GRAMERCY: EM WEEKLY

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Potential clarity on the timeline for finalization of the U.S.-China Phase 1 deal

Market Relevance: A Phase 1 trade deal underpins more optimistic growth forecasts for 2020. The tentative deal avoids implementation of the previously planned December 15th tariffs on additional Chinese goods and includes staged tariff reduction and Chinese purchases of U.S. agricultural goods.

Gramercy View: The progress on the deal is positive and supports sentiment, growth, and asset prices into 2020. The sooner Trump and Xi sign the deal, the better for markets as prolongation of finalization may stir-up doubt on revisions or ultimate completion. The specifics on the scope and timeline of tariff rollback will also be key. While Trump has stated that dialogue on a Phase 2 deal will begin right away, we do not anticipate meaningful progress on this in the near-term. The benefits from the Phase 1 deal should be sufficient for short-term economic conditions and political support among distressed U.S. farmers. The remaining issues under debate, particularly related to technology, will be structurally more difficult to resolve. It is more likely in our view that U.S. pressure on China persists with utilization of a broader toolset beyond tariffs, which could include targeted measures in the technology sector as well as further efforts to drive financial decoupling. Lastly, we expect the threat of tariff 'snap-back' to remain in the background of the Phase 1 agreement throughout 2020.

IMF Executive Board's approval of $498 million disbursement for Ecuador

Market Relevance: Last week, the IMF reached a staff-level agreement with the government on the combined second (delayed) and third reviews under Ecuador's extended fund facility (EFF) program. The formal approval by the IMF's Executive Board, which is expected to take place on December 19th, will allow the disbursement of close to $498 million from the $4.2 billion facility. This will complete Ecuador's 2019 financing requirements and support investor sentiment on the credit heading into 1Q20.

Gramercy View: Ecuador's Eurobond complex has recovered significantly from the November shock and we believe some limited further upside can materialize in early 2020 on the back of attractive valuations relative to peers, the possibility of modest progress on reforms, and a highly flexible IMF that has set very manageable conditionality in 2020 in order to remain involved and continue to support the government financially. All this being said, we expect that investors will start growing increasingly nervous with Ecuador's sovereign credit story as 2020 progresses. By 2H20, the market's focus will shift mainly on what promises to be a highly uncertain and divisive campaign for the February 2021 Presidential elections. Recognizing that the elections are still more than a year away, we believe that the economic and political environment that is likely to prevail in 2020 will be conducive to electoral scenarios that might usher in a reversal in the generally market-friendly economic policy trajectory under current President Moreno.

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Mexico Central Bank decision on December 19th

Market Relevance: The market anticipates a 25bps cut in the policy rate to 7.25% on the premise that real rates remain too restrictive at 4.5%, amid weak economic conditions and declining inflation.

Gramercy View: We agree with the consensus view for this meeting. However, additional easing may be limited to 50bps as opposed to the current market consensus of 75-100bps. This is due to a likely hike in the minimum wage that will pressure inflation as well as a desire for a consistent gap between Mexico's policy rate and the Fed Funds rate. In the event of sustained peso appreciation on the back of approval of USMCA in early 2020, the prospects for additional easing in the context of a Federal Reserve on hold would be greater.

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