

IMF Spring 2020 Meetings: Dive, Survive, Revive or Differentiate

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Global Macro Outlook

The overall tone was very downbeat on the economy, but impressed (some might say self-congratulatory) on the immense policy reactions. The big uncertainties included the usual debate over whether the recovery will be V-, U-, L-, or an endless W-shape. Uncertainty around COVID-19 was a big part of this discussion, as was uncertainty over how much damage (job losses, debt, capacity closure, etc.) would result in permanent capacity loss. A further rise in global savings (even in already high-saving North Asia was another concern). Still, most saw a return to “normalcy” (whatever that will mean post-crisis) as one to four months away—the discussion moved to the staged return to work, with uncertainty around further waves of COVID-19 an ongoing risk. One interesting development was that issues we’ve raised in the past—basically, where does this end—were finally part of the discussion. If government yields are zero, isn’t fiscal debt being monetized and doesn’t that mean that money and bonds become identical (something old-time EM folks understand deeply, but DM folks consider esoteric). This could be an issue in Europe.

- **There was very little “global” macro, as the discussions were, for the most part, national.** Even in the quasi-nation of the European Union/Eurozone, the discussions were significantly national. The only “global” player was the Fed.
- **The IMF has played second-fiddle, so far, but was grasping for a role.** We believe, This is most likely a reflection of the times, with major countries including

the US, China, India, Brazil, Russia, Turkey, the UK, the Philippines and increasingly the large European countries, moving to optimizing national outcomes, as opposed to optimizing global outcomes. This is driving policy. These countries own the IMF via their shareholdings, literally. They would support greater IMF lending, and give it more capital to do so. But, the world has clearly changed even to global elites, in this writer’s perspective, over the past decades of meeting participation. We feel the need to re-emphasize that we are reporting, not polemicizing.

- **The DM idea that debts and central bank balance sheets are unlimited might have to be generalized.** It won’t be presented this way, but terming-out bilateral, official and even commercial debt will become a very big topic. At some unknown point. And not in the econ-textbook way of rising inflation, in our view. It will be culturally, socially- and politically-driven, not by economists. And if it does, it means that times are hard. And shutting down finance when times are hard is hard to do. Nobody will want their fingerprints on such a decision. So, we believe the game of musical chairs will continue, just globally.
- **Because the same authorities that set up the current “architecture” are still in charge, it will be tempting to use the same playbook.** A big conflict could be coming. We see this in the QE (quantitative easing) and MMT (modern monetary theory) discussions. (Our simple view is that if one supported QE, it is hard to oppose MMT, regardless of whether both end badly

or not). In particular, the old playbook says that when debt is deemed unsustainable, defaults must happen, and the IMF is senior, official IFIs (international financial institutions) and bilaterals are next and commercial debt (EM bonds, etc.) have to take haircuts. Again, would you want your fingerprints on triggering a financial crisis in the midst of a public healthcare crisis and, perhaps, Depression? We see a Santa Claus approach of endless terming-out of liabilities as very appealing in practical political-economic terms. (And, if asked our prescription, even this “recovering economist” would give the lame economics answer of “don’t start here”.)

- **More asset-price inflation, and all the social and political challenges that entails, we believe will be a key likely scenario ... down the road.** The economics textbook says use rates and fiscal stimulus to pump the “portfolio balance channel” (i.e., ginning-up asset prices to encourage hiring, investment and spending). You only stop when there’s inflation. (By the way, who wants inflation? Debtors. Who are the biggest debtors? Governments, in many cases. Aging populations, or the growing numbers of poor certainly don’t want it). Does that give you a flavor of the nature of our future? The next big chapters of this story are cultural, social and political, in our opinion. The only cause for hope is that it probably isn’t a story for now, as nobody has written the new textbooks (yet).
- **Jubilees predate the Bible and are recurrent.** That’s another summary of the preceding bullet points. Epochal, in other words. But, this could play out over years or decades. We are only framing the situation so you can understand it as it plays out. As we’ve told many of you, none of this is new in history and certainly not new for EM economies. It’s just new for the rich world that constitutes our readers. We wrote a piece in 2012 that we thought might not be relevant for decades, but it is just eight years later. Timing is tricky.
- **The G-20 stepped up late and lame, but with a good heart.** As a driving political entity behind the IMF, this is consistent with the prior points. The good news is that they proposed a “standstill” on the poorest countries’ bilateral sovereign debts to the richest, implying a terming-out. The great news is that they did this explicitly saying that forcing private lenders to

do the same was “voluntary”. That shows recognition that creating a financial crisis in the midst of a public health and economic crisis should be avoided. The bad news is that anyone with any crisis-management experience should know no to use the word “standstill” on debt unless one is inviting a sudden stop of capital and financial crisis. We’ll chalk that up to the learning curve. The other bad news was that their communique was over 20 pages. The standard for good communiques is that of the ECB’s Mario Draghi, when he said just three words—“whatever it takes”. Perhaps we quibble, but communication is maybe the only thing that matters in crises and simple and strong should be the guidelines.

- **ESG on the back-burner, at best.** We did not hear the term “green agenda” or “ESG” once. Getting people back to work was the only focus. In poor countries, these jobs are often in extractive industries. It was unsaid, but making the poorest pay with joblessness and high energy prices for an elite-driven agenda would only fuel “populism”, which in this conference is a bad word. Higher demand for oil was an explicit focus for policy. If that doesn’t tell you everything related to the “green agenda” at this moment in time, we’re not sure what else will. Again, we’re not getting into proper prescriptions, just describing the state of the debate.

USA

The U.S. was viewed as playing the central global role in the current crisis, as having an excellent economic policy response and the Fed and U.S. Treasury were broadly lauded for the speed and scope of their response. The fiscal response was also lauded, as was the U.S. legislature’s ability to coalesce around a response. U.S. elections were discussed, but they sounded to us like a discussion in the DC “bubble” with absolutely no content different from that in popular media.

- **A key economic question is whether the hits to income, jobs and debt will result in permanent capacity loss and thus lower potential growth.** Related, of course, was the ubiquitous discussion on whether the U.S. will see a V-, U- or L-shaped recovery. Our view is that a letter may not be the best answer and that a bumpy complicated road lies ahead.

- **The U.S. enters this crisis with public debt 20 percentage points higher, relative to GDP, compared to the GFC.** This will be a key uncertainty after whatever-shaped recovery we see in the nearer term. Recovery may look V-shaped initially, but end up W-looking. We reiterate our view that a letter may not be the best way to look at the economy (we use them only because they are part of common economic parlance).
- **Government debt to GDP may rise above 100%.** When it stabilizes and large fiscal deficits are seen to be no longer required, debt should stabilize. It never has, though. All agreed this was an important question, but nobody thought it was a question for today. We think that this is because the U.S. discussions were dominated by U.S. experts and EM folks have much more experience with how quickly leverage can become a problem. Anyway, at some point, we believe economic actors begin to acknowledge that taxes will possibly have to rise and that has significant and often immediate economic implications (often triggered by some political/social event, as if we don't have enough of those already).
- **The flexibility of U.S. labor markets means greater risk of a sharper downturn in employment, but not necessarily GDP.** Unemployment can quickly rise to 9% from around 6.5%. (Europe's greater restrictions on layoffs mean perhaps only an additional 1% to unemployment.) However, the dramatic change in policy support for the unemployed in the U.S. could mean that employment drops, but GDP doesn't drop as much as one would expect. Many studies show big sectors of the unemployed with higher incomes on government support than if they remained employed. Either way, the U.S. remains emphasizing "buying" dynamism over social stability (compared to the European bias).
- **Data on employment may be hinky.** Now, not seeking work no longer excludes you from the eligibility denominator. If companies have payroll insurance, why not wait a little longer before rehiring ... or rehire earlier. As noted earlier, some support will actually raise incomes for workers, which complicates data and behavior expectations, obviously. Don't read the numbers as you normally would. A key framing is whether the current problem, which is mainly a cash-

flow problem met with loans, becomes a balance sheet problem met with unforeseeable policy reactions. A key fact driving the above is that out-of-pocket healthcare costs are still very large, even with insurance. We believe, this will be the first point of strain. The next will be debt repayment. Forbearance policies should be assumed, in our opinion.

- **If this crisis is a two-month one, current policies could be sufficient; if it is longer, or comes in recurrent waves, more policy support may be needed.** For now, it looks like the CARE Act (Coronavirus Aid, Relief, and Economic Security Act) in the U.S. is working, with three-month payroll protection (worth around \$350bn) and pandemic unemployment insurance (worth around \$250bn) direct responses. Economic stimulus via other fiscal policies are on deck. Estimates we heard showed that money will be in the hands of households within weeks, and will total \$1tn. The marginal propensity to spend the checks is a key economic variable. Another big factor is that savings rates may rise permanently, regardless of how quickly COVID itself lasts, for simple and obvious behavioral reasons.
- **Whether additional support for businesses and local governments is relief or stimulus is semantic.** That's our opinion. At the end of the day, the Fed may buy the forgivable loans and the lines between Treasury and the Fed are blurred. Our view is that this kind of thing ends up permanent. (Please see the piece we wrote in 2012 that basically says the Fed, Treasury, and banks have become one entity ... that money and bonds are on the road to unification: [M-Infinity: How to Measure Strains Created by the New Financial Architecture](#).)
- **Large fiscal deficits and stimulus will be a two-year phenomenon, if not longer.** Stimulus is not just for 2020, we believe it will probably recur within 2020 and will also be a feature of 2021. The permanent loss of capacity (or the risk of it) is a central question and reason for recurrent stimulus.
- **The usual arguments about the limits of debt aren't obviously acute ... yet.** The usual economic argument is that government borrowing crowds out private borrowing. That's obviously out the window with the Fed buying credit risk. Inflation is the other historical concern, but it is hard to see it anywhere. Expectations

of higher taxes in the future are the other concern the economics “profession” invokes. Also hard to see those on the horizon; if anything, they look to be lowered. (Our view: inflation will show up in asset prices and this may become a political/social issue, with wealth taxes front-and-center, but what do we know, we are EM experts who see constraints on debt and money, not DM experts and DM live in a world that sees debt and central bank balance sheets as limitless).

- **U.S. foreign policy credibility absent.** What is viewed as U.S. failures in the Middle East and its foreign policy generally is now openly discussed as “almost-epochal”. It is a hit to U.S. credibility and nobody seriously argues anymore that these failures started the day President Donald Trump was elected; it is systemic and is openly acknowledged. Conferences no longer even invited generals and national security experts to opine on any topic. That is a first in this writer’s decades of attendance. Nobody was asking: “What can the U.S. do to help in this or that political situation?” Again, we are not saying this is fair or correct, we are simply reporting the conferences.
- **Russia not wearing the black hat; a Biden presidency would put it back on.** Russia is still part of this section on the USA and its political situation, not part of normal disheartened economic analysis. Russia was no longer everyone’s “bad guy”; a Biden presidency would reverse this, though. The Russian role of “bad guy” was proposed by many, but continues to be taken even less seriously, other than by those with obvious interests in Russia playing that role. Russia’s less demonic role is partly because of its strong economic policy. Partly because many view it as having stabilized the Middle East. Partly because its media-purported role in the Saudi oil price war dissolved within days. Partly because of the strong domestic popularity of President Vladimir Putin. Partly, one would suppose, because of looming indictments of former U.S. government officials in setting Russia up as a cause of Trump’s election. Partly because Washington power-players have a new gig making China the new “bad guy”. To re-emphasize, whether this, or any of the above is factually correct, in-and-of-itself, is a separate discussion; we are only describing how the discussions played out. Still, we see a higher risk than we did six months ago, of U.S.

sanctions reversing before President Trump gets into full election mode, but if former Vice President Joseph Biden is the next U.S. president sanctions may return with a vengeance, in our opinion. President Trump’s phone calls with President Putin have increased exponentially, we are told.

- **All agreed that candidate Biden would try to out-“bash” candidate Trump on China and on trade.** This is exactly what happened during the 2016 election, with candidate Clinton pivoting to an anti-trade and anti-China stance as those stances turned out to be popular. The biggest difference, it seems to us, is that a Biden presidency could possibly mean a return to growing sanctions on Russia (where U.S. business has limited interests), coupled with a good chance of a resumption of focus on China as a source of profitability for global U.S. businesses. It was frequently noted that Trump relies on individual campaign contributions, whereas Biden depends on New York and primarily globally-oriented business campaign contributions.
- **Listening to the U.S. political debate was depressing because it seemed so narrow and uneducated.** Our job is just to analyze and predict, but many political “experts” only provided soundbites, no new ideas, and seemed oblivious to the 2016 election, yet alone Brexit, the “yellow vests” and many other obvious signs that “the times they are a-changin’”. I’ve heard better discussions in a cab than I did from these panels. It was all soundbites and an almost complete ignorance of the existence of other countries and perspectives that weren’t good or evil, just different.

China

The China discussion was bifurcated—some saw a new elevation in stature (the majority view), others saw nationalism and dissembling (as an eventuality). On the one hand, it is recovering already and many saw a mature policy response across the board, from quarantine, to innovative public health technology and the well-publicized economic measures. The health of some its technology sectors, particularly health-related, were also noted (a theme our emerging markets equities colleagues have emphasized). Also, Chinese authorities inched a little closer toward the traditional global practice of a common stance on bilateral debt (i.e., if one of us terms out debt, we all should and on the same conditions) and on being more

transparent on how much it is owed, to whom and on which terms and balance sheets. On the other hand, there was nothing dramatic from China on that “debt diplomacy” front, with many senior policymakers seeing only vague language, no concrete promises and no leveraging of the crisis to push further reforms. Related, in a credit-starved world, SOEs (state owned enterprises) were viewed as the likely winners. Manufacturing was widely viewed as recovering first, with services second. Even higher savings rates were a common “concern”.

- **China is the likeliest to see a V-shaped recovery.** Manufacturing has rebounded first and is at 90-95%. The services sector may recover next, which will be more a function of how lockdowns are phased out. There is great anecdotal evidence of pent-up demand in services from restaurants to hotels.
- **This is China’s largest fiscal stimulus ever, which may reverberate through North Asia.** Korea and Taiwan, in particular, seem poised to benefit most. Worrying about the debt later seems reasonable to us, especially given Chinese credibility thus far.
- **Chinese debt will return as a concern, someday.** In China, we don’t distinguish as much between private, public, state, corporate, etc., as the lines are blurrier than in most countries. Anyway, after stabilizing from 2015-2018, debt will spike again with the current fiscal stimulus. This is precisely why 0% interest rates might be in sight, with all the risks those entail.
- **Balance sheets are stretched.** Total debt/GDP is at 270% now, going to 290% by year end. SOEs are already at 100% of GDP. Many corporates, though, are cashed-up for precautionary reasons. Household savings are famously high, but behaviorally may increase further after the crisis. Belt-and-road lenders will be under huge pressure as will export-import banks to allocate capital. There will be huge infighting with a big risk that SOEs win. Will China provide debt relief? is a rising question in policy corridors.
- **Will Chinese interest rates approach 0%?** We don’t think that’s a nutty question. Capital controls keep the money prison walls strong. If the money stays in (and China has a positive net international investment position, and superficially high reserves, assuming the

controls remain effective), it could work to greatly boost fiscal support. It would also mean many EM countries could turn to China for lending support. If China moves to global norms, as per the Paris Club, this could be a big moment in its entry to the global financial system

- **Newer issues in China will include debt and the details of the development model.** Trade will arguably be less important, in a world risking an endless W-shaped recovery. Debt may be important as a tool today, but limited in the future, as the Chinese are not reluctant to admit (admirably). Technology, including 5G and AI, look set to rise as foci. They also look set to rise as major tension points with the U.S., maybe more tense than they already looked to be.

Europe

Europe came out as an unequivocal loser. The only good news might be that it historically comes out of these meetings, what we view as a loser (because the basic structure doesn’t make sense and was undemocratic—crises were supposed to be cherished opportunities to impose fixes, but haven’t been). Old tools such as the ESM (European Stability Mechanism) were touted and the ECB relaxed its capital key (allowing the purchase of more low-rated sovereign bonds). Another piece of good news is that Chancellor Angela Merkel’s popularity bump was viewed as a stabilizer. The rest was, frankly, dismal. All the issues we’ve written about over the years are coming to the fore more forcefully. How do you coordinate ECB action that involves purchases of sovereign bonds, when there are many sovereigns with different ratings and banking systems? And, some sovereigns can’t be assumed to remain in the EU or the EZ (Eurozone) indefinitely. How does that risk maintain confidence in the money itself? Do the banks have enough capital buffers and how long can they stay so unprofitable? As we’ve been putting it over the years—“if the ECB keeps rates low, they bankrupt the financial system, which is a contingent liability of the sovereign(s); if they raise rates, they risk bankrupting the poorer south, whose bonds are now ECB assets”.

- **Europe’s basic flaws are being tested—there is a huge divide in the debate over debt ‘mutualization’.** There’s a lot of semantics around using old mechanisms and giving them new acronyms, like “pandemic bonds”

(which strike us as a re-named ESM). The bottom line is that there is no breakthrough on issuing pan-European bonds with a pan-European obligor.

- **The rich north (ex-France, as calling it rich is a bit complex) does not want to pay for the poor south and the crisis is not changing that.** The press statements that seem to get repeated in media as positive developments, strike us as “just say some stuff while we watch this thing play out”. European officials applaud themselves for their statements and latest acronyms, but nobody in the audiences was.
- **The ECB relaxed its capital-key—will it buy endless amounts of Italian bonds?** The capital-key sets out how many of each member’s bonds the ECB can buy. Will the ECB decide that all their yield should be the same as Bunds’? It may have to, but it will be tough given the democracy deficit that characterized the entire European experiment. Asking for taxpayers to pay for something they never approved of (never forget—every referendum on “Europe” failed, or was cancelled because it would, and roughly 60% of Germans opposed monetary union, but it went ahead anyway).
- **COVID is seeing only national responses, basically.** A feature of the European project was that crises were fortunate opportunities to forge a new structure. So far, the opposite is happening.

Emerging Markets Macro

The EM discussion was very complex, but EM now implicitly have the only market-priced bonds based on capitalist principles (whether things get worse before they get better is a separate discussion). They will face less harsh recessions than DM. But they enter the crisis with more debt than before the GFC and many have weaker healthcare infrastructure. The G-20 endorsement of a “standstill” (which was broadly acknowledged as bad word choice for a group that should understand the importance of language during a crisis) on payments from the poorest countries to the richer Paris Club countries, without conditioning this on defaulting on commercial bonded debt (the stuff we trade) was viewed as a big positive (rightly so, in our opinion). IMF support lines in the form of lending, as well as in the form of USD swaps to countries not getting them from the Fed or PBoC (People’s Bank of China) were also highlighted.

- **Is EM now the only game in town if you want market-based spreads?** It was implicit that whatever the risks in EM, investor focus should be to find winners and losers. The fact that the ECB, and now the Fed, are reducing premia in traditional credit means that the only remaining place to get a spread based purely on market supply/demand will be in EM. We can’t emphasize this enough. There will be winners and losers, of course, but if you want credit risk priced by markets and capitalism, EM is arguably the only game in town now. The anchoring of risk-free and risk yields by the ECB and Fed give the impression of a ceiling on yields, as well.
- **DM countries are spending and monetizing, whereas EM countries are not, or doing much less of it—in theory this should eventually put downward pressure on the USD and upward pressure on EMFX.** We believe this is a long-term question. Also, if you’ve been reading this far, you know our strong view is that this is best answered on a country-by-country basis. Our investments favor countries with high real policy and market rates, relative to fundamentals, at a minimum.
- **The stability of the Chinese currency is a new and important anchor for EMFX.** EMFX has already dropped 30-35% vs. the USD (declines in their interest rates have cushioned the returns on local bond funds, to anticipate a question). Imagine the damage to EMFX if the RMB depreciated by even 10%. These real reductions in effective EM exchange rates to both the USD and RMB are a real tailwind, assuming no sudden stops and a resumption of global demand.
- **EM are cutting interest rates—this is a big change, with potentially big asset-price implications.** In the past, EM countries raised interest rates to defend currencies and prevent growing imbalances on debt (rising) and external accounts (excess importing). Because investment returns are significantly based on growth and carry, this new response is important. We should emphasize that the countries we find attractive investments in this environment have high real policy and market rates and fiscal space to stimulate (see our other reports for our views on where to invest and why).

- **EM central banks are not doing what they don't want to do—inflation is low and nowhere in sight and fiscal stimulus isn't truly happening because it can't.** On the side of maintaining good credit quality, though, we should note that EM countries are generally not engaging in big fiscal stimulus, so lower rates without a big rise in debt and no signs of inflation is a very digestible meal.
- **A sudden stop in capital flows is a risk.** We've written about this in the past and it remains a key risk. EM central banks are not intervening in their FX (foreign exchange) markets, preserving reserves. This raises the risk of outflows of the stocks in portfolio investments. Hopefully, inflows into bond funds just resumed in the first half of March, but it is early days.
- **EM is entering this crisis with much higher government and private debt.** Overall EM government debt is around 50% of GDP and EM private debt is 140% of GDP. This, by definition, raises default risks. Of course, we think the best approach is country-by-country, and not simply investing in "safer" countries, but investing in countries where the premium is way too high for the fundamentals. One bank sees about 20% of the \$1.2T in the EMBIG as at risk of default. Importantly, though, 10% of it has already happened/is happening (Ecuador, Lebanon are fresh into this, Argentina could be exiting this). But, a sudden stop in capital flows would mean further defaults. Selectivity is key, as we always say. We owned and own no Lebanon or Ecuador, and owned and own only Argentina at prices reflecting certainty of default, for what it's worth. An investment process, and selectivity, are even more necessary in this environment.
- **The IMF will have to re-think its debt-sustainability framework—forcing defaults in a public health crisis and during depression risk is something nobody wants their fingerprints on.** The Fund has \$1T of lending resources, of which around \$800B are unused. The G-20 (belatedly, and using language reflecting poor crisis-management experience such as "standstills") chipped in significantly. They are implying a standstill on payments of the poorest countries' bilateral debts to the rich countries (the Paris Club), without forcing defaults on private bonded debt (the securities we trade). This is a huge development, and reflects

understanding that risking a sudden stop in capital flows is self-defeating. The issue will become more acute for the middle income countries, which is where the IMF will, in our opinion, have to adjust its old DSA (debt sustainability analysis) playbook due to this same logic.

- **We see a good chance that the U.S. would help in recapitalizing the IMF, as long as the issue is raised before election season.** If done quickly, meaning not to close to U.S. elections, U.S. Treasury Secretary Steven Mnuchin has proved effective in getting bipartisan support for crisis measures. It is noteworthy that it is usually Republicans who more vociferously oppose IMF recapitalizations. It is not a complicated argument to note that pensioners' bond holdings would suffer if defaults on commercial debt are forced. The broader issue of recapitalization and a re-think of the DSA will play out over time, not in a single headline, we would reckon.
- **The U.S. delayed its now overdue "currency manipulation" report.** We view this as a sign of the flexibility in thinking in the U.S. and the "all hands on deck" attitude of the Treasury.

COVID-19

There was broad uncertainty on this topic. The key questions were how long it would take to develop a vaccine, whether testing was useful at all due to its very questionable quality at the current stage and whether we will see an endless W-shaped recurrence. Which countries would suffer most and least was also a big part of the discussion. We wrote a brief piece on COVID and EM as the crisis was brewing in [Exploring How COVID-19 Impacts EM vs DM](#). We're obviously not epidemiologists, but try to relay some points from experts that may be relevant.

- **Uncertainty was the watchword.** Data were unclear. Regions varied dramatically. Data standards (basic things like which systems attribute an inevitable death to COVID or to the pre-existing conditions) were big analytical problems. Hospital data were a lagging indicator for a lot of these reasons. We will learn more as lockdowns are relaxed, likely in phases and with regional differences, globally and within nations. Watch the data after re-opening and downplay

hospital data was a message. Vaccines are at least a year away (12-18 months seemed to be the commonest view).

- **Testing was doubted.** Not that good tests would help, only that current tests were very unreliable. Nobody argued that even poor tests shouldn't be administered. Only that they shouldn't be relied upon.
- **Most seemed to think that we will see COVID waves.** After lockdowns are relaxed, another wave of infections is likely. The summer (in regions it occurs) could mitigate this second wave. The waves could be permanent, until vaccines exist.
- **Lockdowns appear to work.** One test case will be close-linked Sweden and Denmark, which have dramatically different lockdown attitudes. It appears that cases peak and decline four to six weeks after lockdowns and then one needs to analyze second waves.
- **In the U.S., key danger/uncertainty zones appear to be New York City and New Orleans.** Social distancing appears tougher, cars are fewer and public transport more central.
- **There was greatest confidence that COVID has peaked in North Asia (China, South Korea and Taiwan).** Germany and Spain also seem to have peaked, with a good degree of confidence. Italy was unclear, due to poor data, to the point of generally not collecting it, even though it would be thought to have peaked given its early status as a COVID zone. France and the U.K. are very unclear, and appear to be four to six weeks away from peaking. There, one only gets tested when one enters hospital, another example of the variations in econometrics and the difficulty in analysis.
- **Europe's basic flaws are being tested—there is a huge divide in the debate over debt 'mutualization'.** There's a lot of semantics around using old mechanisms and giving them new acronyms, like "pandemic bonds" (which strike us as a re-named ESM). The bottom line is that there is no breakthrough on issuing pan-European bonds with a pan-European obligor.

What Investors Expect/are Pricing

This is not the pre-GFC EM, but the post-GFC EM. In the pre-GFC era, EM would be undergoing some form of

"sudden stop" in capital flows and forced or opportunistic defaults. Now, as with the entire post-GFC era, it is viewed as a permanent part of the investment universe and most were simply looking for winners and losers, rather than as "EM bad" or "EM good". That may change, as the current crisis is challenging, to be sure. But, the focus was on finding winners and losers.

- **Almost nobody expects a V-shaped recovery.** We believe most investors expected a U-shaped, W-shaped, or L-shaped recovery. Few expected a V. We view that as bullish, obviously, as bonds carry in a U, and because that stance implies bearish positioning.
- **More COVID waves expected.** Most expect another COVID wave into 2021, with almost none expecting a return to work in June.
- **Safety is king—gold, IG, U.S. Treasuries.** Gold and investment grade bonds were favored, with U.S. Treasuries up there too. Our response is they better not see a V-shaped recovery because that will kill duration. A U-shape favors carry, or course.
- **China and Russia were loved.** They were viewed as possibly in a better position to weather the storm and come out of it stronger.
- **South Africa, Turkey and Argentina were the most disliked.** Argentina is arguably firmly priced that way, as is South Africa, in our opinion, though that's a tougher call. Turkey is not priced for bearishness, in our view, but priced due to government asset-price manipulation.
- **EM local currency was widely disliked.** The USD was loved.
- **Biden next U.S. president.** Biden is now viewed as the most likely winner of U.S. elections in November, keeping the House. This was largely viewed as the result of a weak economy.

Specific EM Country Observations

Big winners include China, Russia, Ukraine, Czech, Angola, Gabon and Indonesia. Korea and Taiwan by being in north Asia and having good policy. Poor countries like Angola and Gabon were particular winners, due to moves to forgive debt without forcing defaults on market debt. Mexico seems a winner, as does Indonesia. Big losers include

Ecuador, Lebanon, Turkey and Nigeria. In the middle/unclear ones were India, Argentina (not a pure loser due to its being far along in its crisis), Colombia and maybe Chile, due to social risks.

- **China a winner.** Please see comments in the China section above. Policy and credibility are sound and intact, the money prison, geopolitical tension with the U.S. and limits on debt are challenges. For now, it's viewed as a winner and that can be self-fulfilling (we're not arguing that's the only rationale).
- **Russia a winner.** Growth remains Russia's key structural problem. In our opinion, this is ultimately based on the legal system's subordination to the Executive and the weakness of the rule of law/corruption in general. Russia's rise in the World Bank's EDB (ease of doing business) survey is laudable, but the rule of law is central to raising long-term growth (and birth rates), in our opinion. Russia comes out a winner due to its macro strength and political stability. Russia enters the crisis with weak growth. We believe, The big advantage remains its super-low debt and the ability of the currency to weaken with little inflationary impact. If real wages decline, the government's popularity can counter this, as long as U.S. foreign policy remains so helpful to President Putin's popularity. A small service sector also helps in the context of COVID-19. Macro stability is virtually unassailable, with high reserves, a floating exchange rate, a small public sector, low inflation, an independent central bank and on and on. A "perma-hater" was at pains to find problems in Russia, we note as a normalizer. Russia's sale of Rosneft Trading's Venezuelan operations was openly viewed as a possible rationale for an end to sanctions on Rosneft itself. Still, a Biden presidency means back-to-never-ending-sanctions.
- **Ukraine a winner.** They are increasing the size of their IMF program in the midst of the crisis. All the deep and politically costly reforms we've written about are being maintained. Land reform and peace with Russia are big boosts to growth. Real rates are high. External financing is virtually ensured by its IMF program. Not much more to say.
- **Czech Republic a winner.** The fact that the Czech Republic is in Europe is a big negative, because the

region is shaping up to be a loser in the current crisis. However, the country's stellar institutional framework is a powerful anchor, in addition to the government's and the central bank's response to the crisis, which was very impressive. The CNB (Czech National Bank) cut its policy rate by 125bps in just 10 days and announced its own QE program (government bonds) to support the economy. Importantly, the CNB has more room to lower rates than regional peers, because its international reserves are by far the highest in Central Europe (approximately 30% higher than Poland's, approximately four times higher than Hungary's, and approximately three times higher than Romania's). This provides additional firepower to cushion the koruna if necessary. Finally, the central bank has actual experience of operating under a zero rates regime (keeping its benchmark rate at 0.05% for 4.5 years), so it knows the drill so to say and is less likely to make policy mistakes.

- **Gabon a winner.** We believe, lower oil prices and oil production will have a serious impact on the Gabonese economy, pushing GDP growth sharply lower, the current account deficit and the fiscal gap wider and the public sector debt higher. The government is trying to mitigate the fiscal impact by putting its capex programs on hold, but a supplementary budget is probably inevitable. There is a number of factors that strengthen Gabon's resilience in the current environment. First and foremost, the country is under the IMF program and among the first recipients of the RFI (Rapid Financing Instrument) emergency facility. Importantly, Gabon's RFI disbursement (USD147M) is only 50% of the country's IMF quota, which means that there is room for additional support. Second, Gabon's economy is more diversified compared to its peers—and manganese mining, as well as wood and agriculture might be less affected by the current turmoil. Finally, the French guarantee for FX convertibility is still in place, while the BEAC (Bank of Central African States) has more reserves than the IMF's usual threshold for the region.
- **Mexico a winner.** It has the world's highest real interest rates, other than some outliers. Fiscal policy has been good, despite risks around the new president's commitment. Pemex is a mess—as a company it deserves little credit. But, we see the government as

slowly taking over its liabilities, which amount to 10% of GDP. Swap lines with, proximity to, and a healthy geopolitical relationship with the US are huge assets.

- **Indonesia a winner.** Indonesia is trying to do the right thing. It supported its bond market with direct purchases. Fiscal policy looks financed by official international support. It is basically in the camp of the U.S., in an Asia with fewer U.S. friends. Reserves are high, debt is low and policy is basically orthodox. It's a bit of a slow mover and follower, in our view, but it's historically ended up moving in the right direction, however irregularly.
- **Angola a winner.** Basically all of its external debt due in the next year is to bilateral or multilateral lenders, who look set to term out those obligations without forcing the country to default. It's sticking to its IMF program with stunning conviction (a 7% primary fiscal surplus, for example), that is keeping the credibility strong. It also has one of the youngest populations on earth, theoretically insulating it from COVID risks.
- **Colombia in the middle.** Colombia is one of EM countries that now has its own QE program. What the IMF meetings revealed, however, is that both the central bank and the government treat their new policy tool with a great deal of caution. In fact, they look at it only as the last resort. Authorities are very open about the fact that Colombia's fiscal metric may deteriorate, but the alternative is total economic collapse. A good sign, however, is that the government is trying to be as prudent as possible under the circumstances. Its first line of defense as regards financing additional expenditures is to use alternative sources, such as the royalty fund, or even the pension fund. The government might also consider special credit lines with the IDB (Inter-American Development Bank) and the World Bank, as well as from the IMF—but mostly as "insurance policy". Colombian policy was somewhat orthodox, but it was historically back-and-forth on its fiscal commitments. Its strong geopolitical relationship with the U.S. is a big asset and such things are more important than normal in current times.
- **South Africa in the middle.** The central bank maintains high real rates and the domestic financing

markets are deep. However, the banking system is wholesale funded, an obvious weakness in the current environment. At the end of the day, everyone strikes us as bearish, in a common short ("Texas hedge") style, market rates are high and ratings downgrades appear priced.

- **Turkey a loser.** It is running out of reserves, stimulating fiscal policy, using weak controls to keep the currency from collapsing and President Recep Tayyip Erdogan is unlikely to give up control to the IMF, amidst all the obvious geopolitical tectonic shifts. How its banking system keeps rolling over its foreign debts, particularly to European lenders, is a mystery to us. It's happened so far, but we are doubtful this time.
- **Nigeria a loser.** It still manages its exchange rate using reserves and controls, is oil-dependent, has a heterodox policy bias, and isn't poor enough to be an obvious candidate for forbearance without a fight (though it's historically ended up getting it, even in much milder situations).
- **Hard to find European winners other than EM countries like Czech Republic and Poland.**

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