Ashmore

Global noise and relative EM quiet

By Gustavo Medeiros

Geopolitical risks increased after the attack on Saudi Arabian oil facilities, but the odds of a major escalation in tensions with Iran seem low. The US and China continue to move slowly towards a truce over trade. The US Fed cut the policy rate by 25bps. Concerns over the functioning of liquidity markets in the US are likely to be short-lived. In Emerging Markets (EM), events were more muted. The central bank in Brazil cut the policy rate by 50bps to 5.50%, Indonesia also cut rates, Venezuela's opposition split, prospects for Saudi financial assistance to Lebanon improved, India slashed the corporation tax rate, Ghana's inflation rate declined and Ethiopia and Egypt remain at loggerheads over the pace at which the reservoir for the Grand Ethiopia Renaissance Dam will be filled.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.6	–	-0.45%
MSCI EM Small Cap	10.9	–	0.11%
MSCI Frontier	9.0	–	-1.37%
MSCI Asia	12.4	–	-0.80%
Shanghai Composite	10.6	–	-0.78%
Hong Kong Hang Seng	7.7	–	-2.87%
MSCI EMEA	9.1	–	-1.00%
MSCI Latam	12.1	–	-0.77%
GBI-EM-GD	5.24%	–	-0.80%
ELMI+	5.16%	–	-0.43%
EM FX spot	–	–	-1.16%
EMBI GD	5.19%	342 bps	0.75%
EMBI GD IG	3.48%	169 bps	0.67%
EMBI GD HY	7.44%	569 bps	0.84%
CEMBI BD	5.13%	342 bps	0.33%
CEMBI BD IG	3.67%	196 bps	0.28%
CEMBI BD Non-IG	7.22%	551 bps	0.39%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	16.4	–	-0.49%
1-3yr UST	1.64%	–	0.20%
3-5yr UST	1.56%	–	0.46%
7-10yr UST	1.68%	–	1.08%
10yr+ UST	2.13%	–	3.08%
10yr+ Germany	-0.58%	–	2.10%
10yr+ Japan	-0.21%	–	0.37%
US HY	5.57%	359 bps	0.23%
European HY	3.66%	390 bps	-0.13%
Barclays Ag	1.35%	-33 bps	0.50%
VIX Index*	15.47	–	0.80%
DXY Index*	98.69	–	0.07%
EURUSD	1.0987	–	-0.13%
USDJPY	107.44	–	0.63%
CRY Index*	178.15	–	-5.02%
Brent	64.0	–	-7.23%
Gold spot	1524	–	1.72%

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

Emerging Markets

- **Brazil:** The Brazilian central bank cut interest rates by 50bps to 5.5%, in line with expectations. Further cuts are likely as core inflation is anchored around 2.5%, versus a 4% target. The Brazilian economy has been going through a painful deleveraging process since 2016. We believe the deleverage phase is close to an end and that upside surprises on growth are likely over the next few years due to low rates and cleaner balance sheets. Credit is already recovering as the unemployment rate slowly declines. Oil field concessions are schedule for December and an ambitious privatisation programme will inject further momentum into the economy in 2020.

- **Venezuela:** A group of small opposition parties have entered into an agreement with Venezuelan President Nicolas Maduro to extend political dialogue. US-backed opposition leader Juan Guaidó did not participate in the agreement; a sign that the Venezuelan political opposition is now seriously divided. The agreement includes the creation of an oil-for-food programme, rejects sanctions imposed by the US, re-introduces government representatives into the National Assembly and backs the adoption of a system of proportional representation for the 2020 legislative election. It is unclear if the agreement will be honoured as the Maduro Administration has frequently reneged on similar agreements in the past. Segments of the political opposition in Venezuela are hoping that the initiative may help to re-open the National Assembly, which is currently held in contempt by the Supreme Court, which is under Maduro's control.

- **Lebanon:** Saudi Arabian Foreign Minister Mohammed Al-Jaadan said discussions with Lebanese authorities for financial support are ongoing. Saudi support would boost confidence and relieve pressure on the currency. However, financing should be accompanied by further macroeconomic reforms in order to spur economic growth and bring Lebanon's stretched fiscal accounts onto a more sustainable footing.

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Emerging Markets

- Indonesia: Bank Indonesia cut its policy rate by 25bps to 5.25% and simultaneously eased macro-prudential policies to boost credit growth. The bank categorised its policy stance as "accommodative" and consistent with low inflation and stable external balances. Inflation has remained within the 2.5% - 4.5% target range since late 2015.

- India: Finance Minister Nirmala Sitharaman implemented a significant cut in corporation tax, moving the effective tax rate from 35% to 25%. We think that the lower tax rate will boost competitiveness and unleash new private sector investments. The fiscal impact is estimated to be around USD 20bn, or 0.7% of GDP, which will push the 2020 fiscal deficit to 4.0% of GDP. Over the medium term, we expect the short-fall in tax revenues from the cut in the corporate rate to be offset by greater collections due to higher economic activity as well as spending cuts.

- Ghana: The yoy inflation rate declined to 7.8% in August from 9.4% in July. The drop in inflation is partly due to a rebasing of the inflation index basket of goods. Meanwhile, economic growth surprised on the downside as construction and utility output contracted and service sector activity slowed. On the other hand, the oil sector experienced a strong expansion. The Bank of Ghana left the policy rate unchanged.

- Ethiopia: Egypt and Ethiopia have fallen out over the pace at which the reservoir for the Grand Ethiopian Renaissance Dam should be filled. Ethiopian Minister of Water and Energy Sileshi Bekele proposed that the dam should be filled over a three year period, but this was rejected by Egypt, whose government is concerned about the impact on the flow of water downstream. Egypt has requested a seven year filling period. The USD 4bn dam is expected to generate more than 6,000 megawatts once completed, thus transforming Ethiopia into an energy powerhouse in the horn of Africa.

Snippets:

- Argentina: The Central Bank announced a small expansion of the monetary basis (2.5%) in September and October in order to provide some relief from the growth slowdown, following the recent primary election result which created uncertainty regarding the country's political outlook. The IMF approved the change.
- Nigeria: President Buhari constituted an eight-member economic advisory team to recommend economic policy measures. It remains to be seen if the new team will have enough political gravitas to implement its policies.
- South Africa: The South African Reserve bank kept the policy interest rate unchanged at 6.5% in a unanimous decision. The committee called for urgent implementation of fiscal measures and macroeconomic reforms in order to raise the potential GDP growth rate and attract investments.
- Turkey: The rate of unemployment increased from 12.8% in May to 13% in June.
- Ukraine: Ukraine's GDP expanded by 4.6% in yoy terms in Q2 2019, according to an official forecast. The Agriculture Ministry reported grain exports increased at a rate of 49% yoy as of mid-September.

Global backdrop

In the United States, the US Federal Reserve's monetary policy committee (FOMC) cut the US interest rate target range by 25bps to 1.75%-2.00%. The rate cut was widely expected. Three FOMC voting members disagreed with the decision. US President Donald Trump also weighed in, demanding "deeper cuts" via twitter just minutes after the decision was announced. In other news, a set of unusual factors conspired to cause a temporary drop in excess bank reserves, which in turn pushed short term repo rates above the Fed Fund ceiling. This raised concerns in some quarters that the drop in liquidity could contaminate broader asset prices. However, we think that the Fed is likely to be able to meet any temporary excess demand for liquidity with conventional policy instruments.

In the Middle East, tensions increased after an attack on Saudi Aramco's oil processing facility briefly knocked out a significant part of Saudi Arabia's oil production. Saudi Aramco pledged to restore the lost production capacity by the end of September. However, oil markets may be unstable for some time as the focus shifts to concerns about an escalation in the US-Iran conflict. For now, the risk of a major escalation looks low due to:

- Lack of public support in the US for direct intervention following failures in Afghanistan, Iraq and Syria. So far the main US response has been an ineffective increase in sanctions on Iran.
- Concerns that further spikes in oil prices could disrupt the US economy ahead of the 2020 election.
- Unwillingness to jeopardise the expected upcoming public offering of Saudi Aramco.
- Unwillingness on the part of Iran's leadership to enter a wider conflict due to the adverse economic consequences.

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Global backdrop

The conflict with Iran is a 'lose-lose situation' for the countries in the region. Geopolitical chokepoints, such as Yemen, Syria, Lebanon and the Persian Gulf are repeatedly disrupted. The Iranian population suffers as the economy weakens under the sanctions. Saudi Arabia spends billions on weapons with much progress in terms of regional security. The main winners in the conflict are those who sell weapons to fuel the conflict as well as oil producers outside of the region.

Regarding the **US-China trade war**, the odds of a truce in the trade dispute improved after US President Donald Trump postponed the next round of tariff increases from the 1st to the 15th of October. China pledged to increase the purchases of agricultural products. We believe that a truce as well as the ongoing Chinese stimulus will be a blessing to EM assets.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	3.92%	-2.26%	8.24%	1.40%	7.24%	2.16%
MSCI EM Small Cap	3.46%	-3.06%	3.52%	-3.94%	2.31%	-0.27%
MSCI Frontier	-3.08%	-2.21%	9.33%	3.20%	7.30%	-1.66%
MSCI Asia	3.68%	-2.53%	8.00%	-0.50%	7.39%	4.11%
Shanghai Composite	4.23%	2.03%	23.41%	12.87%	2.13%	7.46%
Hong Kong Hang Seng	3.31%	-3.40%	6.33%	-0.22%	6.13%	3.05%
MSCI EMEA	3.64%	-4.41%	8.38%	6.62%	5.57%	-1.05%
MSCI Latam	3.41%	-4.86%	7.35%	10.82%	7.99%	-1.73%
GBI EM GD	1.48%	-0.28%	8.42%	12.30%	3.60%	0.17%
ELMI+	1.64%	-1.60%	1.91%	3.61%	2.24%	-0.37%
EM FX Spot	0.97%	-3.30%	-1.64%	-1.73%	-3.23%	-6.62%
EMBI GD	0.06%	2.03%	13.57%	13.25%	5.16%	5.72%
EMBI GD IG	-0.96%	4.06%	15.49%	15.58%	5.55%	5.62%
EMBI GD HY	1.25%	-0.12%	11.62%	10.89%	4.75%	5.64%
CEMBI BD	0.55%	1.57%	10.55%	11.19%	5.19%	5.11%
CEMBI BD IG	-0.32%	2.50%	11.38%	12.25%	4.77%	4.80%
CEMBI BD Non-IG	1.79%	0.29%	9.37%	9.69%	5.94%	5.50%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	2.36%	2.19%	21.13%	4.18%	14.08%	10.51%
1-3yr UST	-0.31%	0.39%	2.87%	4.32%	1.48%	1.30%
3-5yr UST	-0.84%	0.65%	4.77%	7.48%	1.77%	2.25%
7-10yr UST	-1.79%	2.01%	9.08%	13.44%	2.37%	3.70%
10yr+ UST	-3.84%	6.42%	18.11%	23.52%	4.29%	6.71%
10yr+ Germany	-2.99%	4.76%	15.96%	20.68%	4.50%	7.69%
10yr+ Japan	-2.56%	0.75%	6.22%	8.60%	1.97%	5.01%
US HY	0.69%	1.66%	11.77%	6.90%	6.56%	5.17%
European HY	0.20%	1.58%	9.28%	4.48%	4.45%	4.29%
Barclays Ag	-1.01%	0.72%	6.33%	7.07%	1.87%	1.92%
VIX Index*	-18.49%	2.59%	-39.14%	32.45%	25.87%	3.62%
DXY Index*	-0.23%	2.66%	2.61%	4.74%	3.36%	16.57%
CRY Index*	4.57%	-1.60%	4.91%	-8.16%	-2.70%	-35.87%
EURUSD	0.05%	-3.39%	-4.19%	-6.48%	-2.13%	-14.48%
USDJPY	-1.08%	0.38%	2.09%	4.99%	-5.98%	1.35%
Brent	5.96%	-3.79%	19.01%	-18.74%	39.53%	-33.89%
Gold spot	0.25%	8.14%	18.85%	27.12%	13.96%	24.59%

*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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