# Market Letter

Third Quarter 2021

## *Concern about rising inflation (stagflation?) and Evergrande saga.*

Challenging environment down the road: In coming months, GDP growth should stay solid and inflation will likely be higher than projected, however, the growth impulse could start to fade, at the time when policymakers start the pathway to reduce stimulus. As the worst of the virus seems over, we start to worry about the risk of a not-so-transitory inflation, hence interest rates drifting higher.

- ***Growth*** rates have decelerated around the globe. In the aftermath of an over-10% plunge in global GDP last year, the world economy has staged a remarkably rapid recovery. Although the initial rebound in 2H20 was widely anticipated, growth exceeded expectations and GDP reversed two-thirds of the pandemic drop within the first two quarters of the expansion. The global economy exhibited impressive resiliency through the second wave of COVID-19. China's policy shifts and credit overhang remains the biggest risk to growth. The lagged impact of policy tightening in 1H including fiscal and credit tightening, decarbonization efforts, and supply-side bottlenecks have had a larger-than-expected impact on economic activity. Although Evergrande is not expected to be a systemic risk to the banking system, defaults in the China HY market may rise, however, the government should be able to ultimately manage the systemic risk.


- ***Inflation:*** permanent or transitory? There's a great deal riding on the answer since higher inflation would lead to higher interest rates and thus, potentially lower asset values. The US 10yr increased lately, stabilizing close to 1.5%. This rapid move has made investors wonder whether we are entering into a new interest rate regime or if this move will ultimately be transitory. The move higher in yields appears to have been triggered by the Fed signaling that conditions have been met to start tapering bond buying (which could end by the middle of 2022). Global core inflation although moderate, should stay elevated. Near-term dynamics remain dominated by transitory factors related to the pandemic shock that lifted global core inflation to 4%. Survey-based measures of inflation are starting to trend higher as supply shortages are spilling into the real world via Nat Gas prices, labor shortages and ongoing disruption in used car prices. Concentrated goods price pressures, linked to supply chain bottlenecks and rising transportation and material costs, are behind this acceleration but are expected to ease next year. The latest **US CPI** data came in a little below expectations but it would be premature to think that US (or global inflation) is in the process of peaking out. Oil prices are still under upward pressure. The global gas shortage will increase oil-fired power generation and the deficit we are currently observing will not be reversed in coming months (too big for any realistic OPEC+ ramp up and the shale supply-response just starting). This sets the stage for inventories to fall to their lowest level since 2013 by year-end. There will still be inflationary pressure across supply chains. Central banks who have been arguing for transience in inflation are going to be forced to ignore yet another acceleration of prices throughout the winter or remove liquidity which would further strain consumers and industry.

- There are **two inflation stories** playing out: Core inflation has surged to 3% oya— the fastest pace in the past quarter century—and the inflation surge could persist longer than expected even as the August CPI softened. The spate of high month-on-month inflation readings earlier in the year is behind us as price-level normalization is occurring in sectors that experienced large pandemic-induced price swings. However, last year's pandemic produced a rare and extreme downturn in global service-sector inflation and the normalization of service prices is still in its earlier stages and has longer room to run. The acceleration in services price inflation could offset a gradual moderation in goods price pressures, and a move toward service-sector price normalization could push up core inflation in typically sticky components of the price basket. Labor supply constraints combined with evidence of lifting rent inflation bear monitoring. The market is divided. The first is that inflation is only a transitory phenomenon, triggered by the disruptions COVID-19 had on the labor market and global supply chains. The argument is led by the Federal Reserve, who needs a justification for keeping interest rates low, despite the inflation rate jumping above 5%. At the other side of the argument are economists who argue that the inflationary pressures are longer term in nature. They point that the labor market is undergoing structural changes, with the phasing out of the baby boom generation from the labor force and the reduction of immigrant arrivals due to changes in immigration laws. Moreover, China is no longer an exporter of deflation. Increases in Chinese wages, increased protectionism and a decline in globalization is leading to a permanent rise in prices of traded goods. Last of all, lack of investment in many primary sectors, particularly mining and energy, is leading to significant increases in commodity prices. The Federal Reserve expects U.S. inflation to fall to 2.3% by next year, but if inflation stays above 4% in the next months, the market may think the Fed is behind the curve and they may take matters into their own hands.

- Escalating regulatory risk in **China** and its **property market** are seen as the biggest near term risk across the board. Credit markets have remained remarkably resilient in the face of the **Evergrande** saga. China policymakers are expected to contain the financial fallout, which is neither idiosyncratic nor systemic but an industry-wide problem. A probable outcome should be an orderly restructuring.

Evergrande's debt crisis stems from regulatory reforms and efforts to reduce leverage. Limited spillover effect triggered by regulatory tightening. An overall property market slowdown is a significant risk as it constitutes nearly 30% of China's GDP.

- What do hawkish central banks imply for markets? Global **central banks remain accommodative** but are inching towards faster normalization. FOMC delivered a hawkish surprise both on the pace of tapering and timing of the first rate hike: Tapering will start in November and conclude around the middle of 2022, alongside expectations of 6-7 rate hikes through 2024. Other DM central banks (e.g. Norges and BoE) are joining in sending more hawkish signals recently. Against the backdrop of a full year of boomy growth and a rise in global inflation to quarter-century highs, central banks are displaying patience globally.

- THE STRENGTH OF THE **DOLLAR** reflects the shift from the Fed´s reaction function/inflation concern. Risks from the property sector in China may continue to cloud the cyclical outlook and drive the dollar stronger in a growth-off scenario.

- US-China relationship has evolved into a full-fledged strategic competition centered on emerging technologies.

- The debate over the new **debt ceiling** legislation could extend into the next couple of months, but the risk of a technical default remains extremely low. Interest rates have been expected to rise in the second half of 2021 but not because of tapering. The primary driver of higher interest rates will be supply. Since April the supply of Treasury debt issuance has been negligible, but that will change dramatically once the debt ceiling is increased. The Treasury has indicated that it wants its balance at the Fed to be $750 billion at the end of Q3 and $800 billion at year end. This suggests the Treasury will need to sell another $300 billion to reach their higher target balance relative to previous years. In total a tsunami of $2.6 trillion may have to be auctioned in the next 6 months. At the peak of the Pandemic the Treasury was able to issue more than $2 trillion in debt as fear was rampant.

- **COVID** cases continue to decline, and this trend is likely to continue. Delta virus and supply-chain problems impinged on consumer spending. Confidence declines have been broad and particularly large in Asia and the US, where the Delta waves are most significant. The pandemic is far from over and won't be for a while longer. Vaccinations have done wonders no doubt, but the variants are evidently keeping the global economic recoveries on the tips of their toes. There is an early indication that Delta may be nearing a peak. The Rate of Change on the 7-day average of new cases has been coming down but is still above 0%. A stronger signal will be provided when it drops below 0% as that would indicate an absolute peak in cases.

- **South America's much-needed respite.** South America has been particularly punished during the coronavirus pandemic. With 24% of global Covid deaths despite representing just 6% of the population, the region's health systems were overrun, economies pummeled and about 20 million people were pushed into poverty. So, the sudden improvement seen over the last several months has been a light at the end of the tunnel for many. Several factors explain it. Vaccine hesitancy is extremely low in the region as people are used to getting shots for diseases such as yellow fever, malaria, meningitis and tuberculosis. Countries have picked up the pace in the past few months. Chile and Uruguay have fully inoculated nearly 75% of their popultions. In the Brazilian mega-cities of Sao Paulo and Rio de Janeiro, about 99% of eligible adults have received at least a first dose. Another factor at play is the fact that the region was ground zero for the outbreak of the gamma and lambda variants which were born deep in the Amazon and in the Andes, respectively. Those variants are considered more contagious and were behind the rapid and deadly second wave that swept the region in the first half of 2021. As a result, a lot of the population had already been exposed to or tested positive for Covid, and also delta has thus far been crowded out to some degree by the similar mutations already present in South America.

- According to the latest data from the Institute of International Finance (IIF), **global debt**, which includes government, household, and corporate and bank debt, rose to a new record high of nearly USD 300tn (353% of global GDP) in the second quarter. The rise in debt levels was the biggest among emerging markets, standing at USD 9tn.

- In the Eurozone, a leftish drift in German elections alters the political composition of the government – paving the way to a more expansionary fiscal policy (net public investment has been negative for most of the Merkel era, according to Ambrose Evans-Pritchard) but with higher taxes and perhaps a watering down of previous German labor market reforms. As far as the ECB is concerned, it will continue to send a message that monetary policy is accommodative even though the PEPP bond program is subject to modest tapering, but it is a long way from actually increasing benchmark policy rates.

## Global Drivers

- **Global growth:** *Uncertainty about the 2022 outlook. Policymakers are withdrawing emergency stimulus. The Federal Reserve has signaled a likely reduction in asset purchases beginning soon.*

Growth rates have decelerated around the globe. Recovery remains incomplete. There is a cyclical slowdown in the global economy despite the unprecedented looseness in US monetary conditions alongside massive fiscal stimulus. Global GDP stood more than 2%-pts below its pre-pandemic path at midyear. Further downside risks around 3Q and 4Q growth, as momentum loss in activity has extended into the fall. The Delta wave has not derailed the global recovery, but it has stopped the synchronized expansion. To complete the recovery global GDP needs to rise more than 4%. The culprits of the global slowdown were supply-chain disruptions, COVID-19 variants and signs of labor shortages. In China, the recent regulatory crackdown by the authorities and the severe problems facing Evergrande in the property sector might have contributed to a decline in sentiment.

**Global capex healthy.** Alongside a persistent supply crunch, growth in businesses' equipment spending remains resilient, even if it has downshifted from its recent torrid pace. Data from Japan and Taiwan show a solid expansion in domestic capital investment. Taiwan's capital goods imports posted strong gains. Globally, equipment investment is decelerating but still expanding.

- **Monetary policy outlook:** *Fed's more hawkish tone than expected. Powell attesting to more inflation being non-*

*transitory. Other central banks are tightening or talking about it. The rundown of the US Treasury General Account has finished, taking downward pressure off long-term rates.*

The Fed has expressed increasing confidence in the recovery. CBs were able to stick to their transitory inflation narrative as inflation expectations were relatively well anchored around the 2% target and markets largely priced that well, at least in the US. Interest rate hikes have begun in some small economies, but the Fed seems at least some quarters away from a window when they can begin to hike, and the ECB and BOJ appear to have no such window coming any time soon.

The outcome of the September 22nd FOMC meeting was more hawkish than expected. Without saying anything specific Chair Powell confirmed that the FOMC will announce its tapering plans at the November 3 meeting. A majority of FOMC members agreed that the FOMC's 2% inflation target had been achieved. How much will the FOMC taper each month? Chair Powell said the taper would end in mid-2022. The only way that is possible is if the FOMC reduces the monthly purchases by $15 billion a month which would allow the taper to end in 8 months. The FOMC dot forecasts[1] for policy rates all went up to medians of 0.25%, 1.0% and 1.75% for end '22, '23, and '24, respectively.

Inflation won't be as transitory nor recede as quickly as the FOMC thought in June. Powell noted that goods inflation had been negative in the 25 years prior to the Pandemic and implied that it won't be long before goods deflation takes hold again. "Over the 25 years preceding the pandemic, durables prices actually declined, with inflation averaging negative 1.9 percent per year." What he didn't mention was that was only possible after the U.S. outsourced millions of jobs to China which then provided much cheaper appliances and other goods due to lower labor costs. That is unlikely to be repeated. If inflation isn't transitory, the Fed has the tools to smother it and won't hesitate to use them.

- **Commodities:** *Oil, natural gas and coal prices surged to multi-year highs. China's slowdown has had a dramatic impact on demand growth for base metals and iron ore, even as mobility indicators are recovering.*

Global commodity prices rose 56% y-o-y in September, driven by sharply higher energy commodities while metals and agricultural prices mostly fell due to global growth concerns, including risks to China's growth. Sharply higher gas and coal prices largely reflect supply constraints and are disrupting broader economic activity.

The sell-off in iron ore, with spot iron ore prices down 55% from the May 2021 highs, follows a deceleration in Chinese steel production, seemingly driven by environmental-related output cuts and pressure to make progress on longer term decarbonization targets as well as a broader economic slowdown. China accounts for ~50% of global base metals demand, and the property sector is responsible for ~25% of Chinese steel demand, with Evergrande comprising just ~1% of Chinese demand, suggesting that output curbs, not Evergrande, are the larger driver behind the iron ore sell-off.

The global climate policy agenda could lead to limits on investment and supply shortages in high carbon-emitting commodities. This in turn could exacerbate supply disruptions in such commodities and extend pricing pressure at least over the near term. This appears to be materializing in a global energy price crunch also exacerbated by acute seasonal demand.

**Oil**: gradually rising prices. Prices for natural gas

[1] https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20210922.pdf

and coal are likely to stay elevated amid low inventories. OPEC+ should strategically add barrels in relatively restrained increments. OPEC exports are rebounding driven by the easing of supply disruptions, and the group is planning to add production over the coming months. Oil and gas companies do not reinvest their profits, rather pay down debt and return money to shareholders. Why are the incumbent majors not falling over their feet to extract more hydrocarbons out of the ground considering excellent business opportunities? Well, the global establishment is no longer interested in them doing it. The elites of policymaking and investor communities across modern economies have signed on to the agenda of carbon neutrality. This even includes China that hopes to play a visible role in this herd-like behavior, mainly to reduce hostility toward Beijing in the Western world. But China's and other nations' electricity shortages are the result of draconian regulation to get carbon emissions to zero by 2050/60.

**INVESTMENT OUTLOOK:** *THE OUTLOOK FOR RISK REMAINS PRECARIOUS AS FINANCIAL CONDITIONS TIGHTEN INTO YEAR END. The stock market seems afraid of higher inflation, hence interest rates.*

The UST10y YTM touched 1.5% lately, from 1.3%. This rapid move has made investors wonder whether we are entering into a new interest rate regime or if this move will ultimately be transitory. The move higher in yields appears to have been triggered by the Fed signaling conditions have been met to start tapering bond buying. Are investors overreacting in the short run or does this portend something more disruptive as it relates to rates? Weaker JPY and precious metals suggest we are not under a risk-off environment, but more like a rate differential move. Despite all the inflationary signs, the market for gold, which historically has been bought for protection against inflation, seems to agree with the bond market that the outlook for inflation is benign. The bigger problem is the wave of supply that could capsize the Treasury market. Before year end the Treasury Market will have to deal with enormous supply, sticky inflation, less Federal Reserve buying, and spending increases well over the horizon. Sounds like a perfect storm is forming that could cause an increase in Treasury yields.

China remains a drag for EM assets. The fallout from Evergrande has mainly impacted EM corporates. Risk from China for the broader EM complex can emerge from a property sector slowdown, which could spill over to EM growth and commodity exporters. Underweight EM FX as risks surrounding China warrant hedging and a hawkish Fed stance does not help EM currencies given the best of global liquidity conditions is likely behind us. Energy producers such as Russia should fair better, while others like India or Turkey will suffer more with the energy shock.

**Risks:** *Stagflation, China's slowdown, Evergrande contagion worries, supply chain disruptions, energy price surges, an appreciating dollar, rising Treasury yields, US debt ceiling anxiety, lingering Covid issues, North Korea firing missiles.*

**CONCERNS ABOUT INFLATION**: *inflation is likely to be higher in the next decade in developed economies than it was in the years before the pandemic, however lower than current levels.*

Fed leaders admit that they're not highly confident regarding their expectations. Fed inflation projections for 2023 fall between 2% and 2.3%. Higher prices for inputs ("cost-push" inflation) and more dollars chasing goods ("demand-pull" inflation) may result in an excess of demand over supply and thus rising inflation. On the other hand, there are the arguments for why higher inflation might prove "transitory": Many of the shortages affecting finished goods and manufacturing inputs can be seen as a natural consequence of restarting the economy and, especially, the global supply chain. A lot of the inflation seen in the first half of 2021 can be attributed to increased consumer spending financed by Covid-19 relief. The current high levels of non-services inflation globally will diminish over time, and this represents the so-called “transitory component” of inflation. The ending of enhanced unemployment benefits in September should bring more workers into the job market, reducing the impact of labor shortages on wages and thus the prices of goods. The growth of the economy should slow after 2021 or 2022, by which time the impact of 2020’s pent-up consumer demand should ebb significantly. There’s hope that the recent levels of stimulus, deficit spending and money printing will recede in the next few years (or at least their rate of growth will slow) as the economy continues to expand, meaning these factors will decline relative to the size of the economy. Technology, automation and globalization are likely to continue to have significant deflationary effects.

**EVERGRANDE CRISIS**. There is a cash crunch in the entire Chinese real estate sector. Housing activity is contracting and in turn pressure is ramping up on highly leveraged real estate developers. Policymakers in China want to facilitate the deleveraging of property sector debt while limiting financial spillovers through support for consolidation, funding, and banks. By virtue of China’s financial system being mostly state-owned or state-controlled, it differs from the Western developed world. So far there is no sign that China’s financial system is under any meaningful stress.

Evergrande is the second largest developer by sales, but it only accounted for 3.2% of the country’s property sales last year. The scale of exposure does not appear to be of systemic proportion. Evergrande’s problem stems from its highly levered balance sheet. Its gross debt ratio has been hovering above 80%, and its cash reserve has been well below its short-term debt level since 2017. This precarious leverage situation creates a persistent need for fresh funding to operate, while also falling afoul of the government’s regulatory thresholds, cutting its access to any financing from domestic banks and financial markets. All of this has made it extremely difficult for Evergrande to service its liabilities. Developers have long been restricted from raising funds in the domestic stock market, and access to bank and bond market funding has also tightened in recent years. This has increasingly forced Evergrande to rely on account payables to contractors and suppliers for short term funding. Evidence that Evergrande has been in trouble since early this year has made these creditors reluctant to extend financing to the company, exacerbating its liquidity stress. The government will not permit a messy default to metastasize into systemic instability. The country’s largely state-controlled financial system does not operate strictly based on market principles, which ironically endows the system with counterintuitive resilience to manage this type of shock. The government is rightly concerned about the country’s sky-high property prices and worsening housing affordability, but it was ultimately policy uncertainty that amplified Evergrande’s woes and turned its liquidity stress into a solvency crisis.

Deteriorating housing affordability is not unique to China, and property prices have been surging in most major cities around the world of late. The conventional wisdom is that China’s housing sector is massively oversupplied, supported by sensational stories of “ghost towns'' and empty building complexes. The relentless multi-year increase in home prices, however, suggest otherwise, i.e. persistent undersupply. The supply demand imbalance is particularly acute in first-tier cities where residential construction has dropped dramatically in recent years. Even at the national level, housing supply does not appear overly excessive, especially considering the country’s massive population and rapid pace of urbanization.

**STAGFLATION**: The split between temporary price-level adjustment and entrenched higher price and wage-setting behavior remains unclear. And it is still early for the "stag" bit of the term, as absolute growth levels are still good. Persistent inflationary pressures in recent months in the United States and to a lesser extent in Europe and the slowdown in activity indicators raise fears that the world economy is heading toward stagflation reminiscent of the 1970s. Over the short-term inflation forecasts point to temporary yet persistent upward pressures that should dissipate as productive capacity increases. The question is, how long will it take for supply to meet demand given fears of new Covid variants and waves of contagion? Going forward, the key will be to avoid spiraling price and wage increases and a de-anchoring of expectations. This may require monetary policy to act sooner than expected, and even overreact. The recovery cannot be expected to continue as fast as during the rebound from the deep trough of 2020, but the near-term consensus is for growth in 2021 and 2022 in the United States and Europe to be above potential.

## Countries

**China:** *Evergrande's Over-Levered Balance Sheet: From Liquidity Stress to Solvency Crisis. Power crunch. Recent activity data signal further downside risk.*

The Evergrande crisis is another deflationary shock to the Chinese economy, which will prompt an acceleration of the reflation policy that is already underway. China needs to ease monetary policy quickly, as the Evergrande debacle will strain liquidity conditions in the real estate sector, at a time when the economy has already weakened substantially. Simultaneous monetary and fiscal tightening have pounded the Chinese economy. Stringent control of developers' access to financing could be eased, alleviating liquidity stress for the peers of Evergrande. In terms of investment strategy, the headline risks associated with Evergrande will persist for a while longer, amplifying the downward pressure on Chinese equity prices. Nonetheless, the risk of a systemic failure is very low. The gathering headwind for the economy will force the Chinese authorities to relax policy further to help growth.

China may be diving headfirst into a power supply shock that could hit Asia's largest economy hard just as the Evergrande crisis. The crackdown on power consumption is being driven by rising demand for electricity and surging coal and gas prices, as well as strict targets from Beijing to cut emissions. The economy is at risk of a severe shortage of coal and gas this winter.

USD/CNY has traded in a range, and the Evergrande episode is likely a short-term sentiment hit for CNY FX rather than an instigator of durable currency weakness. Our YE forecast for CNY remains unchanged at 6.5.

**Brazil:** *Booming trade picture buffeted by a wave of political turmoil. Unemployment rate falls to the lowest level since June 2020*

President Bolsonaro tried to whip up his political base by calling for pro-government rallies on Brazil's Independence Day, September 7th. Thousands of people took the streets across the country. The president used the opportunity to rail against members of the Supreme Court. With his support plunging below 20%, and the numbers for Lula rising, he has turned to Trump tactics, raising doubts about the efficacy of the electoral and voting process. Elections are still a year away, but there are worries that Bolsonaro will call on his military allies to subvert the electoral process.

Rising vaccination rates will tamp down the effects of COVID-19. Nevertheless, increased militancy and violence by his political base is casting a shadow on Brazilian asset prices.

**Mexico:** *Good news on the economic front.*

A recovery in services and a strong export sector will put the economy on a growth path of about 6% y/y for 2021. On a four-quarter trailing basis, the current account surplus rose to a new record high US$35.1bn (3.0% of GDP) driven by rising non-oil trade surpluses and record remittances, which grew 19.4% in the 12-months, reaching a new record high of US$46b (4.2% GDP) or more than double the US$20b in crude oil export receipts.

The ratification of Rogelio Ramirez de la O as Finance Minister also ensures good economic stewardship. In his inauguration speech, the new minister vowed to adhere to President Andres Manuel Lopez Obrador's (AMLO) fiscal austerity and support for state-run energy companies, i.e. Pemex.

**Argentina:** *Primary PASO elections towards November 14 midterm elections. Strong Real GDP Rebound in June-July Driven by Improving Covid and Mobility Backdrop*

The incumbent administration suffered a defeat in the PASO election. The most important takeaway from the midterm primary elections is a rejection of radicalism and an embrace of moderation. At national level, Frente de Todos (FDT) obtained 31% of votes, compared with 40% for Cambiemos. If this result is extended to November's General election, at the upper chamber, FDT will lose simple majority and quorum, while no material changes are expected at the lower house. The immediate consequences of this setback have been a revamp of the cabinet and exposed the fragmentation inside the governing coalition. Over the next 4 months the government will apply higher public spending to improve its performance in November's general election. The primary fiscal deficit may climb to 4%.

A chunky $1.8bn IMF loan was repaid. There is no other alternative to an IMF program or otherwise risk an intense market backlash that undermines the fragile economic recovery and complicates the next two years of the Fernandez mandate.

**Chile:** *Things didn't go so badly during the presidential primaries. Although copper prices are down from their highs, they are still about twice as high as they were in the depths of the pandemic.*

In the presidential election in November the leading candidates are fairly new faces, and the Concertación, the center-left alliance that dominated most of that period, is no more. The winner will at first cohabit with a convention which is writing a new constitution, and which could decide to curtail the normal four-year presidential term. Chile is still picking up the pieces after an explosion of massive and sometimes violent protests in late 2019. At the heart of the protests was anger over narrowing opportunities and inadequate and unequal access to health care, pensions and education.

The first round will be on November 21st, and a second round of elections will be held on December 19th, if no candidate wins a clear majority. Boric leads in the polls (22%), a former student leader who promised free education, but rejected major changes to the country's economic model. Neo-conservatist Kast (15%) snatches second place from Sichel (12%), who is committed to maintaining the country's economic model, while providing continued relief to the poorer elements of the society.

**Peru**: *President Pedro Castillo tacks to the center.*

Congress gave a vote of confidence to the cabinet. This marks a major victory for the new leader. Although Castillo campaigned on a Marxist platform, he has been moving much more to the center. He recently forced Foreign Minister Hector Bejar to resign. Bejar is a renown radical, with strong ties to Cuba and Venezuela. He was replaced with Oscar Maurtua, a well-respected former diplomat. Castillo's move to the center is straining his relationship with Vladimir Cerron, the leftist strategist behind his campaign. However, it is also making him more palatable to the country's business establishment and international investors. Unfortunately, Moody's did not share the optimism and downgraded the country's debt to Baa1.

**Ecuador:** *High beta status on a weak IMF anchor.*

The election of Guillermo Lasso, a seasoned banker with close ties to the business community, has pushed the country to the right. Lasso has had a series of successes, increasing the vaccination rates for Ecuadorians, he has pushed through several tax and tariff reforms, enjoys an approval rate of 78% and completed a 6.5 billion Extended Fund Facility with the IMF (this will provide the country with 1.5 billion in fresh funds before the end of the year). A look at the country's Sources and Uses of Funds shows a healthy surplus, which explains why it has been able to accumulate international reserves since the end of the pandemic.

There is no quick fix for macro imbalances. It's all about execution risks on economic reform. The political strategy is critical. The Lasso administration seems to understand the political and economic challenges with emphasis on progressive reforms. The path for approval is tricky. The submission to the Assembly is probably just for show on expectations for failure under a tight 30-day deadline and no pre-negotiations of several complex reforms. The more important test is the popular referendum scheduled for possibly February 2022. If the markets understand this political strategy, then there shouldn't be much if any disappointment to a setback at the Assembly. More important is the marketing strategy and the broader socialization with the voter base.

**El Salvador:** *Bitcoin legal tender*

Negotiations are currently underway with the IMF for a new Extended Fund Facility. The US/El Salvador diplomatic relations continue to deteriorate. Downgraded to Caa1 by Moody's. The rating agencies could continue the threat of more downgrades to the C rating category. Given president Bukele´s immense popularity, it is almost certain that he will be around for, at least, another term in office.

**South Africa:** *Considering introducing a basic income grant after a wave of violence*

The arrest of former president Jacob Zuma, increased poverty and restrictions introduced due to the pandemic have fostered the widespread protests. The unemployment rate reached 44%. Unfortunately, the vaccination rate has decreased, as more remote communities complain about the lack of information about the shots. Around 20% of the adult population is fully vaccinated.

**We thank you for your continued support.**

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