Issued: 29 June 2020

Policy rate cuts in Hungary, Philippines and Mexico take EM rates to all-time lows

By Gustavo Medeiros

Policy rate cuts by the central banks of Hungary, Philippines and Mexico took EM policy rates to a new all-time low. Colombian President Ivan Duque said rating agencies should consider the current coronavirus emergency before adjusting sovereign ratings. Trade surplus improved in Argentina, but its fiscal deficit deteriorated. Chinese industrial profits rose to positive levels for the first time in 2020. Brazil approved a sanitation reform to attract private sector investments. South African fiscal deficit widened significantly in the 2020 budget, as the Finance Minister proposed a zero-based budget framework to balance the debt in the future. In Ecuador, the PSC leader Jaime Nebot said he will not run for president in 2021. Angola revised the budget to reflect a USD 33 per barrel oil break-even after China agreed on a short-term debt moratorium. Malawi elected a new president after the re-run of the fraudulent 2019 election.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.4	–	-0.14%
MSCI EM Small Cap	10.0	–	-0.18%
MSCI Frontier	12.4	–	0.73%
MSCI Asia	13.1	–	0.41%
Shanghai Composite	10.7	–	1.78%
Hong Kong Hang Seng	7.7	–	-0.16%
MSCI EMEA	10.0	–	-1.38%
MSCI Latam	11.3	–	-4.28%
GBI-EM-GD	4.54%	–	-0.52%
ELMI+	2.00%	–	-0.21%
EM FX spot	–	–	-0.66%
EMBI GD	5.52%	481 bps	0.10%
EMBI GD IG	3.10%	234 bps	0.43%
EMBI GD HY	8.95%	829 bps	-0.29%
CEMBI BD	4.96%	442 bps	0.18%
CEMBI BD IG	3.37%	283 bps	0.28%
CEMBI BD Non-IG	7.29%	676 bps	0.04%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	18.7	–	-2.86%
1-3yr UST	0.17%	–	0.05%
3-5yr UST	0.30%	–	0.15%
7-10yr UST	0.64%	–	0.42%
10yr+ UST	1.37%	–	1.84%
10yr+ Germany	-0.48%	–	0.92%
10yr+ Japan	0.00%	–	-0.06%
US HY	6.77%	615 bps	-1.15%
European HY	6.51%	608 bps	-0.38%
Barclays Ag	0.95%	31 bps	0.16%
VIX Index*	34.73	–	-0.39%
DXY Index*	97.43	–	-0.19%
EURUSD	1.1219	–	0.37%
USDJPY	107.22	–	-0.33%
CRY Index*	134.41	–	-3.56%
Brent	41.0	–	-2.77%
Gold spot	1771	–	1.57%

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

Emerging Markets

- **Policy rates:** After the latest rate cuts by Hungary, Philippines and Mexico, Emerging Markets (EM) policy rates measured by the JP Morgan Global Bond Index – Emerging Markets Global Diversified (GBI EM GD) hit an all-time low at 2.65% from 2.89% at the end of May. Lower policy rates are largely anchored by a steep decline in CPI inflation at 2.21% in May, therefore not posing a threat to currency stability, in our view. Investors holding positions in EM bonds still receive an attractive carry as GBI EM yields are down only 1bp to 4.54% since the end of May. The yield on the GBI EM GD index is, therefore, 1.89% wider than policy rates, close to the highest levels since 2013. It's the first major crisis in 30 years in which EM central banks cut policy rates, supporting local liquidity and asset prices. Steep curves are also supportive to EM banks, potentially leading to a stronger rebound from the recession.
- **Hungary:** The National Bank of Hungary cut the main policy rate by 15bps to 0.75%, surprising consensus expectations for no cut. It was the first policy rate cut since 2016, at the first meeting after the unexpected resignation of Deputy Governor Marton Nagy, an advocator of tighter monetary policy to anchor the HUF. The surprise decision drove 10yr swap rates to outperform, tightening 25bps to 1.27% and the HUF to underperform, selling-off by 2.3% against the USD.

Continued overleaf

Emerging Markets

- Philippines: The central bank cut policy rate by 50bps to 2.25% against a consensus expectations for no cut. The fiscal deficit increased to PHP 562bn from January to May, tracking a 2.9% of GDP deficit from close to zero in the same period of 2019. Philippines has ample room to ease monetary policy, in our view, after starting 2020 with a debt/GDP ratio below 40%.

- Mexico: The Central Bank cut policy rates by 50bps to 5.00%, in line with expectations. CPI inflation surprised on the upside at 3.2% on a yoy basis in the first 15 days of June, from 2.9% in the same period of May. Economic data surprised on the downside as retail sales declined 22.4% in April after falling 1.3% in March. The IGAE survey for economic activity was down 19.9% on a yoy basis in April, from -2.3% yoy in March. The external account deteriorated as the trade balance posted a USD 3.5bn deficit in May, contrasting with consensus expectations for a USD 1.3bn surplus, as exports contracted by 56.7% on a yoy basis and imports were lower by 47% yoy.

- Colombia: President Ivan Duque called on rating agencies to measure their rating revisions against the emergency faced due to the coronavirus. Mr. Duque highlighted that rating downgrades could impact credit costs precisely at the time governments need to navigate a healthcare shock. In other news, industrial confidence rose to -21.3 in May from -35.8 in April, while retail confidence increased to -9.2 from -25.5 over the same period.

- Argentina: The trade balance increased to a USD 1.9bn surplus in May from a USD 1.4bn surplus in April. Imports declined to USD 3.2bn in May, half of the level in the same period of 2018 as exports rose to USD 5.1bn in May. The yoy rate of real GDP growth contracted by 5.4% in Q1 2020 after declining 1.1% yoy in Q4 2019. Poor economic activity drove the unemployment rate higher by 1.5% to 10.4% over the same period. The fiscal deficit widened to a record ARS 251bn (USD 3.7bn) in May after an ARS 229bn (USD 3.4bn) deficit in April, taking the cumulative fiscal deficit to USD 11.8bn from USD 7.4bn in the same period last year. In other news, the government announced it will return to a hard lockdown in the Buenos Aires metropolitan area until 17 July as the number of coronavirus cases increase.

- China: Industrial profits rose by 6.0% on a yoy basis in May from -4.3% yoy in April. The US Senate approved a sanctions bill penalising banks doing business with Chinese officials involved in implementing the Hong Kong national security law. The White House managed to dilute the bill before its approval as the sanctions will apply "only if a bank knowingly does business with an official who has already been sanctioned". In other news, the PBOC made the creation of a "credit system covering all of society" a core development goal, to ensure liquidity reaches the real economy. The authority will focus on using technology to share enterprise credit information in a unified system.

- Brazil: Congress approved the first structural reform post the coronavirus shock, a new legal framework for the sanitation sector allowing for an expansion of private investments in the area. The reform targets BRL 500-700bn of investment until 2035 in order to bring sewage and drinking water to at least 90% and 99% of the population respectively. Today, only half of the population has access to sewage and 15% of the population has no access to treated water. Mixed data on external accounts as the current account surplus declined to USD 1.3bn in May after a USD 3.8bn surplus in April, bringing the 12-month current account deficit to 2.5% of GDP, while foreign direct investment rose to USD 2.6bn in May, adding to 4.0% GDP over the last year. In other news, the Central Bank reduced the 2023 inflation target to 3.25%, 25bps lower than the target for 2022.

- South Africa: The government announced a supplementary budget focused on spending reallocations until March 2021. The consolidated budget deficit is expected to rise to 15.7% of GDP, from 6.3% in the prior fiscal year as real GDP growth contracts by 7.2%. The ratio of debt/GDP is expected to reach 82% in March 2021 and to stabilise at 87% only in 2024 as the government returns to a primary surplus. The target is anchored in a zero-based budget framework which forecasts an outright cut in expenditures in 2021. In other news, CPI inflation plunged to 3.0% on a yoy basis in April from 4.1% yoy in March.

- Ecuador: The leader of the Social Christian Party (PSC) Jaime Nebot said he would not run for president in the 2021 elections. This is good news, as his voter base is likely to migrate to market-friendly candidate Guillermo Lasso, who lost to current President Lenin Moreno by a small margin in previous elections. Former President Rafael Correa signalled he will run as a vice-president given he has already served the two-term presidential limit allowed by the constitution. However, to qualify for any public post Mr. Correa will have to avoid a final conviction from the several cases on trial against him.

- Angola: The government approved a revised 2020 budget using a reference oil price of USD 33 per barrel (-15% from previous budget) and oil production of 1,360 mbod (thousands of barrels per day). Both revenues and expenditures were reduced to AOA 13.5tn (USD 23.4bn) from AOA 15.8tn (USD 27.3bn). Lower costs were supported by a three-year moratorium on interest and principal repayment from USD 21.7bn of debt owed to China. In other news, net FX reserves declined to USD 10.2bn in May from USD 10.9bn in April.

- Malawi: Lazarus Chakwera was inaugurated as Malawi's new president after defeating the incumbent President Peter Mutharika with 58% of the votes, vowing to increase wages, create 1m jobs and cut fertiliser costs. Last year the Supreme Court ruled for a rerun of the fraudulent 2019 elections.

Continued overleaf

Ashmore

Emerging Markets

Snippets:

- **Czech Republic:** The Czech National Bank kept policy rate unchanged at 0.25% as expected.
- **Chile:** The Senate Budget Commission approved a bill allowing the Banco Central de Chile (BCCh) to buy government debt.
- **Egypt:** The Central Bank kept the deposit and lending policy rates unchanged at 9.25% and 10.25% respectively. The IMF approved a USD 5.2bn stand-by arrangement to support social and health spending, avoid excessive public debt, anchor macroeconomic policies and implement reforms.
- **Kenya:** The central bank kept the policy rate unchanged at 7.00%. Exports of tea and horticulture increased close to normal levels in May and remittances from overseas Kenyan workers rose to USD 258m in May from USD 208m in April.
- **Malaysia:** Core CPI inflation inched down to 1.1% on a yoy basis in May from 1.3% yoy in April as the CPI was unchanged at -2.9% deflation yoy.
- **Mongolia:** The Mongolian People's Party won 62 out of 76 seats in parliament. The victory signals with policy continuity and is conducive to another IMF programme.
- **Morocco:** CPI inflation declined -0.2% on a yoy basis in May from +0.9% yoy in April.
- **Nigeria:** The manufacturing PMI inched lower to 41.1 in May from 42.4 in April but the non-manufacturing PMI index rose to 35.7 in May from 25.3 in April. In other news, the World Bank board approved a USD 750m loan to the Power Sector Recovery Program.
- **Pakistan:** The central bank cut policy rates by 100bps to 7.00% due to an improvement in the inflation outlook and downside risks for growth. The current account was balanced in May after a USD 0.5bn deficit in April as imports of oil and services declined strongly.
- **Paraguay:** The central bank cut policy rates by 50bps to 0.75%.
- **Rwanda:** The yoy rate of real GDP growth declined to 3.6% in Q1 2020 from 8.4% yoy in Q4 2019.
- **Singapore:** Industrial production declined by 7.4% on a yoy basis in May, surprising consensus expectations of a 7.7% yoy increase as pharmaceutical output surprised on the downside.
- **Taiwan:** Industrial production rose 1.5% on a yoy basis in May, underperforming consensus expectations for a 3.0% yoy rise. Weak non-tech output was partially offset by strong production of tech goods.
- **Thailand:** The trade surplus rose to USD 2.7bn in May from USD 2.5bn in April as exports contracted 22.5% on a yoy basis and imports declined by 34.3% yoy.
- **Turkey:** The Central Bank kept policy rates at 8.25% against expectations for a 25bps cut, justifying the decision on higher than expected core CPI inflation and a wider current account deficit.
- **Venezuela:** Colombian-born businessman Alex Saab was arrested in Cape Verde where the private jet he travelled stopped to refuel. Mr. Saab was traveling from Iran to Venezuela and is believed to be the main deal-maker allowing Venezuela to circumvent US sanctions.
- **Zambia:** President Edgar Lungu said budget revenues will be one-quarter lower than targeted and expenditures would exceed the target by one-fifth.

Global backdrop

- **Coronavirus:** Global stocks sold-off last Friday after Florida reported coronavirus cases increasing by 7.8% last Thursday, higher than the 4.1% increase on average in the previous seven days. In Texas, Governor Gregg Abbott rolled back reopening schedules for bars and restaurants as Houston reported its intensive care unit beds were close to full capacity. Other hotspots in the US and UK have, or are thinking of, pausing the reopening of businesses. In spite of the spike in cases, the number of daily deaths continues to decline. The decline in deaths may be attributed to (a) better treatments, (b) deaths lagging the rebound in cases from mid-June, and/or (c) younger population contracting the virus. Florida reported a median age of 37 years for new cases last week, similar to California where just under half cases were reported in those under 35 years. In Texas, the majority of cases hit people under 30 years old. Furthermore, the likelihood of a return to broad lockdowns remains low in our view, as mainstream media opinion articles continue to argue for targeted lockdown policies.[1]

[1] https://www.wsj.com/articles/coping-with-covid-19-11593041285
https://www.telegraph.co.uk/opinion/2020/06/26/justify-loss-liberties/

Continued overleaf

Global backdrop

- **Bankruptcy news also hurt market sentiment last week:** In the UK, mall owner Intu collapsed into administration as talks with creditors failed. The FT reported that UK retailers paid only 14% of the GBP 2.5bn due for rent for the three months to 29 September, according to Re-Leased, a property data company.[2] A fraud was unveiled in Germany after Wirecard acknowledged that USD 2bn of cash reported on its balance sheet was non-existent, bringing the company into insolvency. Over the weekend shale oil giant Chesapeake filed for Chapter 11. On a related matter, the Fed released a stress test on the banks concluding "the system can remain strong in the face of the harshest shocks".[3] In the same report, the Fed noted that the largest 34 banks in the system would suffer losses ranging from USD 560bn to USD700bn, taking capital ratios from 12% in Q4 2019 to between 9.5% and 7.7% under hypothetical downside scenarios. The risk of large losses led the Fed to request large banks to preserve capital by suspending share buybacks and capping dividend payments.

- **Global GDP:** The IMF downgraded its 2020 global real GDP growth forecast to -4.9%, from -3.0% in its April forecast, and projected a more gradual recovery than previously anticipated. The downward revision contrasts with better than expected data in Q2 2020, as the Citibank global surprise index rose close to pre-coronavirus levels. High frequency data suggests a 'V-shaped' economic recovery taking place as countries allow businesses to reopen. Mastercard reported global transaction volumes declined by only 1% on a yoy basis in the week ending in 21 June with US volumes increasing 5% yoy and the rest of the world declining by only 5% yoy. Total card spending data from Bank of America shows US card spending converging to pre-coronavirus levels in the week ending 20 June.

- **US:** Durable goods orders rose 15.8% in May, boosted by a 20.4% rise in defence orders. Initial jobless claims in the week ending on 20 June was stable at 1.5m, while continuing claims in the week ending on 13 June declined by 1.0m to 19.5m. The Markit manufacturing PMI rose to 49.6 in June from 39.8 in May, broadly in line with consensus expectations. Consumer spending rebounded 8.2% in May (after declining 12.6% in April and 6.6% in March) despite a 4.2% drop in personal income as government transfers dropped 17% and salaries recovered 2.7%.

- **EU:** The Germany IFO business expectations survey rose to 91.4 in June from 80.5 in May, close to the pre-coronavirus shock level. The current conditions survey inched up to 81.3 from 78.9, well below the high-90 levels prior to the shock. The Markit Eurozone manufacturing PMI improved to 46.9 in June from 39.4 in May, surprising on the upside in Germany, France and the UK. In Italy, consumer confidence rose to 100.6 in June from 94.3 in May, surprising on the upside. Indeed, businesses seems to be experiencing fewer cash shortages as bank lending to Euro area corporations rose by EUR 51bn in net terms in May after rising EUR 73bn in April and EUR 121bn in March.

- **Index rebalancing:** The weight of Chinese local bonds in the GBI EM GD index will increase from 3% to 4% at the last business day of June. The weights of Brazil and Indonesia will decline by 72bps and 35bps to 9.07% and 9.67% respectively. In EM equities, MSCI launched a consultation to reclassify Turkey to Frontier status and confirmed Kuwait will be upgraded from Frontier to EM in November 2020. In other MSCI Frontier news, Argentina survived a downgrade from the MSCI Frontier Index to stand-alone (not included in any benchmark) as Nigeria and Lebanon were placed under watch for downgrade. We note that most consultations take several quarters before a final decision, but could be accelerated by market access deterioration.

[2] https://www.ft.com/content/325403ad-f1c0-46fd-a861-a46db7c32580

[3] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm

Continued overleaf

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	7.72%	18.53%	-9.40%	-2.08%	2.09%	3.18%
MSCI EM Small Cap	9.05%	27.23%	-12.66%	-7.96%	-2.78%	-1.49%
MSCI Frontier	2.23%	15.47%	-15.28%	-10.30%	-1.41%	0.03%
MSCI Asia	8.82%	17.22%	-4.29%	3.24%	3.71%	4.64%
Shanghai Composite	5.13%	9.27%	-1.48%	1.29%	0.42%	-6.66%
Hong Kong Hang Seng	4.35%	4.65%	-10.09%	-5.35%	1.86%	-1.86%
MSCI EMEA	4.06%	19.87%	-20.75%	-18.39%	-2.74%	-1.94%
MSCI Latam	4.67%	18.53%	-35.50%	-32.63%	-6.91%	-3.23%
GBI EM GD	0.57%	9.93%	-6.79%	-2.31%	1.01%	2.33%
ELMI+	0.89%	3.52%	-5.26%	-3.57%	0.11%	0.78%
EM FX Spot	0.25%	4.07%	-10.83%	-11.31%	-6.09%	-5.09%
EMBI GD	3.49%	12.23%	-2.79%	0.77%	3.39%	5.25%
EMBI GD IG	1.86%	9.11%	3.18%	8.73%	6.37%	6.17%
EMBI GD HY	5.56%	16.42%	-9.70%	-8.01%	-0.05%	4.13%
CEMBI BD	2.81%	11.21%	-0.10%	4.08%	4.48%	5.10%
CEMBI BD IG	2.05%	8.46%	1.89%	5.86%	5.05%	4.92%
CEMBI BD Non-IG	3.89%	15.29%	-2.88%	1.55%	3.72%	5.38%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	-1.03%	16.97%	-5.96%	5.33%	9.38%	9.64%
1-3yr UST	0.01%	0.22%	2.98%	4.22%	2.67%	1.88%
3-5yr UST	0.07%	0.57%	5.98%	7.40%	4.03%	3.12%
7-10yr UST	0.13%	0.97%	11.21%	13.33%	6.41%	5.27%
10yr+ UST	0.84%	0.96%	22.07%	27.19%	11.37%	9.86%
10yr+ Germany	0.81%	1.09%	6.23%	4.87%	6.64%	6.70%
10yr+ Japan	-0.73%	-1.05%	-1.88%	-2.42%	1.72%	3.53%
US HY	1.37%	10.60%	-3.43%	0.52%	3.51%	4.78%
European HY	2.44%	12.29%	-5.85%	-2.56%	0.89%	2.78%
Barclays Ag	0.88%	3.31%	2.97%	4.46%	3.67%	3.68%
VIX Index*	26.25%	-35.13%	152.03%	130.31%	203.58%	84.24%
DXY Index*	-0.93%	-1.63%	1.08%	1.27%	0.01%	2.05%
CRY Index*	1.64%	10.37%	-27.65%	-25.75%	-21.80%	-39.88%
EURUSD	1.06%	2.26%	-0.09%	-1.44%	0.28%	0.47%
USDJPY	0.57%	0.52%	1.27%	0.42%	4.17%	15.51%
Brent	16.11%	80.39%	-37.85%	-38.31%	-10.50%	-35.16%
Gold spot	2.37%	10.85%	16.32%	25.35%	42.39%	50.68%

*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.

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

Other locations

Lima

Shanghai

Bloomberg page
Ashmore <GO>

Fund prices
www.ashmoregroup.com
Bloomberg
FT.com
Reuters
S&P
Lipper