IMF 2019 Fall Meetings: Storm Clouds over DC

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The mood was somber in DC with talk of a synchronized global slowdown mixing with a number of popular credit stories becoming more challenging amid overweight investor positioning. There were frequent investor complaints about the lack of bright spots, with only Ukraine, Egypt and Brazil providing brief rays of sunshine. The emerging markets debt team spent the better part of the week there, running between large conferences and small meetings, to gather the best intelligence; below is their key takeaways:

#1: Global synchronized slowdown in a world without credible policy responses

The predominant feeling at the meetings was that the U.S.-China trade tensions were feeding into a synchronized global slowdown that emanated from core economies: the U.S., Germany and China. In fact, 90% of the world is currently slowing. At the same time, negative sentiment towards Quantitative Easing/negative policy rates is getting more and more pronounced. With policymakers in developed markets unwilling or unable to use fiscal policy and structural reform to boost growth, all the weight rests on central bankers who have, in our view, become "celebrities" whose every word moves financial markets but appears time and time again ineffective at achieving the desired macroeconomic outcomes.

#2: The structural (and most likely intractable) nature of the US-China conflict

There is a growing realization amongst policymakers that the U.S.-China trade war is only one element of a much bigger conflict to win military, technological and ideological superiority between the two countries. Initial hopes that the conflict would resolve once Trump was no longer President are fading as it becomes more blatantly obvious that China bashing is a bi-partisan pastime in the U.S. For its part, China is not going to abandon its plans to move up the production value chain with its "Made in China 2025" initiative just because the U.S. desires it, nor will it abandon plans to become a world superpower.

#3: De-globalization in action and the de-dollarization reaction

The largest shock to globalization is coming from the top of the value chain with a permanent rift between the U.S. and China on technology and the need for other countries to choose sides. Value chains will realign around these two poles and those countries that choose the China route will need to develop non-U.S. dollar payment infrastructure. Europe has already started this process in response to the U.S. sanctions on Iran and Russia with the creation of a special purpose vehicle (SPV) to enable trade with Iran. As the U.S. increasingly weaponizes the dollar to achieve each new foreign policy objective, we believe, the global move away from the dollar will accelerate.

#4: Digitalization of policies and money

We think EM governments finally saw the light and realized that technology is their best new friend - especially as regards consolidating fiscal accounts and reducing corruption. We do not think we've heard the world "eGovernment" as often before. Being "paper-dependent" is no longer considered cool or fiscally responsible. The experience of trailblazers (Russia, India) is extensively studied and replicated across the EM world. Way to go!

#5: The U.S. shale oil & gas revolution has structurally changed energy markets

Both investors and policy makers expect range bound oil prices in the mid-50s. The U.S. is now the world's largest producer of oil and gas, and a major exporter. OPEC can no longer wield the same influence over oil prices as in the past. Numerous policymakers referred to this as a structural change to markets that will have long lasting effects on their trade balances and budgets.

#6: Investor complacency amidst crowded overweight positioning

It has been a spectacular year for EM fixed income, the Argentina debacle notwithstanding. In our view, Investors are accordingly positioned overweight and are considering if and when to take profits. This setup could be conducive to painful corrections, as any negative shock may lead to a rush to the exit to lock in returns before year-end. Conversely, because U.S. treasuries appear to be one of the most crowded long positions, positive growth surprises out of the U.S. economy may lead to a duration selloff. Additionally, we believe there are some very popular country exposures that possibly have outsized moves to the downside from a negative shock. In sovereign credit: Ukraine, Egypt, Argentina and Ecuador; and in local markets: Egypt, Ukraine and Nigeria.

#7: Many more country losers than winners

On the winner's podium stood Ukraine, Egypt, and Brazil. All three countries are implementing robust reform agendas to tackle structural problems in their respective economies and to lift growth. Uruguay has a chance to join them if the opposition wins the upcoming October 27 election after which it would implement pension reform and monetary policy reform.

Ukraine recently elected a young, reform minded government working hard to raise the growth rate with productivity enhancing reforms: labor reform, land reform and privatization. If successful, growth can accelerate to over 4% per annum with inflation near the 5% central bank (CB) target.

The Egypt macro story remains solid - low inflation, robust growth, an improving fiscal position and deleveraging. The main challenges are boosting investments and reducing interest payments as a percentage of gross domestic product (GDP). The government is keen to continue its engagement with the International Monetary Fund (IMF).

Brazil is attempting to maintain positive reform momentum after passing the pension reform that is critical to the long-term viability of its public finances. The CB head, Roberto Campos, commented on privatizations at the meetings: "Our aim is to reinvent the country with private money."

> The many losers, on the other hand, either tried and failed, or did not even try, to rise to the challenges presented. In our view, Ecuador, Nigeria, Ghana, South Africa, Jordan and Lebanon were some of the more concerning stories.

Ecuador was unable to regain the market's confidence in the wake of President Moreno's failed attempt to remove fuel subsidies in order to meet the terms of the fiscal adjustment agreed with the IMF. But the government instead possibly spooked investors with a surprise meeting to test the waters for an oil revenue backed financing, once again raising concerns that the IMF program is not "fully funded."

Nigeria struggled to explain the recent sharp decline in its international reserves and added to confusion by blaming balance of payments concerns on data issues. Ghana disappointed by missing fiscal targets, mainly due to poor growth and revenue collection, even before the expected ramp up in pre-election fiscal spend; additionally, energy sector contracts are a fiscal time bomb and will need to be renegotiated.

South Africa was circumspect about their reform plans, asking investors to wait for the upcoming Medium Term Budget Policy Statement (MTBPS). Turkey avoided providing explanations to investors by not showing up.

Finally, in the Levant, both Jordan and Lebanon had disappointing fiscal performance. Jordan lost significant revenue due to tax evasion, lower import prices and delays in passing corporate reform. Lebanon failed to make progress on reforming the energy sector and instead attempted to tax the extremely popular messaging tool WhatsApp, leading to wide scale protests that endanger government stability.

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