September 2024

Emerging Market Debt Indicator

The fast view

Market background

In another positive month for the asset class, all areas of emerging market (EM) fixed income posted gains. The Federal Reserve's first rate cut in over four years, together with improved sentiment around the global economic outlook, provided a supportive backdrop.

Africa

Zambia completed the restructuring of US$1.5bn of Chinese commercial loans. While the ongoing drought is impacting Zambia's economy, signs of rising copper production give cause for optimism. Falling inflation in Ghana led to a 200bps rate cut. Ghana's reserves continue to expand and growth momentum remains strong. Inflation also continued to fall in Egypt.

Asia

China's authorities announced a raft of stimulus measures. This prompted a strong positive reaction in equity markets, although the renminbi and local bond yields were broadly unaffected. Sri Lanka's presidential election yielded a surprise result. Bank Indonesia surprised the market with a 25bps rate cut, while there was lower-than-expected inflation in the Philippines and a sizeable cut in the country's reserve requirement ratio.

Latin America

A severe drought continues to impact several countries, including Brazil, Peru, Bolivia and Ecuador. A number of central banks continued with the easing of monetary policy, with Brazil the exception by hiking rates. The judicial reform bill was passed in Mexico, causing concern among market participants; rating agencies are split in their views on this.

Central and Eastern Europe, Middle East, and South Africa

Growth remains lacklustre in CEE, although there are signs of improving momentum. Inflation remains mixed and cautious central-bank messaging accompanied rate cuts in Czechia and Hungary. Turkey continues to rebalance its economy and it earned a rating upgrade from Fitch. Improving inflation dynamics allowed the South African Reserve bank to cut rates. Rising geopolitical risk in the Middle East impacted neighbouring hard currency debt markets.

EM corporate debt highlights

The EM corporate debt market continued to outperform in September, helped by the strong global market backdrop. Investment-grade and high-yield bonds contributed equally to overall total returns of the index.

Werner Gey van Pittius
Co-head of Fixed Income

Market background

September was a strong month for EM fixed income assets, across local and hard currency markets.

The global market backdrop was supportive, with developed market bond yields falling as the European Central Bank and the US Federal Reserve (Fed) both cut rates over the month – by 25bps and 50bps respectively. This marked the first rate cut in over four years in the US, where the inflation picture has continued to improve. The Fed's decision, combined with some more encouraging data on the US economy, boosted risk assets across the globe.

Across emerging markets, several central banks in Latin America continued to ease monetary policy, boosting local bond markets; the exception was Brazil, where a resurgence of inflation prompted a rate hike. Many countries are also battling a severe drought, which is impacting energy production and causing wildfires. In Asia, Chinese policymakers announced a raft of stimulus measures aimed at boosting confidence and supporting the equity market, while Asian currencies benefited from US dollar weakness caused by the fall in US bond yields. In Central and Eastern Europe, growth data remained on the weak side, and several markets were impacted by significant floods.

The local bond market (JP Morgan GBI-EM) returned 3.4% in September, with local bond markets and currencies appreciating. Among hard currency assets, the sovereign debt market (JP Morgan EMBI GD) gained 1.8%, while the corporate market (JP Morgan CEMBI BD) returned 1.2%, with high-yield and investment-grade market segments contributing positively to the latter.

Top-down views and outlook

Top-down positioning at the end of September 2024

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

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From a top-down perspective, we continue to have a positive overall risk target, and increased this target as expectations grew surrounding the Fed's first rate cut. To implement this, we changed our top-down positioning in hard currency debt from neutral to overweight. We are also overweight local rates but remain underweight EM FX given the lower relative carry offered by the asset class.

We are overweight EM local rates for several reasons. EM central banks delayed their cutting cycles earlier in the year in response to the previous 'higher for longer' US interest rate outlook, meaning yields still remain attractive. A broad softening of inflation across EM economies means that real (inflation-adjusted) yields also remain attractive – a key driver of long-term returns. As inflation continues to print lower than consensus expectations, rate cutting cycles have further room to go in some EM economies, and recent data on the global economy – combined with dovish commentary from the Fed – gives us increased confidence around this. We have recently increased duration in high-quality markets to reflect this view.

In EM FX, we retain a more cautious view given lower carry offered by the asset class when compared with credit and rates markets. In addition, weaker global growth could weigh on EM currencies.

In EM hard currency, we are now running an overweight top-down position as the Fed 's recent front-loading of interest rate cuts should be supportive for higher-yielding EM bonds in the short term.

Outlook

The global economy has shown some signs of slowing, with the US labour market cooling and the manufacturing sector weakening. In September, the US Federal Reserve (Fed) began its rate cutting cycle with a reduction of 50 basis points. Chair Powell signalled that the Fed was more comfortable with the US economy's inflation trajectory and that a 'recalibration' was needed. Markets continue to price in an aggressive amount of rate cuts over the next few months and quarters, so further rate-market volatility could materialise if the pace at which the Fed loosens monetary policy undershoots expectations. The recent stimulus announcement from China has boosted sentiment and may prove to have a fundamental longer-term positive impact on growth, consumption and investment, with possible spillover to the broader EM universe.

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, and the more fragile economies continue to receive plenty of support from the IMF and other multilaterals. EM bond market valuations look attractive – with some markets still pricing in significantly more risk than we believe is justified.

Regional highlights

Africa

Market participants welcomed reports that Saudi Arabia is looking to invest a further US$5bn into property in **Egypt**, which would further boost the economy's financial account. To encourage private sector growth, Egypt's authorities announced measures to simplify the tax system for business. Although the removal of subsidies has fed through to higher inflation in the short term, the market is instead focusing on the underlying momentum of inflation, which continues to fall, and should allow the central bank to start easing rates in Q1 2025.

Following its mission to **Senegal**, the IMF issued a very negative press release, highlighting significant fiscal deterioration in the economy. This prompted a strong negative reaction in Senegal's bond market. On a related theme, Senegal's parliamentary elections were called for 17 November; should the incumbent coalition party be re-elected, it should be easier to implement necessary economic reforms and engage with the IMF.

Falling food prices caused inflation in **Ghana** to print below expectations and allowed the country's central bank to cut its policy rate by 200bps. The country's reserves have continued to increase, expanding by US$2.5 billion so far this year to reach US$7.5bn. Economic growth momentum is equally strong. Elections are approaching in December; the market remains sanguine on both candidates ahead of the election, as the economic policies of both are broadly similar.

A focus on bringing down inflation led to **Nigeria's** central bank hiking interest rates by 50bps and increasing the cash reserve ratio. The bank's governor sounded very hawkish, acknowledging that inflation will take time to fall. The country's debt management office provided more clarity on the recent domestic US dollar bond issuance, which was oversubscribed by 1.8x and raised US$900 million, helping the central bank to rebuild reserves.

Following the newly restructured hard currency bonds in June, **Zambia** completed the restructuring of US$1.5bn of Chinese commercial loans. The draft budget for 2025 was released and would target a deficit reduction to 3.1% of GDP next year, which was taken positively by the market. The impact of the drought, which has been ongoing since January this year, is evident in the GDP data, with year-on-year growth at 1.7%. We expect growth, however, to improve from here as there are signs that copper production is rising.

In **Kenya**, tax revenue collection underperformed in July and August, but markets focused instead on unconfirmed reports that UAE will provide a US$1.5bn loan to the country for each of the next three years.

Domestic banks in Angola are now obliged to release a third of the foreign currency they buy from oil and diamond firms into the market to improve liquidity; an issue that has been weighing on the Angolan

kwanza. In other news, a visit by US President Biden in October could pave the way for additional investment in the country.

Asia

The main news in Asian markets centred around developments in **China**. Against a backdrop of subdued economic activity, falling bond yields, equity market weakness and increasingly elusive growth targets, China's authorities announced a long-awaited raft of stimulus measures. While some details were yet to emerge at the time of writing, measures included: a cut to the reserve requirement ratio (RRR) and the seven-day policy rate; easing of mortgage rules; property market stimulus; and increased liquidity for the stock market. The main goal appears to be a boost to China's equity market and broader confidence. The renminbi and local bond yields were broadly unaffected by these moves. Crucially, we do not think the policies announced so far are sufficient to change China's overall growth trajectory. Away from these policy announcements, recent economic data prints disappointed, including retail sales, unemployment, fixed asset investment and property prices. The exceptions remain technology and electric vehicle exports.

Sri Lanka held presidential elections in September, with Anura Kumara Dissanayake (AKD), leader of the Janatha Vimukthi Peramuna (JVP) party, winning in the second round. The country's hard currency bonds fell sharply following the news but had largely recovered by month end. One of AKD's first acts as president was to dissolve parliament, calling for parliamentary elections on 14 November. This is understandable given his party only had three seats in government, making it very difficult to form a cabinet. At the time of writing, he has yet to articulate his plans for the debt restructuring or in terms of tax policies and continuation of the IMF programme. He has mentioned that he wants to progress quickly on both fronts, assuaging some concerns in the market, although we are unclear at this stage what his terms are for an agreement. Our expectation is this will be drawn out for a few months while we wait for a functioning government to be installed and for negotiations to recommence.

Encouraging fiscal data continued to emerge from **India**, and economic growth remains solid, but inflation data is starting to print higher than market expectations. In addition, the trade deficit widened, with weak exports not helping, while gold imports surged after import tariffs were reduced.

Both inflation and growth were weaker than expected in **South Korea**, paving the way for the Bank of Korea to start cutting interest rates (now broadly expected in the fourth quarter). However, the central bank has remained hawkish in its messaging, given concerns over domestic financial stability and potential overheating of the real estate market in parts of the country.

Bank **Indonesia** cut rates by 25bps in a move that took financial markets by surprise and boosted local bond prices. Key for investors to watch next month is the inauguration of the new president and the composition of his cabinet – especially the minister of finance.

Inflation in the **Philippines** was lower than expected, and the central bank reduced the RRR by a sizeable 250bps. In **Taiwan**, the central bank kept rates on hold, but increased the RRR in a bid to cool the domestic property sector. Taiwanese tech exports continued their strong run, while growth also remained strong. The central bank in **Malaysia** kept rates on hold as expected, and although strong imports weighed on the trade balance it remains in surplus.

Latin America

A severe drought continues to impact several countries in the region, including Brazil, Peru, Bolivia and Ecuador. This is causing devastating wildfires and impacting energy production from hydroelectric power plants. At the same time, several central banks continued with the easing of monetary policy, with Brazil the exception by hiking rates.

Continuing the theme that we have seen for much of this year, **Argentina's** fiscal health improved, putting the economy on track for a balanced fiscal account in 2024. Argentinian hard currency bond prices continued to strengthen. In addition, the recently announced tax amnesty, whereby individuals can bring offshore assets back into the country without tax penalties, provided a further boost to sentiment as it will increase the amount of US dollars in the country. On the growth side, although Q2 GDP data showed a contraction (in line with expectations), more recent high frequency indicators such as industrial production have started to improve.

Given a rise in inflation expectations and resilient economic growth, the central bank in **Brazil** hiked rates by 25bps and suggested that more rate hikes will be needed. On the fiscal side, the government announced spending cuts in response to lower-than-expected tax revenues but local bond yields rose as market participants deemed the cuts insufficient. The 2025 budget raised similar concerns, with the proposed 0% fiscal target considered a stretch given optimistic revenue assumptions.

In **Chile**, the central bank cut rates by 25bps in a unanimous decision. Accompanying comments were dovish, reflecting the central bank's concerns around domestic growth; it has signalled that it will bring monetary policy back to neutral by the first half of 2025 and this boosted Chilean local bonds. The peso also appreciated given the rally in copper prices, as Chile is a key exporter of the commodity.

The judicial reform bill in **Mexico** was passed by both houses of Congress. It means federal judges will be directly elected by the population – widely considered a negative development as it will likely weaken the independence from judiciary. The peso weakened initially on the news, but the rally in risk assets over the month meant it soon recovered. Rating agencies are split in their views of the decision: S&P says it will not have an impact on the credit rating directly, but it will watch its impact on other metrics; Moody's said the reform may impact the rating.

The central bank in **Peru** continued with its cutting cycle, reducing rates by 25bps as expected. The bank did hint at a pause in its next meeting as the economic activity data has been strong, while inflation remains at its target levels. Moody's kept Peru's rating at Baa1, but removed the negative outlook. Ongoing wildfires prompted three regions to declare a state of emergency during the month.

The government in **Colombia** passed its 2025 budget by decree after it was rejected by congress. Congress was concerned that the budget relied on overly optimistic revenue assumptions, however the market reaction to this was minimal. At the end of the month, the central bank reduced rates as expected by 50bps.

Ecuador is experiencing severe electricity blackouts due to the drought effecting electricity production at hydroelectric power plants, which Ecuador relies on heavily. The government has also imposed limits on drinking water given its scarcity. Despite this, hard currency bonds appreciated over the month, buoyed by the rally in global risk assets and expectations of another debt for nature swap.

There were some rating changes among frontier markets, with Moody's upgrading **Costa Rica** to Ba3, while S&P added a positive outlook to **Jamaica**.

Central and Eastern Europe, Middle East, and South Africa

Growth data in Central and Eastern Europe (CEE) remains on the weak side, reflecting the disappointing growth backdrop across the continent. However, the run of negative data surprises appears to be waning, particularly in **Czechia** where there were some positive surprises. By contrast, **Poland**, which is currently the strongest growth story in the region, posted some weaker-than-expected numbers, showing it is still vulnerable to the wider growth slowdown.

Inflation data was mixed overall, with question marks continuing around the stickiness of core inflation momentum. But this didn't curtail central banks from continuing to ease monetary policy, with **Czechia** and **Hungary** cutting by 25bps. However, both continued to sound relatively cautious, and the cutting cycle appears to now be well priced by markets.

Regarding political newsflow, there were news reports of **Hungary** gearing up to loosen fiscal policy in 2025, due to the polls being very tight for the elections in 2026. Although this was disputed by the minister of finance, it does look like Hungarian macroeconomic policy will start to focus more on gearing up the economy to support Prime Minister Orban's re-election prospects. **Romania** is a good case study for pre-election fiscal spending, as the country is looking at an 8% deficit ahead of the elections in December this year; during the month it issued US$5 billion Eurobonds to help plug the gap.

There were extreme floods in the region, having a negative impact on **Czechia** and **Poland** in particular. This will impose some fiscal cost, although a large part will be covered by EU funding.

In the rest of the region, macroeconomic rebalancing continues in **Turkey** given the tight monetary conditions, with growth continuing to weaken and the current account continuing to improve. The central bank kept rates on hold but signalled that the start of the rate cutting cycle was getting closer, suggesting that it will depend on inflation dynamics from here. The inflation print for September indicates continued inertia to the disinflationary process and the central bank is likely looking for

greater signs of underlying momentum ebbing before it commences a cutting cycle. On the rating agency front, Fitch upgraded Turkey to BB-, becoming the first to upgrade the country above B+, while S&P also continues to sound positive on the ratings outlook.

The **South African** Reserve Bank cut rates for the first time in this cycle by 25bps. There was also a lower-than-expected headline and core inflation number. Economic data continues to be mixed overall, with weaker retail sales and mining production.

The conflict between **Israel** and Hezbollah worsened over September, increasing the volatility in Israeli markets, with some spread widening in neighbouring country hard currency bonds (such as Jordan). At the time of writing tensions between Israel and Iran are very high, weighing on global risk markets.

EM corporate debt highlights

September was a strong month for EM corporate debt markets. The global market backdrop was supportive, with developed market bond yields falling as the European Central Bank and the US Federal Reserve (Fed) both cut rates over the month – by 25bps and 50bps respectively.

The EM corporate bond index (JP Morgan CEMBI BD) gained 1.2% in September, taking Q3 returns to 4.5% and year-to-date returns to 8.5%. Both the high-yield and investment-grade segments performed in a similar fashion from a total return perspective in September, with the high-yield market benefiting more from credit spread tightening (reflecting improved sentiment) and carry, while investment-grade bonds were boosted by the fall in US Treasury yields.

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