

Argentina's new cabinet has pragmatists in key positions

By Gustavo Medeiros

Argentina's President-elect Alberto Fernandez made pragmatic choices for key government positions. Chile adjusted fiscal policy to smooth the impact of protests. Ecuador slashed public expenditure and a further tax adjustment was approved by a key Congressional committee. Brazil's economic growth accelerated as reforms continued to pass in Congress. Lebanese FX reserves declined by less than expected. India's central bank kept rates unchanged. Tax reform made progress in Colombia. South Africa announced the first decisive step towards reforming state-owned enterprises (SOEs) as GDP growth slowed. Gabon reshuffled Cabinet in yet another anti-corruption clampdown.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.2	–	0.88%
MSCI EM Small Cap	11.4	–	0.27%
MSCI Frontier	12.1	–	0.84%
MSCI Asia	12.9	–	0.62%
Shanghai Composite	10.6	–	1.39%
Hong Kong Hang Seng	7.7	–	1.03%
MSCI EMEA	9.4	–	0.21%
MSCI Latam	12.6	–	2.92%
GBI-EM-GD	5.24%	–	1.02%
ELMI+	2.96%	–	0.49%
EM FX spot	–	–	0.78%
EMBI GD	5.12%	324 bps	0.12%
EMBI GD IG	3.58%	168 bps	-0.06%
EMBI GD HY	7.27%	542 bps	0.35%
CEMBI BD	5.05%	326 bps	0.07%
CEMBI BD IG	3.70%	191 bps	0.01%
CEMBI BD Non-IG	6.96%	516 bps	0.14%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	17.4	–	0.21%
1-3yr UST	1.61%	–	-0.01%
3-5yr UST	1.65%	–	-0.15%
7-10yr UST	1.82%	–	-0.41%
10yr+ UST	2.26%	–	-1.36%
10yr+ Germany	-0.30%	–	-1.35%
10yr+ Japan	0.00%	–	-0.70%
US HY	5.48%	360 bps	0.35%
European HY	3.66%	393 bps	0.20%
Barclays Ag	1.46%	-36 bps	-0.07%
VIX Index*	13.62	–	1.00%
DXI Index*	97.63	–	-0.23%
EURUSD	1.1068	–	-0.10%
USDJPY	108.53	–	-0.41%
CRY Index*	181.19	–	4.54%
Brent	64.2	–	5.42%
Gold spot	1463	–	0.03%

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

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- Argentina:** President-elect Alberto Fernandez unveiled his cabinet. He appointed Martin Guzman as his Economy Minister in line with information leaked to the local press earlier in the week. Guzman is an academic from Columbia University business school, whose specialisation is debt restructurings. In a recent presentation in UNCTAD, Mr Guzman called for a quick deal with bondholders to be done by Q1 2020. The deal should avoid imposing a haircut on the debt but include a two-year grace period for interest and principal repayments. His core ideas have been referred to a few times by Fernandez himself. Argentina needs to rekindle growth in order to afford to service debt. Fernandez appointed Felipe Sola as Minister of Foreign Affairs and Daniel Scioli as Argentina's ambassador to Brazil. In addition to these key appointments, the Cabinet also includes people close to Vice-President Cristina Kirchner. However, the fact that pragmatic appointments have been made in the critical areas of government is welcome news for business sentiment and the prospects of a friendly re-profiling of the debt with the International Monetary Fund (IMF) and bondholders. In other news, industrial production increased by 5% on a seasonally adjusted basis in the month of October after contracting in the prior two months. Construction activity declined by 3.5% in the month of October. This was the fourteenth month in a row of declining construction due to high inflation and tight monetary conditions.
- Chile:** The government announced a USD 5.5bn (2.1% GDP) stimulus package, which consists of USD 3bn fiscal spending, USD 2bn of support for small companies and USD 0.5bn for infrastructure investment. The CEO of Codelco, Chile's state-owned copper mining company, Octavio Aragneda, pledged to his part in adjusting government expenditures after weeks of protests. The company will cut investment by USD 8bn over the next ten years and seek USD 1bn of cost reductions per year. The idea is that these measures will enable Codelco to pay out larger dividends to the government. In other news, the central bank kept the policy rate unchanged at 1.75%, whereas the market has expected a cut of 0.25%. Monetary policy is already at

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stimulative levels, and further cuts could only have added pressure to the currency, in our view. The currency appreciated by 3.4% last week due to the combination of higher fiscal spending, tighter monetary policy and the government's massive FX intervention programme, which enables the government to sell up to USD 20bn in the spot and the swap markets between now and May next year. CPI inflation rose to 2.7% on a yoy basis in November from 2.5% yoy in October. The increase in inflation was mainly due to higher food prices.

- Ecuador:** The Economic Committee of the National Assembly approved the draft tax reform bill. The bill goes to the floor of the National Assembly for a final debate today. If approved, the bill increases tax revenues by USD 600m in 2020 via reductions in tax deductions for individuals earning more than USD 100k per year as well as a temporary increase in income taxes for companies with turnover of more than USD 1m per year. When the reform is approved, the IMF will be able to disburse USD 500m in December, which in turn unlocks payments from other multilateral institutions. The government has been working hard to adjust the fiscal balance by slashing USD 4bn of expenditures from January to November of 2019 compared to the same period last year in order to compensate for USD 2bn in lower revenues. As a result, the government has racked up an impressive primary surplus of USD 350m in the first 11 months of the year.
- Brazil:** Brazilian President Jair Bolsonaro urged Mercosur to implement a cut in the region's common external tariffs and implement a trade agreement with the EU promptly. Brazil's Congress approved the 'anti-crime package' designed by Minister of Justice Sergio Moro by a vast majority. The bill contains a comprehensive package of measures to fight organised crime and corruption, including the creation of a DNA data bank for criminals. The leader of the Lower House of Congress Rodrigo Maia is pushing for more reforms and criticised the government's recent decision to postpone administrative reform to 2020. Meanwhile, Brazil's economic data continues to improve. Real GDP growth was 0.6% on a yoy basis in Q3 2019 compared to 0.5% yoy in Q2 2019. Industrial production (IP) increased by 0.8% in October, which was a marked improvement from September (0.3%). The improvement in IP was due to stronger consumer and capital goods manufacturing. On the inflation front, the consumer price index (CPI) rose to 3.3% on a yoy basis in November from 2.5% yoy in October. Inflation is set to rise again in December due to base effects, but is likely to close the year below 4%, thus ending the year comfortably within the central bank's 2019 inflation target of 4.25%. The inflation target will be reduced to 4% in 2020, 3.75% in 2021 and 3.5% by 2022.
- Lebanon:** Construction businessman Samir Khatib withdrew his candidature from consideration for the post of Prime Minister, thereby forcing President Michael Aoun to delay talks to select a new prime minister by yet another week. The current Prime Minister Saad Hariri asked France and Saudi Arabia for trade finance to help stabilise food and essential goods imports. The Banque du Liban, Lebanon's central bank, reported FX reserves excluding gold of USD 38bn in October compared to USD 38.6bn in September. The broadly stable level of reserves suggests that fears of an imminent debt restructuring may be overblown.
- India:** The Reserve Bank of India (RBI) left the key policy rate unchanged at 5.15% in a unanimous decision, which surprised market participants, who had expected a cut of 0.25%. The central bank mentioned that a pause was needed in order to assess the impact of previous cuts on growth and inflation. The RBI reduced the 2020 real GDP growth forecast to 5.0% from 6.1% and increased its inflation forecast for 2020 to a range from 4.7% to 5.1%. India's composite PMI rose to 52.7 in November from 49.6 in October with both manufacturing and services moving above 50.
- Colombia:** A key congressional committee approved the government's tax reform bill, which now moves to a full vote on the floor of Congress. The progress of the tax reform comes in spite of protests last Wednesday. Meanwhile, CPI inflation declined to 3.84% on a yoy basis in November from 3.86% yoy in October, which was a surprise to the downside vis-à-vis market expectations. The lower than expected inflation print was mainly due to lower food prices. The current account deficit widened to USD 3.9bn in Q3 2019 from USD 3.6bn in Q2 2019 and USD 2.9bn in Q1 2019 with increased transfers from Colombians abroad partially compensating for the wider deficit in traded goods. The balance of payments remains strong as Foreign Direct Investment (FDI) posted a solid USD 3.3bn of inflows in Q3 2019, which took cumulative inflows for 2019 to USD 10.8bn, thus fully funding the current account deficit.
- South Africa:** The government of President Cyril Ramaphosa took its first decisive steps towards dealing with the country's financially troubled SOEs by placing beleaguered airline South African Airways (SAA) into business rescue. SAA appointed Les Matuson as business rescue practitioner. His mission is to save the company in a manner that balances the rights and interests of all relevant stakeholders. The company will receive an injection of government cash and government guarantees worth ZAR 4bn (USD 274m) as part of the restructuring plan. In other news, real GDP growth slowed to a yoy rate of just 0.1% in the Q3 2019 from 0.9% yoy in Q2 2019 due to weak mining activity as well as soft manufacturing and transport activity. The current account deficit was 3.7% of GDP in Q3 2019, which was an improvement from Q2 2019 (4.1% GDP).
- Gabon:** Several former public officials were jailed as part of an anti-corruption crackdown following a cabinet reshuffle in Libreville. Most of the jailed individuals were close to the former Chief of Staff, Brice Lacruche Alihanga, who stands accused of embezzling public funds.

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Snippets:

- **Angola:** The IMF approved its second review in the Extended Fund Facility programme with Angola. The approval allows for USD 250m to be disbursed with an additional potential disbursement of USD 500m from the World Bank.
- **China:** The China Federation of Logistics Purchasing index rose by 3.1% in the month of November. This is the fifth consecutive monthly expansion. Trade data also pointed to stronger domestic economic activity as imports rose by 0.3% on a yoy basis in November. Exports declined at a rate of 1.1% yoy due to the impact of US sanctions.
- **Hong Kong:** Retail sales declined at a rate of 24.3% on a yoy basis in October compared to -18.2% yoy in September. The PMI survey declined further to a very depressed 38.5 in November from an already weak reading of 39.3 in October. The government increased the size of an economic relief package from HKD 21bn to HKD 25bn (USD 3.2bn) mainly via additional tax relief to individuals and corporations.
- **Hungary:** The volume of industrial output increased at a rate of 6.4% on a yoy basis in October, which was a slowdown from a sizzling yoy rate of expansion of 9% expansion in September.
- **Malaysia:** The trade surplus increased to USD 4.1bn in October from 2.0bn in September on higher exports of electrical and electronic products. On a yoy basis, the trade numbers remain in contraction territory due to base effects.
- **Namibia:** Incumbent President Hage Geingob won the presidential election with 56% of the votes. Moody's downgraded Namibia's sovereign rating to Ba2 (two levels below investment grade) with a stable outlook.
- **Nigeria:** Moody's affirmed Nigeria's sovereign credit rating at B2, but moved the outlook to negative reflecting increasing risks arising from the government's fiscal balance and the country's external balance position amidst narrowing revenues and weak growth.
- **Pakistan:** The rating agency Moody's affirmed Pakistan's sovereign credit rating of B3, but upgraded the outlook to stable from negative citing the continuing improvement in the balance of payments as a result of ongoing policy adjustments and currency flexibility.
- **Philippines:** CPI inflation was 1.3% on a yoy basis in November versus 0.8% yoy in October. The rate of unemployment declined to 4.5% in October from 5.4% in September.
- **Russia:** CPI inflation declined to a yoy rate of 3.5% in November from 3.8% yoy in October. This was a downside surprise, which was attributed to lower than expected food prices.
- **Saudi Arabia:** Saudi Aramco raised USD 25.6bn in the world's largest IPO, which values the company at USD 1.7tn. Total demand was USD 119bn, spearheaded by local investors and institutional investors from the Middle East region.
- **Serbia:** Real GDP growth accelerated to a yoy rate of 4.8% in Q3 2019 from 2.9% in Q2 2019 buoyed by hefty investments in the real estate sector as well as substantial public and private consumption.
- **Singapore:** The manufacturing PMI survey rose to 49.8 in November from 49.6 in October. New export and electronics orders led the improvement.
- **Turkey:** Real GDP growth rose at a yoy rate of 0.9% in Q3 2019 in a significant recovery from the contraction in Q2 2019 (-1.6% yoy). It was the first positive print since Q3 2018, supported mainly by government expenditures. Credit expansion, particularly mortgage loans from public banks, also provided short term support to growth.
- **Uzbekistan:** Real GDP growth was 5.7% on yoy basis in Q3 2019 supported by investment and consumption.

Global backdrop

US President Donald Trump re-imposed tariffs on imports of steel and aluminium from Brazil and Argentina. The measure will only have a very marginal economic impact, since Brazil's steel exports to the US amount to only about USD 2bn per year, or 1% of total Brazilian exports (equivalent to 0.1% GDP). The impact is even smaller in Argentina. Trump also threatened to increase tariffs equivalent to USD 2.4bn on French products in retaliation against a technology tax introduced in France, which affects mostly US companies.

In contrast to the tide of protectionism in developed countries, China and South Korea agreed to boost bilateral cooperation and accelerate the China-Japan-South Korea free trade zone. South Korean President Moon Jae-in said South Korea is looking to coordinate its development strategies with the China Belt & Road Initiative and enhance people-to-people exchanges between the two countries.

In other news, a federal appeals court ruled that Deutsche Bank and Capital One must hand over years of Trump's tax returns. Trump's lawyers are likely to appeal the decision to the Supreme Court, which is already examining two related cases on the matter. Releasing the numbers ahead of the 2020 presidential elections is expected to be damaging to Trump.

The main US data releases continue to be consistent with real effective exchange rate mis-alignment as production data remains weak, but employment and consumption data is strong. The ISM manufacturing survey weakened to 48.1 in November from 48.3 in October, while non-manufacturing ISM slid to 53.9 in November from 54.7 in October. Construction spending also declined by 0.8% in the month of October after falling by 0.3% in September. Trade numbers also showed deterioration with imports declining faster than exports due to the impact of tariffs on consumer goods. Lower imports led to a small adjustment on the trade balance to USD 47.2bn deficit in October from USD 51.1bn in September. Meanwhile, the University of Michigan consumer sentiment index rose by 2.4 points to 99.2 in November, which is the highest point since May. Corroborating the strength of consumption, credit and debit card information from Bank of America showed early holiday sales (the last 21 days ending on black Friday) rising 2.2% compared to last year. This is the best outcome since 2013. The week ended with a robust labour market report as 266k new jobs were created in the non-farm economy in November compared to 156k in October. Unemployment inched down to 3.5%, but average hourly earnings declined to 3.1% in November from 3.2% in October.

In Germany, the SPD party has voted against breaking up the coalition with the CDU/CSU. Still, the leadership change within the SPD may make the alliance more unstable, in our view, as Germany moves towards the adoption of more expansionist fiscal policies. German economic data remained soft as factory orders declined by 0.4% in October following a 1.5% mom expansion in September. Euro area GDP growth was unchanged in Q3 2019 from Q2 2019 at 0.9% (qoq).

The Japan Times newspaper reported that the government is preparing a fiscal stimulus package worth JPY 13.2trn (USD 122bn), including JPY 9.4trn in spending. This follows an economic slowdown caused by natural disasters and a recent VAT increase. If confirmed, Japan will join a growing number of developed countries, including UK and the European Union (EU) in expanding fiscal policy. In 2020, the budgetary expansions in Japan, UK, Germany and other countries will stand in contrast to an expected fiscal contraction in the US, which may push down the Dollar next year. The US has wasted an opportunity to improve its potential GDP growth, because the tax cut approved in late 2017 was used to buy back stock instead of investing in the real economy, thus lifting stocks prices without any improvement in trend growth. Most of the fiscal spending in the EU is likely to be geared towards easing the transition from a carbon-intensive economy towards renewable energy, thus incentivising a new industry with a vast potential to boost the economy and jobs. Thoughtful increases in fiscal expenditures in Japan will go in the same direction, in our view.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.88%	5.00%	11.49%	10.35%	9.77%	4.10%
MSCI EM Small Cap	0.27%	3.50%	5.59%	5.67%	5.13%	1.61%
MSCI Frontier	0.84%	3.05%	14.02%	9.36%	8.49%	1.33%
MSCI Asia	0.62%	5.47%	11.72%	10.40%	10.26%	5.35%
Shanghai Composite	1.39%	0.25%	19.62%	14.52%	-0.84%	1.94%
Hong Kong Hang Seng	1.03%	2.04%	6.68%	3.06%	6.18%	1.63%
MSCI EMEA	0.21%	2.93%	8.74%	7.91%	6.66%	0.88%
MSCI Latam	2.92%	3.09%	9.83%	10.17%	9.44%	2.13%
GBI EM GD	1.02%	2.06%	10.08%	11.93%	6.31%	1.50%
ELMI+	0.49%	1.90%	3.34%	4.24%	3.65%	1.02%
EM FX Spot	0.78%	1.19%	-1.33%	-0.97%	-1.64%	-5.23%
EMBI GD	0.12%	-0.07%	12.91%	13.83%	6.42%	5.52%
EMBI GD IG	-0.06%	0.46%	15.74%	16.86%	7.42%	5.35%
EMBI GD HY	0.35%	-0.69%	9.92%	10.65%	5.34%	5.65%
CEMBI BD	0.07%	1.30%	12.07%	12.54%	6.22%	5.52%
CEMBI BD IG	0.01%	0.49%	12.07%	12.97%	5.94%	4.77%
CEMBI BD Non-IG	0.14%	2.42%	12.03%	11.94%	6.70%	6.70%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	0.21%	6.09%	27.90%	19.07%	14.71%	10.91%
1-3yr UST	-0.01%	0.28%	3.36%	4.06%	1.78%	1.36%
3-5yr UST	-0.15%	-0.09%	5.09%	6.40%	2.48%	2.12%
7-10yr UST	-0.41%	-0.91%	8.85%	10.65%	4.00%	3.14%
10yr+ UST	-1.36%	-2.72%	16.51%	19.21%	7.54%	5.21%
10yr+ Germany	-1.35%	-5.00%	11.32%	11.22%	5.47%	5.68%
10yr+ Japan	-0.70%	-1.81%	4.25%	5.38%	1.95%	3.94%
US HY	0.35%	0.96%	12.48%	10.44%	6.22%	5.68%
European HY	0.20%	1.19%	10.00%	9.88%	4.38%	4.37%
Barclays Ag	-0.07%	-0.17%	6.15%	7.40%	3.80%	2.27%
VIX Index*	7.92%	-16.13%	-46.42%	-41.37%	15.91%	-8.53%
DXY Index*	-0.66%	-1.76%	1.51%	1.15%	-3.90%	10.08%
CRY Index*	2.57%	4.17%	6.71%	-1.61%	-5.62%	-27.83%
EURUSD	0.44%	1.54%	-3.50%	-2.54%	4.80%	-10.55%
USDJPY	-0.88%	0.42%	-1.07%	-4.24%	-5.92%	-9.33%
Brent	2.87%	5.66%	19.37%	4.13%	18.20%	-3.92%
Gold spot	-0.08%	-0.65%	14.07%	17.55%	26.11%	18.84%

*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, DX Y 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

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