April 2024

Emerging Market Debt Indicator

The fast view

Market background

Sticky inflation, labour-market resilience, and hawkish comments from the US Federal Reserve caused US Treasury yields to rise sharply and the US dollar to strengthen. This made for a challenging month for emerging market sovereign debt.

Africa

Egypt's external funding situation continued to improve, with the UK providing support. Senegal's new government committed to both an IMF programme and to maintaining the common currency, allaying market concerns. Drought continued to weigh on Zambia and Ghana's economies. Benin saw its credit rating upgraded by S&P.

Asia

Asian currencies came under some pressure from continued US dollar strength and a widening interest rate differential with the US. In China, economic activity data was mixed, and authorities suggested that policy will remain supportive. The trend of strong economic data continued in India, and exports related to artificial intelligence boosted Taiwan and South Korea's economies.

Latin America

Hawkish narratives from central banks continued, particularly in Brazil and Mexico. In Argentina, fiscal data remained strong. The government in Brazil proposed a small deterioration in its fiscal targets, weighing on the Brazilian real. Ecuador reached a Staff Level Agreement with the IMF for a new four-year US$4 billion programme.

Central and Eastern Europe, Middle East and South Africa

There was significant demand for the lira post the local elections in Turkey, allowing the central bank to start rebuilding its US dollar reserves. Election-related uncertainty continued to weigh on South African assets. Signs of a modest economic recovery continued in Central and Eastern Europe, with PMIs broadly improving, albeit still in contractionary territory.

EM corporate debt highlights

Like other fixed income markets, the EM corporate debt market was affected by the rise in US Treasury yields. The negative impact was most pronounced in the investment-grade market, given its higher sensitivity to Treasuries. Credit spreads tightened, particularly among high-yield bonds, helped by robust fundamentals and supportive supply/demand dynamics.

Werner Gey van Pittius
Co-head of Fixed Income

Market background

A combination of sticky inflation, labour-market resilience, and hawkish comments from the US Federal Reserve (Fed) caused a sharp rise in US Treasury yields over April. The US Consumer Price Index (CPI) revealed higher-than-expected inflation (3.5% year on year), while core inflation – which strips out food and energy prices – was higher still at 3.8% over the same period. Responding to this, Fed Chair Jerome Powell was notably more hawkish in his statements. Powell reiterated that recent economic data suggests it is likely to take longer than expected to bring inflation down to target, and that the Fed can keep interest rates at their current elevated levels for longer if needed. This led to a repricing in the US Treasury yield curve and a reset in the market's expectations of interest rate cuts. In Europe, sovereign bond yields across the continent rose over the month, although not as significantly as in the US. The European bond market sell-off was partly driven by the correlation with the US, but also a result of market participants removing rate cuts from their 2024 expectations.

April was a difficult month for emerging market (EM) sovereign debt, with the broader asset class coming under pressure from the sell-off in sovereign bond yields across developed markets. Starting with local bonds and currencies, the JP Morgan Government Bond Index-Emerging Markets fell by 2.1% over April, with both EMFX (-1.2%) and hedged local bonds (-1.0%) weakening, with the former impacted by the stronger US dollar. In hard currency debt, the sovereign index (JP Morgan EM Bond Index) also fell by 2.1%, with the more interest rate-sensitive investment-grade portion of the index falling by 2.8%, while the high-yield segment fell by 1.4%.

Top-down views and outlook

Top-down positioning at the end of April 2024

	– –	–	0	+	+ +
Overall risk			■		
Hard currency debt			■		
Local rates				■	
FX			■		

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From a top-down risk perspective, we have moved to a neutral stance overall in EM assets. We are now neutral across EM hard currency debt and EM currencies, acknowledging the risks around US Treasury market volatility, given stubborn inflation. In EM hard currency debt, sticky developed market inflation may keep rates volatility high, so we prefer to focus selectively on bottom-up opportunities among high-yield hard-currency debt issuers. For EM currencies (EMFX), while we acknowledge strong underlying country fundamentals, the higher real rates in the US creates a more challenging environment for the asset class. We remain overweight local rates, as we note that inflation in EM economies continues to surprise to the downside, select markets continue to exhibit attractive real rates, and rate-cutting cycles have further to go in some EM economies.

Outlook

Recent data releases have led markets to become more confident of a 'soft landing' (rather than a recession) for economies, especially the US. Despite the messaging at the Fed's May press conference being slightly more dovish than expected, sticky inflation and resilient economic growth mean the outlook for rates remains uncertain. The market is now pricing in the first rate cut for later this year but if the eventual pace at which the Fed unwinds it tight monetary policy undershoots expectations, further rate-market volatility could materialise.

While financial markets are likely to remain volatile, we continue to be constructive on the medium-term outlook for returns from the EM debt asset class. Many EM economies have solid fundamental foundations. The more fragile economies are receiving plenty of support from the IMF and other multilaterals. Furthermore, with much of the painful interest-rate hiking now behind them, most EM economies are in an enviable position relative to developed markets overall, with most EM central banks either having completed their hiking cycle or beginning to cut rates. EM bond market valuations look attractive – with some markets still pricing in significantly more risk than we believe is justified.

Regional highlights

Africa

The positive external funding story continued in **Egypt** over April, with the United Kingdom providing further support to the country. Combined with flows from various multilaterals, the EU and the UAE, Egypt's US dollar inflows will total c.US$48 billion. On the local currency side, a recent IMF report highlighted the commitment of the government to increase the transparency of how the new exchange rate regime would function. This commitment to transparency was further supported in the budget as 59 government entities that were previously excluded from the budget, are now being included. The budget overall is targeting a 3.5% primary surplus. Less positively, the current account deficit for 2023 widened to US$7 billion, caused by both dividend and income repatriation, as well as Suez Canal traffic being at 50% of typical levels due to the tensions in the Red Sea.

In **Ghana**, uncertainty remains over the country's debt restructuring, as bondholders and the government failed to reach a deal during the restricted period. This was perceived negatively by the market, impacting asset prices. We still believe that a deal is likely to be reached before the elections in December. In addition, there was continued pressure on domestic cocoa production due to the ongoing drought. The impact of this on Ghana's current and fiscal account will be important to monitor, especially as it may increase the likelihood of bond issuance.

Drought is also having a large impact in **Zambia**. The country now needs to import maize and electricity given its reliance on hydroelectricity. The IMF made a visit towards the end of the month to discuss the financing gap that has now arisen, and we expect multilateral support to be forthcoming. In other news, Zambia reached a deal with bondholders.

US dollar reserves in **Nigeria** fell after the government paid off some of its liabilities. Funding from the World Bank and the African Development Bank is likely to arrive in the short term to help alleviate pressure on the reserves. Inflation rose given food prices and a weaker naira.

In **Senegal**, the newly elected government helped to alleviate some of the market's concerns around the path for policymaking. The new administration has committed to both an IMF programme and to the common currency, the CFA franc. The market has reacted positively to this.

The government in **Angola** started to reduce diesel subsidies, which is helping the fiscal account. It also indicated that it is hoping to issue a Eurobond and a green bond later in the year.

In **Kenya**, there was a delay in the IMF's review as the country has lagged on its fiscal revenue measures. While we take the proposed 2024/5 budget as a positive signal of the government's continued commitment to fiscal consolidation, the government's plan to address this will be an important test to see if it remains committed to the IMF deal. Kenyan authorities have suggested than they want to issue a sustainability-linked bond towards the end of the year.

Benin saw its credit rating upgraded by S&P from B+ to BB-, supported by strong growth, a declining fiscal deficit and favourable debt dynamics.

Asia

Asian currencies came under some pressure over April from the continued strength of the US dollar and the widening interest rate differential between most Asian markets and the US. In this vein, several Asian central banks were on the hawkish side, most notably Indonesia, where there was an unexpected increase in the policy rate.

In **China**, economic activity data released in April for March was mixed. The Q1 GDP figure was better than expected at 5.3% year-on-year versus 4.8% expected, but retail sales figures for March were disappointing. While real GDP numbers are strong, nominal GDP growth remains very weak, with the GDP deflator (the ratio of nominal GDP to real GDP) staying in negative territory for the last four consecutive quarters. On the property front, activity (sales and purchase data) remains weak, especially in the primary market, but the secondary market is improving as prices have been allowed to adjust lower more freely than in the primary market. Similarly, the growth in credit (a measure of the appetite for loans) was also soft in March. April Purchasing Manager Indices (PMIs) made for more encouraging reading: the manufacturing number was better than expected, especially among the export-oriented industries, but the services PMI was weaker, suggesting a fall in domestic demand in March after a decent start to the year. Towards the end of April, the government staged its Politburo meeting focusing on economic issues. At the meeting, the authorities appeared to be satisfied with the Q1 GDP data, but they recognised that domestic demand was weak, and that the external environment remained challenging, hence the policy stance is to remain accommodative to supporting growth.

The trend of strong economic data in **India** continued over April, with the services PMI reaccelerating to an impressive 61.2, and the composite number is now at all-time highs. The trade balance was also significantly better than expected, which should result in a modest current account surplus for Q1 2024. The Reserve Bank of India (RBI) left its key policy rate unchanged as expected, with the accompanying statements remaining fairly hawkish given strong growth and inflation that is still above the RBI's target.

South Korea held its parliamentary elections over the month, in which the opposition party won a majority, however no major changes in policy direction are expected. On the economic front, domestic demand likely got a boost ahead of the elections, which led to GDP coming in better than expected, while external demand remains very strong, notably for sectors related to artificial intelligence.

The Bank of **Thailand** was somewhat hawkish in its decision to remain on hold. The member vote split stayed at 5-2, with the 2 dissenters in favour of a rate hike, which was exactly the same as the previous meeting. With little sign of an imminent rate cut, the market began to price out any rate cuts in 2024, and this weighed on the local bond market. The bank remains concerned around the level of household debt and is closely monitoring the weakness in the baht versus regional peers.

Bank **Indonesia** surprised the market with a 25bps rate hike in April in a bid to defend the currency. The rupiah, along with other Asian currencies, has been susceptible to the strong US dollar caused by the widening interest rate differential with the US. This caused the country's yield curve to bear flatten (short-dated bonds selling off relative to longer-dated bonds).

The central bank in the **Philippines** left interest rates on hold as expected, while the messaging remained on the hawkish side given resilient growth, above-target inflation and fiscal pressures.

In **Taiwan**, CPI inflation for March was significantly lower than expected at 2.1% year-on-year, while core inflation was also much lower. On the trade front, the March trade balance was stronger than expected at US$8.7 billion versus US$7.5 billion expected, with exports growing at 18.9% year-on-year versus just 7.5% expected. Q1 GDP growth was also very strong, at 6.5% year-on-year, supported by both an improvement in domestic demand and exports related to artificial intelligence. However, the Taiwan dollar weakened over the month, largely from the stronger US dollar, but equity outflows were also significant at around US$5 billion for April, taking year-to-date flows to broadly neutral.

Latin America

For the region as a whole, central banks continued with their hawkish narratives, particularly in Brazil and Mexico. Monetary policymakers remained cautious, particularly with regards to the infamous 'last mile' problem (closing the gap between current inflation and reaching target inflation).

In **Argentina**, the trend of strong fiscal data continued over March, with the fiscal account remaining in a surplus for the third month in a row, thanks to tight fiscal policy. In this vein, President Milei's omnibus reform bill continued to make progress through the political system, and was approved by the lower house on the last day of the month before moving to the Senate. The bill includes more laws that will further aid Argentina's fiscal tightening, such as reinstating income tax to help the provinces, and labour market reforms. We expect the bill to face stronger opposition in the Senate but to still end up being passed as the government has shown signs of being more willing to negotiate.

The government in **Brazil** proposed a 0% primary fiscal balance for 2025, which is a small deterioration relative to the previous 0.5% surplus. The market reacted negatively to this, with the real weakening over the month. At the recent IMF spring meetings, the central bank governor stated that uncertainty has risen due to the geopolitical backdrop and the fiscal risks, and pace of rate cuts could slow. This is despite inflation continuing to fall.

The Central Bank of **Chile** adopted a slightly less dovish narrative. It continued to cut rates, but slowed the pace of cuts to 75bps versus 100bps at the last meeting. The accompanying statement suggested that the bank won't take monetary policy to a neutral level until 2025. The peso benefited from this, while also being boosted by the strong copper price. On the growth side, activity data for the country has begun to show signs of recovery.

Recent inflation data in **Mexico** was slightly higher than expected, while retail sales data was strong. This is keeping the central bank (Banxico) on the hawkish side after its initial rate cut in March. Banxico has said that it will remain data dependent and the cut in March did not signify the start of a new cutting cycle.

Colombia's central bank (Banrep) was also more hawkish in its recent meeting minutes following the 50bps interest rate cut. It highlighted that inflation remains above target and fiscal risks are looming. In other news, President Petro's health reform has been halted after a lack of support from Congress, while the pension reform continues to make progress, but the amendments made to it have been market friendly, helping the fiscal outlook.

Inflation for March in **Peru** was also slightly above expectations, driven by food and education costs, while economic activity data was weaker but better than expected. Regarding the recently approved pension fund withdrawals, Moody's has confirmed that this doesn't affect the long-term credit rating. S&P, however, surprisingly downgraded the sovereign rating to BBB-.

In **Ecuador**, the government announced new power cuts after issues at its suppliers, while the recent referendum showed support for President Noboa's tougher stance on violence in the country. The government also reached a Staff Level Agreement with the IMF for a new four-year US$4 billion programme.

Fitch downgraded **Panama** to high yield (BB+) over the month, citing fiscal and governance concerns.

Central and Eastern Europe, Middle East and South Africa

Post the local elections in **Turkey**, there was significant demand for the lira from both locals and offshore investors. This allowed the central bank to start rebuilding its US dollar reserves. At the same time, the central bank continued to tighten liquidity conditions, which transmitted into higher interest rates for consumers on the loan and deposit side. President Erdoğan backed his economic team, and the Minister of Finance, Mehmet Şimşek, promised further fiscal consolidation measures over time. Inflation continues to disappoint markets, but the government's ongoing commitment to tight policy should start to help inflation in the coming months.

Asset-price moves in **South Africa** continued to be dominated by uncertainty around the upcoming election at end of May. However, we think that these market moves reflect excessive pessimism around the likely election outcome. Away from the election, the economic backdrop remains sluggish but with high and sticky inflation. As a result, the South African Reserve Bank is in no hurry to

commence its cutting cycle and the central bank governor reiterated his view that the bank may lower its inflation target after the elections, which would necessitate an even slower cutting cycle.

The US funding approval of US$60 billion should be sufficient to support **Ukraine's** military efforts for the remainder of the year. There are also significant discussions underway with the creditor committee, and a debt restructuring deal should be completed within the coming months.

In the **Middle East**, geopolitical tensions continue to weigh on the outlook for global oil prices and increase the uncertainty for the region as a whole. In the Caucasus, there was mixed newsflow over the month: there are signs that Armenia and Azerbaijan are getting closer to a peace deal; while in Georgia, the passing of a controversial new law, which will impact civil liberties, led to large street protests. This makes the outcome of the election later in the year particularly important.

Turning to **Central and Eastern Europe** (CEE), we are continuing to see signs of a modest economic recovery, with PMIs broadly improving across region, albeit still in contractionary territory. The end consumer has also continued to recover on the back of nominal wage growth remaining strong and inflation falling, which has led to an increase in retail sales. There are also signs that the external demand picture is slowly recovering too, although progress on this front remains lacklustre and uneven. The upturn in growth in itself is not enough to slow the monetary policy cutting cycle that is underway across much of the region, however inflation is no longer printing below expectations amid stubborn services inflation. As a result, central banks are being more hawkish in their guidance, but the National Bank of **Hungary** still cut rates by 50bps over the month, and the **Czech** National Bank did the same at the start of May. The National Bank of **Poland** kept rates on hold in April and continues to sound relatively hawkish; the market has now priced out almost all rate cuts in 2024. In **Romania**, the central bank is getting closer to the start of its cutting cycle, but the most recent communications sounded hawkish, and any easing cycle is likely to be shallow.

EM corporate debt highlights

The JP Morgan Corporate EMBI fell 0.9%, once again impacted by the rise in US Treasury yields. Investment-grade bonds (-1.26%) drove the negative return, while high-yield issuers only fell by 0.34%. Credit spreads in the market tightened, particularly among high-yield bonds given robust fundamentals and supportive supply/demand dynamics. On a sector basis, all areas of the index were negatively impacted by US rate moves, while at a country level, most markets posted negative returns with the exception of Argentina and Turkey, where corporate issuers benefited from the positive developments at the sovereign level. In terms of issuance, despite picking up in the final week of April, activity in the primary market was fairly muted compared to historical levels, with net financing broadly neutral over the month.

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