January 2025

Emerging Market Debt Indicator

The fast view

Market background

Gains across the asset class despite significant volatility in global government bond markets. Emerging market currencies recovered, and high-yield debt markets continued to outperform.

Africa

Moody's upgraded Kenya's outlook from negative to positive. New hard currency debt issuance from Egypt was five-times oversubscribed. Ghana's new government took office and announced measures to improve the fiscal balance.

Asia

Strong exports and industrial production data revealed a flurry of activity at the end of 2024, ahead of the early Lunar New Year and President Trump's inauguration. Central banks' differing priorities drove divergent policy moves.

Latin America

Tariff-related uncertainty cast a broad shadow in January. Monetary policy divergence within the region grew as the current cycle progressed

Central and Eastern Europe, Middle East, and South Africa

Industrial activity remained weak in Central and Eastern Europe, with downside data surprises across the board. In contrast, retail sales data still suggests that a modest recovery is underway.

EM corporate debt highlights

Positive returns, especially in the high-yield market segment, with credit spreads tightening on increased global investor confidence.

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Co-Head of Fixed Income

Market background

Fixed income markets began the year on a volatile note, reflecting oscillations in government bond markets. Cautious rhetoric from some members of the US Federal Reserve's (Fed) rate-setting committee, coupled with surprisingly strong economic and labour market data, prompted a sell-off in the 10-year US Treasury market. Subsequently, however, signs of improving inflation dynamics, more dovish rhetoric from the Fed, and a temporary sense of relief (Trump did not immediately impose tariffs after taking office) persuaded markets that two rate cuts are still possible this year; the Treasury yield retreated somewhat to end the month broadly unchanged.

It was a better month for emerging market (EM) currencies after the sell-off seen at the end of 2024, with the US dollar weakening after Trump's initial hints at a softer stance on tariffs. Within emerging market economies, China reported stronger-than-expected growth, thanks to ongoing strength in exports, but activity levels in both the manufacturing and services sectors were weaker. In Latin America, divergent trends in inflation saw rates being cut in Peru and hiked in Brazil. Capping a strong year for the country's economy, Argentina reported a fiscal surplus for 2024. Turkey's current account data was better than expected and the central bank cut interest rates for the second time in this cycle, as expected. Meanwhile, encouraging inflation dynamics in South Africa increased the prospects of a rate cut there. Elsewhere, developments in Lebanon – namely, the appointment of both a prime minister and a president and hopes for an improvement in the geopolitical situation – were supportive for asset prices.

Against this backdrop, EM fixed income and currency markets posted gains. The local currency debt market (JP Morgan GBI-EM GD) gained 2.1%, driven by local currency strength. The hard currency sovereign debt index (JP Morgan EMBI GD) finished the month 1.4% higher, with strong performance from some high-yield markets again providing a boost. In the corporate debt market, the JP Morgan CEMBI BD gained 0.8%, with the high-yield segment outperforming investment grade.

Top-down views and outlook

Top-down positioning at the end of January 2025

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

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From a top-down risk perspective, we have moved modestly overweight risk. 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. We have shifted to a neutral target on EM FX due to positioning and valuations, which increase the likelihood of a reprieve if tariffs are delayed or applied more selectively. 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.

Outlook

While attractive yields and proactive monetary policies offer support for emerging market debt, global economic uncertainties - particularly regarding US policy direction, potential tariff adjustments, and market volatility - call for measured optimism from investors.

The reaction of EM assets to rising US Treasury yields and a stronger US dollar has been relatively modest. This may reflect several factors: in Trump's first 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. That said, the likely knee-jerk market response to any announcements relating to tariffs on specific countries is likely to over/underestimate the longer-term economic risks; short-term market volatility may well present opportunities for the focused investor.

While financial markets are likely to remain volatile, we maintain a positive view on the medium-term outlook for EM debt asset class returns. EM resilience is supported by strong domestic reform agendas especially in frontier markets where risks related to bilateral funding disruptions remain small relative to overall funding needs.

Regional highlights

Africa

Egypt's economy grew by 3.5% year on year in Q3 2024 as reforms began to feed through. Inflation declined and with base effects now beginning to come through, further significant drops are expected. This should allow the central bank to ease policy rates. New hard currency debt issuance was five-times oversubscribed.

Moody's upgraded **Kenya's** outlook from negative to positive but kept its credit rating at Caa1. Inflation came in slightly higher than expected in December but still comfortably below the central bank's target, leaving plenty of room for the monetary policy easing cycle to continue.

The new government in **Ghana** settled in, with ministers and officials appointed, including the new central bank governor. Spending cuts to control the country's fiscal account include reducing the number of ministries. The central bank kept rates unchanged as inflation continued to rise.

During an investor call, **Senegalese** officials sought to reassure the market amid concerns over remarks about a potential restructuring. While they did not comment on the 2025 budget, they indicated that the release of the audited debt numbers would be postponed by a few weeks.

The **Nigeria** naira rallied on a combination of higher oil exports, remittance inflows, and the rollout of the central bank's electronic FX trading platform.

Efforts continued to conclude **Zambia's** debt restructuring with external bilateral creditors; Zambia reached agreement on US$130 million with Saudi Arabia.

Asia

Strong exports and industrial production data revealed a flurry of activity at the end of 2024, ahead of the early Lunar New Year and President Trump's inauguration. Differences in central banks' focus (growth vs. inflation risks) were reflected in their divergent policy moves.

US tariff-related noise weighed on sentiment towards **China** before signs of a softening stance by Trump provided some relief; the renminbi ended the month broadly flat. China's economy grew by a surprisingly strong 7.6% quarter on quarter in Q4 – boosted by strong exports – with full-year growth hitting the country's 5% target. China's authorities are expected to pledge increased economic support at the annual parliamentary meeting in March, with the anticipated impact of US tariffs a key determinant of the extent of this support. Local currency bonds continued to rally but later in the

month this reversed as authorities tightened liquidity on concerns around the strength of demand and its impact on yields; the People's Bank of China suspended its government bond purchases in the secondary market. After a strong December, purchasing managers' indices dipped slightly before the Lunar New Year.

India's bond market benefited from a lower-than-expected CPI print and a liquidity injection from the country's central bank (RBI). Reserves fell and the rupee weakened, a trend which has been in force for the last few months. We believe the RBI may be inclined to let the currency weaken, given its recent outperformance relative to peers. Meanwhile, ongoing intervention to prevent currency depreciation is becoming more difficult amid persistent equity outflows. Post month-end, the budget announcement was broadly in line with expectations, although the income tax policy dealt a slight surprise – the minimum earnings threshold is set to increase, but well-contained expenditure means this should not derail the country's fiscal consolidation. That said, expected income tax receipts seem ambitious.

Another muted GDP print in Q4 (+0.4% quarter on quarter) brought **South Korea's** 2024 growth to 2%, in line with expectations. The Bank of Korea downgraded its 2025 forecasts to 1.6%, but FX related concerns dominated, and the bank defied consensus expectations of a rate cut to keep rates on hold. The weaker growth outlook helped the local rates market, and the won benefited from the National Pension Service's implementation of strategic currency hedging measures to stabilise the currency. More broadly, asset prices benefited from receding political risks. Semiconductor exports remained strong, although front-loading ahead of the Lunar New Year means this data is rather noisy.

In contrast to its counterpart in South Korea, growth concerns were front-of-mind for **Indonesia's** central bank, which cut rates unexpectedly; until now, currency weakness was the key determinant of policy. The move resulted in a bull steepening of the country's yield curve.

Elsewhere in the region, a particularly severe typhoon season in the **Philippines** drove up inflation (CPI printed at 2.9% vs 2.6% expected) and overshadowed a steady rise in remittances to weigh on growth. With inflation still well within the central bank's target range, a continuation in the rate cutting cycle seems likely. Turning to **Taiwan,** trade data reflected ongoing strength in AI-related exports – export orders grew by 21% year on year vs. 19% expected. Tech export strength was also in evidence in **Malaysia,** where, a combination of disappointing growth data and a soft inflation print suggests room for rate cuts, although monetary policy is likely to remain stable until further details emerge around the fuel subsidy this summer. **Singapore's** 2024 growth rate of 4% beat expectations. The country's central bank eased policy which was well anticipated by the market. Finally, Sri Lanka's hard currency debt market was boosted by the country's debt restructuring, which included the introduction of instruments that make macro-related payouts; market expectations of a stronger growth outlook lifted bond prices.

Latin America

Tariff-related uncertainty cast a broad shadow in January. Monetary policy divergence within the region grew as the current cycle progressed.

Behind the tariff-related noise, in **Mexico**, economic activity data beat expectations and inflation fell to 3.7%. Several members of the monetary policy board spoke of the need to accelerate rate cuts, signalling a potential dovish shift. Hard currency debt issuance by the sovereign was well subscribed. Post month-end, Trump announced a 25% tariff on all imports from Mexico, but then agreed to delay the implementation of these by a month as an agreement was reached on combatting drug trafficking and illegal immigration.

Trump-related headlines were also dominant in **Colombia**, with threats of tariffs and sanctions. President Petro's poor handling of the situation resulted in domestic political turmoil; markets reacted positively to the reduced prospect of his policies – such as a de-centralisation reform that would enable increased fiscal power to local states – making it through Congress. Preliminary data pointed to 2024 fiscal targets being missed, while economic activity data was weaker than expected.

In another Trump target – **Panama** – the social security reform bill made progress through the political system, but it was delayed and watered down significantly.

Trump taking office wasn't all bad news for the region; signs that **Venezuela's** President Maduro may cooperate with Trump to try to reset relations between the two countries helped the country's external debt.

Confirmation of a fiscal surplus for 2024 capped a remarkable year for **Argentina**. The IMF completed its mission in the country, although an agreement has yet to be reached on an FX regime once capital controls are removed. Inflation remains on its downward path, despite a slight month-on-month increase in December. This prompted the central bank to announce it would be slowing its crawling peg to just 1% every month (i.e., reduce the pace of currency devaluation).

In contrast, inflation expectations for **Brazil** rose significantly. This reflects weakness in the real, which is expected to pass through to inflation, and also a lack of confidence in fiscal sustainability. In line with earlier guidance, the central bank hiked rates by 100bps and still plans to do the same in its next meeting, though a mention of negative risk from potential trade wars could be considered a slight dovish tilt. With Congress in recess, there was limited news on the fiscal front.

Chile's pension reform passed – involving higher contributions and marking a key step in building up the savings pot that has been eroded in recent years by large withdrawals. Inflation data was encouraging, falling in December to end the year at 4.5%. Although the central bank kept rates on hold, its guidance was less dovish, suggesting a more uncertain outlook for monetary policy. Strong export performance boosted the trade surplus. New hard currency bond issuance was well subscribed and limited further issuance is expected this year.

Stronger commodity prices helped **Peru's** bond prices as exports of gold and copper stand to benefit. In addition, well-behaved inflation (back below target) provides space for the central bank to continue cutting rates.

Ecuador's debt performed well in the lead up to February's general election, with polls pointing to an increased likelihood that market-friendly incumbent President Daniel Noboa will win.

Central and Eastern Europe, Middle East, and South Africa

A noticeable decline in December inflation led to **Czechia's** central bank turning more dovish, paving the way for a cut in February. Other central banks were more hawkish, though. In **Hungary,** upside risks to inflation led to continued hawkishness from the central bank. In **Poland**, the central bank governor also continued to sound hawkish given risks to inflation from rising energy prices in the second half of the year. While these concerns are justified to an extent, his hawkishness is perhaps more reflective of political considerations ahead of the presidential elections, with other members of the MPC suggesting the rate-cutting cycle could start somewhat earlier.

Newsflow was busiest in **Romania**. Another rating outlook cut (to negative) leaves a narrow path for avoiding a downgrade to high yield. The government passed a 2025 budget that (on paper at least) matches the consolidation commitments under the EU excessive deficit mechanism, albeit with some optimistic revenue assumptions. The rerun of the presidential election was confirmed for May, meaning that more far-reaching revenue reforms (VAT etc.) likely have to wait until the summer to become reality.

Ukrainian bonds continued to perform well on increased prospects of a ceasefire, with Trump now in the White House. Political developments also played an important role in the Middle East. **Lebanon** saw the long-overdue election of a new president. This led to a continued rally in Eurobonds on the prospect of the country finally cleaning up its banking sector and getting an IMF deal. Meanwhile, the Israel-Gaza ceasefire helped **Israeli** assets to outperform. The Bank of Israel was also relatively dovish after another below-expectations inflation print. In the Gulf, **Oman** unveiled a very prudent budget for the year ahead, paving the way for continued fiscal surpluses even if oil is somewhat softer.

Turkey's central bank continued its tentative rate cutting cycle, reducing the policy rate another 250bps to 45%. Foreign inflows into the local bond market picked up. Inflation progress in December was slightly ahead of expectations (although at the time of writing, the January print disappointed). The wider growth picture remains surprisingly robust, with both retail and industrial sector data pointing to a growth outlook that is somewhat better than many economists expected.

In **South Africa**, another good inflation print paved the way for 25bp cut, as broadly expected, towards month end. Growth indicators remain mixed, with PMIs flat to contractionary, manufacturing

and mining data disappointing, while retail sales surprised more positively with early pension withdrawals helping consumption.

EM corporate debt highlights

The emerging market corporate debt market posted a positive return in January, proving resilient when global government bond markets sold off early in the month. The JP Morgan CEMBI BD gained 0.8%, with the high-yield segment (+1.0%) outperforming investment grade (+0.6%). Credit spreads tightened on increased global investor confidence. Ukraine was the top-performing market in the index, followed by Israel – in both cases reflecting positive sentiment around geopolitical developments. It was a busy month for new issuance, and this was met with strong demand.

General risks: The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Past performance is not a reliable indicator of future results. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Investment objectives and performance targets are subject to change and may not necessarily be achieved, losses may be made. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments. **Specific risks:** Emerging market (inc. China): These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems.

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