November 2023

Emerging Market Debt Indicator

The fast view

Market background

November was a strong month for financial markets across the board, with emerging market fixed income no exception. A key driver was the sharp decline in US Treasury yields, reflecting revived hopes that the US Federal Reserve's rate-hiking cycle has concluded.

Africa

Delays to Zambia's debt restructuring weighed on domestic assets. In contrast, positive funding developments in Egypt included news that the IMF may increase the size of its existing programme, and continued progress on the sales of state-owned assets.

Asia

GDP data for Q3 was broadly better than expected, boosted by ongoing strength in the technology sector, especially in North Asia. China's renminbi had a strong month vs. the US dollar, and reports that regulators are creating a list of property developers eligible for extra financing improved sentiment towards the country's real-estate sector.

Latin America

Javier Milei was elected as the Argentina's new president, and the market welcomed his selection of a credible finance minister. In a first for both Brazil and Colombia, the former announced sustainable bond issuance on international markets and the latter issued a hard currency sustainable bond. The central bank in Chile took a more hawkish tone, but hawkish messaging was toned done somewhat in Mexico.

Central and Eastern Europe, Middle East and South Africa

Turkey's central bank continued with its aggressive rate-hiking cycle, raising rates by more than expected. In CEE, growth indicators continued to be soft, although there are increasing signs of a modest recovery as real incomes rise, and the disinflationary picture is still strong.

EM corporate debt highlights

The market (JP Morgan CEMBI BD) gained 3.6% over the month, with the high-yield and investment-grade (IG) segments making an equal contribution to this. While the US Treasury market rally drove this strong performance, credit spreads also tightened to give both markets an extra boost.

Werner Gey van Pittius
Co-head of Fixed Income

Market background

November was a strong month for financial markets, with emerging market (EM) fixed income no exception. In large part, this was thanks to a sharp decline (rally) in US Treasury yields across the yield curve. The driver of the rally was a revival of hopes among market participants that the US Federal Reserve's (Fed's) rate-hiking cycle has come to an end and that the Fed could begin cutting rates next year. A lower-than-expected US CPI inflation print, plus messaging by the Fed – which suggested that financial conditions have significantly tightened – both contributed to this shift in expectations.

In the Euro Area, inflation hit a two-year low, influenced by declining energy prices and a slowdown in food-price inflation. This helped European yields to fall over the month, adding to the fixed income market rally.

Within EMs, libertarian candidate Javier Milei was elected as Argentina's new president, and the market responded positively to his appointment of a credible finance minister. In Asia, strength continued in the technology sector in the north of the region, with robust exports and industrial production boosting these economies. In China, the renminbi strengthened over the month as the central bank fixed the currency's daily trading band at stronger levels against the US dollar. In Turkey, the central bank continued with its aggressive rate hikes to tackle inflation, raising rates by 500bps versus 250bps expected.

Among EM fixed income and currency indices, the local currency bond index (JP Morgan GBI-EM) gained 5.3%, driven equally by rates and FX. In the hard currency space, the sovereign debt market (JP Morgan EMBI BD) gained 5.7%, while EM corporates (JP Morgan CEMBI BD) climbed 3.6%, with both high-yield and investment-grade bonds contributing equally.

Top-down views and outlook

Although some recent inflation prints have been higher than expected, with higher oil prices also posing a risk to inflation, the global inflation picture continues to be one of moderation overall. Furthermore, recent data releases have led markets to become more confident of a soft landing (rather than recession) for economies, especially the US. 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 EMs 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.

Into the end of last year and the start of this year, one of the key headwinds to EM debt – the relentlessly strong US dollar – initially reversed its trend, however, in recent months the dollar index has been stronger, reversing part of this weakness. At the same time, markets began to consider when peak global monetary policy rates might occur. While uncertainty and volatility are likely to remain a feature of global markets for some time, we believe that in the coming months, the Fed will reach the end of its hiking cycle and bond yield curves have already begun to reflect this. There are risks to this view, which include the Fed ramping up its hawkish rhetoric if financial conditions ease too much, or if inflation proves stickier than the Fed expects, resulting in short-term rates being more sluggish in reversing course than is currently priced by markets.

From a top-down risk perspective, we have moved our target to a modest overweight as the global environment has tilted more favourably towards EM and risk assets in general. We are overweight EM hard currency debt, and we believe we are near the peak in US yields, which should result in reduced core rates volatility and be supportive for EM external (hard currency) assets. In the EM local currency space, we have moved to an overweight as the expectation of reduced volatility in global rates should give confidence to some previously cautious EM central banks, which had been hesitant about cutting

rates. We remain neutral in EM currencies, acknowledging strong underlying country fundamentals, high carry and healthy external balances, but also recognising that short-term valuations look less attractive.

Top-down positioning at the end of November 2023

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

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Regional highlights

Africa

Zambia's debt restructuring was delayed unexpectedly, following a disagreement between China, the Paris Club and other bondholders. The IMF had agreed to the terms and reached a staff-level agreement with Zambia, but the programme cannot be finalised until the restructuring agreement is complete. This caused weakness in the Zambian kwacha. In other news, the central bank tightened domestic liquidity (hiking rates by 100bps and increasing the reserve requirement by 250bps) to help alleviate pressure on the currency. The weaker currency is also passing through to inflation, with the most recent numbers showing a rise to 12.9% up from 12.6% the previous month.

In **Nigeria**, the central bank governor gave a speech in which he committed to move the central bank to an inflation-targeting approach and suggested that the bank will improve the (currently dysfunctional) monetary-policy transmission mechanism. However, the speech lacked detail on the timing of implementation. Inflation continues to be high, at 27.3%, with pressure from the weaker currency feeding through. Moody's kept the country's rating at B- with a stable outlook.

In **Egypt**, there was positive news on the funding side, as the IMF is considering increasing the size of the existing programme, while the programme of state-owned asset sales has continued to make headway. There has also been progress on the foreign exchange rate, as the government admitted that more needs to be done on FX flexibility. All of this has created better sentiment towards Egyptian assets. In other news, there was confirmation that liquid natural gas (LNG) exports will resume in the new year, although the weaker tourism outlook – given Egypt's proximity to Israel and Gaza – may offset the benefits of the LNG sales. Also during the month, Fitch downgraded Egypt to B- with a stable outlook.

The government in **Ghana** presented its 2024 budget, which was positive overall, aiming for a primary surplus. Encouragingly, the budget contained realistic expectations on revenue forecasts and showed fiscal discipline, despite it being an election year next year. The market is waiting for an agreement from official creditors on the debt restructuring deal, which is needed for further IMF disbursements.

Angola's parliament approved its 2024 budget, which was also positive overall given continued fiscal discipline. In other news, oil production is starting to increase, and the finance minister spoke of plans to remove fuel subsidies by 2025 and to issue a green bond next year.

Ethiopia has entered into the common framework agreement, meaning that it will restructure all of its debt. Although it has not technically defaulted yet (the government may well still pay the December coupon on the 2024 bonds), the 2024's are likely to be included in the broader restructuring deal. The bonds sold off on the back the announcement given the uncertainty regarding the payment of the 11 December coupon.

Asia

At the regional level, GDP data for Q3 was broadly better than expected. This was helped partly by ongoing strength in the technology sector, especially in North Asia, where exports and industrial production continued to do well. On the economic activity side, November's purchasing managers' indices (PMIs) showed improvement, but remained at subdued levels.

Turning to **China**, the renminbi had a strong month versus the US dollar as the People's Bank of China (PBoC) strengthened the level of the daily renminbi fixings. On the local rates side, yields rose modestly due to a combination of tight interbank liquidity and high levels of debt issuance, which kept short-dated rates elevated. Improved growth expectations also weighed on bond prices. Regarding economic data, industrial production came in above expectations, as did retail sales, while unemployment was unchanged. But fixed investment was lower than expected and data in the property sector continued to be weak, with new home sales and property prices still disappointing. However, there was some positive developments in the property sector, with news headlines suggesting that regulators are creating a list of property developers that will be eligible for extra financing. On the geopolitical side, China's President Xi met with US President Biden, and the tone was generally better overall compared to previous meetings. In addition, China has also been mending ties with the likes of Australia and South Korea as it seeks to improve relations with the West.

India's GDP growth for Q3 was strong, continuing the impressive growth story year to date. CPI inflation was a bit higher than expected, driven by food items, but core inflation (which strips out volatile items such as food and shelter) is less of a concern. More negatively, the country's trade balance was surprisingly poor, coming in at a record deficit due to strong import demand and seasonally strong gold imports.

In **Thailand**, the government's fiscal handout scheme continued to make headlines. While there are still details that need to be finalised, it is becoming apparent that the scheme will require more money than initially suggested and is likely to be financed by increased bond issuance. This temporarily put pressure on local rates before global macro forces caused yields to fall. On the trade side, exports were softer than expected, but still robust overall, while the trade balance was slightly weaker given larger-than-expected imports growth. The central bank kept rates on hold.

The central bank in **South Korea** also kept rates on hold at 3.5%, and it raised its inflation outlook slightly for 2024 to 2.6% from 2.4%, but also downgraded its growth forecast to 2.1% from 2.2%. The current account has been improving and is still showing a large surplus.

There was some political noise in **Taiwan** over November. The presidential candidates have filed their applications, and it looks likely to be a three-person race, with the incumbent DPP candidate currently favourite to win the elections on 13 January 2024. As in other North Asian countries, export orders were strong, led by the technology sector.

Elsewhere, in the **Philippines**, Q3 GDP came in at 5.9% versus 4.7% expected, which helped the Philippine peso to appreciate. **Mongolia** is issuing a US$350 million hard currency bond, however the net supply is zero overall given the new bond proceeds are being used to redeem other outstanding dollar debt.

Latin America

The biggest news in **Argentina** over the month was the election of Javier Milei as the country's new president. In his victory speech, Milei reaffirmed his commitment to making significant structural changes to the economy, highlighting the country's widening budget deficit as his top priority. A noticeable omission from his speech, however, was the prospect of dollarisation, with the notion of moving rapidly towards the adoption of the US dollar as the currency becoming increasingly unlikely. Former President Mauricio Macri is expected to play an important role in Milei's presidency, while Luis Caputo is widely expected to take up the position of economy minister; markets reacted favourably to the news.

Brazil's National Treasury announced the issuance of the country's first-ever sustainable bond on international markets, marking a positive shift towards more sustainable practices. Meanwhile, the central bank cut interest rates by 50bps as widely expected, with more cuts likely to come as inflation continued to show signs of moderating. In terms of economic indicators, Brazil's current account deficit

narrowed sharply in October, albeit still in deficit territory. Industrial production came in softer than expected, suggesting that activity in the country is beginning to ease after a relatively strong year.

The Central Bank of **Chile** took a more hawkish tone, noting that long-term real rates are likely to remain higher for longer, despite signs of inflation starting to cool. The country's economy grew above consensus forecasts in Q3, driven largely by stronger mining activity. Meanwhile, rating agency Fitch downgraded the state-owned copper company, CODELCO, from A- to BBB+ citing a deterioration of the company's credit profile.

The Central Bank of **Mexico** kept rates on hold at 11.25% in November. Despite continuing with its relatively hawkish stance, policymakers toned down their messaging somewhat, suggesting the possibility of rate cuts in early 2024. GDP growth for Q3 came in better than expected, with construction performing particularly well. The country posted a current account surplus for Q3, largely in line with expectations. Remittances into the country exceeded forecasts, meanwhile, President AMLO announced support packages to help boost the economy. Investment data in the region was strong except for foreign direct investments, which came in weaker despite positive newsflow regarding nearshoring activities.

In **Peru**, the central bank cut its policy rate by 25 basis points to 7.0% in November, in line with expectations. Inflation eased considerably below consensus, marking the softest reading since June 2021. Meanwhile, discussions pertaining to pension fund withdrawals continued to gain traction in Congress.

In **Colombia**, the central bank kept rates on hold at 13.25%. Despite two board members voting for cuts, policymakers maintained their relatively hawkish stance in light of elevated inflation levels. Colombia's constitutional court struck down part of President Petro's tax reform, which prohibits oil and gas companies from deducting royalties from their taxable income. While the ruling was perceived as good news for companies, it will have a marginally negative impact on the government's finances. Economic indicators came in broadly weaker over the month, with declines seen across exports, industrial production and retail sales. In more positive news, Colombia issued its first-ever hard currency sustainable bond during the month.

The Central Bank of the **Dominican Republic** surprised investors by cutting its key interest rate by 25bps to 7.0%, against the backdrop of easing inflation. In other news, rating agency Fitch revised the country's outlook to positive from stable, affirming its BB- rating.

In **Panama**, the constitutional court ruled against the government after it awarded Canadian mining company First Quantum a contract for an open-pit copper mine. The awarding of the initial contract sparked nationwide protests, which continued following the court's ruling. First Quantum has since initiated arbitration over the contested contract. Meanwhile, drought conditions in the region prompted Panama Canal authorities to reduce the number of ships allowed to pass through the canal due to low water levels. In other news, ratings agency S&P downgraded the country's outlook to negative.

Ecuador's recently elected President Daniel Noboa embarked on a roadshow to attract new investors, but this failed to garner the level of support initially hoped for. Ecuador's proposed free-trade agreement with Mexico and Chile took a wrong turn after both countries backtracked out of the agreement. The country's legislature began a new session after President Noboa and the party of former President Correa formed a majority coalition.

Central and Eastern Europe, Middle East and South Africa

Starting in **Turkey**, the central bank continued with its aggressive rate hiking-cycle and raised rates by more than expected (500bps versus 250bps expected). Towards the end of the month, foreigners started to re-engage with the local bond market for the first time in several years – a clear signal of improved confidence in the central bank and reduced fears over political interference. The tightening seen over the second half of 2023 is now starting to impact credit growth and feed through into the GDP figures, with weaker GDP for Q3 along with lower home sales. On the financing side, as well as a 5-year Sukuk issuance, the country is getting closer to unlocking the UAE earthquake relief fund. S&P upgraded Turkey's outlook to positive from stable.

In **South Africa**, the main event came in early November with the medium-term budget policy statement. Overall, the forecasted fiscal balance was revised to a smaller deficit than the market was expecting, and the issuance plans for local South African government bonds remained unchanged,

which was also a positive surprise. There are still question marks around the fiscal trajectory, especially on the expenditure side, but at least revenue forecasts seem much more realistic and arguably conservative. In other news, there was an upside surprise in inflation. This was largely driven by food prices. Despite this, the South African Reserve Bank appeared to sound dovish at its recent meeting, and voted unanimously to keep rates on hold (previously, two members had voted for a hike).

The ongoing conflict between **Israel** and Hamas is increasingly expected to remain contained, thus lowering the geopolitical risk in the region and allowing the shekel to retrace its sell-off from the previous month. The Bank of Israel kept rates on hold over the month.

Growth indicators continued to be soft across Central and Eastern Europe (CEE), but there are increasing signs of a modest recovery, led by consumers, as real incomes rise. As a result, momentum in the growth data is improving somewhat, albeit from a low base. This is especially the case in **Poland**, where growth data surprised on the upside and was helped by fiscal handouts from the PiS party in the run up to the election. Staying with **Poland**, after the October election defeat for the PiS party, the president appointed the previous PiS prime minister to try to form a coalition. This is largely expected to fail given he does not have a majority government. He has until 11 December to do this, and after that the opposition coalition will be given the opportunity to form a government.

Turning to inflation in CEE, the disinflationary picture is still strong. Inflation was lower than expected in **Hungary** and appears to be normalising; this is giving greater confidence to the central bank to continue with its rate-cutting cycle, which is evident from the bank's dovish forward guidance. Despite the very constructive inflation backdrop, other central banks across the region sounded more hawkish. In **Poland**, post the sharp cuts from the central bank heading into the election, the central bank has been more hawkish, and the market has started to price out further rate cuts. In **Czechia**, central bank communication has so far suggested that it will want to see seasonal January data before it commits to a cutting cycle, despite inflation now being back at its target level.

On the fiscal side, we are seeing some divergence. At one end of the spectrum, the government in **Czechia** plans to make meaningful fiscal consolidation efforts (spending cuts) next year, despite rising protests from labour unions. Contrastingly, in **Romania**, there is no 2024 budget yet, but the government did pass a new pension law, which will increase substantially the fiscal deficit (all else equal) over the next few years.

Lastly, external rebalancing continues across the region outside of **Romania**, with **Poland**, **Hungary** and **Czechia** posting current account surpluses.

EM corporate debt highlights

Like other global fixed income markets, EM corporate debt had a positive month. The market (JP Morgan CEMBI BD) gained 3.6% over the month, with the high-yield and investment-grade (IG) segments making an equal contribution to this. While the US Treasury market rally drove this strong performance, credit spreads also tightened to give both markets an extra boost. Spread tightening was more pronounced in the high-yield market, which benefitted the most from the increase in risk appetite. Within the CEMBI BD index, all sectors and markets delivered positive returns, with the former led by the oil & gas and real estate sectors and the latter by Argentina.

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