Emerging Market Debt Indicator

The fast view

Market background

The combination of rising bond yields in developed markets and ongoing US dollar strength weighed on EM fixed income markets. Strong performance by some high-yield hard currency debt markets stood out in an otherwise subdued end to the year.

Africa

Senegal and Uganda were among countries to report strong GDP growth. Positive external support for economies continued and the IMF completed reviews in Egypt and Zambia. Nigeria's currency staged a strong rally after the government implemented a new FX trading platform.

Asia

Chinese assets benefited from the central bank's shift to a "moderately loose" monetary policy stance. Sri Lanka's credit rating moved out of 'default' status after it completed its debt restructuring programme. Conversely, South Korean assets were volatile amid significant political disruption.

Latin America

Argentina's fiscal adjustments continued to boost sentiment towards the country's debt, but Brazil's fiscal challenges weighed on asset prices there. While central banks continued to cut interest rates (with the exception of Brazil and Uruguay), some adopted a more hawkish tone (e.g., Chile and Colombia).

Central and Eastern Europe, Middle East, and South Africa

Political uncertainty continued in Romania and new presidential elections were announced for May 2025. Most central banks kept rates steady, but hawkish commentary in Poland and Hungary drove up local bond yields. In contrast, Turkey's central bank cut interest rates, boosting the local bond market.

EM corporate debt highlights

The EM corporate debt market declined in December, in reflection of rising US Treasury yields. A tightening of credit spreads helped to partially offset this. High-yield markets such as Ukraine and Argentina outperformed.

Werner Gey van Pittius
Co-head of Fixed Income

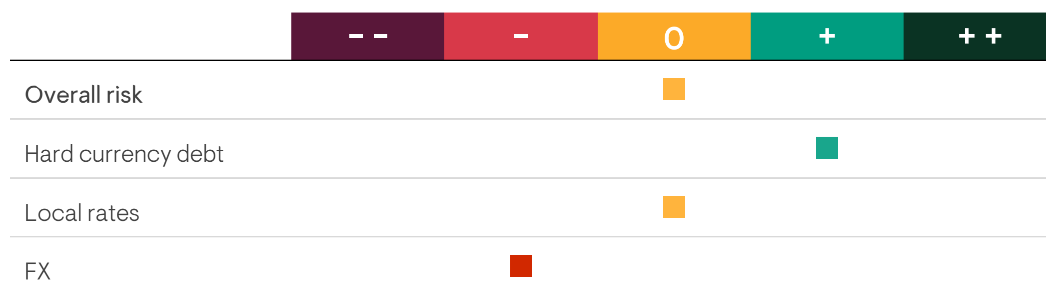
Market background

It was a challenging end to the year for EM fixed income, as developed market bond yields rose, particularly in the US. US Treasury yields resumed their rise given signs of sticky inflation and hawkish forecasts from the US Federal Reserve (Fed) – with the Fed's 'dot plots' pointing to just two rate cuts in 2025, down from four in its previous meeting. The US dollar continued its recent strong run against a global basket of currencies, helped by the Fed's hawkish stance.

Against this backdrop, EM fixed income and currencies struggled, with the local currency debt market (JP Morgan GBI-EM GD) down 1.9% overall, driven by EM FX (-1.5%), with rates returning -0.4%. EM FX was weighed down by the continued US dollar strength, with some Latin American currencies under notable pressure. In the hard currency space, the sovereign market (JP Morgan EMBI GD) fell 1.4%, driven by investment-grade markets which are more sensitive to the moves in US Treasury yields. The high-yield area of the hard currency market fell by a more modest 0.6%, with strong performance by Lebanon, Argentina and Ukraine lifting the overall index.

Top-down views and outlook

Top-down positioning at the end of December 2024



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From a top-down risk perspective, we have kept our target at neutral. This reflects a combination of neutral positioning in local rates, a slight underweight in EMFX, and a small overweight in hard currency debt. We remain positive on the overall outlook for the asset class and continue to express our bottom-up investment views through active relative-value positioning across this increasingly diverse opportunity set.

While the US election result may pose risks to the inflation outlook, we remain constructive on local rates on a longer-term basis: a broad softening of inflation across EM economies means that real (inflation-adjusted) yields remain attractive, which is a key driver of long-term returns. While the magnitude of cuts priced into the market has reduced, the overall trajectory of Fed policy gives us increased confidence that EM central banks will be able to continue cutting rates. Regarding EM FX, the Trump win poses risks relating to tariffs and higher US Treasury yields, both of which may weigh on EM FX; we are underweight as a result.

In EM hard currency, our top-down target remains slightly overweight, with exposure concentrated in the higher yielding portion of the market. Here, we remain constructive on markets that are supported by positive country specific dynamics and sufficiently high yields to cushion against potential volatility. In addition, increased bond supply in January will provide an opportunity to add to higher quality duration risk.

Outlook

The ongoing strength of US economic data, combined with cautious commentary from Fed Chair Powell, hawkish 'dot plots' for 2025 from the Federal Open Market Committee (FOMC), and the anticipation of reflationary policies under the Trump administration, have continued to suppress the market's expectation of rate cuts. The eventual outcome of key policy differences between the Trump

administration and the Biden administration — particularly in areas such as trade and tariffs, immigration, fiscal policy, regulation, and Fed appointments — are being closely monitored by the market.

The reaction of emerging market (EM) assets to rising US Treasury yields and a stronger US dollar has been relatively modest. This may reflect several factors: in Trump's prior term, actual policies often diverged significantly from initial threats; many market participants had already reduced market risk leading up to this election; and the macroeconomic backdrop continues to price in rate cuts for 2025 (unlike the rate-hiking cycle of 2016), providing some stability to broader risk sentiment.

While financial markets are likely to remain volatile, we maintain a positive view on the medium-term outlook for EM debt asset class returns. 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

In **Egypt**, the European Union disbursed the first of five EUR1 billion loans to support Egypt's reform agenda. Towards the end of December, the IMF reached a staff-level agreement on the fourth review of the country's debt programme to the relief of investors. The US State Department approved a US$5 billion arms sale to Egypt, underscoring improving ties between the two countries and Egypt's strategic importance in the Middle East. Additionally, data released earlier in the month showed economic growth exceeding expectations at 3.5% and the trade deficit narrowing to US$3.7 billion.

In **Kenya**, reserves continue to rise, reflecting the country's robust external position. Inflation remains well below the central bank's 5% target at 3%. Although tax data is lagged, tax revenues are starting to improve.

In **Ghana**, John Mahama of the opposition National Democratic Congress (NDC) won the presidential election. As this outcome was widely anticipated, and no significant shifts in economic policy are expected, market reaction was muted. However, the IMF indicated its willingness to renegotiate Ghana's programme, provided fiscal consolidation efforts continue. Inflation remains on an upward trajectory, driven by rising food prices.

In **Senegal**, Q3 GDP growth was very strong at 11.5% year-on-year, and the country initiated a major gas project in December, which could help to boost future growth. Regarding fiscal policy, while the budget deficit was 11.6% in 2024, the 2025 budget projects a fiscal deficit reduction to 7.1% of GDP. This adjustment will be a key factor in ongoing negotiations with the IMF.

Nigeria's current account continues to strengthen, with a surplus exceeding US$6 billion, while oil production has risen to 1.49 million barrels per day. The budget announcement set a fiscal deficit target of 3.9% of GDP for 2025. Inflation remains high, but it is likely nearing its peak. The government's successful Eurobond issuance and its implementation of a new centralised FX trading platform that has significantly improved market functioning, boosted the currency – which rallied strongly in December.

The IMF completed its fourth review of **Zambia's** Extended Credit Facility arrangement, triggering the release of additional funds. The trade balance returned to surplus in December as copper production increased, boosting exports. While Q3 GDP growth was dampened by the economic toll of the recent drought, the latest PMI reading was above 50 for the first time in a year, suggesting a recovery is underway.

The government of **Angola** issued US$1.2 billion in Eurobonds during the month and used the proceeds as collateral for a US$600 million loan from JP Morgan. This reduces the country's need to return to the capital markets for funding in the short term. To diversify funding sources beyond Eurobonds, Angola has entered into an agreement with Oman to issue sovereign debt in Gulf Cooperation Council (GCC) markets. Q3 GDP growth was robust, expanding by 5.5% year-on-year.

Inflation in **Uganda** picked up in December to 3.3% year-on-year, but real (inflation-adjusted) rates remain positive by a comfortable margin. GDP growth for Q3 was strong at 6.7% year-on-year.

In **Morocco**, GDP growth for Q3 surpassed the market's expectations at 4.3% year-on-year. In addition, S&P will review the country's credit rating in March and September of this year, with scope for an upgrade to investment grade. The country is ready to issue a Eurobond in 2025, but it is waiting for the right conditions in international markets.

Asia

In **China**, local currency bonds rallied (yields fell) after the People's Bank of China shifted its monetary policy stance to "moderately loose" from "prudent" for the first time in 14 years, aiming to boost consumption and stabilise the housing and property markets. While the policy adjustment is supportive for bonds, we still do not expect a significant rebound in growth, as the central bank has limited room to ease monetary policy further. Property market data remained weak, but year-on-year growth rates are stabilising at relatively low levels, driven by sales rather than construction. China's composite PMI surged to 52.2 (up from 50.8 the previous month), led by rises in non-manufacturing services and construction. However, recent export and import data fell short of expectations.

The Reserve Bank of **India** announced a new central bank governor, who we suspect may adopt a more flexible approach to the currency from his predecessor. Although the central bank kept rates unchanged in December, the market will closely monitor potential policy shifts under the new leadership. Reserves fell by an additional US$18 billion, partly due to the balance of payments deficit. The trade deficit was worse-than-expected, impacted by a surge in gold imports in the prior month.

South Korea experienced significant political disruption following President Yoon Suk Yeol's declaration of martial law in early December. This action led to the impeachment of him and subsequently the new acting president, culminating in the country appointing its third president in one month. These events placed significant pressure on Korean asset prices, and to address weakness in the Korean won, the National Pension Service (NPS) is expected to use a strategic hedging facility. On a positive note, two new judges were appointed to the Constitutional Court, enabling it to proceed with impeachment trials, which had previously been delayed by failure to reach a quorum. The situation remains fluid.

The Bank of **Thailand** kept interest rates steady despite hawkish remarks from the central bank governor earlier in December. Positive economic indicators included an uptick in consumer confidence, higher tourism numbers, and inflation printing lower-than-expected. However, the manufacturing production index (MPI) showed weaker performance.

Sri Lanka's external debt restructuring process was finalised in December, prompting rating agencies such as Fitch and Moody's to lift its credit rating out of 'default' status. This boosted the hard currency bond market.

In **Singapore**, data for the month was largely positive. Exports surpassed the market's expectations, driven by the technology sector, while headline inflation was below forecasts, primarily due to lower food prices. GDP growth for 2024 also exceeded market expectations, reaching 4.0%.

Elsewhere, Bank **Indonesia** kept rates on hold at 6%, as expected, due to continuing pressure on the currency from higher US Treasury yields and the stronger US dollar. In the **Philippines**, November's balance of payments data showed a significant deficit, while inflation printed in line with expectations. **Taiwan**'s central bank left rates unchanged at 2%, as expected, while year-on-year industrial production data was stronger than the market anticipated.

Latin America

The fiscal adjustments seen in **Argentina** throughout 2024 continued in December, and are expected to persist into 2025, following President Milei's announcement that spending and tax reforms will remain in place. Adding to the positive sentiment were reports of significant progress in negotiations between the government and the IMF on a new programme. Strong Q3 GDP growth exceeded expectations, while YPF (the majority state-owned oil company) announced a US$3 billion pipeline project that is set to be completed in 2027 – a promising long-term development. As a result,

December rounded off a strong year for Argentina's hard currency bonds, which returned over 100% during 2024.

In contrast, fiscal challenges continued to put pressure on assets in **Brazil** in December. The primary surplus was weaker than expected, while November's spending reduction measures disappointed markets, with no extra significant fiscal measures announced in December. Adding to the interest rate market volatility, the central bank hiked rates by 100bps (versus the 75bps expected) and committed to another hike at its next meeting. In a bid to stabilise the local rates market, the government announced a bond buyback scheme, and the central bank intervened with over US$20 billion to support the real.

The central bank in **Chile** cut rates by 25bps, but accompanied this move with more hawkish commentary, citing inflation risks. Economic data was mixed: retail sales outperformed, but industrial production weakened. Inflation was slightly below expectations at 4.2%, though it remains above the 3% target.

Banxico, **Mexico's** central bank, also cut rates by 25bps as expected and hinted at the possibility of a larger cut (50bps) at its next meeting, citing falling inflation and weak growth. Credit rating action included Fitch maintaining state-owned oil company Pemex's rating at B+ with a stable outlook, and S&P affirming the sovereign rating at BBB with a stable outlook.

Colombia's central bank (BanRep) reduced the pace of interest rate cuts from 50bps to 25bps in December, disappointing the local bond market. Additionally, the government's decision to implement a larger-than-expected minimum wage hike for 2025 weighed on sentiment. On the political front, congress rejected the financing bill, which will likely force the government to cut its 2025 budget to comply with the fiscal rule. Finally, the finance minister's resignation amid corruption allegations further pressured the peso, though the appointment of his successor was received positively by markets.

In **Ecuador**, power cuts have largely ended for consumers, which will help President Noboa's chances ahead of the election in February 2025. Polls are indicating a recovery in Noboa's popularity, implying a tight race between him and the opposition candidate. The government is buying back US$1.6 billion of hard currency bonds as part of the debt-for-nature swap, boosting the bond market, with the resulting savings being allocated to Amazon conservation projects. Separately, the IMF reached a staff-level agreement for Ecuador's first review under the Extended Fund Facility.

In **El Salvador**, the IMF reached a staff-level agreement for US$1.4 billion under the Extended Fund Facility, supplemented by funding from the World Bank and the Inter-American Development Bank (IADB). President Bukele's push to reverse the mining ban has been approved, potentially unlocking economic growth.

Peru's central bank held rates steady in December, while the inflation print of just below 2% was better than expected and aligns with the central bank's target of 2%.

The government in **Panama** failed to pass its social security reform in time for the 2025 budget, which weighed on hard currency bonds. Comments from President-elect Trump, demanding reduced fees on the Panama Canal or its return to US control, added to the pressure. Fitch maintained Panama's BB+ rating with a stable outlook, while Moody's revised its outlook from stable to negative but kept the rating at Baa3.

Elsewhere in the region, **Uruguay**'s central bank unexpectedly hiked rates by 25bps – possibly a signal from the new governor of his commitment to meeting the inflation target. Conversely, central banks in both **Jamaica** and the **Dominican Republic** cut rates; Jamaica's interest rate moved from 6.25% to 6%, while the Dominican Republic reduced its rate from 6% to 5.75%.

Central and Eastern Europe, Middle East, and South Africa

The National Bank of **Poland** (NBP) maintained its policy rate at 5.75% in December. However, Governor Glapiński's hawkish commentary during the announcement surprised markets, leading to a rise in local bond yields. In response, several members from the NBP board have pushed back against the governor's stance. While December's inflation print was lower than anticipated, core momentum is picking up. Economic data has been mixed, though Poland's growth picture remains stronger than other CEE economies.

The National Bank of **Hungary** also kept rates unchanged, as expected, and signalled that no further rate cuts are likely until the new governor takes office in March 2025. Local bond yields rose on

response to the news and wider global backdrop. Inflation was as expected, with core inflation still benign. While growth data remains weak, it is no longer surprising to the downside.

In **Romania**, political developments dominated in December. The constitutional court annulled the first round of the presidential election, with fresh elections expected in May 2025. The more important parliamentary elections were also held, leading to a coalition government that includes the two previous governing parties. With concern around fiscal deterioration – as clearly expressed by rating agency Fitch's downgrade of the outlook to negative – the government swiftly enacted an emergency fiscal bill by decree worth approximately 1.5% of GDP. The bill aims to reduce spending particularly by capping pensions and other payments, while implementing some modest revenue-raising policies. However, more policies are likely needed to meet the EU-agreed deficit target of 7% of GDP in 2025. Inflation remains sticky and the central bank is likely to remain on hold in the near-term in this environment.

In **Czechia**, the Czech National Bank (CNB) kept interest rates on hold, but signalled the possibility of resuming rate cuts in February. Wage growth has exceeded the market's expectations, raising concerns at the CNB, but inflation has been slightly lower than forecast. Persistent momentum in services inflation remains a key concern. Data continues to point to a shallow consumer recovery, but the industrial sector faces significant challenges and PMIs dropped back to recent lows.

In **Serbia**, the central bank left rates on hold, given the backdrop of stubborn inflation.

Inflation in **Turkey** was lower than expected in December. While this was primarily driven by falling food prices, the rest of the inflation basket is also stabilising, and the underlying momentum in core inflation looks encouraging. A more prudent than expected 30% hike in the minimum wage provided the central bank with the confidence to begin its rate-cutting cycle, delivering a 250bps cut. Both the wage hike and the rate cut boosted the local bond market.

In **South Africa**, inflation fell to 2.9% year-on-year, below the 3.1% forecast. This was driven by falling food prices, while core inflation improved slightly. Economic growth data remains mixed, with ongoing weakness in the manufacturing sector.

The Biden administration tightened sanctions on **Russia** which led to an increase in ruble volatility in December. This had a knock-on impact in regional currencies like the **Kazakhstani** tenge and **Georgian** lari given the close links between these economies. The wider geopolitical situation is increasingly tied to the incoming Trump administration: the market is increasingly optimistic of a ceasefire in **Ukraine**, with the countries' restructured Eurobonds continuing to trade well.

The Trump factor is also impacting the **Middle East** where there are greater efforts towards a ceasefire in Gaza, helping the **Israeli** shekel to recover. Meanwhile, **Lebanon's** distressed debt performed well as both a weakening Hezbollah and collapse of Assad's regime in Syria brings renewed hope for meaningful change in the country.

EM corporate debt highlights

With a backdrop of rising US Treasury yields and a more hawkish Fed, the EM corporate debt market fell over December, with the JP Morgan CEMBI BD returning -0.5%. The return for 2024 however was still strong, with the index up 7.6%, led by high yield which rose 11.7%. In December, the impact of US Treasury market moves was the driver of negative performance, but tighter credit spreads helped to partially offset this. Within the index, high-yield bonds (-0.1%) outperformed investment-grade (-0.9%) given the latter's higher sensitivity to US duration. From a country perspective, corporate bonds in Ukraine and Argentina were among the top performers.

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