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Featuring: Argentina | ANGOLA | EUROPEAN CENTRAL BANK | THE WORLD BANK

This week we discuss the IMF's most recent rhetoric around Argentina's debt restructuring proposal and Angola becoming the latest sovereign embarking on a debt re-profiling process. We also comment on the latest stimulus efforts out of Europe, the World Bank's concerns about EM in the post-pandemic global environment, and the continuation of the strong market momentum witnessed through May.

The IMF released a technical note evaluating Argentina's May 26 proposal

Market Relevance: The IMF published a technical note that evaluated the government's May 26 proposal to creditors. In its findings, the IMF stated that the plan is consistent with restoring debt sustainability but that there is limited scope to increase payments to private creditors if Argentina is to meet its debt servicing targets. In the meantime, the deadline for an agreement has been extended to June 12.

Gramercy View: The IMF's most recent statement has received a mixed response from investors, but we believe the Fund's primary objective is to facilitate a deal between creditors and the Fernandez Administration. We see this statement as a reflection that the negotiations are progressing in the right direction as all parties move closer on terms. It is important to note that a footnote to the statement included guidelines reflecting IMF's view on how Argentina could improve its current proposal. The market broadly shrugged off these mixed headlines as

Argentinian bonds moved higher along with the rest of EM in the last few days. Furthermore, we take this note, along with IMF spokesperson Gerry Rice's statement from a few weeks ago that the Fund "stands ready to help Argentina", to suggest the IMF will not block a deal reached between creditors and the administration. In the case of a successful agreement, there is reason to believe that the IMF will work with Argentina to restructure its obligations to the Fund. It remains unlikely that the June 12 deadline will be met given that markets are still expecting Argentina to come forward with a revised offer, as the next significant events are the repayment obligations due at month end with a 30-day grace period. We continue to follow high frequency economic data coming out for May to see if the economy starts to show some initial signs of recovery following the gradual reopening that began last month.

Angola requests debt relief from oil importing partners and G20

Market Relevance: Angola announced this week that it is currently in advanced talks with "some of its oil importing partners" to re-profile debt. The government has also indicated that it is interested in seeking bilateral debt relief under the G20 Debt Service Suspension Initiative (DSSI) for low-income economies. Angola's Eurobonds touched the 30s in early April but have come back to the high-60s/low-70s amid the EM risk on rally in May and June.

Gramercy View: Angola has been hit hard by the collapse in oil prices, as over 60% of government revenue and 90% of exports are commodity based. Having just found its footing following the 2014-15 crash, the country is entering this crisis in a weak position. Real GDP has contracted in each of the last four years as oil production has declined due to aging fields and debt has increased to over 100% of GDP with material depreciation of the national currency, the Kwanza. The latter is at further risk as approximately 90% of the government's debt stock is linked to foreign currency. Angola entered into a $3.7 billion IMF program in 2018 and has made substantial progress, particularly on fiscal consolidation and implementing a floating exchange rate regime, but fiscal and external buffers are low against a large financing gap in 2020 as oil revenues and export earnings come in lower than expected. As a result, debt is projected to head towards 130% of GDP this year. The announced negotiations could provide substantial relief as the main importer of Angola's oil and its main debt holder is China. This process and the extent of Angola's obligations to China are both opaque, but the recovery in prices reflects the market's expectation that some sort of agreement favorable to Angola will be reached and that the country will receive additional funding from international financial institutions. Given that Angola's economic future and private sector debt repayment capacity are tightly tied to oil, a substantial uncertainty exists over the medium term if the recovery in oil markets is weaker than expected or if China requests collateralized oil as payment for obligations. We also think that even though Angola's authorities have emphasized that they do not envision a re-profiling of private sector debt, their interest in the G20 debt relief initiative might reignite market concerns given the number of uncertainties surrounding the G20's expectation about private creditor involvement in the initiative.

The European Central Bank (ECB) boosted its pandemic emergency purchase program (PEPP) by €600 billion to €1.35 trillion

Market Relevance: Having spent €235 billion of its €750 billion bond-purchasing program by May, the ECB announced on June 4 a commitment to buying an additional €600 billion worth of bonds to counter what it currently projects to be an 8.7% contraction in the Eurozone economy this year.

Gramercy View: This move was larger than most economist's expectations (consensus was an increase of €500 billion), underscoring the ECB's commitment to do "everything necessary within its mandate" to support the Eurozone through the crisis. The ECB's policy echoes the Fed's unwavering commitment to backstop markets in the wake of COVID-19 lockdowns. The additional firepower by the ECB comes on the heels of the recently announced package of economic stimulus measures by the European Commission (EC), which includes a proposed recovery fund of around €750 billion that will be financed through the issuance of EU bonds. This marks a material step toward the mutualization of fiscal expenditures on EU-27's recovery efforts in the aftermath of the pandemic, but a material real economy impact will likely take significant time to materialize, in our view.

The World Bank's June Global Economic Prospects report highlights the "lasting scars" of the COVID-19 pandemic on the global economy

Market Relevance: The World Bank released two chapters from its June 2020 Global Economic Prospects (GEP) report prior to the release of the full report. The release highlights two issues currently plaguing the global economy: 1) deep recessions in countries around the world and 2) volatility in oil markets driven by an unprecedented collapse in oil demand. The World Bank is expected to release its full GEP report, including GDP projections, on June 8.

Gramercy View: We agree with the World Bank that the economic consequences of global lockdowns are likely to be severe, especially with respect to emerging market economies. However, we believe there is plenty of room for credit differentiation amongst sovereign and corporate issuers, depending on their starting positions and resilience to shocks. As such, we have focused the past few months on analyzing the key factors driving the credit resilience of countries and corporates in our coverage. On the sovereign level, balance sheet strength and fiscal space coming into the crisis is an important indicator of capacity to support the economy in the wake of the unprecedented COVID-19 economic and social shocks. Countries like Russia and Chile, for example, entered the crisis with significantly more fiscal flexibility than Brazil or Turkey. In addition, we have put extra scrutiny on energy-exporters, who now have to face both a public health crisis and collapse in oil revenues that limits their fiscal capacity.

Markets continue to feed off the strong momentum witnessed through May

Gramercy View: The rally this week was partly owed to a bounce-back in Global PMIs, USD weakness, OPEC+ optimism and expectations of ECB expansion. The rally of consequences has seen a great unwind in CDS protection, with participants reducing hedges, deploying cash in an active primary market and ignoring the U.S. Treasury curve bear steepening as 10s and 30s moved to levels last seen on the Brexit Referendum date. EM Credit ends the week 41bp tighter (+1.9%), but the showstopper sits with High Yield ending 75bp tighter (+3.6%). With dollar weakness, EMFX staged a reasonable rally seeing ZAR break 17, BRL test 5 and MXN trade with a 21-handle, but GBI-EM yields still continue to flirt at all-time tight levels of 4.50%. The moves were broadly consistent with U.S. markets, where HY continues to benefit from the "Fed put" which includes the SMCCF facility allowing the central bank to buy corporate bonds. Going forward we expect investors to remain fixated on equities re-testing February highs (Nasdaq) or querying the next support level on the S&P. Meanwhile as the VIX edges below 25, the market has ripened for primary issuance, yet the question is more whether this could trigger supply indigestion as investors' cash balances dwindle. The alternative school of thought lies with accounts who have decided to fade the rally early, but may simply give-in and re-engage triggering a further squeeze higher.

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