

Inflation peaking in EM

By Gustavo Medeiros

Inflation surprised to the downside across most large EM economies in June. China's central bank cut its reserve requirement ratio by 50bps. Economic data surprised to the upside in Brazil and Taiwan. India's Prime Minister Narendra Modi reshuffled his ministerial cabinet to improve policy execution. The ratings agency Fitch upgraded Ecuador's 'B-' sovereign credit rating outlook to positive. Services PMI was better than expected in Russia and Brazil, but worse than expected in China and India. The minutes from the Mexico central bank monetary policy committee showed most members favoured further rate hikes. Turkey's current account deficit deteriorated. The central bank of Philippines said inflation is likely to come back to its target.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.9	—	-2.59%
MSCI EM Small Cap	12.1	—	-1.13%
MSCI Frontier	11.7	—	-1.88%
MSCI Asia	14.1	—	-2.52%
Shanghai Composite	11.6	—	0.45%
Hong Kong Hang Seng	9.3	—	-4.44%
MSCI EMEA	10.0	—	-0.90%
MSCI Latam	10.2	—	-3.95%
GBI-EM-GD	4.98%	—	-0.56%
China GBI-EM GD	3.09%	—	0.52%
ELMI+	2.98%	—	-0.57%
EM FX spot	—	—	-0.77%
EMBI GD	4.90%	348 bps	0.27%
EMBI GD IG	3.14%	166 bps	0.38%
EMBI GD HY	7.19%	582 bps	0.14%
CEMBI BD	4.24%	304 bps	0.11%
CEMBI BD IG	2.97%	179 bps	0.19%
CEMBI BD HY	5.87%	466 bps	0.00%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.5	—	1.19%
1-3yr UST	0.21%	—	0.09%
3-5yr UST	0.78%	—	0.38%
7-10yr UST	1.35%	—	0.93%
10yr+ UST	1.99%	—	1.64%
10yr+ Germany	-0.29%	—	1.08%
10yr+ Japan	0.67%	—	0.12%
US HY	3.66%	269 bps	0.27%
European HY	3.01%	348 bps	0.02%
Bloomberg-Barclays	1.07%	-28 bps	0.45%
VIX Index*	16.18	—	0.70%
DX Index*	92.21	—	-0.01%
EURUSD	1.187	—	-0.01%
USDJPY	110.19	—	0.64%
CRY Index*	211.8	—	-2.77%
Brent	75.2	—	-2.60%
Gold	1,801	—	0.52%
Bitcoin	34,233	—	-1.01%

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

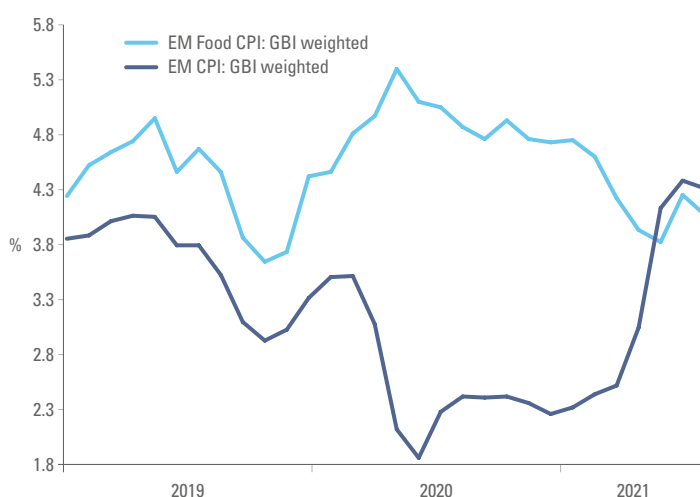
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EM Inflation: Inflation seems to be peaking in Emerging Markets (EM). More than two-thirds of EM countries representing close to 80% of the GBI-EM GD index released their June inflation data.¹ Inflation seems to have stabilised earlier than expected with the yoy rate of CPI inflation dropping to 4.3% in June from 4.4% yoy in May.

Inflation surprised to the downside in Brazil, Chile, China, Colombia, Indonesia, Philippines, Poland and Thailand and was above expectations only in Hungary, Russia, Turkey and Uruguay.

Food prices was one of the main factors leading to downside surprises declining to a yoy rate of 4.1% in June from 4.3% yoy in May, thus returning to a declining trend which started in May 2020 as per Figure 1.

Fig 1: EM CPI Inflation (GBI weighted)



Source: Bloomberg, JP Morgan, Ashmore as at June 2021.

¹ At the publication date, Czech Republic, Malaysia, Romania, Slovakia and South Africa had not released CPI inflation data.

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Some EM central banks where inflation is returning to its targets will keep an accommodative policy stance. Last week, China has announced a 50bps reserve requirement ratio (RRR) cut as the yoy rate of CPI inflation declined to 1.1% in June from 1.3% yoy in May. On the other hand, higher inflation will motivate Hungary and Russia to hike their policy rates further, while Turkey would do well to keep policy rates at higher levels for longer given high inflationary pressures.

China: The People's Bank of China (PBoC) cut the reserve requirement ratio (RRR) by 50bps to 12.0%, releasing around CNY 1trn of liquidity into the economy, especially to small banks. The statement highlighted the move is not a turning point in the policy stance. Aggregate financing rose to CNY 3.7trn in June from CNY 1.9trn in May, above the CNY 2.9trn consensus expectations and the monetary aggregate M2 rose by a yoy rate of 8.6% from 8.3% yoy in May and 8.2% yoy expected. Beijing is likely to accelerate government bond issuance to boost targeted support to small businesses and individuals – cutting the RRR will provide liquidity for higher bond issuance. In other policy developments, China also pledged to sell more metals from its strategic reserves to ensure stable prices.

In economic news, the yoy rate of PPI inflation declined to 8.8% in June from 9.0% yoy in May. The Caixin services PMI declined to 50.3 in June from 55.1 in May, below consensus expectations at 54.9. In political news, President Xi Jinping urged political parties worldwide to oppose any country engaging in "technology blockades" or creating scientific gaps, that leads to decoupling of development. In a speech to the World Political Parties Summit, Xi said countries must do "what is best for them" and emphasised no nation could dictate democracy to other countries as every country should choose its own solution.

Brazil: The IHS Markit Services PMI rose to 53.9 in June from 48.3 in May, reflecting better mobility conditions in spite of the elevated number of cases, as higher vaccinations lead to fewer serious Covid-19 cases. Retail sales rose 3.8% in May after a 5.4% increase in April. Mortgage origination rose to BRL 17.5bn in May from BRL 16.7bn in April, and expanded by a whopping 145% on a yoy basis, aided by lower interest rates for the product. In other news, Petrobras increased gasoline and diesel prices by 6.0% and 3.7% respectively, the first hike of new President Joaquim Silva e Luna. Higher energy prices are likely to keep inflation elevated in 2021, supporting the central bank current hawkish stance.

In political news, a poll by the MDA institute shows former President Luis Inacio Lula da Silva with 41.3% of vote intentions followed by incumbent Jair Bolsonaro with 26.6%. The former Justice Minister Sergio Moro and Ciro Gomes both have 5.9% of vote intentions. The same poll shows Bolsonaro's approval rate declining to 33.8% in early July from 43.5% in February while his rejection rate rose to 62.5% from 51.4% over the same period. In other political news, the Supreme Court authorised an investigation into President Bolsonaro for failing to comply with his public duty by overlooking irregularities in an overpriced purchase of Covaxin Covid-19 vaccines from India.

Taiwan: Exports increased by a yoy rate of 35.1% in June, 2.1% better than consensus expectations, from 38.6% yoy in May, while imports rose 42.3% yoy from 40.9% yoy leading to a narrowing of the trade surplus to USD 5.2bn from USD 6.2bn over the same period. Unemployment rate rose to 4.2% in May from 3.7% in April. The yoy rate of CPI inflation declined to 1.9% in June from 2.5% yoy in May, surprising consensus expectations to the downside.

Russia: The Markit services PMI declined only 1.0 to 56.5 in June, which was 0.7 better than consensus expectations. The current account surplus narrowed to USD 19.9bn in Q2 2021 from USD 23.3bn in Q1 2021. In other news, the yoy rate of CPI inflation rose to 6.5% in June from 6.0% yoy in May and 0.1% above expected. Core CPI inflation rose to a yoy rate of 6.6% from 6.0% yoy over the same period, 0.3% above consensus expectations. Most price pressures came from the service sector, which remains strong despite a recent increase in Covid-19 cases in Moscow.

India: Prime Minister Narendra Modi announced a large cabinet reshuffle halfway into his second five-year mandate, which ends in 2024. Several ministers underperforming their attributions were replaced by new assignees with a promising record of accomplishment. The number of ministerial positions was increased to improve policy execution. In political terms, a number of new ministers come from three states where Modi's BJP Party will be disputing elections in 2022 and 2023 – Uttar Pradesh, Odisha and Bihar. In economic news, the IHS Markit services PMI declined to 41.2 in June from 46.4 in May, reflecting worst mobility conditions due to the pandemic.

Ecuador: The ratings agency Fitch kept Ecuador's sovereign debt unchanged at 'B-' but upgraded the outlook to positive citing low risk of default in the short term, the IMF support and progress at the macroeconomic level with a medium-term economic policy plan supported by structural reforms. In other news, President Guillermo Lasso and some ministers met with US Senators to strengthen the bilateral relationship and seek a trade agreement to boost trade and investments. The IMF pledged another USD 1bn loan via special drawing rights (SDR's) on top of the USD 6.5bn already granted as part of a broader credit programme from 2020 to 2022.

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Mexico: The minutes of the latest monetary policy committee (MPC) confirmed the majority of the board is willing to reduce monetary stimulus to contain inflationary pressures. The two members who opted to keep policy unchanged in the previous meeting, Geraldo Esquivel and Galia Borja argued that price shocks were mostly due to transitory supply side effects. The three other members voting for a 25bps hike to 4.25% said the central bank should act to avoid a de-anchoring of inflation expectations, but highlighted future decisions will be data dependent. Overall, the message is consistent with further rate hikes, in our view. The yoy rate of CPI inflation was unchanged at 5.9% in June while core CPI inflation rose to a yoy rate of 4.6% in June from 4.4% yoy in May as nominal wages rose by 5.0% in June from 4.4% in May. Vehicle production rose to 264k units in June from 242k in May, but remains significantly lower than the average of the previous five years of May of 322k units.

Turkey: The current account deficit widened to USD 3.1bn in May from USD 1.7bn in April, broadly in line with consensus expectations, due to higher energy prices. The yoy rate of CPI inflation rose to 17.5% in June from 17.0% yoy in May, while PPI inflation surged to 42.9% yoy from 38.3% yoy over the same period, both surprising consensus expectations to the upside. In other news, the central bank Governor Sahap Kavcioglu is under investigation due to allegations of plagiarism on his PhD thesis.

Philippines: The Central Bank Governor Benjamin Diokno said in a statement that inflation is likely to settle near the centre of the 2% to 4% target band in 2022 and 2023, albeit temporary increases in oil and food may keep prices under pressure. The yoy rate of CPI inflation declined to 4.1% in June from 4.5% yoy in May, 0.2% lower than consensus expectations. In other news, the trade deficit narrowed to USD 2.7bn in May from USD 3.1bn in April.

Snippets:

- **Argentina:** Vehicle production rose to 40k in June from 35k in May as exports increased to 23k from 20k over the same period, the largest export volume for the month of June since 2018. Argentina has now vaccinated 40% of its population with the first jab and 10% with two doses. In other news, real tax collection declined 2.5% qoq in Q2 2021 from 12.8% qoq growth in Q1 2021.
- **Belarus:** The Supreme Court sentenced former presidential candidate Victor Babariko to 14-year imprisonment for fraud. Babariko was arrested after announcing he was running for President in the 2020 elections. Other members of his electoral campaign received a shorter five-year prison term for inciting of mass protests.
- **Chile:** The yoy rate of CPI inflation rose to 3.8% in June from 3.6% yoy in May, 0.2% below consensus expectations. The CPI ex-volatile components slowed to a yoy rate of 3.2% in June from 3.3% yoy in May. In other news, the trade surplus narrowed to USD 1.1bn in June from USD 1.3bn in May due to lower copper exports.
- **Colombia:** The yoy rate of CPI inflation rose to 3.6% in June from 3.3% yoy in May, led by higher energy prices. Core CPI inflation ex-food and energy rose to a yoy rate of 2.3% from 1.9% yoy over the same period, within the inflation target band of 2.0% to 4.0%.
- **Czech Republic:** The yoy rate of retail sales rose 16.5% in May versus 15.7% yoy expected, down from 21.6% yoy in April.
- **Republic of Congo:** President Felix Tshisekedi appointed long-term IMF official Malangu Kabedi-Mbuye as central bank governor, positive news for monetary policy stability and the relationship with the fund.
- **Egypt:** The current account deficit widened to USD 5.7bn in Q1 2021, but tourism earnings started recovering at USD 1.3bn in Q1 2021 (equivalent to 50% of earnings in Q1 2019). The yoy rate of CPI inflation rose to 4.9% in June from 4.8% yoy in May.
- **Ethiopia:** The government announced the intention to restructure another USD 1bn of external debt, following a USD 2.5bn restructuring with China in 2019. As in 2019, the USD 1bn in Eurobonds due in 2025 are not part of the restructuring.
- **Haiti:** President Jovenel Moise was killed in an attack at his home in Port-au-Prince. The police said they killed four suspects in a running battle and arrested another two but it was unclear who ordered the assassination.
- **Hungary:** Retail sales rose 0.1% in May after a -1.0% decline in April, equivalent to a yoy rate of 5.8% from 10.6% yoy over the same period. The yoy rate of CPI inflation rose to 5.3% in June from 5.1% yoy in May and higher than the 4.9% yoy consensus expectations.
- **Malaysia:** Bank Negara Malaysia kept its policy rate unchanged at 1.75%, in line with consensus expectations and signalled rates are likely to remain unchanged until the end of the year. Industrial production declined 3.4% in May, leading to a deceleration of the yoy pace of growth to 26.0% in May from 28.0% in April.
- **Nigeria:** The Senate approved USD 6.1bn of external loan, which increases the likelihood of a large Eurobond issuance over the next months. In other news, 140 children were kidnapped from a school, taking the number of students abducted since December to more than 1k.

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- **Peru:** Economic advisor Pedro Francke said in an interview to Reuters that President elect Pedro Castillo expects mining firms enjoying high metal prices will accept prudent plans to hike taxes on mineral resources.
- **Poland:** The National Bank of Poland kept its policy rate unchanged at 0.1% in line with consensus expectations.
- **Romania:** Retail sales increased 2.4% (mom) in May after a 2.1% increase in April, bringing the yoy rate to 22.0% from 39.7% yoy over the period.
- **Saudi Arabia:** The government set an upper limit of SAR 2.18 per litre of 91-octane gasoline, a move that increases subsidies for consumers for the first time in five years.
- **South Africa:** Violent protests broke across KwaZulu-Natal and Johannesburg, after former president Jacob Zuma was sent to jail last week to serve a 15-months term for corruption.
- **South Korea:** The government adopted additional mobility restrictions in some areas in Seoul as Covid-19 cases rose to record levels.
- **Tunisia:** The ratings agency Fitch downgraded the outlook on Tunisia's 'B-' credit rating to negative, mostly due to a lack of progress towards an IMF deal.
- **Uruguay:** The yoy rate of CPI inflation rose to 7.3% in June from 6.6% yoy in May, in line with consensus expectations. Core CPI inflation rose to 7.9% yoy in June from 7.3% yoy in May. The central bank kept policy rate unchanged at 4.5% and expressed a positive tone in the evolution of inflation expectations.

Global backdrop

United States: The minutes of the Federal Open Market Committee (FOMC) revealed a lack of urgency to reduce the Federal Reserve asset-purchasing programme. Some FOMC members were concerned about mortgage-backed securities (MBS) purchases driving home prices higher, but there was no consensus to reduce MBS purchases.

In economic news, mortgage applications declined 1.8% in the week ending 2 July after dropping 6.9% in the previous week. Initial jobless claims were stable at 370k in the week ending 3 July while continuing claims declined to 3.34 million from 3.48 million in the previous week. Job openings were unchanged in May at 9.2 million. The ISM services PMI declined 3.9 to 60.1, significantly below consensus expectations as the employment index declined 6.0 to 49.3, while the IHS Markit PMI declined 0.2 to 64.8 in June. Consumer credit rose USD 35.3bn in May from USD 20.0bn in April.

Australia: The Reserve Bank of Australia (RBA) kept policy rate unchanged at 0.1% and repeated the guidance not to raise policy rate before 2024, maintaining the 0.1% target on the April 2024 bond unchanged (but not rolling the target over to November 2024 as expected). However, the RBA said it would reduce the pace of its bond-purchasing programme (QE) in September to AUD 4bn a week, from the current AUD 5bn, a sooner than expected tapering of QE.

Europe: The European Central Bank (ECB) will raise the inflation target to 2.0% with some allowance for overshoot from a previous target of "below, but close to 2.0%". A significant step from a traditionally 'hawkish' institution, albeit a much less flexible framework than the US Federal Reserve flexible average inflation target (FAIT).

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	-3.93%	-3.93%	3.21%	24.70%	9.81%	12.64%
MSCI EM Small Cap	-1.58%	-1.58%	17.99%	51.14%	11.96%	11.73%
MSCI Frontier	-1.54%	-1.54%	13.22%	35.33%	7.44%	9.02%
MSCI Asia	-4.14%	-4.14%	1.95%	22.78%	10.90%	13.99%
Shanghai Composite	-1.56%	-1.56%	2.80%	4.56%	10.38%	5.65%
Hong Kong Hang Seng	-6.66%	-6.66%	-6.03%	-5.83%	0.57%	6.72%
MSCI EMEA	-0.65%	-0.65%	15.43%	32.20%	4.54%	7.54%
MSCI Latam	-4.04%	-4.04%	4.64%	32.00%	2.88%	5.43%
GBI-EM-GD	-0.94%	-0.94%	-4.28%	4.49%	3.27%	3.09%
China GBI-EM GD	0.17%	0.17%	3.27%	11.64%	na	na
ELMI+	-0.94%	-0.94%	-1.54%	5.01%	1.51%	2.22%
EM FX spot	-1.12%	-1.12%	-2.68%	2.55%	-3.61%	-2.94%
EMBI GD	0.22%	0.22%	-0.45%	6.51%	6.13%	4.58%
EMBI GD IG	0.34%	0.34%	-2.12%	2.32%	7.57%	4.79%
EMBI GD HY	0.08%	0.08%	1.50%	11.64%	4.48%	4.29%
CEMBI BD	0.18%	0.18%	1.46%	8.20%	7.43%	5.63%
CEMBI BD IG	0.26%	0.26%	0.12%	5.01%	7.03%	4.76%
CEMBI BD HY	0.08%	0.08%	3.28%	12.71%	7.93%	6.95%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.72%	1.72%	17.23%	40.77%	18.35%	17.65%
1-3yr UST	0.07%	0.07%	-0.02%	0.11%	2.74%	1.62%
3-5yr UST	0.34%	0.34%	-0.70%	-0.62%	4.32%	2.09%
7-10yr UST	0.84%	0.84%	-2.57%	-3.89%	6.17%	2.27%
10yr+ UST	1.63%	1.63%	-6.42%	-10.88%	8.44%	2.79%
10yr+ Germany	1.48%	1.48%	-5.41%	-3.26%	4.73%	1.42%
10yr+ Japan	0.51%	0.51%	0.20%	0.05%	0.97%	-0.62%
US HY	0.40%	0.40%	4.03%	14.54%	7.50%	7.26%
European HY	0.08%	0.08%	3.56%	11.60%	4.24%	4.66%
Bloomberg-Barclays Agg	0.47%	0.47%	-2.75%	2.34%	4.24%	2.28%
VIX Index*	2.21%	2.21%	-28.88%	-40.71%	28.62%	19.41%
DXY Index*	-0.25%	-0.25%	2.52%	-4.60%	-2.77%	-4.39%
CRY Index*	-0.74%	-0.74%	26.22%	49.66%	9.17%	11.34%
EURUSD	0.15%	0.15%	-2.93%	4.39%	1.58%	6.99%
USDJPY	0.82%	0.82%	-6.25%	-2.74%	2.04%	-4.79%
Brent	0.03%	0.03%	45.08%	73.80%	0.94%	55.04%
Gold	1.63%	1.63%	-4.92%	-0.48%	44.45%	35.17%
Bitcoin	0.29%	0.29%	19.75%	271.41%	453.40%	5,000.70%

*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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