

Another step to reset the bilateral relationship between China and the US

By Gustavo Medeiros

The presidents of China and United States (US) held conversations to reset their bilateral relationship. Trade data was stronger than expected in both China and Taiwan. South Korean lawmakers warned giant internet platforms against abusing their dominant position. The index provider MSCI downgraded Pakistan to Frontier Markets. Argentina opposition outperformed the government in legislative primary elections. Supporters of Brazilian President Jair Bolsonaro took to the streets to defend the president against attacks from the Supreme Court. Colombian legislators approved an important tax reform. Ecuador agreed to adjust its existing programme with the IMF. The Mexican President repeated it would like to use the IMF SDR injection to repay existing debt. Peruvian President Pedro Castillo approval rate is at very low levels. Russia hiked policy rate by 25bps. South African economy grew more than expected in Q2 2021. The Central Bank of Turkey signalled a shift in focus to core inflation.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.7	–	-0.46%
MSCI EM Small Cap	11.6	–	-0.68%
MSCI Frontier	12.3	–	0.37%
MSCI Asia	14.2	–	-0.10%
Shanghai Composite	11.9	–	3.39%
Hong Kong Hang Seng	9.3	–	1.12%
MSCI EMEA	9.8	–	-0.72%
MSCI Latam	8.7	–	-2.62%
GBI-EM-GD	5.09%	–	-0.52%
China GBI-EM GD	2.96%	–	0.11%
ELMI+	2.86%	–	-0.36%
EM FX spot	–	–	-0.34%
EMBI GD	4.81%	341 bps	0.00%
EMBI GD IG	3.03%	157 bps	0.08%
EMBI GD HY	6.88%	552 bps	-0.08%
CEMBI BD	4.20%	300 bps	0.14%
CEMBI BD IG	2.87%	169 bps	0.11%
CEMBI BD HY	5.79%	457 bps	0.18%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.2	–	-1.71%
1-3yr UST	0.22%	–	-0.01%
3-5yr UST	0.81%	–	-0.11%
7-10yr UST	1.33%	–	-0.40%
10yr+ UST	1.92%	–	-0.68%
10yr+ Germany	-0.33%	–	-0.28%
10yr+ Japan	0.65%	–	-0.22%
US HY	3.79%	279 bps	0.14%
European HY	3.03%	339 bps	0.14%
Bloomberg-Barclays	1.06%	-27 bps	-0.22%
VIX Index*	20.95	–	4.54%
DXI Index*	92.73	–	0.70%
EURUSD	1.179	–	-0.68%
USDJPY	110.08	–	-0.20%
CRY Index*	220.4	–	0.41%
Brent	73.4	–	1.66%
Gold	1,792	–	-1.73%
Bitcoin	44,824	–	-3.47%

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

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China: Last week, President Xi Jinping had two telephone calls with US President Joe Biden as they agreed to hold further discussions in areas where China's interests converge and diverge with America. The US statements said that Biden is committed to "responsibly manage the competition between the countries", while China emphasised the bilateral relationship needs a rebalance across all areas (i.e. less undermining of China's economy and technology development is necessary for further cooperation in other areas such as climate change).¹ Vice Premier Liu He affirmed support to private companies and vowed to accelerate market reforms, opening up and boosting protection of physical and intellectual property rights. The support may signal the beginning of the end of strict regulations on internet platforms and other sectors of the new economy, which rattled China's equity markets over the last few quarters.

Economic data was better than expected as exports rose at a yoy rate of 15.7% in August (8.4% consensus), from 8.1% yoy in July while imports rose 23.1% yoy (18.5% consensus) from 16.1% over the same period. Bank lending rose only RMB 0.1trn to RMB 1.2trn in August as tight conditions for the property market remains a drag, but aggregate financing rose to RMB 3trn in August (from RMB 1trn in July) on the back of higher bond issuance. The yoy rate of consumer price index (CPI) inflation declined 0.2% to 0.8% in August while producer price index (PPI) inflation rose 0.5% to 9.5% yoy over the same period.

¹ See <https://www.whitehouse.gov/briefing-room/statements-releases/2021/09/09/readout-of-president-joseph-r-biden-jr-call-with-president-xi-jinping-of-the-peoples-republic-of-china/>

Emerging Markets

Taiwan: The yoy rate of export growth declined to 26.9% in August (above 23.4% consensus) from 34.7% yoy in July as imports rose 46.3% yoy from 41.0% yoy over the same period. The yoy rate of CPI inflation rose 0.5% to 2.4% in August while wholesale price index (WPI) declined 0.4% to 11.9% yoy.

South Korea: Lawmakers warned internet giant platforms against abusing their market dominance and ignoring fair competition in the pursuit of wealth and profits. At the same time, parliament legislated that companies providing some financial services (such as price comparison brokers) will face similar regulations as financial companies. Global regulation of large internet conglomerates, enjoying a regulatory arbitrage against traditional sectors and technology companies enjoying monopolistic positions, is only a matter of time but each country will pursue it at its own pace, in our view.

Pakistan: The MSCI Index downgraded Pakistani equities to Frontier Markets, as expected by market participants. Pakistan was a very small country in the MSCI Emerging Markets and the Pakistan Rupee depreciated 58% since the upgrade to EM in 2017. Local news reported the government plans to increase electricity tariffs from October, which would remove a key disagreement between the government and the International Monetary Fund (IMF).

Argentina: Primary elections took place on Sunday, ahead of the 14 November mid-term elections for half of the Lower House and one-third of Senate seats. With 94.2% of the votes counted, the opposition bloc Juntos received 40.2% of the votes against 30.9% for the government coalition Frente de Todos. The government currently controls 120 of the 257 seats in the House and 41 of the 72 seats in the Senate. If the primary election results are replicated in the election, the government would lose its simple majority in the Senate and the largest minority position in the Lower House. The election result is a clear signal that the population is unsatisfied with the government's economic policies, which generated high inflation and low growth, increasing the case for an IMF deal and economic reforms post mid-term elections.

Brazil: President Jair Bolsonaro delivered an inflammatory speech attacking the Supreme Court (SC) to large crowds of supporters during Independence Day on 7 September. Later in the week, Bolsonaro softened the tone by publishing an appeasing letter, written by former President Michel Temer, saying his acts took place in the "heat of the moment" and pledged to respect the Judiciary and Legislative institutions. Truck drivers staged demonstrations, partially blocking roads in at least eight states, but Bolsonaro asked them to unblock the roads to avoid further supply shocks and inflation. Protests in favour of a third way (against Bolsonaro, but also against former president Luis Ignacio Lula da Silva) had a much lower attendance last Sunday, which highlights the lack of coherence (no defined leader or message) of the more moderate political blocks. In economic news, the yoy rate of PPI inflation dropped to 28.2% in August from 33.4% in July, but CPI inflation rose 0.7% to 9.7% yoy, slightly above consensus. Retail sales rose 1.1% in July from -2.1% in June, but vehicle sales dropped 2k to 172k in August and vehicle production was stable at 164k as the industry struggles with supply chain issues.

Colombia: In an important measure to consolidate the fiscal deficit, both houses of Congress approved the tax reform with minimal watering down, raising tax revenues by 1.4% of GDP and social expenditures by 0.7% of GDP. Central Bank Governors Leonardo Villar and Bibiana Taboada signalled a gradual increase in interest rates to keep inflation expectations under control.

Ecuador: The government reached an agreement with the IMF to adjust the Extended Fund Facility funding programme agreed in September 2020, allowing for USD 1.5bn disbursements in 2021 and USD 1.0bn next year. The details for the revamped economic programme were not published, but is likely to contain difficult structural reforms. The agreement will allow for USD 4.5bn of multilateral loans to be disbursed through to the end of 2022.

Mexico: President Andrés Manuel López Obrador repeated he would like to use the USD 12bn IMF special drawing rights injection to repay part of Petróleos Mexicanos (Pemex) debt, which is close to USD 117bn. The Ministry of Finance published the 2022 budget plan containing a small primary deficit of 0.4% in 2021 and 0.3% in 2022 and no tax increases as the government continues to seek higher revenue by fighting tax evasion. The GDP and oil production forecasts seemed optimistic, whilst oil prices were conservative. The government will continue supporting Pemex by cutting the profit-sharing duty from 54% to 40% (was 65% until 2020). In economic news, the yoy rate of CPI inflation dropped 0.2% to 5.6%, in line with consensus while industrial production (IP) beat consensus rising 1.2% in July from -0.9% in June.

Peru: A poll by IPSOS showed President Pedro Castillo's approval rate at 38% whilst his disapproval rate reached 45%, the worst show in history of presidential polls since 1990.² The Central Bank of Peru hiked policy rate by 50bps to 1.0%, in line with consensus. The statement following the decision noted the rate hike does not "necessarily imply a cycle of successive hikes" as real interest rates are at historical low levels, but monetary policy should remain accommodative.

² See (in Spanish): <https://loretonoticias.pe/pedro-castillo-un-gobierno-precario-e-impopular-que-no-puede-contrarrestar-las-crisis-analisis/>

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Russia: The Central Bank of Russia hiked policy rate by 25bps to 6.75% but pledged to extend the hiking cycle due to elevated inflationary pressures, whilst most analysts expected a final 50bps hike last meeting. The yoy rate of CPI inflation rose 0.2% to 6.7%, in line with consensus while core CPI rose 0.3% to 7.1%. The trade surplus rose to USD 23.2bn in July from USD 18.3bn in June, significantly above consensus.

South Africa: The yoy rate of real GDP growth rose 19.3% in Q2 2021, 1.5% above consensus, after contracting 2.6% in Q1 2021 (revised from -3.2%). The agricultural, mining and service sectors outperformed, compensating for poor performance in manufacturing, construction and government services. The current account surplus rose to ZAR 343bn in Q2 2021 from ZAR 261bn in Q2 2021, accumulating 5.6% of GDP on a 12-month rolling basis.

Turkey: Central Bank of Turkey Governor Şahap Kavcıoğlu signaled a shift in their policy focus away from headline inflation to core inflation. The yoy rate of CPI inflation rose to 19.3% in August, but core CPI dropped to 16.8% yoy. The shift in policy focus may open the door to a rate cut demanded by President Recep Tayyip Erdoğan, which would be bad news for macroeconomic stability, in our view. In economic news, IP dropped 4.2% in July after rising 2.2% in June and the current account deficit narrowed to USD 0.7bn in July from USD 1.1bn in June.

Snippets:

- **Chile:** Exports declined USD 0.1bn to USD 7.8bn and imports rose USD 0.5bn to USD 7.8bn in August, resulting in a flat trade balance. The yoy rate of CPI inflation rose 0.3% to 4.8% in August as core CPI inflation rose to 3.8% yoy over the same period, the highest since Q3-2016. The yoy rate of nominal wages rose 0.6% to 6.5% yoy in July, the highest level since 2017.
- **Czech Republic:** The yoy rate of retail sales declined to 1.5% in July from 9.3% in June, lower than consensus. The yoy rate of CPI inflation rose 0.7% to 4.1% in August, 0.5% above consensus.
- **Egypt:** The yoy rate of CPI inflation rose 0.3% to 5.7% in August while core CPI declined 0.1% to 4.5% yoy over the same period.
- **El Salvador:** The Supreme Court paved the way for President Nayib Bukele to run for a second term in office leading Human Rights Watch, to express concerns about the health of El Salvador's democracy.³ During the same week, El Salvador officially adopted Bitcoin as legal tender alongside the US Dollar and purchased some Bitcoin for the Treasury, a move that is unlikely to please the IMF due to financial stability risks.
- **Hungary:** The yoy rate of CPI inflation rose 0.3% to 4.9% in August, 0.2% above consensus.
- **India:** The yoy rate of IP decelerated to 11.5% in July from 13.6% yoy in June, 1.5% ahead of consensus.
- **Malaysia:** Bank Negara Malaysia kept its policy rate unchanged at 1.75%, in line with consensus. IP declined 5.2% in July after rising 1.4% in June a steeper drop than expected.
- **Philippines:** The yoy rate of CPI inflation rose 0.9% to 4.9% in August (0.5% above consensus) led by higher food prices. The yoy rate of export growth declined to 12.7% in July from 17.6% in June (2.9% below consensus), while imports growth lowered to 24.0% yoy from 34.2% yoy over the same period (2.3% above consensus).
- **Poland:** The Central Bank of Poland kept policy rate unchanged at 0.1%, in line with consensus.
- **Romania:** The trade deficit widened to USD 2.2bn in July from USD 1.8bn in June. The yoy rate of CPI inflation rose 0.2% to 5.3% in August, in line with consensus.
- **Thailand:** The government announced that Bangkok will reopen.

Global backdrop

United States: Following the approval of a USD 1.2trn infrastructure bill comprising USD 550bn of new resources, the US Congress has started the budget reconciliation process working on a USD 3.5trn spending bill focusing on the green and human infrastructure parts of the Build Back Better programme. Most resources in the bill go to healthcare, education, childcare and the green economy. The bill is likely to be somewhat diluted before approval given reservation from moderate Senate Democrats such as Joe Manchin and Krysten Sinema. In the meantime, Treasury Secretary Janet Yellen warned Congress that the Treasury could run out of cash within one month if the debt ceiling is not increased.

In economic news, job openings rose by 0.7m to 10.9m in July according to the JOLTS report from the Bureau of Statistics as the number of vacancies exceeded hiring by 4.3m, the most since the inception of the data 20 years ago. Initial jobless claims dropped to 310k in the week ending in 4 September from 345k in the previous week while continuing claims were unchanged at 2.8m in the week ending in 28 August. The yoy rate of PPI inflation rose 0.5% to 8.3% in August while ex-food and energy PPI rose 0.5% to 6.7% yoy both indices were 0.1% above consensus.

³ Human Rights Watch is a non-governmental organisation think-tank supporting human rights:
<https://www.bloomberg.com/news/articles/2021-09-07/el-salvador-democracy-in-rapid-decline-human-rights-watch-says?sref=zUof49ZI>

Global backdrop **Eurozone:** The ECB kept its refinancing, deposit and lending policy rates unchanged at 0.0%, -0.5% and 0.25%, respectively, in line with consensus and announced a recalibration (but no tapering) of the pace of its pandemic emergency purchase programme (PEPP). Most board members agreed that inflation risks are biased to the upside. Real GDP grew by 2.2% Q2 2021 after 2.0% in Q1 2021, 0.2% above consensus. The Germany Zew survey of economic expectations declined to 26.5 in September from 40.4 in August while the current situation survey declined to 31.9 from 29.3, both lower than consensus.

Japan: Opinion polls show Taro Kono as the favourite candidate among both the overall population and LDP supporters. The next Prime Minister will most likely increase fiscal expenditure in order to boost its popularity during the honeymoon period leading to general elections in November and counterbalance the impact of the pandemic in the economy.

Australia: The Reserve Bank of Australia reduced the monthly purchase of government bonds by AUD 10bn to AUD 40bn, in line with expected, but committed not to further reduce its QE programme until Q1 2022.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.10%	-4.14%	3.03%	23.33%	11.82%	10.37%
MSCI EM Small Cap	0.00%	-0.09%	19.77%	44.63%	14.54%	10.42%
MSCI Frontier	1.18%	3.46%	18.97%	33.39%	11.18%	9.95%
MSCI Asia	0.66%	-4.71%	1.39%	20.99%	12.47%	11.28%
Shanghai Composite	4.49%	4.15%	8.76%	16.90%	14.10%	6.12%
Hong Kong Hang Seng	2.38%	-10.99%	-10.39%	-0.38%	-0.12%	2.26%
MSCI EMEA	0.06%	3.56%	20.32%	36.98%	10.31%	7.17%
MSCI Latam	-4.64%	-7.72%	0.62%	26.45%	2.94%	3.42%
GBI-EM-GD	-0.45%	-0.11%	-3.49%	3.58%	6.14%	2.85%
China GBI-EM GD	0.36%	2.10%	5.27%	11.18%	na	na
ELMI+	-0.07%	0.15%	-0.46%	4.36%	3.19%	2.13%
EM FX spot	-0.06%	-0.59%	-2.15%	2.16%	-1.59%	-2.95%
EMBI GD	0.17%	1.57%	0.90%	4.20%	7.18%	4.43%
EMBI GD IG	0.09%	1.36%	-1.13%	0.79%	7.99%	4.83%
EMBI GD HY	0.25%	1.78%	3.23%	8.25%	6.17%	3.91%
CEMBI BD	0.19%	1.12%	2.41%	6.10%	7.83%	5.40%
CEMBI BD IG	0.16%	1.16%	1.02%	3.31%	7.13%	4.68%
CEMBI BD HY	0.23%	1.04%	4.27%	9.98%	8.70%	6.46%

Benchmark performance

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	-1.37%	4.04%	19.89%	35.52%	17.81%	18.12%
1-3yr UST	-0.03%	0.14%	0.05%	0.13%	2.69%	1.67%
3-5yr UST	-0.11%	0.43%	-0.61%	-0.63%	4.30%	2.27%
7-10yr UST	-0.24%	1.35%	-2.07%	-3.25%	6.35%	2.83%
10yr+ UST	-0.22%	3.20%	-4.98%	-7.92%	9.55%	4.18%
10yr+ Germany	-0.98%	2.50%	-4.45%	-1.52%	5.33%	2.32%
10yr+ Japan	-0.25%	0.64%	0.33%	0.54%	1.71%	0.70%
US HY	0.30%	1.20%	4.86%	10.75%	7.23%	6.71%
European HY	0.27%	1.04%	4.55%	9.14%	4.35%	4.11%
Bloomberg-Barclays Agg	0.03%	0.94%	-2.30%	0.81%	4.68%	2.51%
VIX Index*	27.12%	32.34%	-7.91%	-22.03%	69.36%	17.37%
DXY Index*	0.11%	0.32%	3.11%	-0.65%	-1.89%	-3.03%
CRY Index*	1.04%	3.30%	31.37%	50.55%	15.16%	22.08%
EURUSD	-0.14%	-0.50%	-3.56%	-0.65%	0.96%	4.94%
USDJPY	-0.10%	0.92%	-6.16%	-4.02%	1.62%	-7.16%
Brent	0.59%	-2.28%	41.74%	84.33%	-6.09%	55.88%
Gold	-1.23%	1.10%	-5.42%	-8.42%	48.86%	35.42%
Bitcoin	-5.40%	31.31%	56.80%	336.62%	588.67%	7,289.17%

*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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