This was an important pre-condition for an IMF deal and debt restructuring. The Bank of Zambia also cut the policy rate by 225bps to 9.25% as the current account moved to a USD 122m surplus in Q1 2020. Foreign exchange (FX) reserves recovered modestly to USD 1.42bn in May from USD 1.34bn in April.

- **Venezuela:** The US Supreme Court rejected an appeal by Venezuela to keep control of PDV Holding in a case against Crystallex, a Canadian gold miner with a USD 1.4bn compensation claim for expropriated assets in Venezuela. Following the Supreme Court ruling, the Federal Court of Delaware authorised Crystallex to gain control of PDV Holding, the sole owner of the Texas-based oil refinery and distribution company Citgo Holdings. A total of 50.1% of Citgo shares are pledged as collateral to bondholders of the Petroleos de Venezuela (PDVSA) 8.5% 2020 bonds. PDVSA defaulted on its 3rd principal repayment in October 2019, leaving a total of USD 1.7bn of outstanding principal repayments unsettled. To this date, bondholders were unable to enforce the collateral due to a deferred licence under the sanctions regime from the Office of Foreign Asset Control (OFAC). In our view, Crystallex will now have to apply for an OFAC licence to be able to effectively sell PDV shares, which, if successful, would open the possibility for bondholders to enforce the collateral over CITGO Holdings shares.

- **Brazil:** Sao Paulo state moved forward state holidays by a week in order to encourage greater social distancing at this time of elevated levels of coronavirus case numbers. Finance Minister Paulo Guedes announced that an ongoing monthly financial assistance programme of BRL 600 per worker could be extended until September (equivalent to a 3-month extension), but at one third of its original size. Central Bank of Brazil (BCB) Governor Roberto Campos Neto said that BCB expects to increase FX sales as BRL has decoupled from its other EM currencies. Campos Neto also said that BCB could sell further more FX reserves and hike interest rates in case BRL depreciates excessively.

- **African Eurobonds:** The UNECA stated that it is important that African countries stay current on commercial debt in order to retaining market access during the recovery after lockdowns. The statement followed a letter to the same effect signed by African finance ministers last week.[1]

- **Singapore:** In a positive surprise versus the median forecast, Singaporean exports excluding oil increased by 9.7% on a yoy basis. The consensus expectation was for a 5% yoy contraction. The stronger than expected export performance was led by pharmaceutical products (147% yoy). There were also strong increases in data storage and cloud semi-conductor chips. GDP contracted by -4.7% on a qoq basis, which was better than expected (-8.2% qoq).

Snippets:

- **Angola:** The government awarded a fourth telecom licence to Africell.
- **Chile:** The yoy rate of real GDP growth increased to 0.4% in Q1 2020 from -0.1% yoy in Q4 2019, surprising on the upside as the economy recovered from the street protests. The current account deficit declined to USD 1.0bn in Q1 2020 from USD 2.4bn in Q4 2019, thus taking the 1-year rolling current account deficit to 3.7% of GDP from 3.9% of GDP in the previous quarter.
- **Costa Rica:** The OECD invited Costa Rica to join the group. The accession process began five years ago. Final accession now requires a few last details to be ironed out ahead of final sign-off.
- **Egypt:** The Central bank of Egypt announced EGP 100bn (USD 6.4bn) of loan guarantees to businesses impacted by the coronavirus. Last week, the country issued USD 5bn of 4yr, 12yr and 30yr Eurobonds at yields comparable to bonds issued in 2019.
- **El Salvador:** FX remittances from Salvadorans living abroad declined at a yoy rate of 40% in April from -11% yoy in March. Remittances accounts for 20% of the country's GDP.
- **Hong Kong:** Thousands of people took to the streets to protest against new Chinese arrangements for the city designed to "safeguard national security and the prosperity and stability of Hong Kong". The protesters were dispersed with tear gas and pepper spray.

[1] See: *'African finance ministers say support from multilateral organisations should not disrupt access to international capital markets'*, Weekly investor research, 18 May 2020.

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Emerging Markets

- **India:** The Reserve Bank of India cut the repo rate by 40bps to 4.0% in an unscheduled meeting.
- **Kenya:** The World Bank approved a USD 1.0bn loan for budget support.
- **Malaysia:** The rate of CPI inflation declined to minus 2.9% in April from -0.2% yoy in March, led by fuel prices.
- **Mexico:** CPI inflation rose to 2.8% on a yoy basis in the first half of May from 2.2% yoy in the same period of April, driven by a higher rate of core inflation.
- **Mozambique:** The Japan Bank for International Cooperation (JBIC) committed USD 3.0bn to Total's Area 1 oil and gas project in Mozambique. This followed a similar pledge from the Export-Import Bank of the United States. Bloomberg reported that Total has reached an agreement for total funding of USD 14.4bn in senior debt with a syndicate of 20 banks. Production is forecast to start in 2024.
- **Poland:** The number of unemployed increased by over 30k in April as the registered unemployment rate rose to 5.7% from 5.4% in March.
- **Russia:** The yoy rate of real GDP growth slowed to 1.6% in Q1 2020 from 2.1% yoy in Q4 2019. The budget rule was temporarily suspended until 2021 to allow for greater fiscal stimulus.
- **South Africa:** The South African Reserve Bank cut the policy rate by 5-bps to 3.75% in line with consensus expectations.
- **South Korea:** Exports declined by 20.3% on a yoy basis in the first 20 days of May after a 27.6% reduction in April. Exports to China improved while shipments to the rest of the world deteriorated. Semiconductor exports rose by a yoy rate of 13.4%, whereas autos declined by 58.6% yoy.
- **Taiwan:** President Tsai Ing-wen's inauguration speech focused on domestic reforms and avoided direct confrontation with China. Export orders rose by 2.3% on a yoy basis in April from 4.3% yoy in March, thereby surprising versus consensus expectations to the upside.
- **Thailand:** Bank of Thailand cut the policy rate by 25bps to 0.5% in line with consensus expectations as 3 out of the 7 members of the monetary policy committee members voted for no cut.
- **Turkey:** The country increased import tariffs on 800 items (including agriculture machinery) by up to 30% except for countries with which Turkey has a free-trade agreement. In other news, the central bank cut the policy rate by 50bps to 8.25% in line with consensus expectations.
- **Ukraine:** The IMF agreed on a new USD 5bn Stand-By Agreement for 18 months, providing balance of payment and budget support to help addressing the coronavirus shock.

Global backdrop

- **EU:** France and Germany proposed a EUR 500bn (3.6% GDP) recovery fund to offer grants to sectors and regions most affected by the pandemic. The fund would be financed by new EU bonds being issued by the European Commission. If implemented, the fund would mark a first step towards fiscal integration in the EU, thereby significantly expanding the range of policy tools available and improving the overall economic resilience of the monetary union. The proposal will be discussed at a 27 May meeting of the European Commission and at the 18-19 June Council meeting. Conservative Northern and Eastern European, including Austria, Netherlands, Denmark, Poland, and Hungary are likely to oppose the measure. In other news, the Eurozone flash purchasing managers' index (PMI) rose to 30.5 in May from a record low of 13.6 in February. The manufacturing index rose to 39.5 from 33.4, while services rebounded to 28.7 from 12.0.
- **US:** Housing starts declined 30.2% to 891k in April after an 18.6% drop in March. Housing permits also declined by 20.8% in April after a 5.7% decline in March. Existing home sales fell 17.8% to 4.33m houses in April after declining 8.5% in March. This is the lowest level since 2011.
- **Japan:** Prime Minister Shinzo Abe lifted the coronavirus state of emergency in Tokyo presenting a 3-stage reopening plan. The government unveiled an additional JPY 100tn (USD 928bn) stimulus programme to strengthen companies affected by the coronavirus crisis and increase support for idled workers.
- **Monetary policy:** Bank of England Chief Economist Andrew Haldane said negative interest rates is under review as a policy option. His statement represents a U-turn from previous communications. On the other hand, US Federal Reserve Vice Chairman Richard Clarida maintained that there was no need for negative rates in the US, but indicated that yield curve control was a natural complement to forward guidance.
- **Protectionism:** The US Senate approved a bill preventing some Chinese firms from listing on US security exchanges unless they follow standards for US audits and regulations. This is good news, because many smaller Chinese companies that still have not adopted these standards are now likely to so do so, thereby improving transparency. Given the focus of the Chinese government on employment at the current time, we do not expect major retaliation from China against a sharp rise in recent anti-China sentiment on the part of the US government although China is likely to take measures to reduce dependency of foreign components in the technology sector, in our view.

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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	-1.31%	7.74%	-17.65%	-4.88%	-0.79%	0.24%
MSCI EM Small Cap	1.01%	15.12%	-20.97%	-12.57%	-5.60%	-4.11%
MSCI Frontier	3.32%	10.26%	-19.11%	-11.39%	-2.78%	-1.07%
MSCI Asia	-3.14%	5.55%	-13.82%	-1.68%	0.91%	1.44%
Shanghai Composite	-1.35%	2.60%	-7.48%	1.16%	-0.98%	-8.23%
Hong Kong Hang Seng	-5.18%	-0.77%	-14.74%	-5.93%	0.38%	-4.44%
MSCI EMEA	2.90%	14.16%	-24.52%	-15.78%	-5.85%	-3.85%
MSCI Latam	4.16%	10.75%	-39.73%	-30.52%	-9.17%	-5.03%
GBI EM GD	3.64%	7.70%	-8.69%	1.16%	0.61%	1.32%
ELMI+	0.32%	1.45%	-7.15%	-3.18%	-0.58%	0.00%
EM FX Spot	1.41%	2.54%	-12.13%	-10.37%	-6.66%	-5.84%
EMBI GD	5.78%	8.16%	-6.32%	0.20%	2.46%	4.12%
EMBI GD IG	4.27%	6.69%	0.89%	9.82%	6.03%	5.23%
EMBI GD HY	7.86%	10.17%	-14.55%	-10.26%	-1.64%	2.78%
CEMBI BD	3.08%	7.30%	-3.61%	2.51%	3.47%	4.18%
CEMBI BD IG	2.23%	5.77%	-0.64%	5.57%	4.44%	4.20%
CEMBI BD Non-IG	4.31%	9.58%	-7.69%	-1.68%	2.17%	4.18%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.67%	14.71%	-7.78%	5.57%	9.41%	9.00%
1-3yr UST	0.05%	0.18%	2.95%	5.16%	2.67%	1.87%
3-5yr UST	0.14%	0.38%	5.78%	9.02%	4.05%	3.02%
7-10yr UST	0.01%	0.66%	10.88%	16.30%	6.68%	4.83%
10yr+ UST	-1.17%	0.83%	21.91%	33.24%	12.75%	9.03%
10yr+ Germany	-2.03%	1.21%	6.35%	10.16%	7.48%	5.32%
10yr+ Japan	-0.65%	-0.10%	-0.95%	0.21%	2.19%	3.73%
US HY	2.56%	7.18%	-6.41%	-1.21%	2.52%	3.93%
European HY	0.52%	6.92%	-10.35%	-6.27%	-0.52%	1.63%
Barclays Ag	-0.41%	1.54%	1.21%	5.28%	3.32%	3.06%
VIX Index*	-17.54%	-47.40%	104.35%	77.67%	181.88%	132.15%
DXY Index*	0.62%	0.59%	3.37%	2.07%	2.25%	2.40%
CRY Index*	10.53%	6.36%	-30.28%	-27.48%	-28.50%	-42.57%
EURUSD	-0.33%	-1.02%	-2.63%	-2.46%	-2.36%	0.43%
USDJPY	0.63%	0.29%	-0.70%	-1.52%	-3.13%	-12.40%
Brent	43.41%	59.37%	-45.09%	-47.24%	-30.51%	-43.13%
Gold spot	2.73%	9.85%	14.19%	34.42%	36.76%	45.92%

*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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Ashmore

Contact

Head office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE

T: +44 (0)20 3077 6000

@AshmoreEM

www.ashmoregroup.com

Bogota
T: +57 1 316 2070

Dubai
T: +971 440 195 86

Dublin
T: +353 1588 1300

Jakarta
T: +6221 2953 9000

Mumbai
T: +9122 6269 0000

New York
T: +1 212 661 0061

Riyadh
T: +966 11 483 9100

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

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