May 2024

Ninety One

Emerging Market Debt Indicator

The fast view

Market background

For much of May, emerging market (EM) fixed income markets benefited from the increasingly dovish outlook for US monetary policy. Despite the reversal that happened later in the month and led to a sell-off across global bond markets, the EM debt asset class still managed to make gains.

Africa

Ongoing financial-account inflows from Egypt's UAE property deal continued to support the Egyptian pound, and net US dollar reserves reached a historically high level. In Zambia, bondholders accepted the proposed deal to swap three current bonds into two new bonds. Ghana's government and official creditors agreed a memorandum of understanding on the external debt restructuring.

Asia

China's economy remains bifurcated, with weak domestic demand offsetting strong external demand. India held its elections in May, with the results announced in early June. Surprisingly, Modi's BJP party did not secure a majority, returning India to coalition politics. Elsewhere, Bank Indonesia left rates on hold as expected. Rates were also kept on hold in South Korea, Malaysia and the Philippines, but a rate cut appears closer in the latter.

Latin America

Panama's general election yielded no surprises and the market welcomed credible cabinet appointments. The Dominican Republic's election result was also in line with expectations, paving the way for fiscal reforms. Rising inflation expectations turned Brazil's central bank more hawkish, but its counterpart in Peru resumed rate cuts after a lower-than-expected inflation print. Moody's upgraded Brazil's outlook to positive, and record FDI flows in Mexico highlighted the benefits of 'nearshoring'.

Central and Eastern Europe, Middle East and South Africa

Election-related uncertainty in South Africa kept market volatility high. Positive macro dynamics in the country include falling inflation (rates were kept on hold) and energy supply improvements. Elsewhere, a mixed picture for inflation saw central banks in Hungary and Czechia cut rates while their peers in Poland and Romania kept rates on hold. Ukraine reached a staff-level agreement with the IMF.

EM corporate debt highlights

The EM corporate debt market had a positive month, driven equally by both the investment-grade and high-yield portions of the market. Spreads tightened modestly in the high-yield segment, and were unchanged within investment-grade bonds, but the higher duration (interest rate sensitivity) of the investment-grade segment meant that it benefited more from the fall in US Treasury yields over the month. Subdued supply continues to be supportive for credit spreads.

Werner Gey van Pittius
Co-head of Fixed Income

Market background

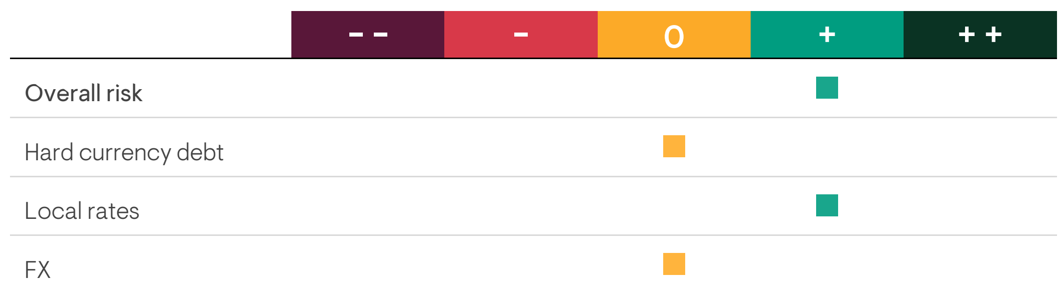
Fixed income markets performed well in the first half of May. Macroeconomic data - including weaker-than-expected US non-farm payrolls and US CPI inflation that was in line with expectations – combined with central bank rhetoric to support a more dovish outlook for monetary policy. This reversed later in the month as the combination of renewed signs of stubborn inflation in the UK and Europe, hawkish comments from the US Federal Reserve, and a series of weak US Treasury auctions prompted a sell-off across global fixed income markets.

For much of May, emerging market (EM) fixed income markets benefited from the increasingly dovish outlook for US monetary policy. Despite the reversal that happened later in the month and led to a sell-off across global bond markets, the EM asset class still managed to make gains. The local currency debt market (JP Morgan Government Bond Index-Emerging Markets) posted a 1.6% gain, driven by positive moves in FX and rates markets. The hard currency sovereign debt market (JP Morgan EM Bond Index) rose by 1.8%, and corporate credit market (JP Morgan Corporate EM Bond Index) by 1.5% - in each case, both the investment-grade and high-yield markets posted gains.

A more divergent inflation picture has made the outlook for monetary policy increasingly diverse. For instance, in Latin America, rising inflation expectations forced Brazil's central bank into a more hawkish stance; in contrast, its counterpart in Peru was able to resume rate cuts thanks to a lower-than-expected inflation print. Turning to Africa, inflation in Nigeria was slightly higher than expected, and the central bank hiked rates by more than expected (150bps). Ghana was one of the top-performing hard currency debt markets; authorities moved closer to signing a memorandum of understanding with bilateral creditors, paving the way for the Eurobond restructuring to be finalised. In Asia, China's economy continued to be bifurcated, with weak domestic demand counteracting strong external demand. India held its elections during May, with the results announced in early June. Surprisingly, Modi's BJP party did not manage to secure a majority, returning India to coalition politics. In South Africa, the incumbent ANC party performed much worse than expected in the elections and did not achieve an absolute majority for the first time since 1994. This has kept market volatility elevated.

Top-down views and outlook

Top-down positioning at the end of May 2024



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

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We increased our top-down risk targets from our previously neutral stance. While US economic growth surprises have been softening (albeit from a high level), EM growth has generally been surprising to the upside, resulting in an evening out of global economic growth. We implemented this top-down change by closing the portfolio's short position in the euro. We retain a neutral top-down risk exposure in EM hard currency debt and EM FX as we think the backdrop of ongoing US Treasury market volatility (as developed-market inflation remains sticky) is more conducive for earning carry and implementing bottom-up relative-value trades than for taking top-down views. In EM hard currency debt, we prefer to focus selectively on bottom-up opportunities and have started to rotate some credit exposure from high-yield to investment-grade markets in reflection of valuations, following recent market moves and to avoid positioning vulnerabilities. We remain overweight local

rates as inflation in EM economies continues to print lower than consensus expectations, although we acknowledge some diverging trends between services and goods price inflation. We still believe select markets offer 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. With the recent messaging and minutes from the US Federal Reserve (Fed) turning more hawkish, plus stubborn inflation in the UK and Europe, the outlook for global interest rates remains uncertain. The market continues to price in the first US interest rate cut for later this year, but further rate-market volatility could materialise if the eventual pace at which the Fed unwinds its tight monetary policy undershoots expectations.

While financial markets are likely to remain volatile, we continue to have a constructive view 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 hikes now behind them, many 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

In **Egypt**, ongoing financial-account inflows from the large property deal with the UAE continued to support the pound. Net US dollar reserves are now at their highest level in history, at US$46.1 billion. In other developments, the government cut the subsidy on bread, as required by the IMF programme. With the price now three-to-four times higher, it will be important to watch the social reaction.

The government in **Ghana** and official creditors agreed a memorandum of understanding on the external debt restructuring, which is now close to being signed – paving the way for the restructuring to be completed. In other news, budget data was in line with expectations at a 1.8% deficit in Q1. The current account remains in surplus, despite declining as falling cocoa exports weigh on the trade surplus; the higher cocoa price is reducing the negative impact.

In **Zambia**, bondholders accepted the proposed deal to swap three current bonds into two new longer-maturity bonds, which were issued on 11 June, and the country exited default status. Copper production has been better than expected, with the trade surplus improving and US dollar reserves rising despite the drought affecting the country.

Disappointing oil revenues are likely to force the government in **Nigeria** to shelve its supplementary budget and revise up its fiscal deficit forecast. Inflation was slightly higher than expected, and the central bank hiked rates by 150bps, which was more than expected, to help tighten financial conditions and support the currency. Higher levels of volatility in the naira were driven by the maturing of some portfolio hedging instruments. This is now largely behind us, and we expect better flows in June on the back of new multilateral loans to the country.

The government in **Angola** is under some social pressure to increase the minimum wage, given the combined pressures of high inflation and weak growth. Continued investment in the country's oil industry has helped to stabilise production.

Kenya is looking to implement a supplementary budget to increase the domestic tax intake. This is in response to the IMF delaying its latest disbursement due to the country's underperformance in tax revenues. The government aims to raise c.US$2 billion to unlock the disbursement. It has also indicated that it is looking to issue a sustainable bond and buy back the 2027 bond. In currency markets, the country's tight monetary and fiscal policy continued to support the shilling.

Moody's downgraded **Uganda's** credit rating by one notch to B3. The government passed its supplementary budget, which is likely to see the fiscal deficit widen. Inflation remains low but has risen to 3.6%; the central bank kept rates on hold at 10.25%.

In early June, **Senegal** issued a US$750 million US dollar bond by private placement, highlighting that the appetite for frontier market debt is improving.

Asia

China's economy continues to be bifurcated. External demand, reflected in exports and export-related industrial production data, remained strong, but weakness in consumer and business confidence, retail sales and domestic demand is providing an unhelpful counterbalance. Inflation in China remains low, with very limited pricing pressure in the country. China's authorities have begun to loosen their tight fiscal policy stance, and we expect this to continue over the next few months. New measures to support the property sector include lower mortgage rates and an easing of home purchase restrictions. There has not yet been a meaningful feedthrough into sales activity data, although it is still early days for the new wave of stimulus. Turning to geopolitics, the US implemented fresh tariffs on imports of Chinese electric vehicles (EVs) and solar panels. While the likely economic impact of these tariffs is limited, it will be important to watch what the European Union (EU) decides to do around tariffs, as the EU is a much larger market for China's EVs. There was some softening of relations between China and Australia, with China lifting the import bans on five major Australian beef producers.

India held its elections over May, with the results announced in early June. Modi's BJP party surprised the market by not managing – by some margin – to secure a majority, returning India to coalition politics. At the time of writing, Modi's plans to form a coalition government in a National Democratic Alliance with two smaller parties seem likely to succeed, meaning the worst-case scenario is likely to be avoided. It is too early to determine the impact of this result as we await many important developments in the coming days and weeks. Crucial signposts will be appointments to key ministries and the revised budget, which will be presented in July. Regarding the latter, the Reserve Bank of India announced a larger dividend payment to the government than the government had budgeted for, providing some breathing room.

In **South Korea**, the central bank kept rates on hold as expected and there are no signs of any imminent rate cuts. GDP data was in line with the market's expectations, with domestic growth continuing to be helped by the semiconductor sector, while inflation for April was lower than expected.

GDP growth in **Thailand** was better than expected, driven by private consumption, and inflation was also higher than the market expected. The more meaningful driver of market sentiment was the increase in political risks over the month. These included the ex-prime minister being indicted by the attorney general for insulting the monarchy; the Move Forward Party defending its case to prevent dissolution; and current Prime Minister Srettha Thavisin defending his position against a petition to have him dismissed. This is all weighing on investor confidence in the country.

Following the surprise 25bps hike in April, Bank **Indonesia** kept rates on hold as expected in May. Exports and imports were both lower than expected, but the overall trade balance was better than expected and is in surplus. On the political side, President Widodo referred to the 3% fiscal cap as arbitrary, which the market has chosen to ignore for now.

In the **Philippines**, the central bank left rates on hold as expected, but in the Q&A session, members appeared somewhat dovish and suggested that a rate cut might be possible in the summer. The central bank also appeared to be less concerned about currency weakness than other Asian central banks, which caused the peso to weaken. On the inflation side, the headline figure was slightly better (lower) than expected, while core inflation pressures remain contained. There was also a positive surprise on the trade balance, but the underlying details were less encouraging: exports were down 7%, and imports were also weak, at -20% versus just -6% expected.

The Central Bank of **Malaysia** kept rates on hold as expected, with no changes to its statement, while April trade data disappointed markets at a MYR7 billion surplus versus MYR11 billion expected.

Inflation data in **Taiwan** surprised the market by being lower than expected, which has helped to mitigate the risk of a potential interest rate hike. GDP growth was strong at 6.5% year-on-year given

Taiwan's large exposure to AI-related industries. On the geopolitical side, newly elected President Lai Ching-te was inaugurated, while China undertook military drills around Taiwan; the market reaction to this was fairly muted.

Latin America

The outlook for monetary policy in the region became increasingly diverse, with rising inflation expectations forcing Brazil's central bank into a more hawkish stance, while its counterpart in Peru was able to resume rate cuts thanks to a much lower-than-expected inflation print.

Fiscal tightening measures under the Milei administration continued to feed through into the data in **Argentina**, which recorded a fiscal surplus for a fourth consecutive month. Newsflow relating to the prospect of Milei's omnibus reform bill made for a volatile month for the country's hard current debt market: the May 25 target date for an agreement with provincial governors passed without a deal being struck; positive signs then emerged around the potential for Senate approval of the bill. Concerns around the prospect of the renewal of a Chinese swap line – necessary to avoid a US$5 billion payment in the next few months – weighed on the debt market. Significant interest-rate cuts began to impact the Blue Chip Swap market (in effect, widening the gap between the official rate and the rate in the parallel FX market), resulting in reduced demand for the local currency. More broadly, subdued activity data revealed the extent of economic adjustment taking place, with industrial production contracting by more than expected.

In contrast, the Purchasing Managers' Index in **Brazil** hit its highest level in several years (56). The country's hard currency debt market benefited somewhat from Moody's upgrading its outlook to positive. However, economic expansion coupled with strong labour market data is pushing inflation expectations further away from the central bank's target. The split vote behind a 25bps cut (with four members voting for a 50bps cut, despite recent hawkish messaging) surprised the market, but the accompanying statement was hawkish. Inflation in April was above consensus expectations at 3.8% but came in below expectations for the first half of May, with core and service inflation showing downside momentum. Other data for Brazil revealed a disappointingly large current-account deficit and weaker-than-forecast FDI.

The main development from **Chile** related to the country's copper exports, with high prices boosting the country's trade balance (almost a US$2 billion surplus). Positive trends in private consumption were also evident. As expected, the central bank slowed the pace of rate cutting (50bps, down from 75bps). Inflation was a little higher than expected but broadly in line with forecasts.

In **Mexico**, data for Q1 revealed a disappointingly large current account deficit, despite strength in tourism revenue, and the early Easter period weighed on GDP relative to the same period last year. Signs of the beneficial effect of 'nearshoring' came through in the form of record FDI flows. The country's central bank, Banxico, remained very hawkish and paused rate cutting after just one cut. Towards the end of the month, Banxico revised down its 2024 growth forecasts (from 2.8% to 2.4%); this should allow it to resume cuts later in the year. The country's state-owned utility (Pemex) dollar debt benefited from talk by the deputy minister of finance of a potential large buyback of its debt after the elections, although this has yet to be confirmed. For further information on the Mexican election which occurred on 2 June, please see our year of the ballot report.

A much lower-than-expected inflation print in **Peru** allowed the central bank to resume cutting rates following a hiatus of several months. A 1% current-account surplus was in-line with expectations. In other news, there was talk that the state-owned Petroperú might be transferred to the private sector, which would be a positive for the sovereign balance sheet.

Discussion around a possible change to the fiscal rule, while unlikely to materialise, weighed on sentiment towards **Colombia** and highlighted rising fiscal pressure. Data also revealed revenues underperforming and expenditure ramping up to deplete the government's cash buffer. There was limited market reaction to the passing of the pension reform, which has been watered down from initial (fiscally costly) proposals. Petro did make another attempt at getting his healthcare reform bill through Congress, but this appears unlikely to succeed. In economic data, GDP growth for Q1 printed below expectations and both retail sales and industrial production were disappointing. In line with expectations, the central bank cut rates by 50bps and continues to adopt a cautious stance, given ongoing concerns about sticky core inflation and some risks to the currency if it were to accelerate the pace of cuts, despite weak growth.

Elsewhere, the general election in **Panama** yielded no surprises but the market responded positively to some credible cabinet appointments. Positive news for **Ecuador** came in the form of an announcement by the minister of finance that the country is expecting US$8 billion in additional multilateral funding, in addition to the US$4 billion IMF programme. Moody's upgraded **El Salvador** to a positive outlook. **Paraguay's** debt market benefited from news that the country had reached an agreement with Brazil to renegotiate the long-term contract for energy exports from Paraguay's hydroelectric dam and increase the price of electricity. An exceptionally high PMI reading from the **Dominican Republic** (71.1) pointed to positive momentum there and the country's election yielded no surprises, opening the door for fiscal reforms to be passed.

Central and Eastern Europe, Middle East and South Africa

The main focus in **South Africa** was the general election. The incumbent ANC party performed much worse than polls had suggested, not achieving an absolute majority for the first time since 1994. At the time of writing, coalition and governing arrangement talks are ongoing. Away from the election, Eskom surpassed 40 days with no load shedding as energy supply is improving. Inflation data was lower than consensus expectation, both in headline and core terms. Q1 GDP growth was also slightly lower than expected, at 0.5% year-on-year versus 0.8% expected. The South African Reserve Bank left interest rates on hold as expected.

The authorities in **Turkey** continued to tighten financial conditions over the month, helping the Turkish lira. Although the central bank kept rates on hold as expected, it added fresh loan growth rules and implemented measures to encourage further de-dollarisation. Economic data has now started to turn softer given the tight monetary policy, but it is not yet suggesting that a sharp downturn is imminent. Inflation data released in early June was higher than expected, but this was largely due to negative base effects from the freeze in utility prices last year. However, when adjusting for this, inflation data was marginally better, albeit still stubbornly high.

Ukraine reached a staff-level agreement with the IMF on the fourth review of the programme, which is expected to lead to a disbursement. However, spreads on the country's hard currency debt, widened given investors' fears of a debt restructuring.

Turning to Central and Eastern Europe, in **Poland**, the central bank kept rates on hold, and monetary policy committee members retained their hawkish rhetoric. CPI inflation was lower than expected, at 2.5% versus 2.8% expected. This was driven by food prices – the reinstatement of VAT on food products after two years has not yet fed through to the inflation numbers. The current account deficit for March was weaker than expected even though the trade balance outperformed.

Inflation in **Hungary** was in line with expectations at 3.7%. The central bank cut rates by 50bps as expected, and also signalled that there might be room for a further cut of 50bps in June, helping the local bond market. On the economic growth front, the picture is mixed. While there were strong retail sales and high wage growth, industrial production was worse than expected.

The **Czech** National Bank cut interest rates by 50bps in a unanimous decision, taking rates to 5.25%. After the cut, inflation in the country came in much higher than expected at 2.9% year-on-year versus 2.5% expected, driven by higher food prices. This weighed on local bonds, with the market now expecting the central bank to slow the pace of cuts. More positively, the current-account balance was much better than expected.

The central bank in **Romania** surprised the market by keeping rates on hold rather than cutting by 25bps. The fiscal deficit in Romania remains weak and was worse than expected at 3.3% of GDP over 2024 to end April. While some fiscal deterioration was expected given the presidential and parliamentary elections at the end of the year, it was not expected to be so weak. Wages in the country continue to grow at a fast pace, while the preliminary GDP numbers for Q1 show a deterioration in GDP growth.

EM corporate debt highlights

The EM corporate debt market had a positive month, with the JP Morgan Corporate EM Bond Index gaining 1.5%. This return was driven equally by both the investment-grade and high-yield portions of the market. Spreads tightened modestly in the high-yield segment, and were unchanged within investment-grade bonds, but the higher duration (interest rate sensitivity) of the investment-grade segment meant that it benefited more from the fall in US Treasury yields over the month. Within the index, all sectors and countries posted positive returns, led by real estate issuers. Supply continues to be subdued, with net financing turning negative again. This positive market dynamic continues to be supportive for credit spreads.

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