Twists and turns in US-China tensions

By Gustavo Medeiros

In the latest in US-China tensions, a US court blocked the proposed closure of WeChat, while Bytedance kept a majority shareholding position and control over its algorithm in TikTok. Economic data surprised to the upside in China. Argentina tightened capital controls. Brazil's administrative reforms could save BRL 816bn over 10 years. Indonesia and South Africa left policy rates unchanged. Angola received an additional USD 1bn disbursement from the International Monetary Fund (IMF).

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.6	–	1.59%
MSCI EM Small Cap	12.2	–	2.85%
MSCI Frontier	12.6	–	1.10%
MSCI Asia	14.5	–	1.77%
Shanghai Composite	12.6	–	2.41%
Hong Kong Hang Seng	8.3	–	0.65%
MSCI EMEA	10.4	–	0.32%
MSCI Latam	12.0	–	-0.01%
GBI-EM-GD	4.44%	–	0.76%
ELMI+	1.78%	–	0.76%
EM FX spot	–	–	0.57%
EMBI GD	4.91%	414 bps	-0.48%
EMBI GD IG	2.87%	205 bps	-0.16%
EMBI GD HY	7.68%	696 bps	-0.88%
CEMBI BD	4.45%	390 bps	-0.11%
CEMBI BD IG	2.98%	243 bps	-0.06%
CEMBI BD Non-IG	6.57%	602 bps	-0.19%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.0	–	-0.60%
1-3yr UST	0.14%	–	-0.01%
3-5yr UST	0.28%	–	-0.07%
7-10yr UST	0.70%	–	-0.16%
10yr+ UST	1.46%	–	-0.56%
10yr+ Germany	-0.49%	–	0.19%
10yr+ Japan	0.00%	–	0.09%
US HY	5.52%	490 bps	0.10%
European HY	4.43%	512 bps	0.12%
Barclays Ag	0.90%	20 bps	0.54%
VIX Index*	25.83	–	-1.04%
DXY Index*	92.78	–	-0.27%
EURUSD	1.1869	–	0.02%
USDJPY	104.31	–	1.28%
CRY Index*	151.54	–	5.04%
Brent	43.1	–	8.71%
Gold spot	1953	–	-0.16%

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

Emerging Markets

- **US-China tensions:** Both TikTok and WeChat were allowed to operate in the US despite intense pressure from the Trump Administration to shut down the companies or shift ownership to a US company. Bytedance, the parent company of TikTok, kept a majority shareholding in a deal with Oracle, while also maintaining control over the social media algorithm, which is the key piece of intellectual property supporting the company. In exchange for a major capital injection from Oracle, Bytedance promised to spend some money on education and to hire some Americans in a new office in Texas. A US court blocked WeChat's closure over freedom of speech concerns. In China, the government issued guidelines on how it intends to manage a newly developed list of 'unreliable entities', that is, firms, organizations, or individuals, who pose a threat or potential threat to China's interests. This list was established in direct response to the Trump Administration's witch hunt against China.[1] Penalties could include restrictions on trade, investment, and entry permits. The Trump Administration's witch hunt against China serves a narrow set of political interests, but hurts the economic interests of the vast majority of Americans and Chinese people.

- **China:** Economic data surprised on the upside in August. The yoy rate of industrial production (IP) rose 5.6% from 4.8% in July. Retail sales rose at a yoy rate of 7.6% in August from 6.9% in July, while fixed asset investment expanded by 0.5% on a yoy basis from -1.1% yoy in the previous month. Cement and power output increased at yoy rates of 6.8% and 6.6%, respectively. In other news, in a speech President Xi Jinping sharpened his government's focus on bringing China to the global frontier in science and technology. Looking forward, this coming Thursday FTSE Russell, an index provider, is expected to announce the results of its annual market classification review, which could include news that China is to be included in its World Government Bond Index (WGBI), its flagship index. If this happens, inflows to Chinese fixed income could reach USD 150bn starting in 2021.

[1] See: *'The China Witch Hunt'*, The Emerging View, 10 June 2020.

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Emerging Markets

- **Argentina:** The Ministry of Finance announced a 4.5% primary fiscal deficit target for 2021 with approximately 40% of the budget funded by local currency bond issuance and 60% by central bank transfers to the Treasury. The high level of debt monetisation is already impacting the value of Argentina's currency. The central bank lost USD 1bn of FX reserves in the period from 31 July to 18 September. Rather than fixing the underlying causes of reserve loss, the government last week imposed a 35% tax on USD purchases, which comes on top of a pre-existing 30% tax on foreign exchange. In an even more damaging policy initiative, the government announced limitations on access to foreign exchange for banks and companies. They will only be allowed to buy 40% of their requirements for paying upcoming principal. The balance will have to be obtained through renegotiation with creditors. Clearly, this amounts to government-imposed private sector defaults, which is very negative to investor confidence as it may force even solvent companies to restructure their debt. Lastly, foreign holders of local currency bonds were barred from repatriating capital on the blue chip parallel foreign exchange market. One of the consequences of relying on money printing to finance the fiscal deficit is that inflation remains very high. Consumer prices index (CPI) inflation was 2.7% in August alone, up from 1.9% in the month of July. The mom rate of core CPI inflation was 3.0% in August.

- **Brazil:** The Central Bank of Brazil kept its monetary policy rate ('Selic') stable at 2.0% in line with consensus expectations. The Brazilian Institute of Macroeconomic Research and Policy (Ipea) said that the administrative reforms proposed by the government could save up to BRL 816bn (c. USD 150bn) over 10 years mostly due to a 2-year freeze of public servant wages, which has already been approved by Congress, as well as other changes to the working conditions for civil servants which are under negotiation. Finance Minister Paulo Guedes advocated the abandonment of rules indexing fiscal expenditure to inflation to avoid breaking the fiscal spending cap and to add greater flexibility to allocate resources to important areas, such as education.

- **Indonesia:** Bank Indonesia (BI) kept the 7-day reverse repo policy rate unchanged at 4.0% in line with consensus expectations. BI purchased IDR 99tn of bonds directly from the Ministry of Finance. This is equivalent to 24% of the total purchasing programme announced. BI stressed that President Joko 'Jokowi' Widodo will preserve central bank independence and affirmed its view that IDR is fundamentally undervalued. The trade surplus narrowed to USD 2.3bn in August from USD 3.2bn in July.

- **South Africa:** The South African Reserve Bank (SARB) kept the policy rate unchanged at 3.5% and thus surprised the consensus of forecasters, who had expected SARB to cut the interest rate by 25bps. Two out of the five members in the monetary policy committee voted in favour of a cut. The government announced that South Africa's borders will reopen after a decline in coronavirus cases. Lower levels of hospitalisation have also taken away some of the pressure on the healthcare system. Still, a rebound in tourism is likely to be slow as restrictions on travel from countries with high number of cases remain in place.

- **Angola:** The IMF approved the third review of the existing Extended Fund Facility (EFF) programme with Angola, increasing the size of the programme by USD 765m and authorising an immediate disbursement of USD 1bn. The total programme is now USD 4.5bn of which USD 2bn will be available for disbursement through 2021. Angola also announced the result of a re-profiling of its debts with China and commercial lenders, thus reducing debt repayments by USD 6bn in the period until 2023.

Snippets:

- **Ghana:** The yoy rate of real GDP growth was -3.2% on a yoy basis in Q2 2020 following positive growth of 4.9% in Q1 2020. The rating agency S&P downgraded Ghana's sovereign credit rating to B- from B with a stable outlook as the debt to GDP ratio is expected to reach 70% following an expected 13.5% of GDP fiscal deficit in 2020.
- **India:** The yoy rate of CPI inflation declined to 6.7% in August from 6.9% yoy in July. Wholesale prices rose by 0.2% on a yoy basis from -0.6% yoy in July. The trade deficit widened to USD 6.8bn in August from USD 4.8bn in July.
- **Peru:** The Peruvian Congress voted against the removal of President Vizcarra with 78 lawmakers voting against the impeachment and 32 for it. Minister of Finance María Antonieta Alva Luperdi also survived impeachment proceedings in Congress.
- **Philippines:** President Rodrigo Duterte approved a second stimulus bill of PHP 140bn (c. 0.8% of GDP). As a result, the fiscal deficit is now expected to reach 9.6% of GDP this year.
- **Poland:** The central bank kept policy rate unchanged at 0.1%, in line with consensus expectations.
- **Russia:** The Central Bank of Russia kept the policy rate unchanged at 4.25%.
- **South Korea:** Exports rose at a yoy rate of 3.6% during the first 20 days of September, which was a significant improvement from the rate of -7.5% recorded over the same period in August, although this was partly due to working day adjustments.

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Emerging Markets

- Taiwan: The central bank kept its policy rate unchanged at 1.125% in line with consensus expectations and upgraded its 2020 real GDP growth forecast from 1.5% to 1.6%.
- Zambia: The largest copper miner in Zambia, First Quantum, announced plans to expand its processing operations at its largest mine, Kansanshi. The expansion is expected to result in USD 650m of new investment.

Global backdrop

- Global Markets: Last week was yet another week with soft performances for equities in developed markets (DM) due mainly to soft technology stocks. Small caps stocks and commodities outperformed with the Russell 2000 Index rising 2.6% last week (-1.6% mtd). In contrast, the Nasdaq was down -0.6% for the week and -8.3% mtd. The Thompson Reuters CRY commodity prices index rose on the back of higher copper and oil prices (2.15% and 9.51% on the week, respectively).
- Coronavirus: The total count of Covid-19 cases exceeded 31 million worldwide as a second wave now looms large in Europe. In Spain's capital, Madrid, almost 1m people protested against mobility restrictions, which have been imposed in zones with more than 1k infections per 100k inhabitants. Hopes for a vaccine to be approved imminently faded. Forecasters from the Good Judgement project downgraded the odds of an FDA-approved vaccine that can inoculate 25m people and be distributed in the US before Q1 2021 to 49% from 69% the previous week.[2] AstraZeneca, a leading vaccine producer, said that its Covid-19 vaccine trial was still on hold in the US.
- US: With less than two months before the 3 November presidential election, President Donald Trump pledged to fill the Supreme Court vacancy created by the death of Ruth Bader Ginsburg. The political dispute over Ginsburg's replacement has the potential to escalate. The Republican Party will secure a 6-3 majority in the Supreme Court if the Senate approves a new conservative judge before the election, potentially affecting legislative interpretation in the future. Senate Leader Mitch McConnell says a vote will go ahead, but some Republicans have indicated misgivings. Democrats are upset and have already been threatening to increase the number of judges on the court. The immediate concern is with respect to the November election. Trump has consistently argued that the election will be the 'biggest fraud in history', which means that he could dispute the legitimacy of the result in which case the Supreme Court gets involved.[3] This risk is particularly great if the election outcome is very close. There are also longer-term societal concerns involved, which deeply divide Republicans and Democrats, including abortion rights, gun laws, and other issues. The Supreme Court issue will also make it harder for Congress to reach a deal on further fiscal stimulus with negative consequences for the economy. As such, everything points to a volatile period until and potentially after November's election. A survey of asset managers by Bank of America Merrill Lynch found that 80% of investors expect the market to weaken in a scenario where the Senate gets a Democrat majority.

In economic news, more evidence points to marginal weakness in the US economy. IP rose 0.4% in the month of August with manufacturing output 1.0% higher, but both surprised to the downside. Retail sales were 0.6% higher in August, which was also below consensus expectations. The Philadelphia Fed manufacturing survey slowed to 15 in September from 17.2 in August. The University of Michigan consumer sentiment survey rose to 78.9 in September from 74.1 in August, but remains close to the most depressed level since December 2013. Real estate data also disappointed consensus expectations as the housing starts survey declined 5.1% and building permits were down 0.9% in August. The Fed kept its policy rate and quantitative easing targets on hold in September, but signalled no change in the policy rate until 2024, and then only provided that inflation is above the 2% target and the economy is back to full employment. The Fed also repeated its call for larger fiscal stimulus to boost the economy.

- EU: IP excluding construction rose 4.1% in July compared to 9.5% in June, thereby leaving the indicator 7.2% below the pre-coronavirus shock levels.
- UK: The Bank of England did not hint at an imminent increase in quantitative easing, but mentioned it would "begin structured engagement" with regulators negative interest rates would work in practice.

2 See: https://goodjudgment.io/covid-recovery/#1363

3 We highlighted this risk on 3 August 2020. See: *'New highs for Chinese economic data and US anti-China hysteria'*, Weekly investor research, 3 August 2020.

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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	0.74%	12.28%	1.42%	11.36%	2.61%	8.88%
MSCI EM Small Cap	2.44%	16.59%	1.82%	10.41%	-0.41%	4.95%
MSCI Frontier	1.15%	8.85%	-8.27%	-0.84%	-1.42%	3.46%
MSCI Asia	0.52%	13.04%	7.78%	18.32%	4.89%	10.40%
Shanghai Composite	-1.67%	13.06%	11.93%	14.43%	2.15%	3.81%
Hong Kong Hang Seng	-1.63%	2.27%	-8.84%	-2.80%	-0.58%	3.54%
MSCI EMEA	0.16%	4.79%	-17.50%	-12.30%	-3.82%	1.34%
MSCI Latam	1.80%	5.95%	-31.27%	-25.26%	-10.22%	2.63%
GBI EM GD	0.87%	3.58%	-3.56%	0.46%	0.74%	4.78%
ELMI+	0.73%	3.21%	-2.31%	0.68%	0.09%	2.45%
EM FX Spot	0.53%	2.45%	-8.76%	-6.89%	-6.11%	-3.08%
EMBI GD	-0.02%	4.22%	1.34%	2.99%	3.97%	6.02%
EMBI GD IG	0.16%	3.37%	6.60%	7.99%	6.81%	6.91%
EMBI GD HY	-0.25%	5.29%	-4.81%	-2.89%	0.74%	4.92%
CEMBI BD	0.22%	3.47%	3.30%	5.82%	4.97%	6.16%
CEMBI BD IG	0.24%	3.04%	5.03%	6.32%	5.63%	5.65%
CEMBI BD Non-IG	0.19%	4.06%	0.87%	5.03%	4.07%	7.04%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	-5.08%	7.48%	4.16%	12.52%	12.00%	13.38%
1-3yr UST	-0.01%	0.07%	3.08%	3.88%	2.61%	1.84%
3-5yr UST	-0.04%	0.12%	6.16%	6.77%	3.99%	2.88%
7-10yr UST	0.10%	0.13%	11.28%	10.97%	6.47%	4.59%
10yr+ UST	0.25%	-0.02%	21.19%	18.62%	11.48%	8.41%
10yr+ Germany	1.76%	0.58%	6.50%	0.78%	7.60%	5.54%
10yr+ Japan	0.59%	0.34%	-1.78%	-3.14%	1.70%	3.07%
US HY	-0.22%	5.45%	1.44%	3.80%	4.63%	6.38%
European HY	0.75%	3.91%	-2.25%	-0.70%	1.70%	3.74%
Barclays Ag	0.31%	3.35%	6.43%	7.05%	4.06%	3.90%
VIX Index*	-2.20%	-15.12%	87.45%	68.60%	167.11%	28.25%
DXY Index*	0.69%	-4.73%	-3.74%	-5.82%	0.57%	-3.24%
CRY Index*	-1.09%	9.84%	-18.43%	-14.55%	-17.37%	-23.02%
EURUSD	-0.63%	5.57%	5.70%	8.03%	-0.54%	5.85%
USDJPY	1.45%	3.37%	4.09%	3.06%	7.78%	15.33%
Brent	-4.90%	4.64%	-34.76%	-33.01%	-23.69%	-11.98%
Gold spot	-0.95%	9.50%	28.26%	28.24%	51.02%	72.35%

*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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