



Schroders Emerging Markets Lens: Emerging Market Debt

Strategic Research Unit

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Summary

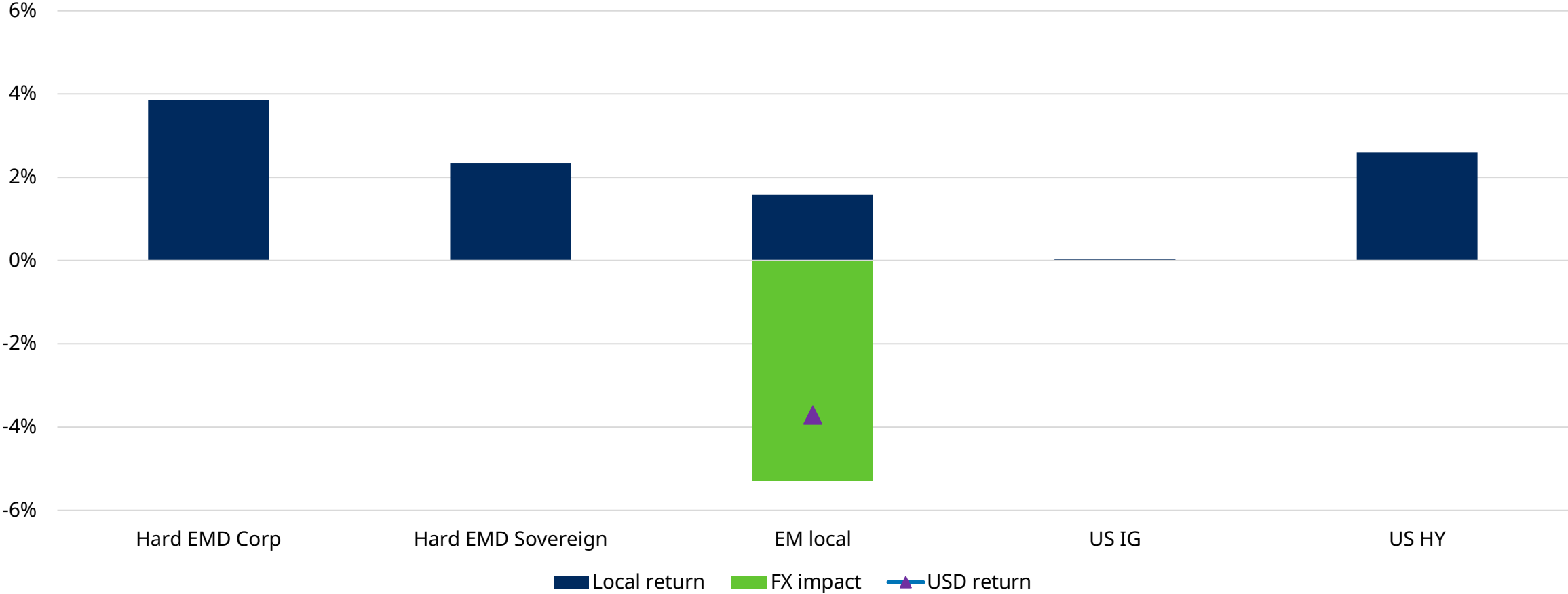
Q2 saw mixed performance from EMD, with hard currency advancing, notably corporate, and local debt under pressure. On a year-to-date basis, EM corporate debt continues to outperform, with total returns from hard currency sovereign also positive. Conversely, local EM debt remains in negative territory, owing to US dollar strength.

Hard currency emerging market debt (EMD):

- YTD hard currency performance remains divergent between the high yield (HY) and investment grade (IG) sub-sectors (slides 4-5).
- The HY index spread has moved above its historical median again. The IG sub-index spread is well below the historical median, and has fallen further YTD, but there is more to this story (slides 10-11).
- Spread dispersion between index markets has continued to fall from peak, after 2022 shock (slide 15).
- **Local currency** EMD:
 - The average real yield premium of EM over DM is off its long-term lows. The average EM and DM real yields have both increased YTD, but EM by a wider margin (slides 37-38).
 - The average local EM ex Turkey yield curve is upward sloping (slide 36).
 - There are undervalued **currencies** in all three EM regions (slide 42), but the degree of value varies significantly.

Hard currency EM outperforming so far in 2024

Year-to-date, total return (USD)



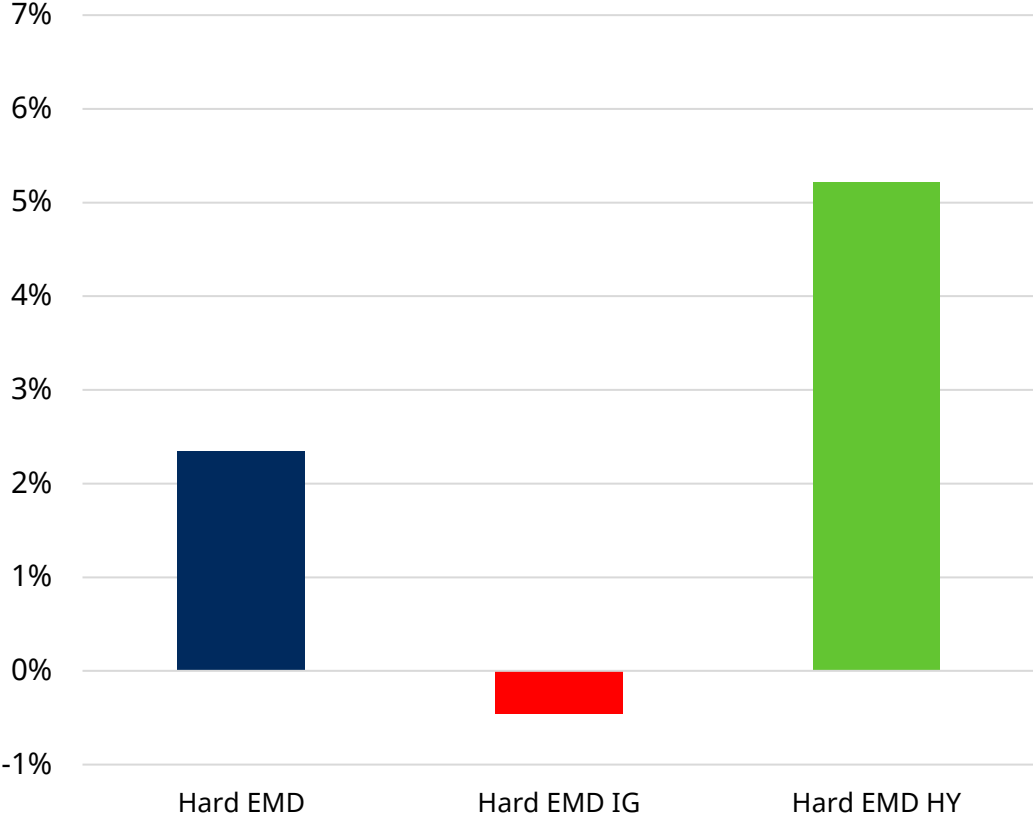
Past performance is not a guide to future performance and may not be repeated.

Note: Local currency = US dollar for all apart from local EMD which is in the relevant local EM currency.

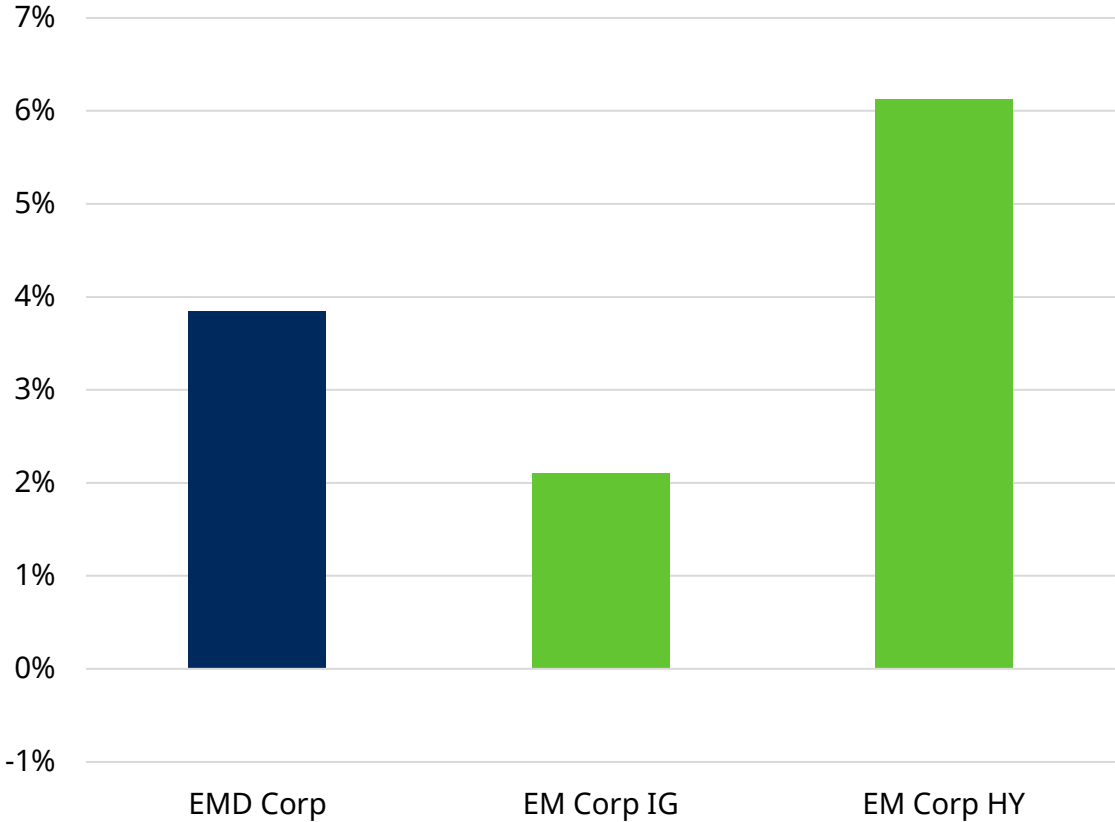
Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

YTD hard currency returns underpinned by high yield

HC sovereign, year-to-date total return (USD)



HC corporate year-to-date total return (USD)

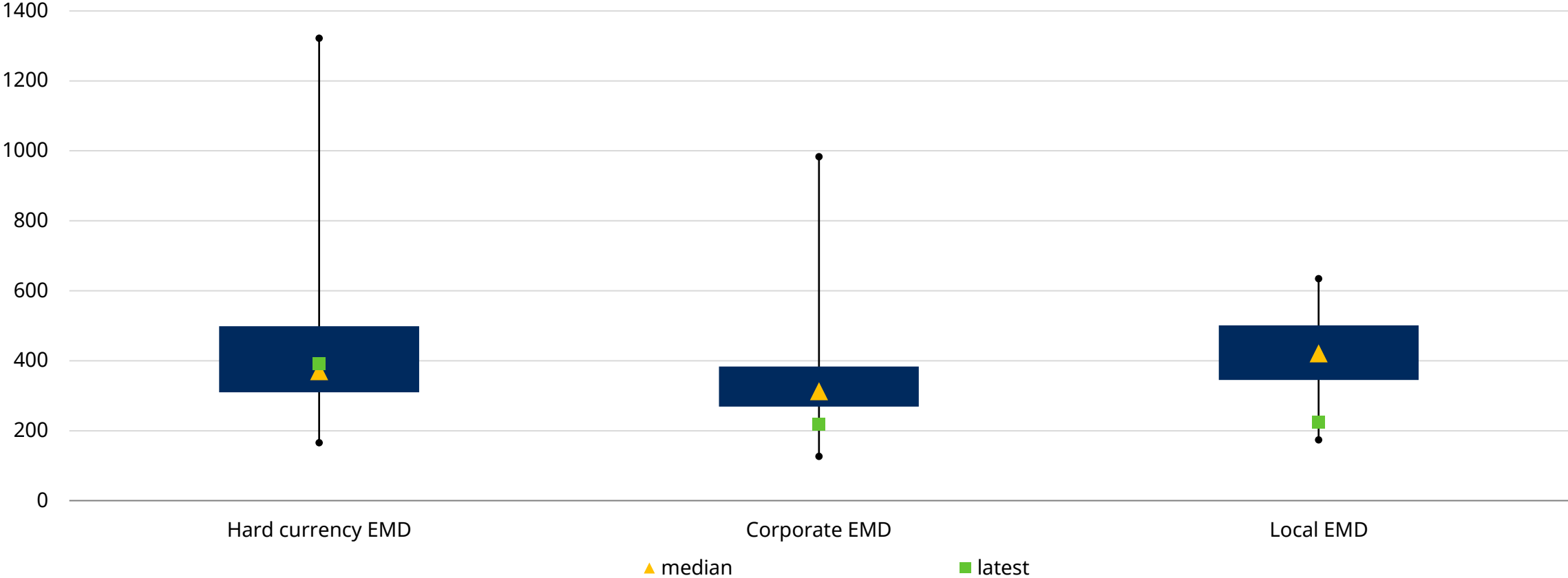


Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

EMD headline valuations – there is more to this story...

Spreads of key EMD indices (basis points)



Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, LSEG Datastream, J.P. Morgan. Data as at 30 June 2024. Hard EMD =stripped spread, Local EMD =Spread to 5 year UST, Corporate EMD = spread to worst. Please see relevant disclaimers on page 45.



Emerging market debt:

Hard currency

Summary: hard emerging market debt

- Hard currency sovereign EMD has returned 2.3% year-to-date. Underlying the headline return, there remains significant divergence between HY (+5.2%) and IG (-0.5%) sub-index performance.
- The IG sub-index spread has continued to trend lower YTD and is at its tightest level since 2007. This is impacted by compositional change and the addition of higher credit quality Middle Eastern markets from 2017.
- The spread on the HY index moved above its historical median again in Q2, driven by spread widening in Latin America, and the re-inclusion of Venezuela in the index.
- Sovereign spread dispersion has fallen quite steeply YTD, from the multi-decade highs reached in late 2022.
- Corporate EMD spreads on both the IG and HY sub index spreads are below their historical median and have continued to fall.
- Following the Covid pandemic and 2022 economic shock, credit ratings for issuers included in major sovereign/corporate EMD benchmarks have improved. Net credit rating changes are positive on 12-month unweighted basis.

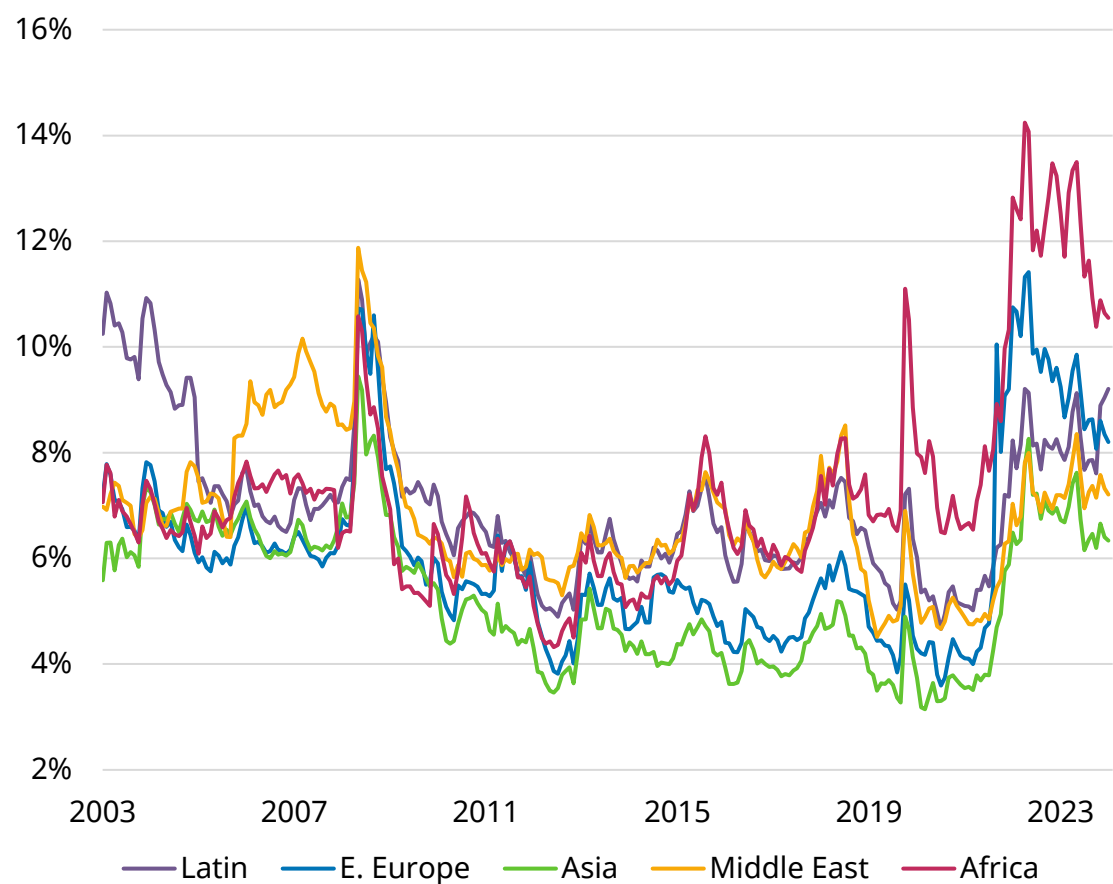
Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 30 June 2024.
Please see relevant disclaimers on page 45.

Hard EMD yield below 2023 peak, but picked up again in Q2 and remains elevated versus history

Hard currency sovereign EMD index yield



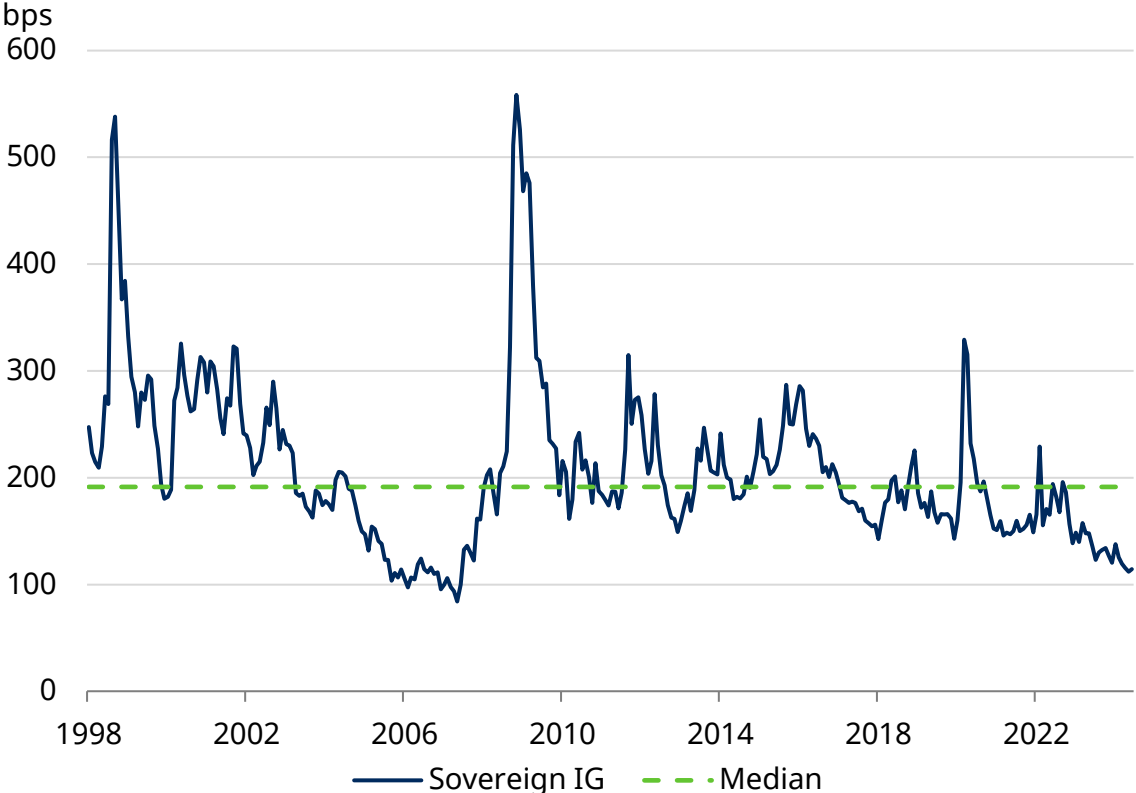
Hard currency sovereign EMD index yield by region



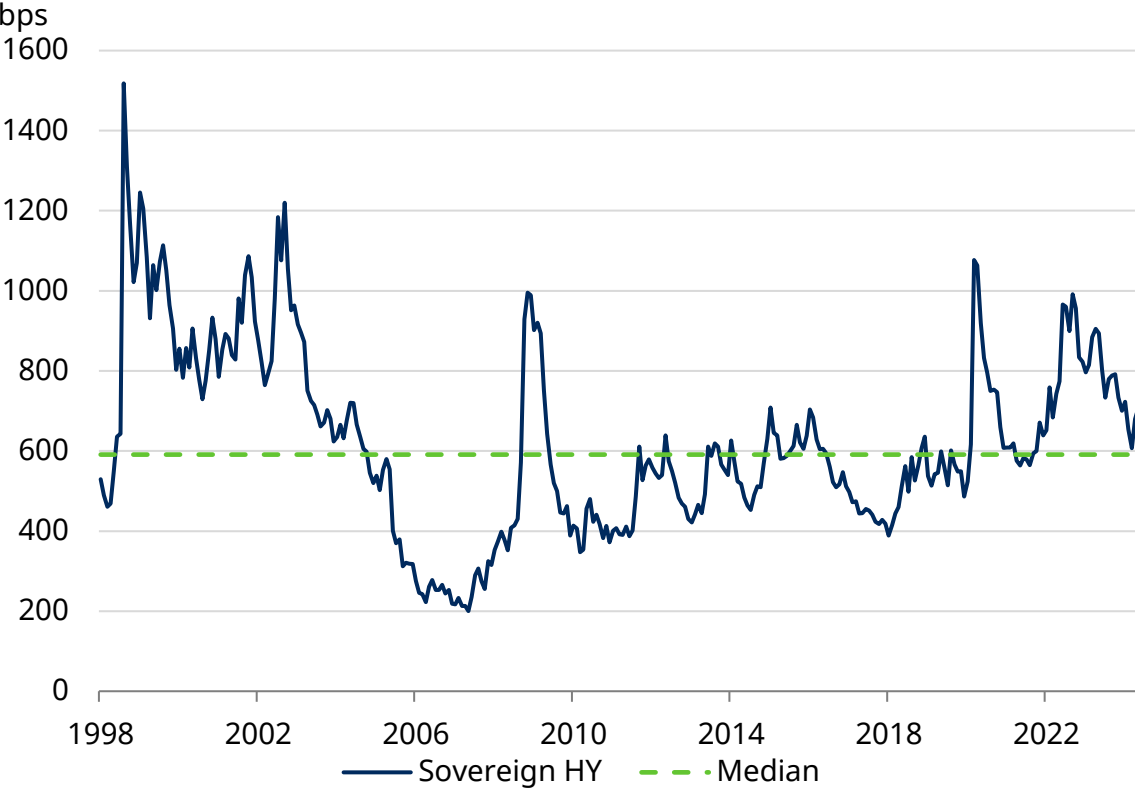
Past performance is not a guide to future performance and may not be repeated.
Russia was removed from all JP Morgan EMD indices from 31 March 2022.
Source: Schroders, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Hard currency sovereign spreads: HY spread has lifted again, but IG still trending lower

Hard currency sovereign EMD IG spread still falling



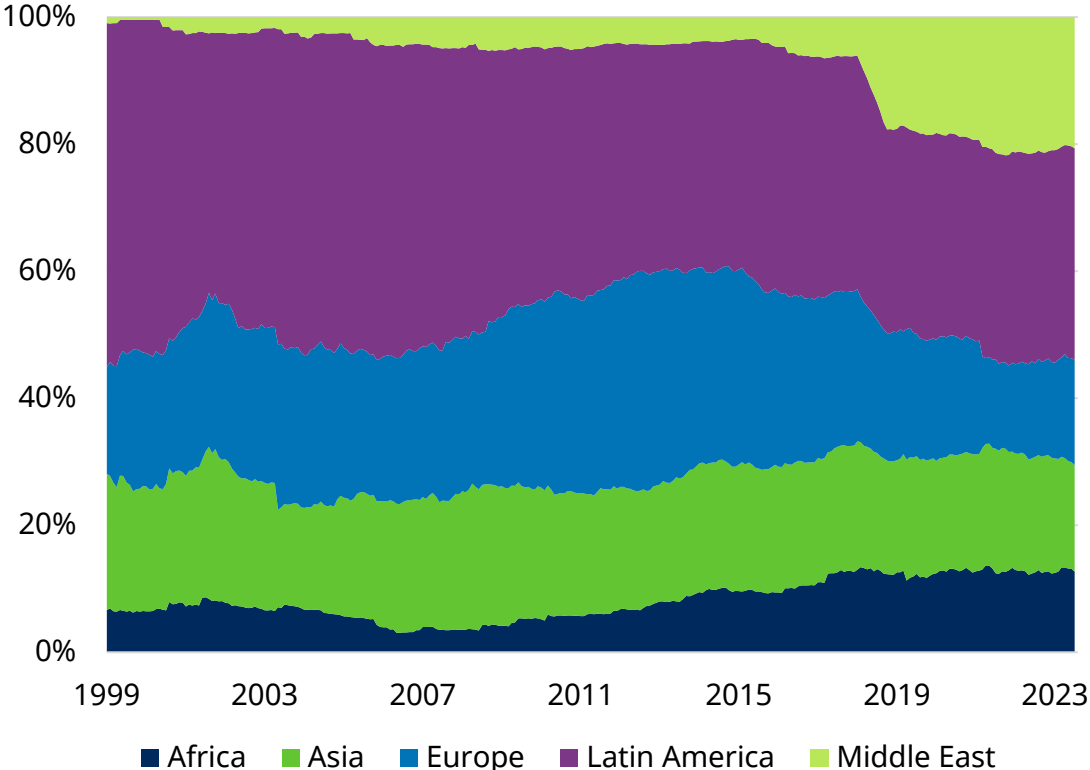
Hard currency sovereign EMD HY spread has widened



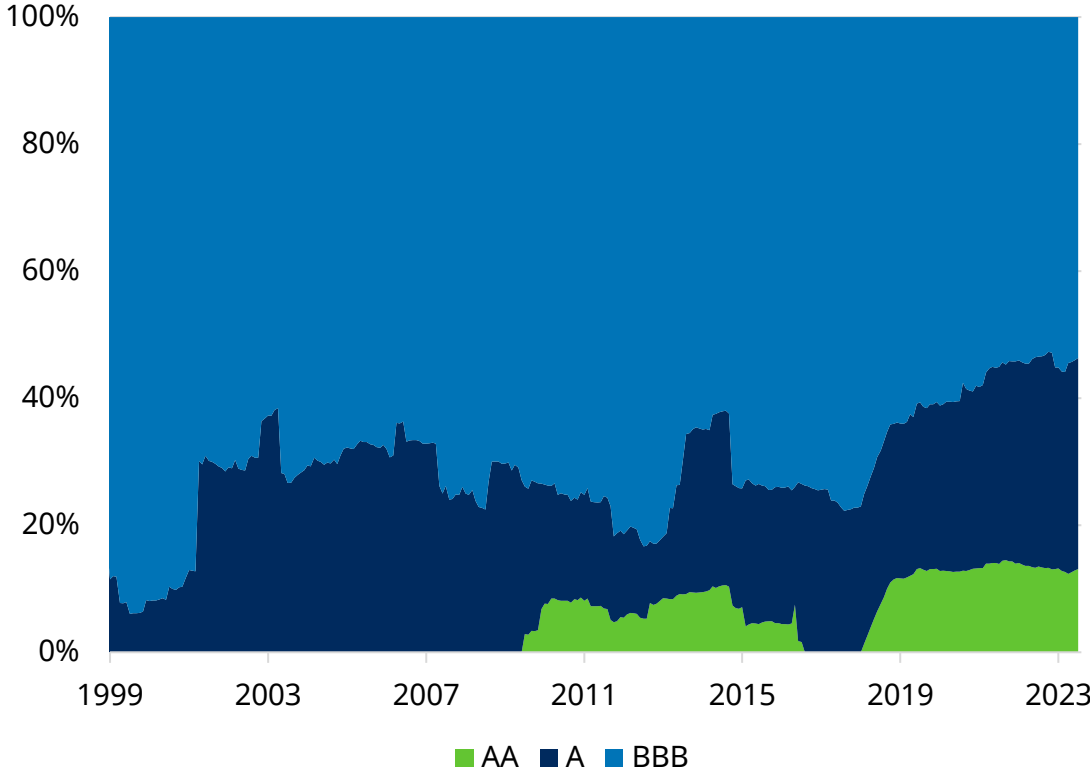
Past performance is not a guide to future performance and may not be repeated.
Source: LSEG Datastream, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Reminder: the rise of the Middle East has impacted IG spreads – its index weight has quadrupled since start 2017

Sovereign EMD regional split



Sovereign EMD IG-sub index ratings split

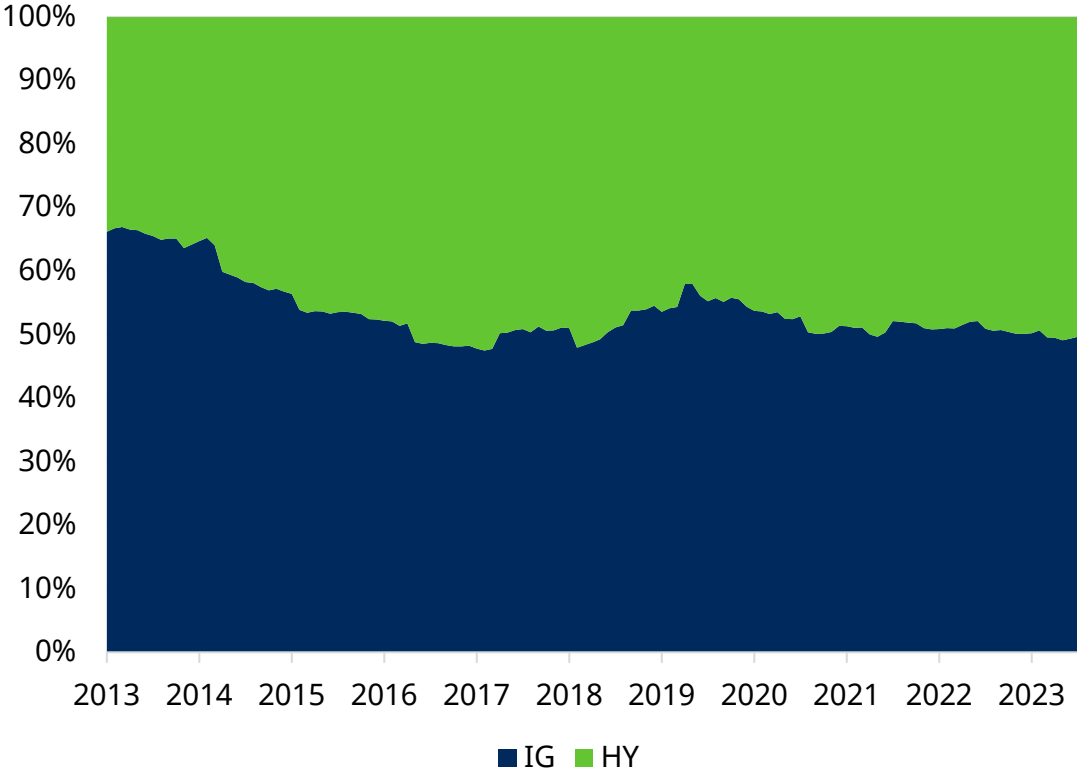


The Middle East is higher rated, and consequently the average credit quality of the IG index has improved

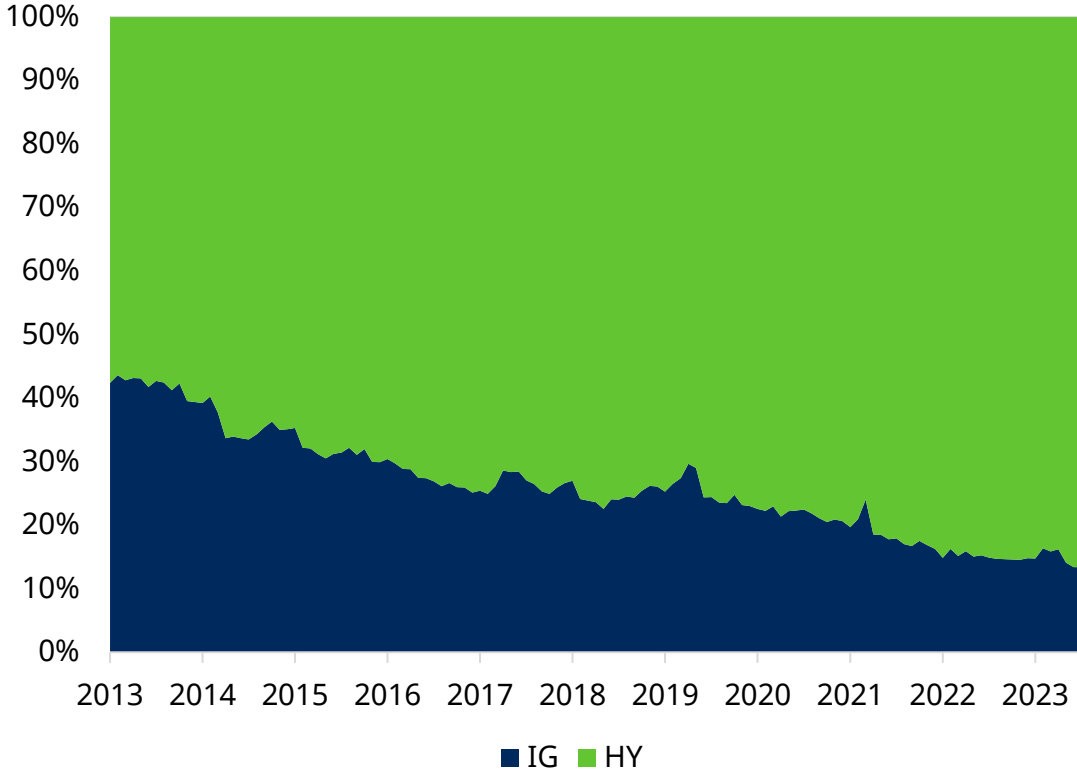
Source: LSEG Datastream, JP Morgan. Data as at 30 June 2024. IG sub-index is 49.7% of JP Morgan EMBIG Diversified Index. Please see relevant disclaimers on page 45.

Hard currency spread increasingly driven by HY component

HY and IG index weights relatively stable over time



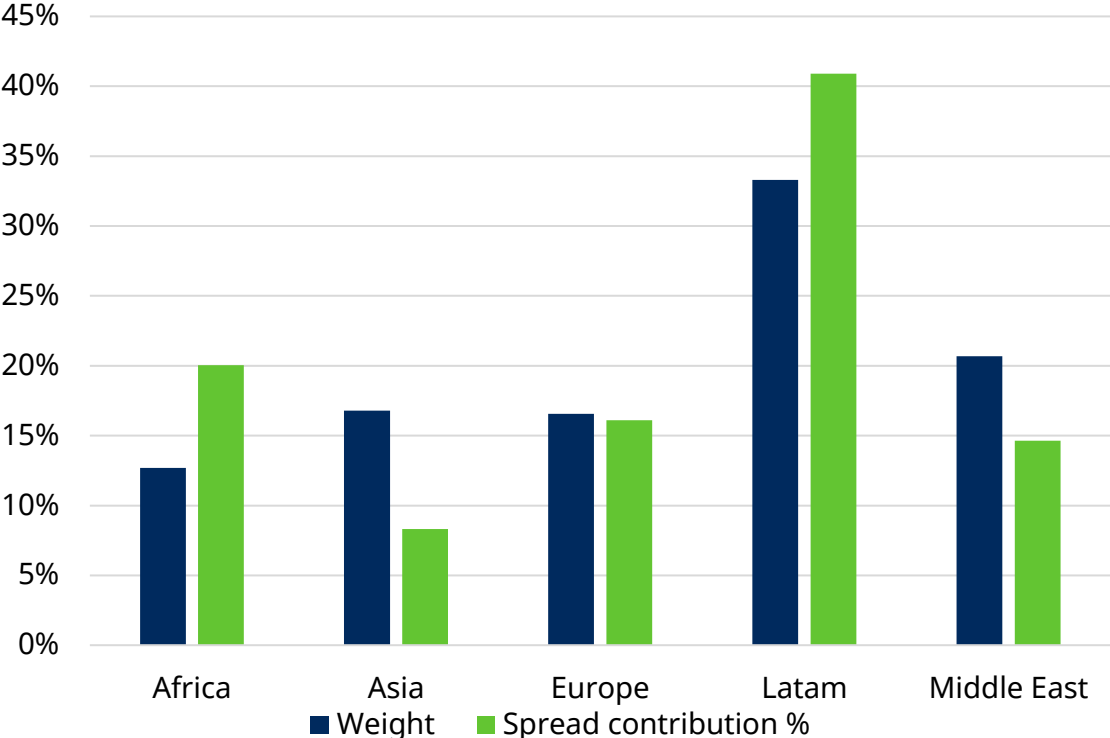
But HY share of spread contribution has increased



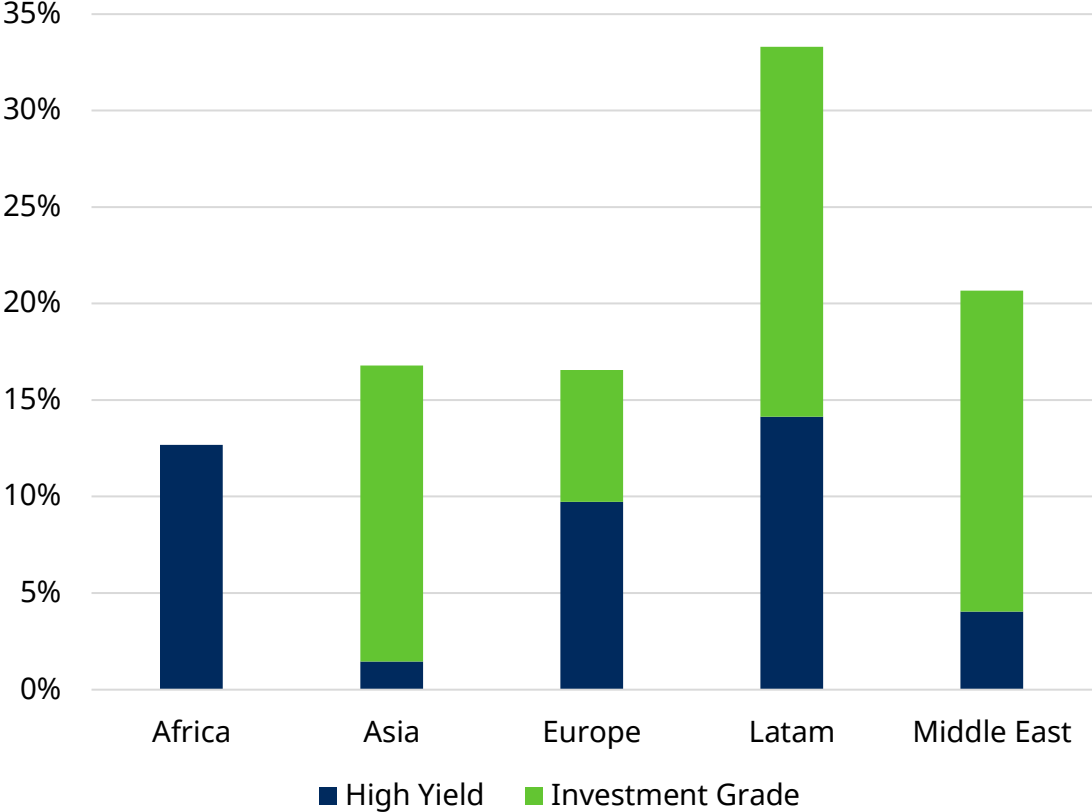
Source: LSEG Datastream, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45. Spread contribution calculated as HY spread multiplied by index weight, and equivalent for IG. Percentage contribution for IG and HY shown as share of total spread contribution (IG and HY).

Latin America dominates sov. hard currency index, but Africa punches above its weight in spread contribution

Hard currency index weights and spread contributions



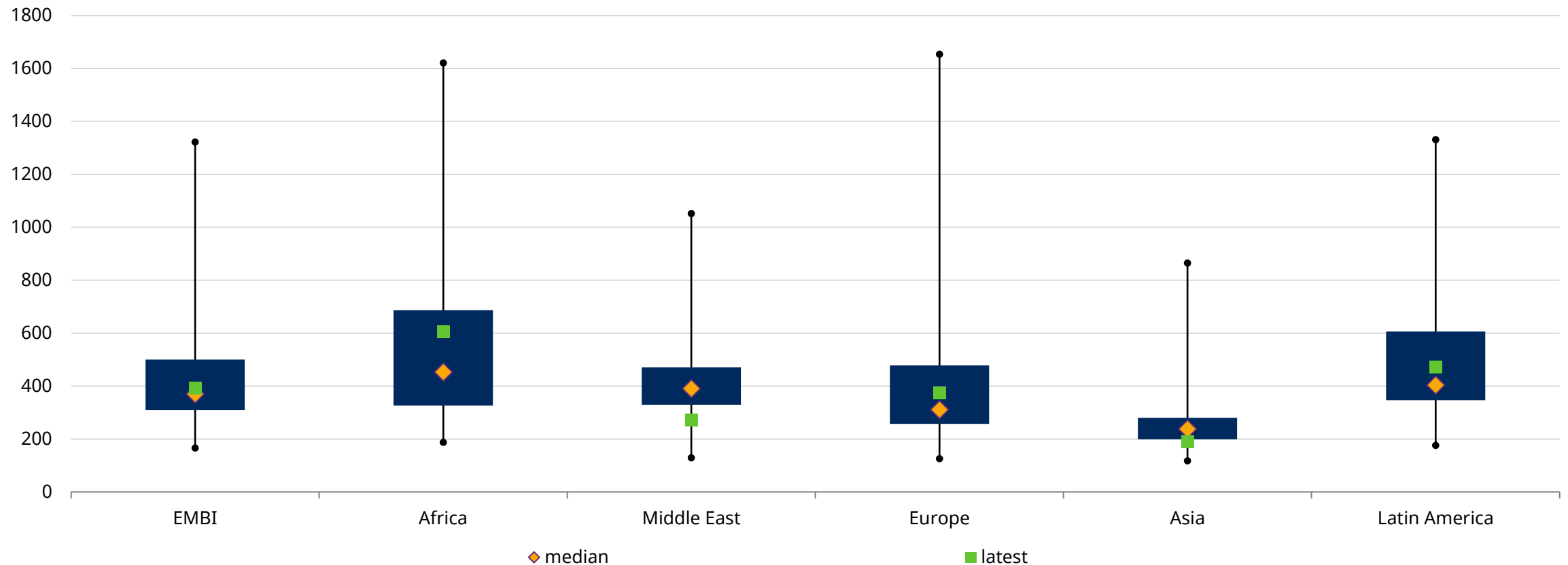
Hard currency weights split by HY/IG



Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45. Spread contribution calculated as weight of the region multiplied by the spread of that region. IG/HY split Schroders calculation.

Africa, Europe and Latin America offer the highest spreads versus history

Spreads of key regional hard currency EMD indices (basis points)

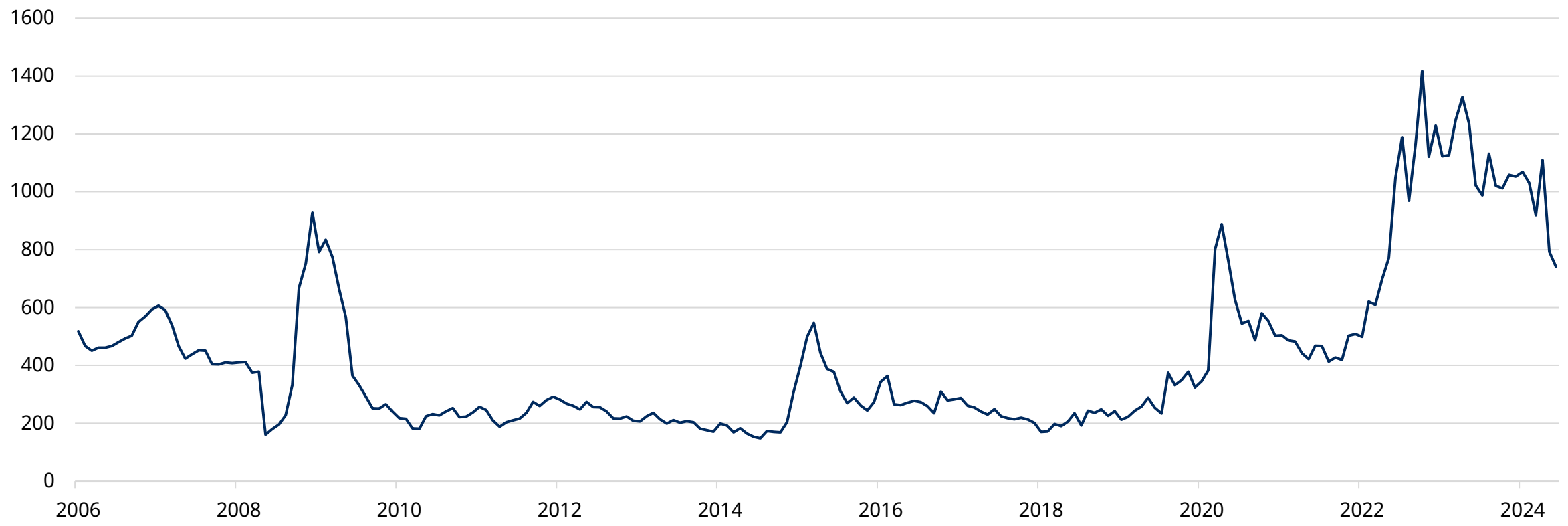


Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Spread dispersion between index markets has continued to fall from peak after 2022 shock

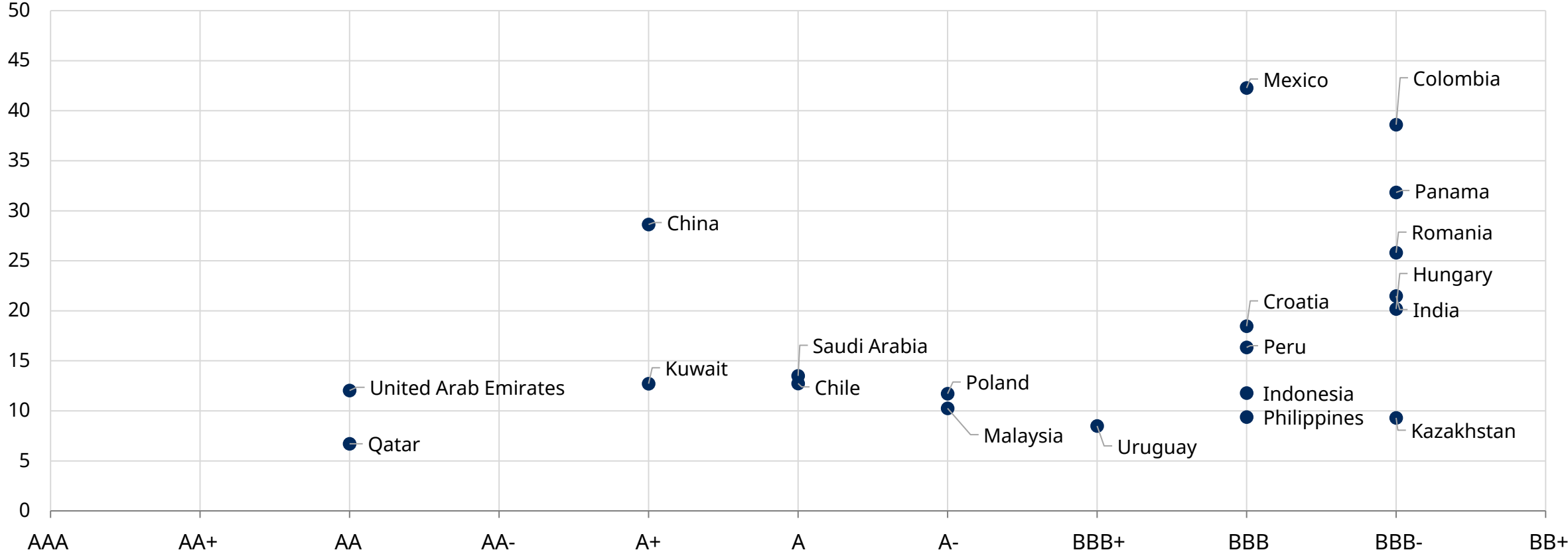
Standard deviation of sovereign EMD spreads¹



Source: Schroders, LSEG Datastream. Data as at 30 June 2024. ¹Based on individual country indices of the JPM EMBI Global Diversified Index. Excluding Lebanon and Venezuela. Please see relevant disclaimers on page 45.

Duration adjusted spreads of IG countries

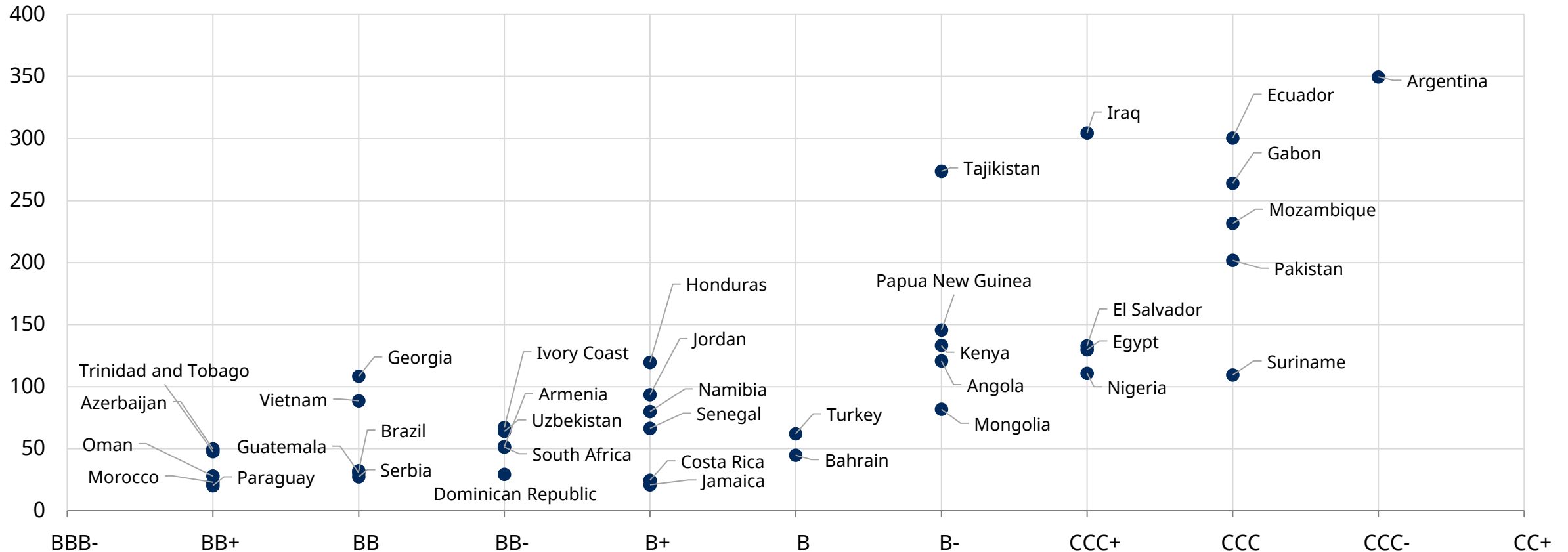
Hard currency sovereign EMD IG: spread vs. duration vs. credit rating



¹The JPMorgan EMBI Global Diversified Index includes both sovereign and quasi-sovereign bonds.
 The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, LSEG Datastream, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Duration adjusted spreads of HY countries

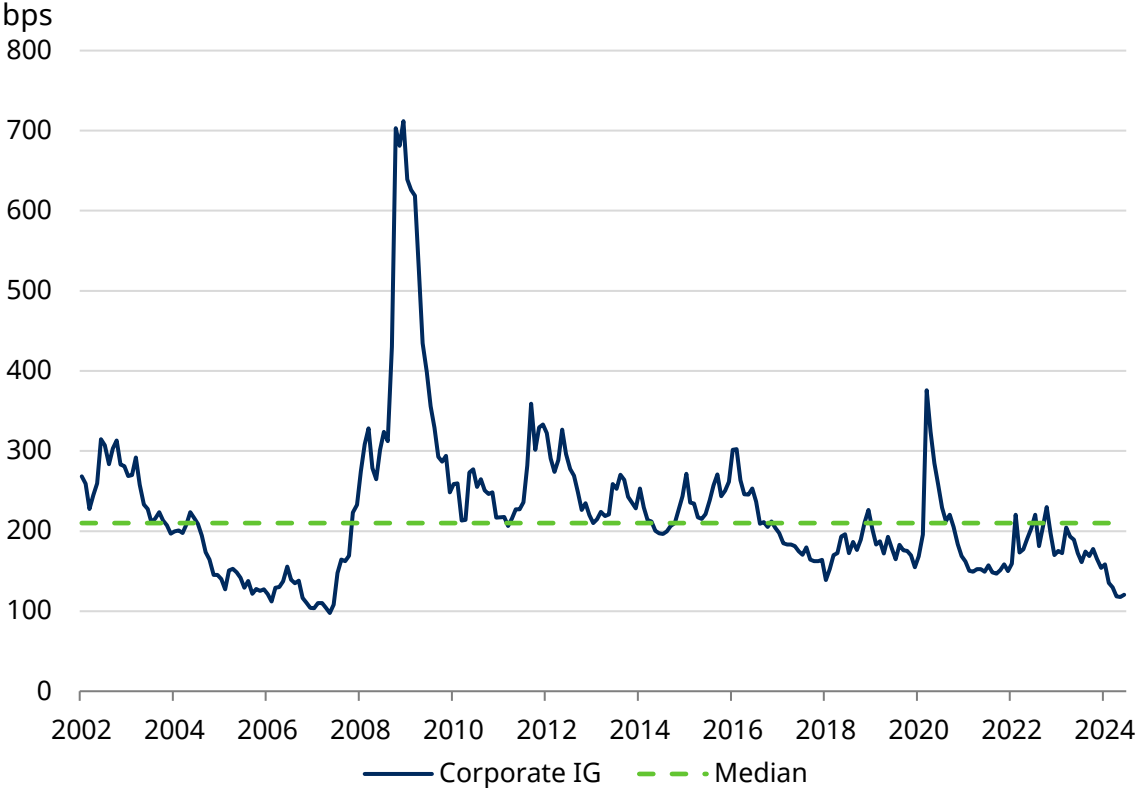
Hard currency sovereign EMD HY: spread vs. duration vs. credit rating



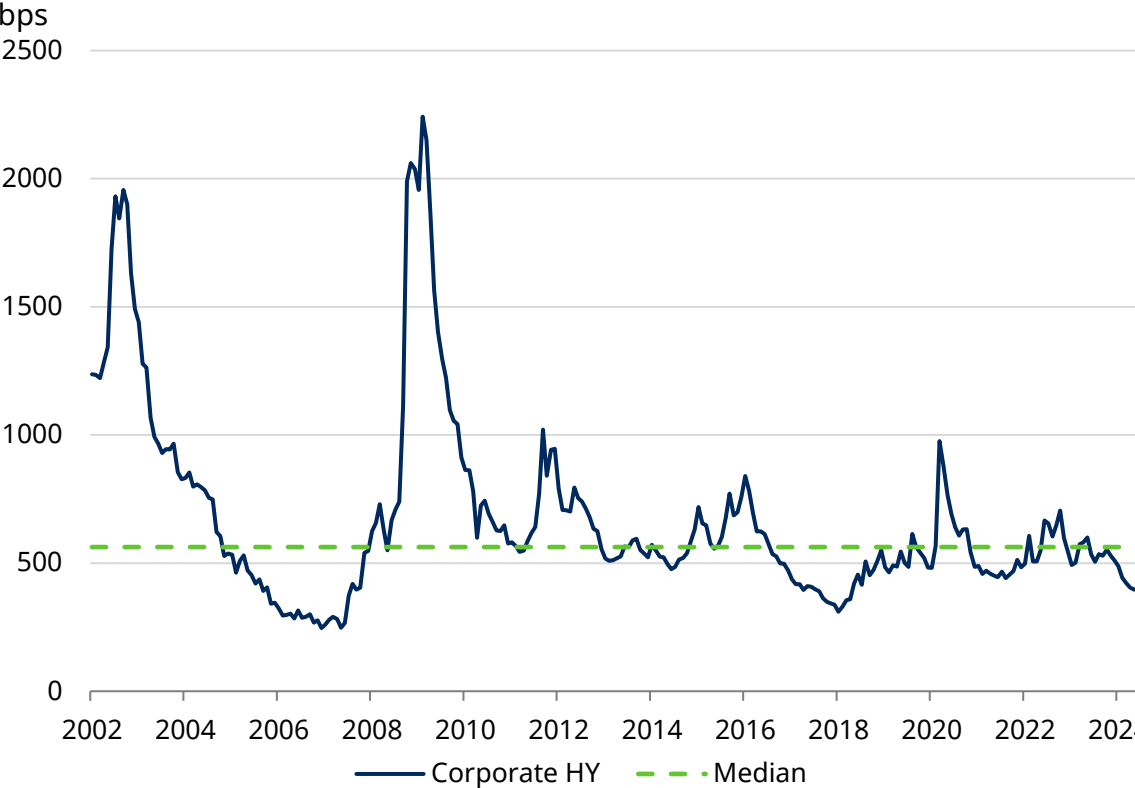
¹The JPMorgan EMBI Global Diversified Index includes both sovereign and quasi-sovereign bonds.
 The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, LSEG Datastream, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Hard currency corporate EMD spreads are below the historical median

Hard currency corporate EMD IG spread



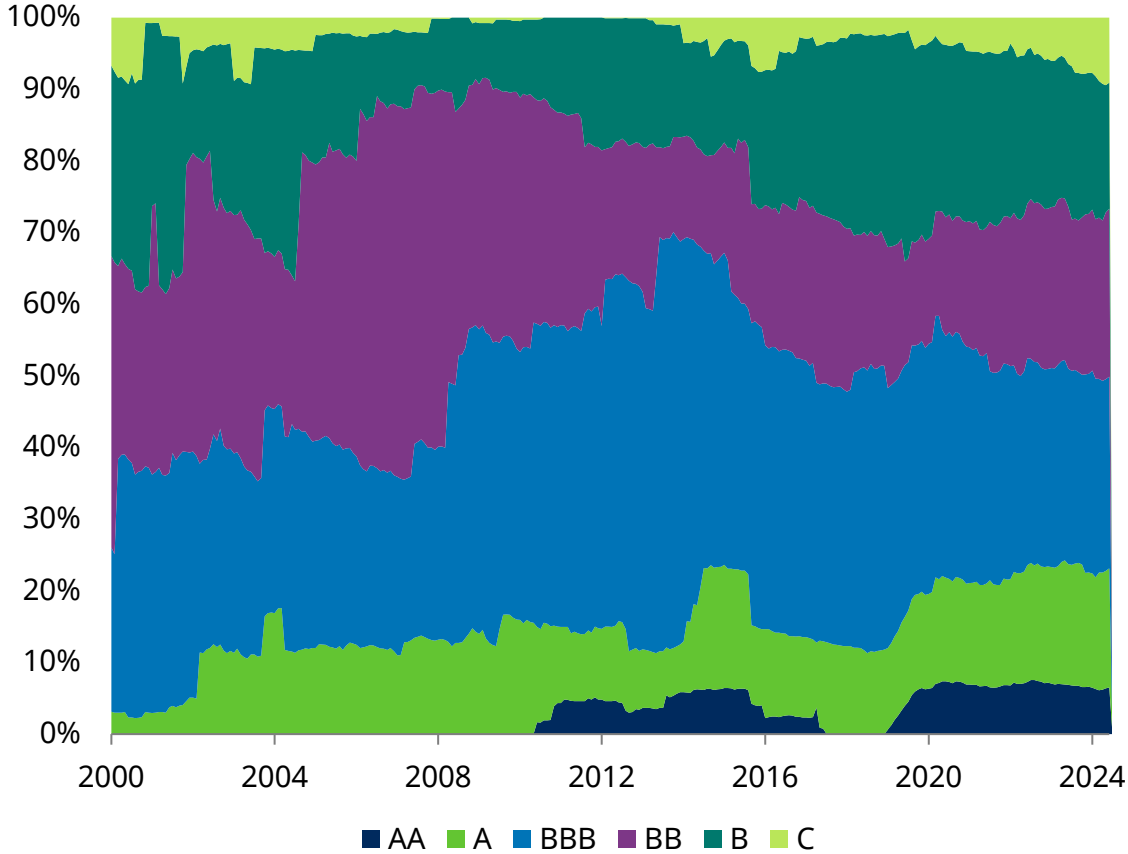
Hard currency corporate EMD HY spread



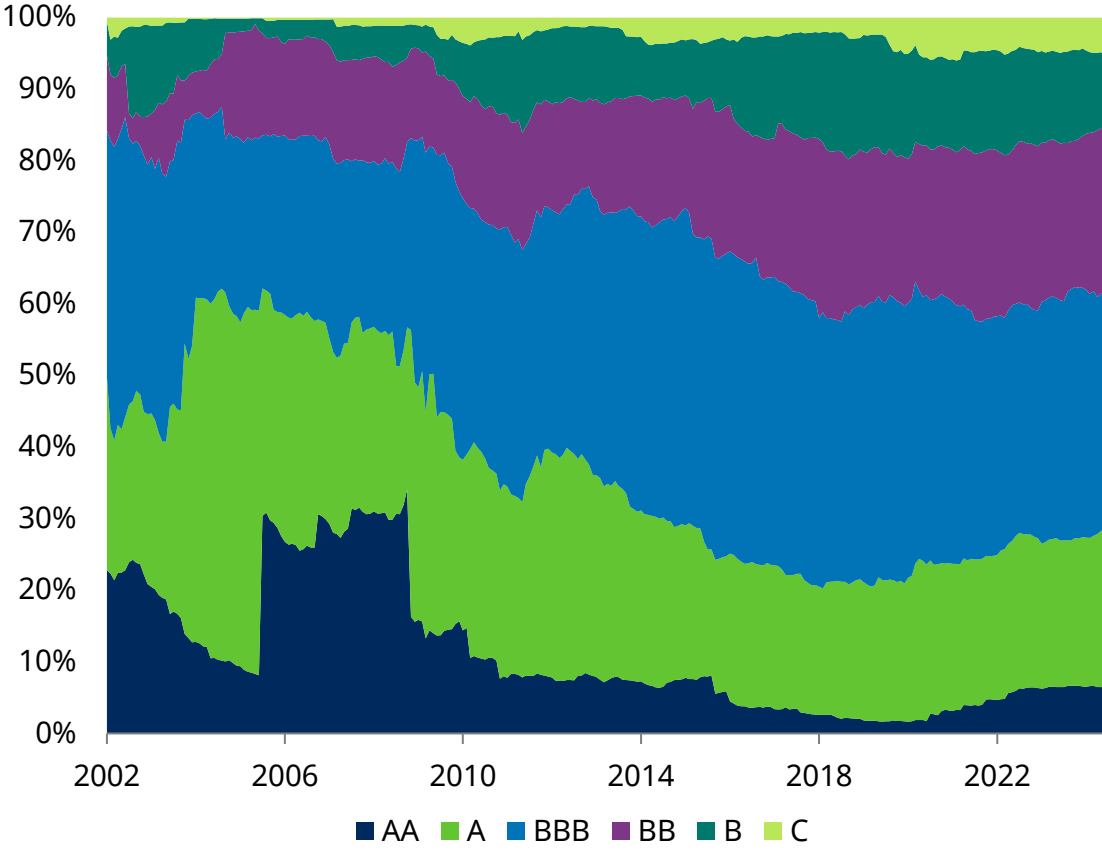
Past performance is not a guide to future performance and may not be repeated.
Source: LSEG Datastream, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Share of IG bonds has fallen in the sovereign and corporate indices in the last decade

Sovereign EMD ratings split



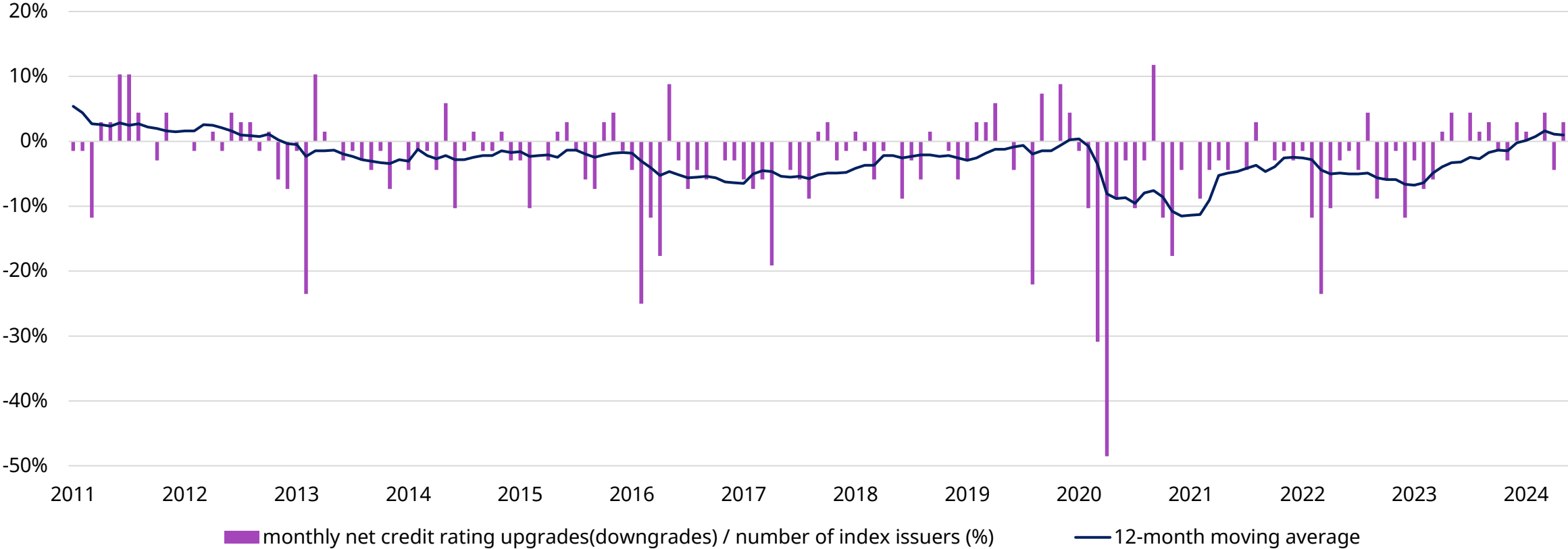
Corporate EMD ratings split



Past performance is not a guide to future performance and may not be repeated
 Source: Schroders, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Net credit rating changes have turned positive

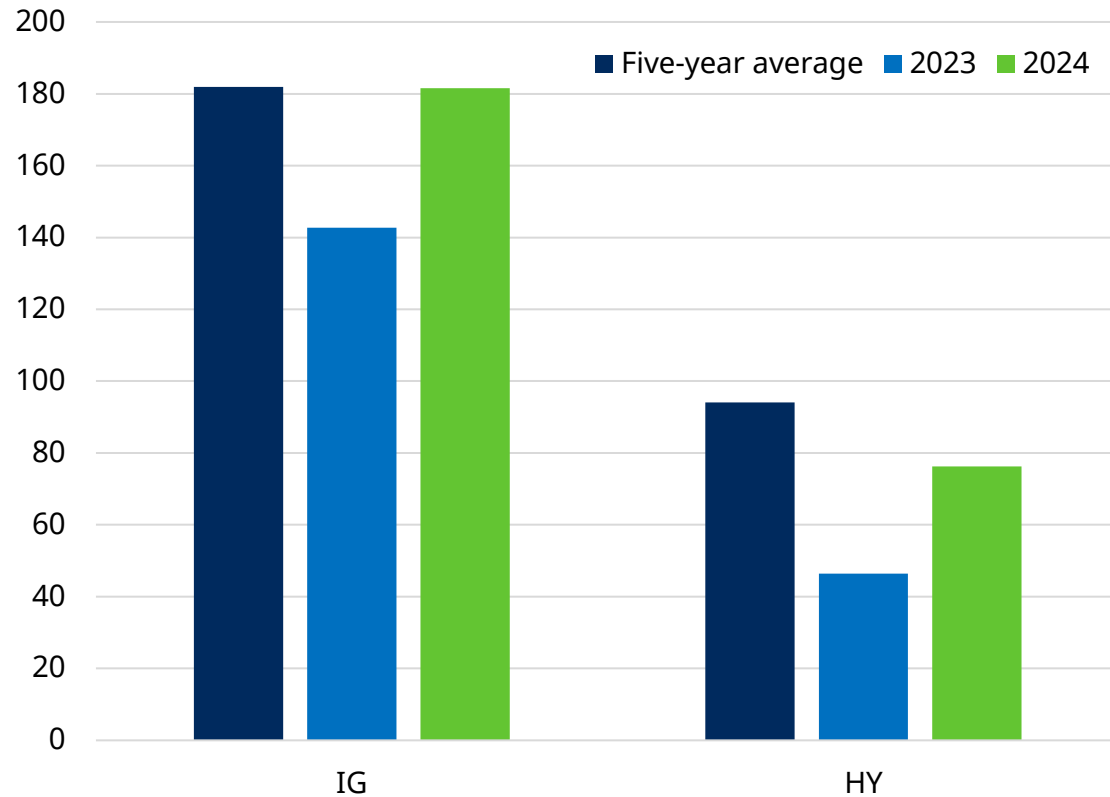
Sovereign hard currency index net credit rating upgrades/downgrades



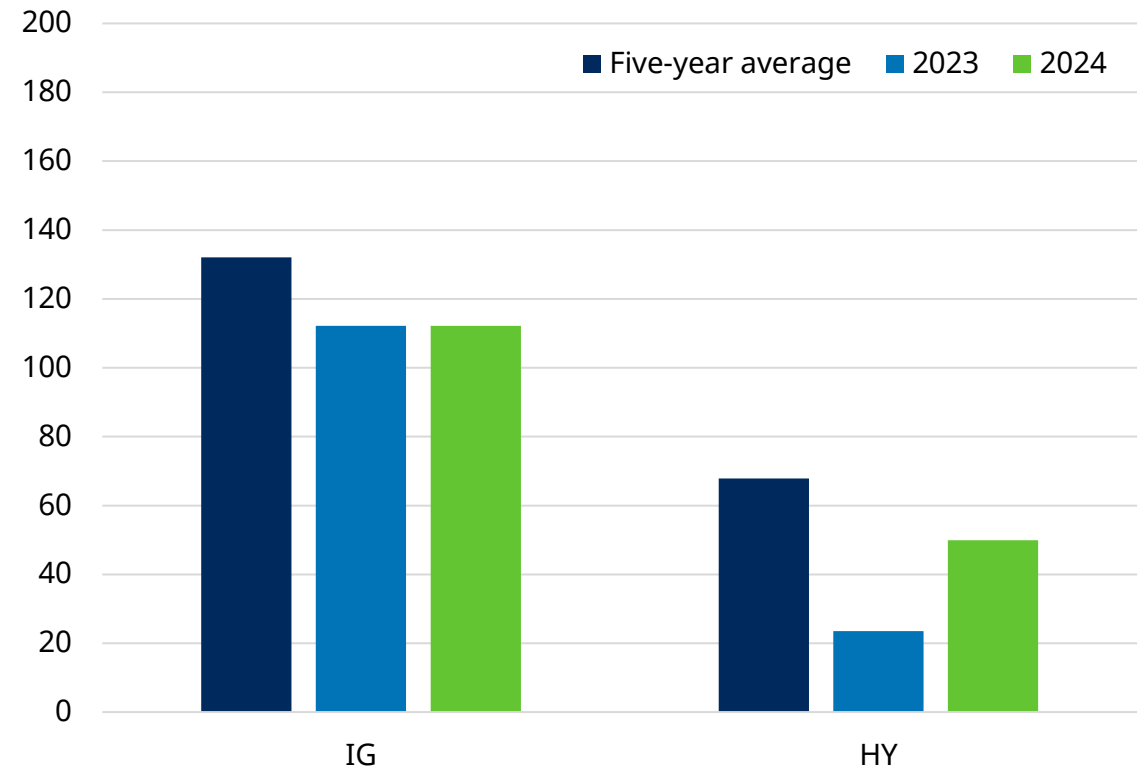
Past performance is not a guide to future performance and may not be repeated.
Weighted by number of issuers, not size of issuer.
Source: Schroders, Bloomberg. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

YTD IG sovereign and corporate issuance close to or above five-year average; HY also improvingly markedly

Overall hard EMD (USD billion)



Hard corporate EMD (USD billion)



Five-year average is 2019-2023. 2024 YTD vs. equivalent 2023 YTD and five-year average YTD. Total sovereign and Corporate hard EMD. BAML, data as at 30 June 2024. Please see relevant disclaimers on page 45.

Characteristics of EM hard currency issuers

Hard currency corporate issuers



■ Financials ■ Nonfinancials

Hard currency sovereign issuers



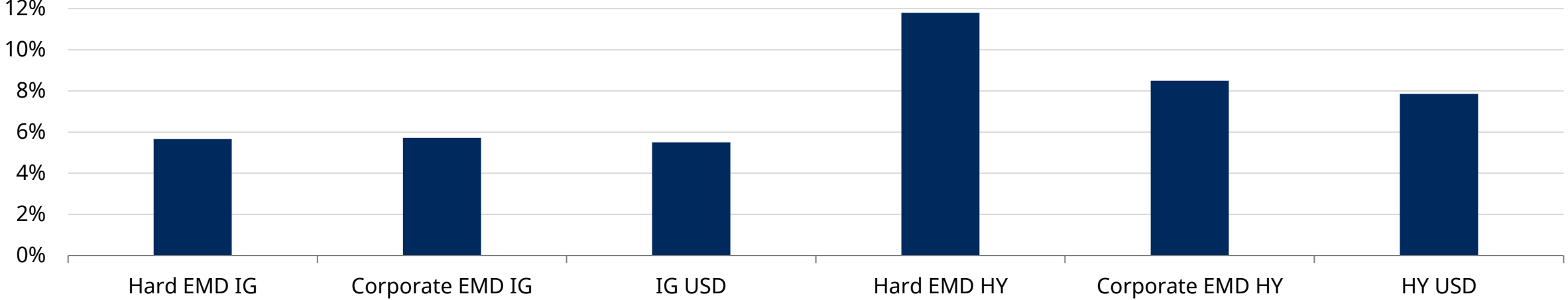
■ Sovereign ■ Quasi Sovereign

Source: LSEG Datastream, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Hard and corporate EMD offer a yield and spread pick-up over equivalent rated US corporate debt

	Hard EMD IG	Corporate EMD IG	IG USD	Hard EMD HY	Corporate EMD HY	HY USD
Yield	5.7%	5.7%	5.5%	11.8%	8.5%	7.9%
Spread (bps)	114	121	96	730	399	318
Duration	7.7	4.8	6.8	5.4	3.3	4.0
Rating	A3	A3	A3	B1	B1	B1
Percentage of EMD index	49.7%	58.9%	-	50.3%	41.1%	-

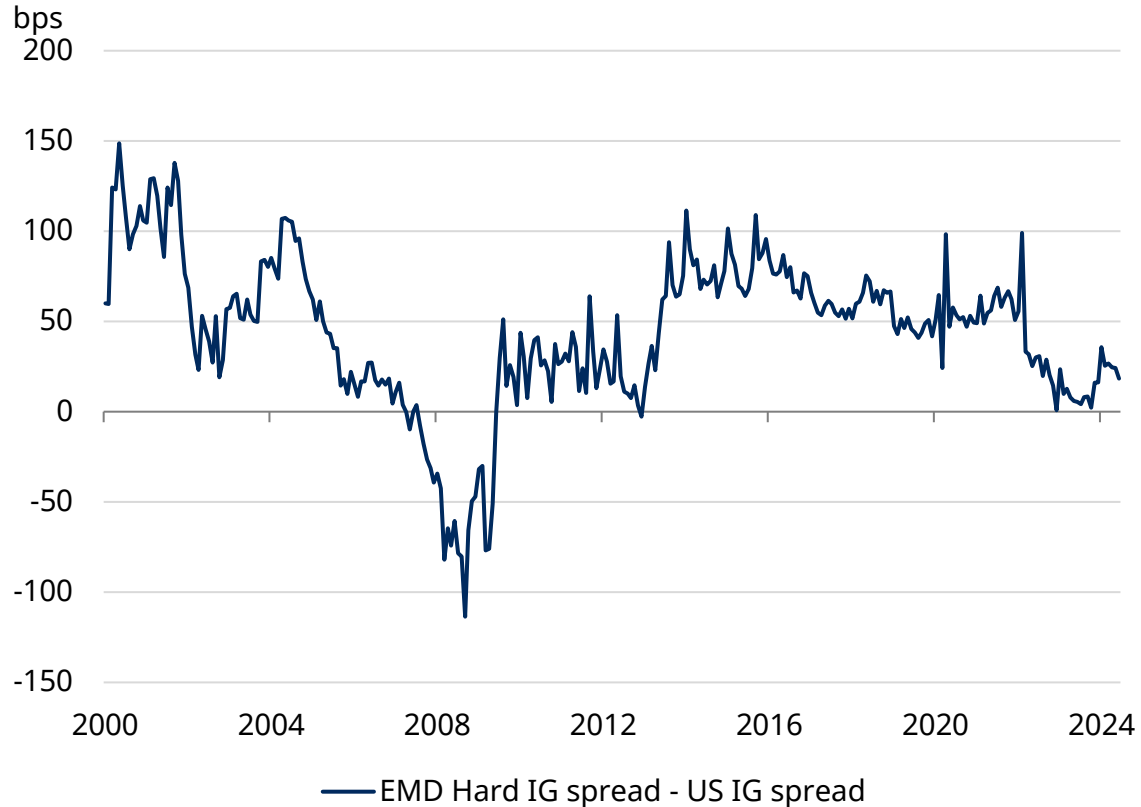
EM vs. DM yields



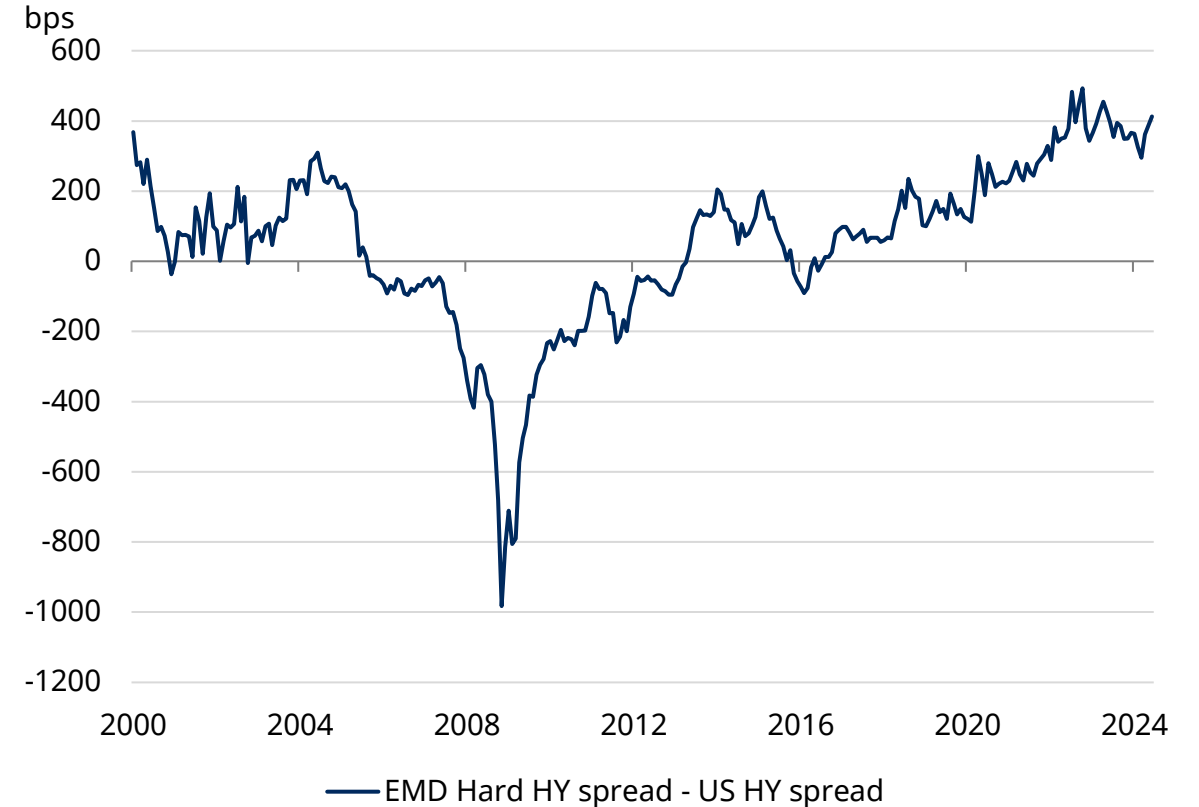
Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Sovereign EMD vs. US corporates spreads

Sovereign EMD IG spread continues to narrow vs. US



Sovereign EMD HY spread starting to widen vs. US

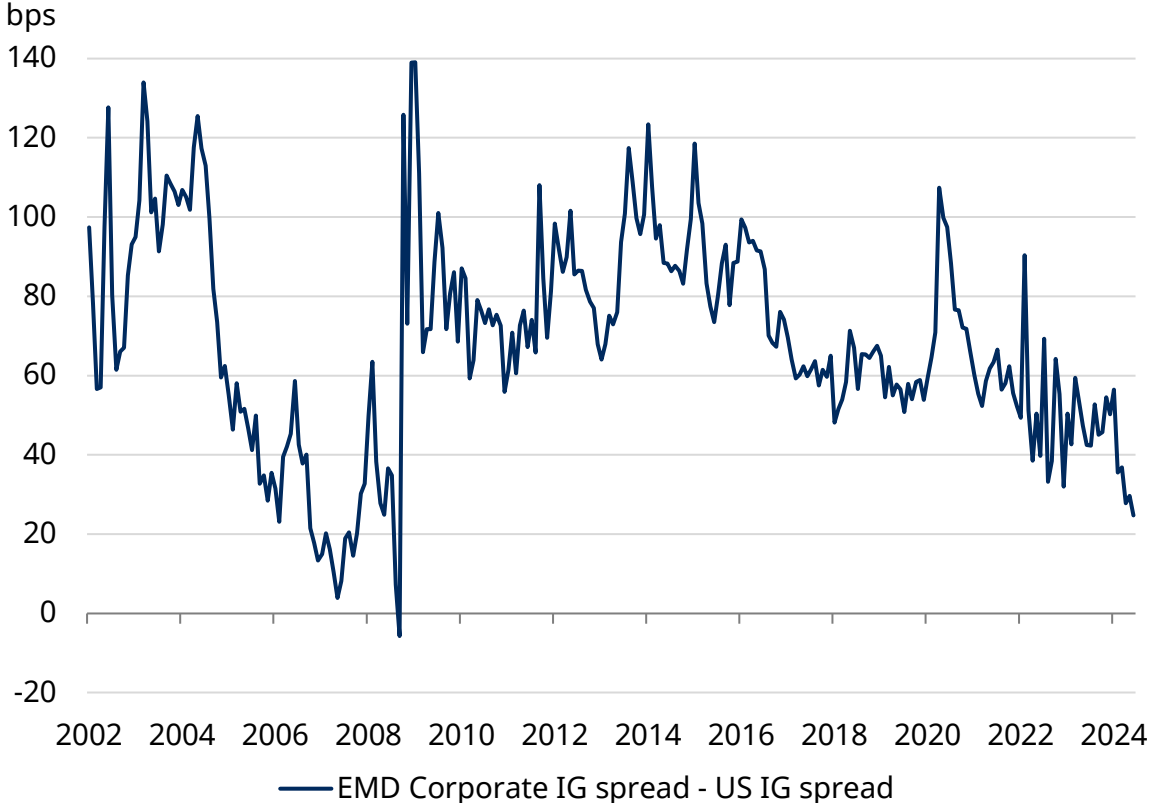


Past performance is not a guide to future performance and may not be repeated.

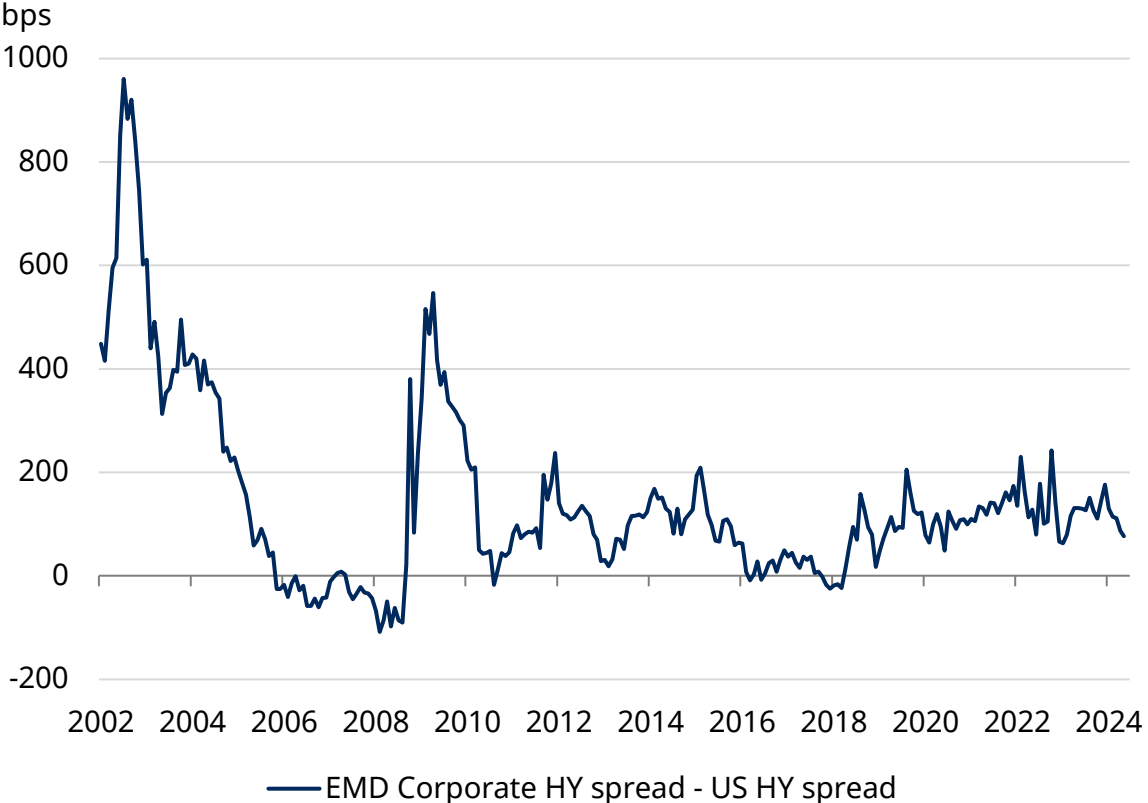
Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Corporate EMD vs. US corporates spreads

Corporate EMD IG spread premium narrowing vs US



Corporate EMD HY spread premium also falling vs. US HY



Past performance is not a guide to future performance and may not be repeated.
Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.



Emerging market debt:

Local currency

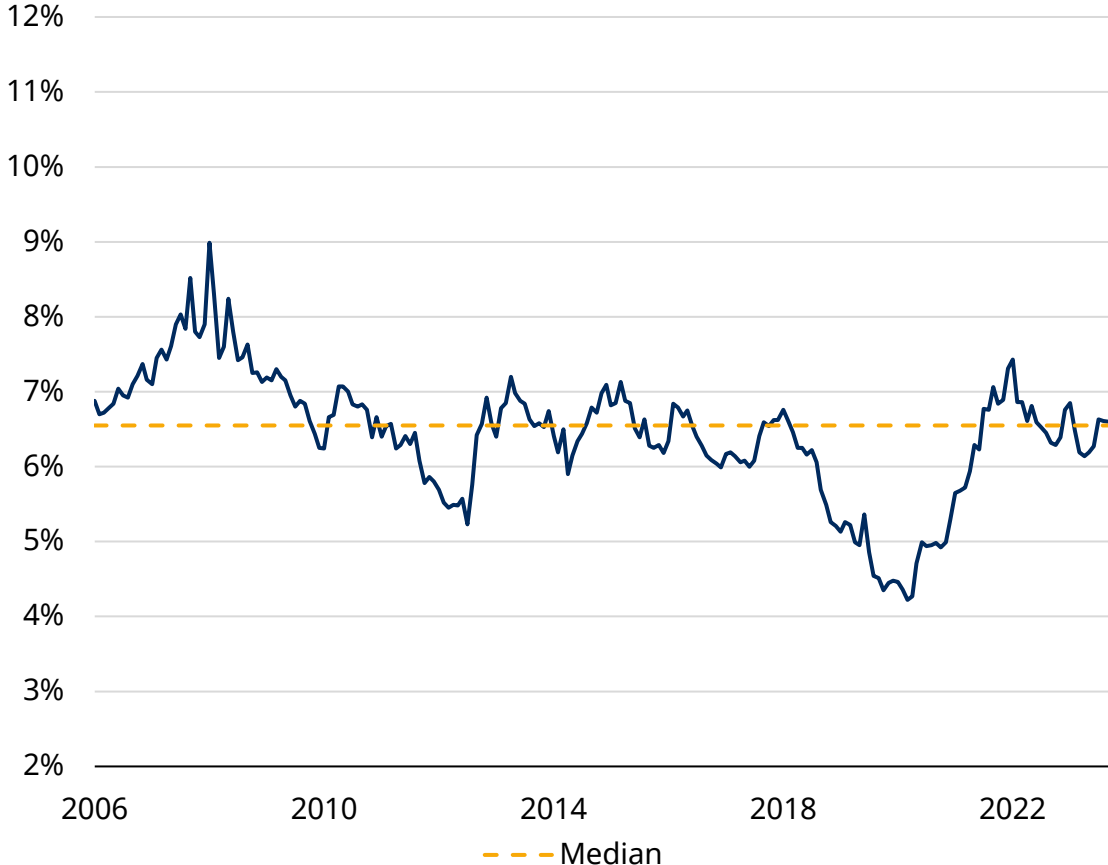
Summary: local currency emerging market debt

- Local EM bonds are down 3.7% year-to-date, with currency weakness accounting for negative returns.
- The yield on the local EM bond index is close to the historical median, but there is significant variation between regions; yields in Latin America are markedly higher than in EM Asia.
- EM ex Turkey headline and core inflation has fallen significantly and is close to or moving towards target in many EM. China is a notable exception.
- Interest rate cuts are underway in various markets, led by Latin America and EM Europe. However, there is a risk that postponed Fed rate cuts constrain the extent of EM easing cycles, or even curtail further easing. The average local EM ex Turkey yield curve is now upward sloping.
- The average real yield premium of EM over DM is off its long-term lows. The average EM and DM real yields have both increased YTD, but EM by a wider margin.
- India's inclusion in the local index commenced in June, with a 1% weight added each month for the next ten months, to a maximum of 10%.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

EM local currency index yield close to historical median, but significant dispersion by region

Local EMD index yield



Local EMD yield by region

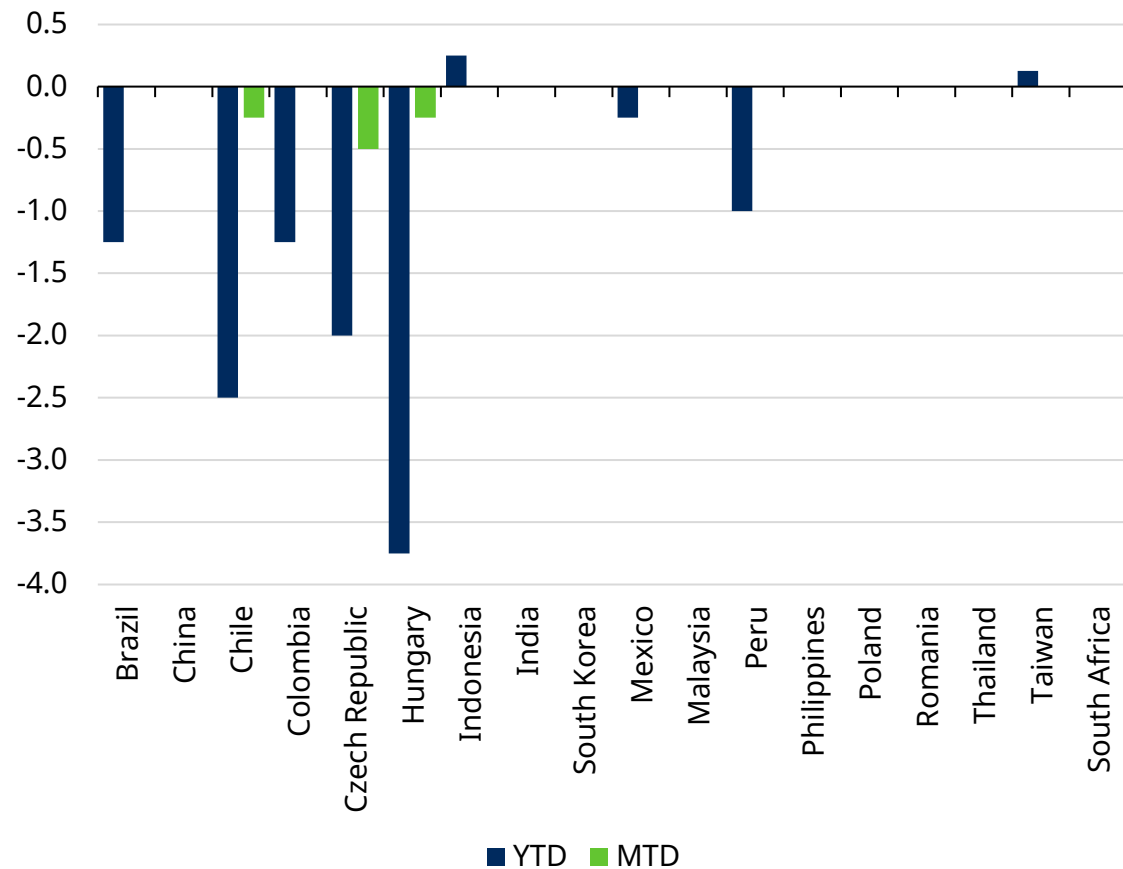


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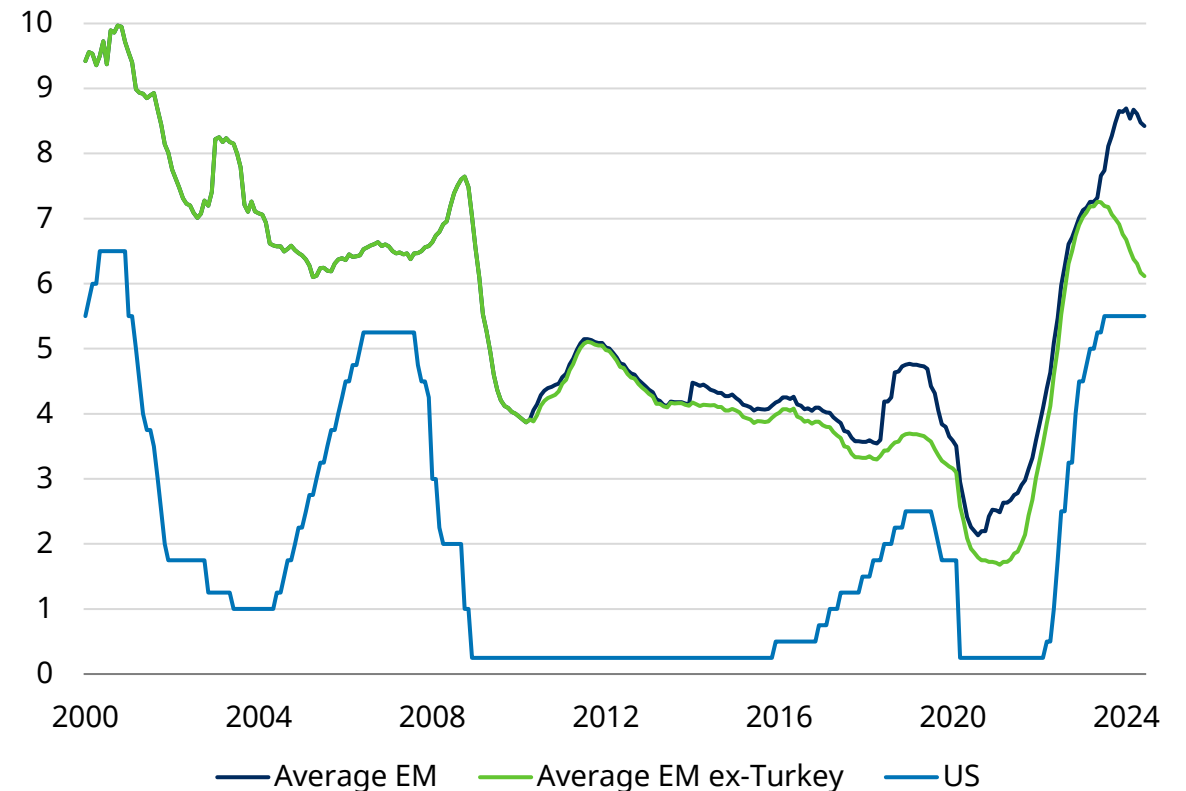
Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Russia was removed from all JP Morgan EMD indices from 31 March 2022. Please see relevant disclaimers on page 45.

Average EM policy rate is falling, led by Latin America and Europe

Change in EM policy rates MTD/YTD(%)*



Average EM policy rate¹ (%)

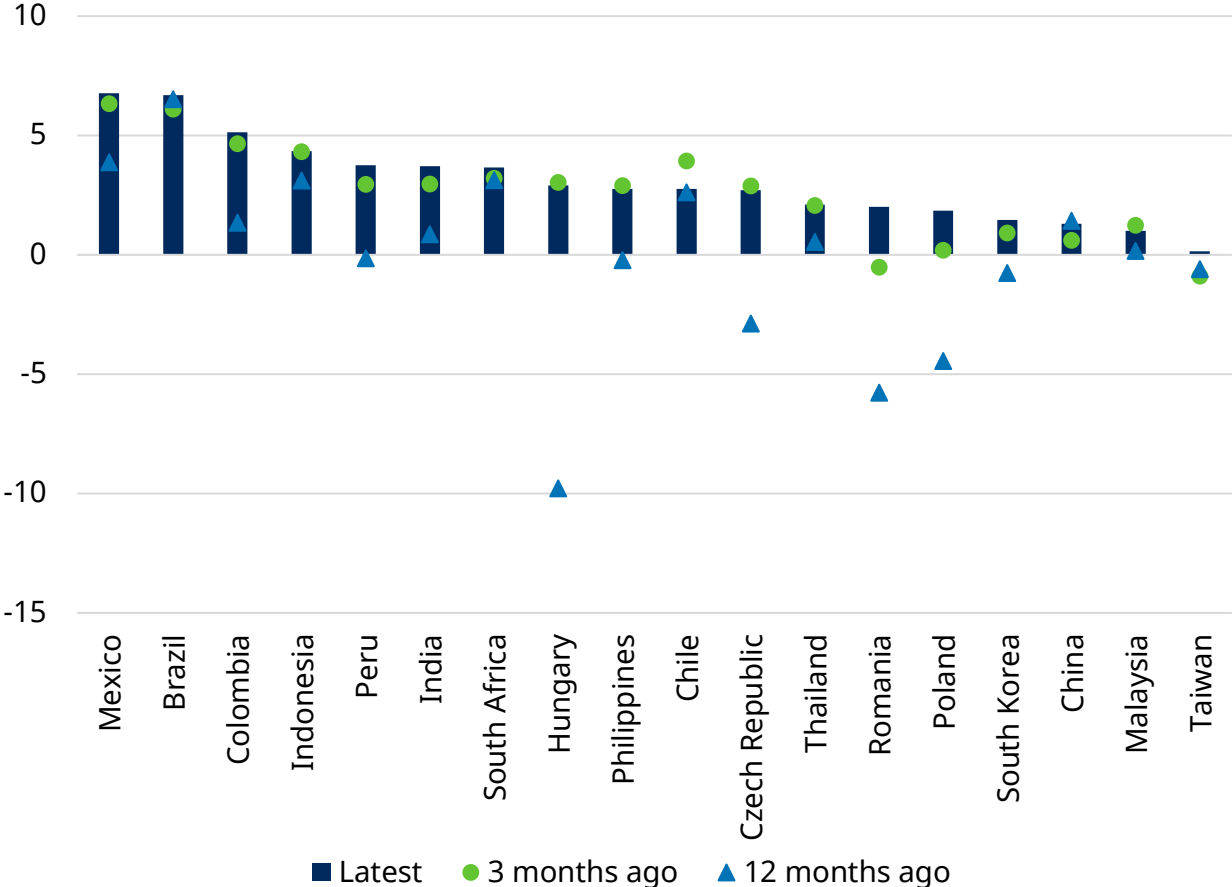


Source: Schroders, LSEG Datastream. Data as at 30 June 2024. ¹Based on 19 major EM countries. Please see relevant disclaimers on page 45.

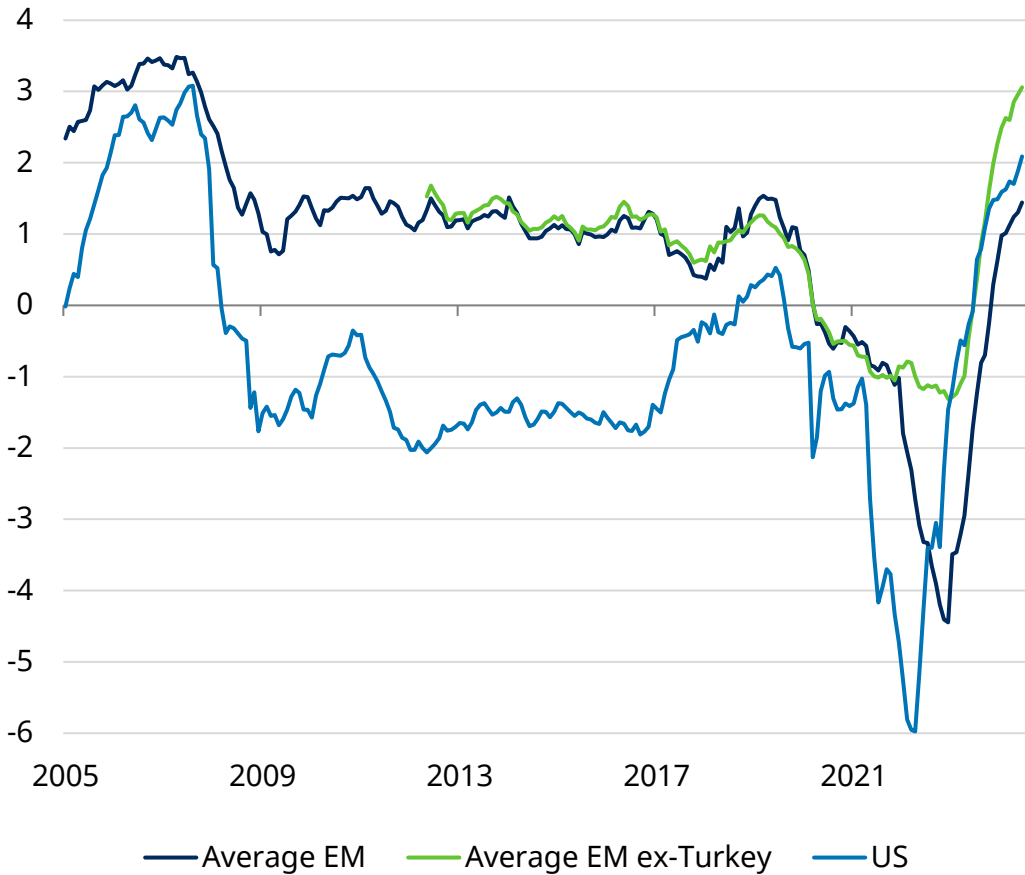
*Turkey is excluded from the bar chart due to scale of hikes compared to the rest of EM.

EM real policy rates are positive across the board

EM real policy rates (%)



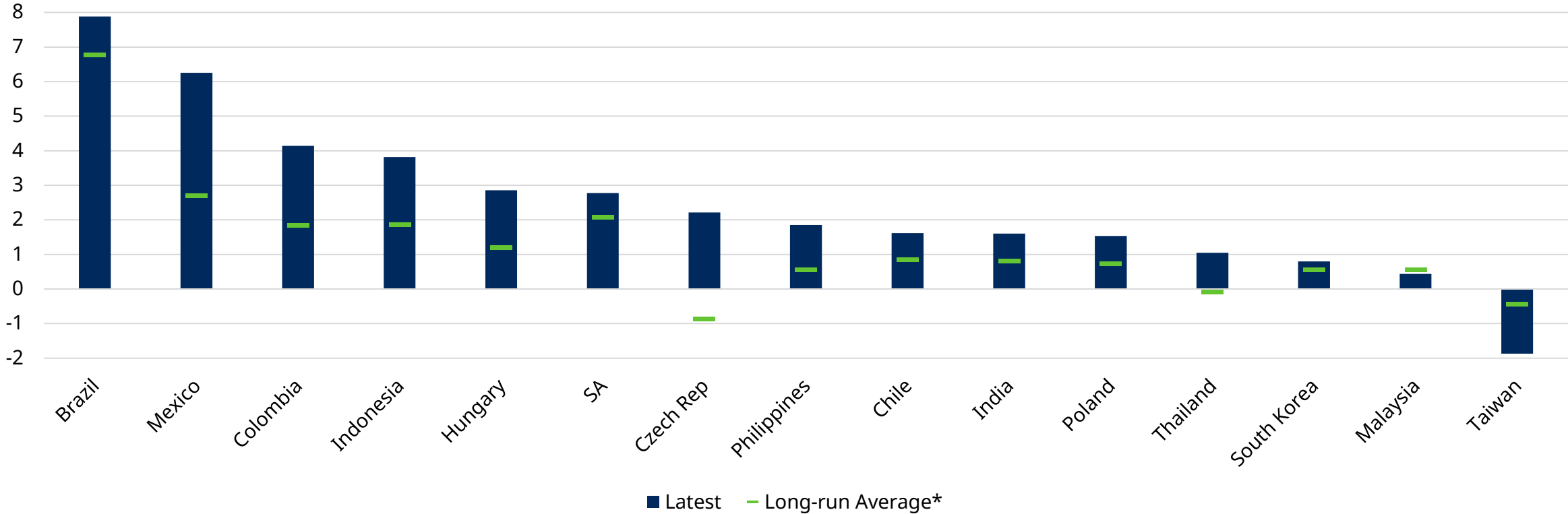
Average EM real policy rate¹ (%)



¹Based on 19 major EM countries, using core inflation. Turkey has very high inflation, with the annual core inflation at 75%. Despite large rate hikes, Turkey's policy rate of 50.0% is well below core inflation. Hence, Turkey's real policy rate is very negative at -25%, skewing the EM average.
 Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Nominal policy rate minus annual core inflation. Please see relevant disclaimers on page 45.

Market expectations for real policy rates are above the long-run average in most EM

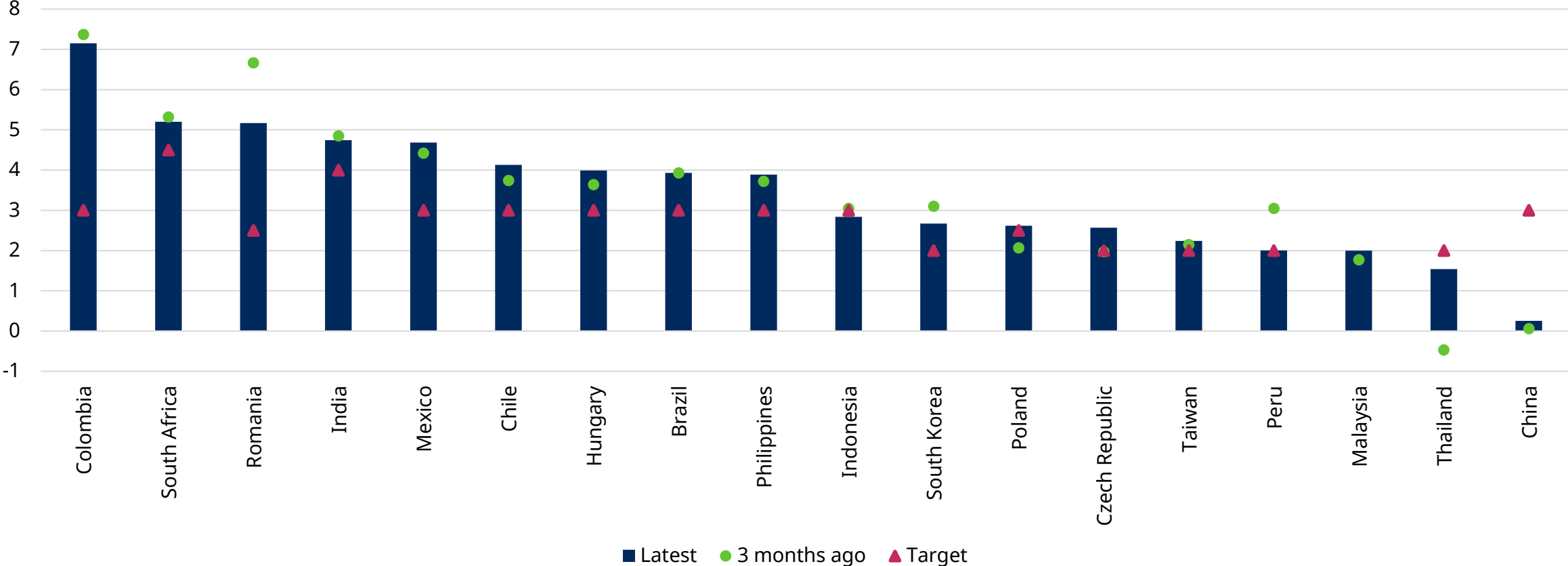
1 Year Ahead Market-Implied Policy Rate - 1 Year Ahead Rolling Consensus Inflation Forecast



Source: Schroders, LSEG Datastream, Bloomberg. Latest data as at 28 June 2024. Please see relevant disclaimers on page 45. 1 year ahead market-implied policy rate proxied by 1 year bond yield.

Headline inflation moving towards target in most EM – China a notable exception

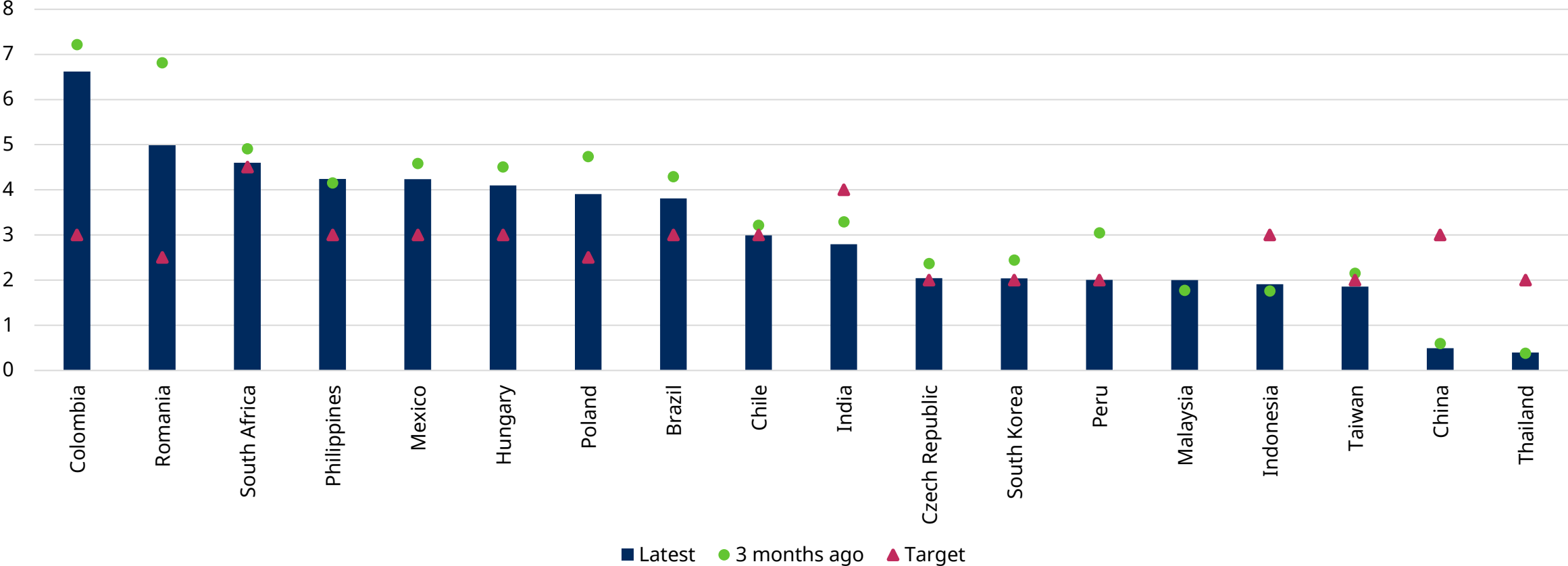
Headline inflation (%)



Turkey's annual headline inflation (75%) omitted from the figure.
 Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Core inflation is also falling in most EM

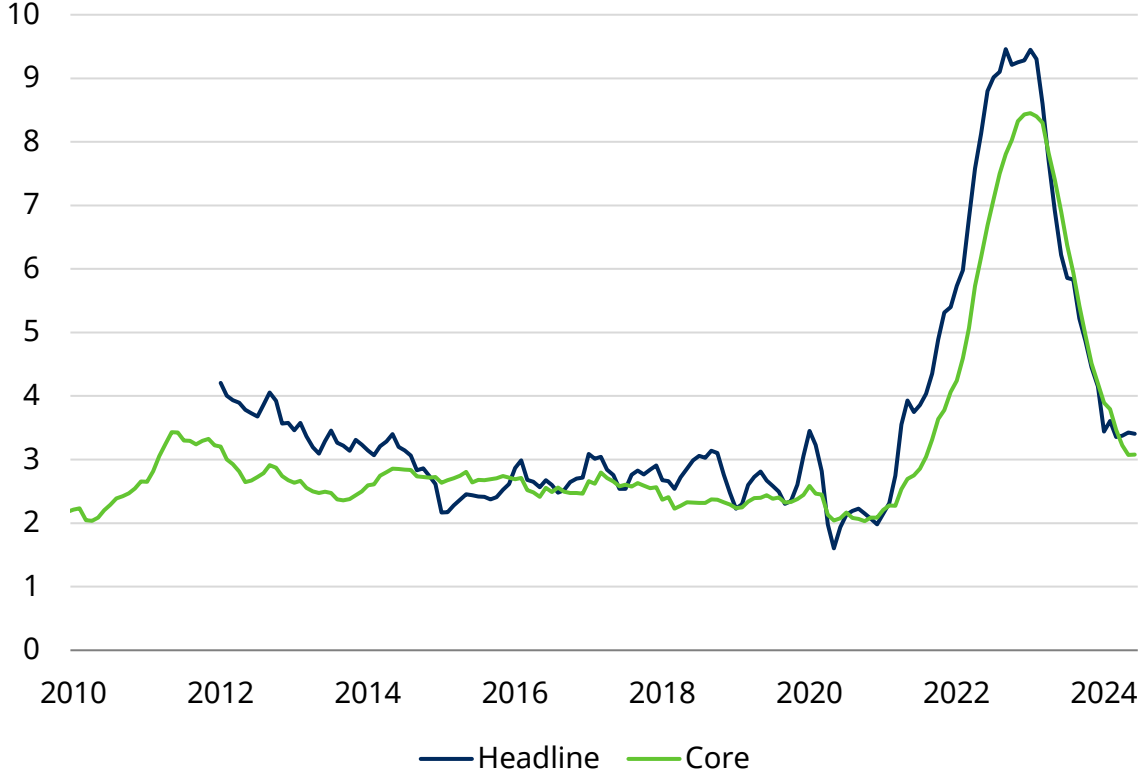
Core inflation (%)



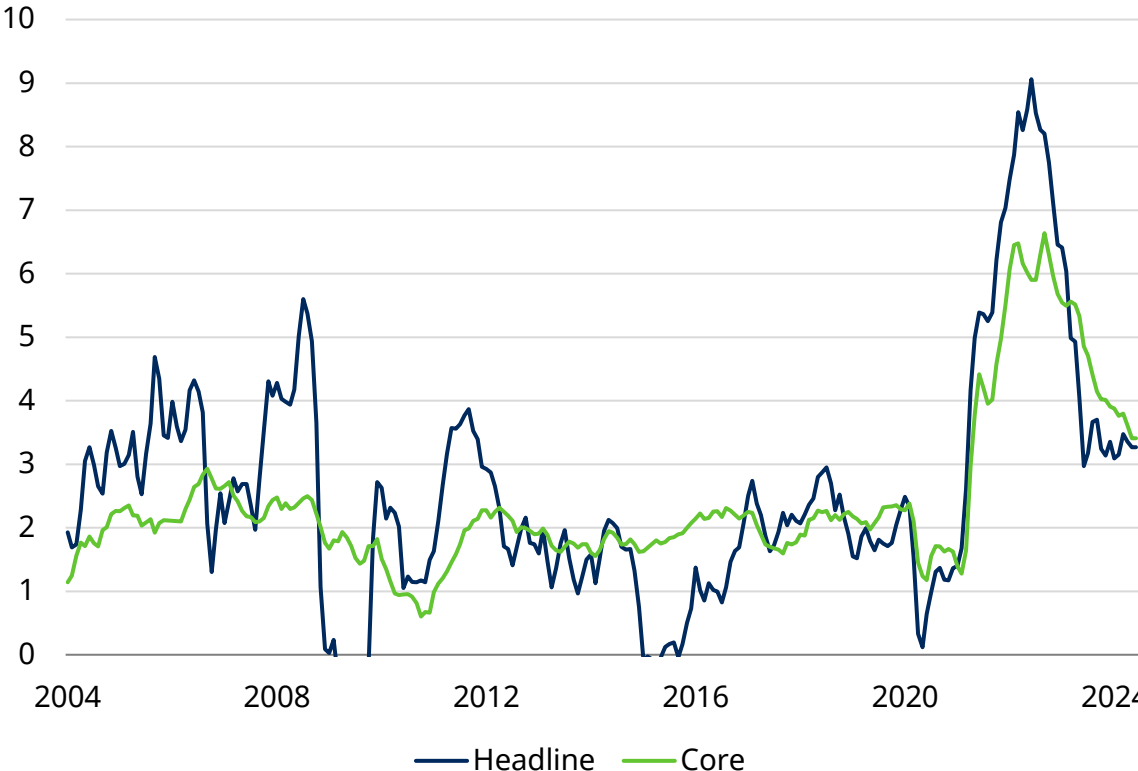
Turkey's annual core inflation (75%) omitted from the figure.
 Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Headline and core EM inflation have fallen significantly, but remain above the range of the last decade

Average EM inflation ex Turkey¹ (%)



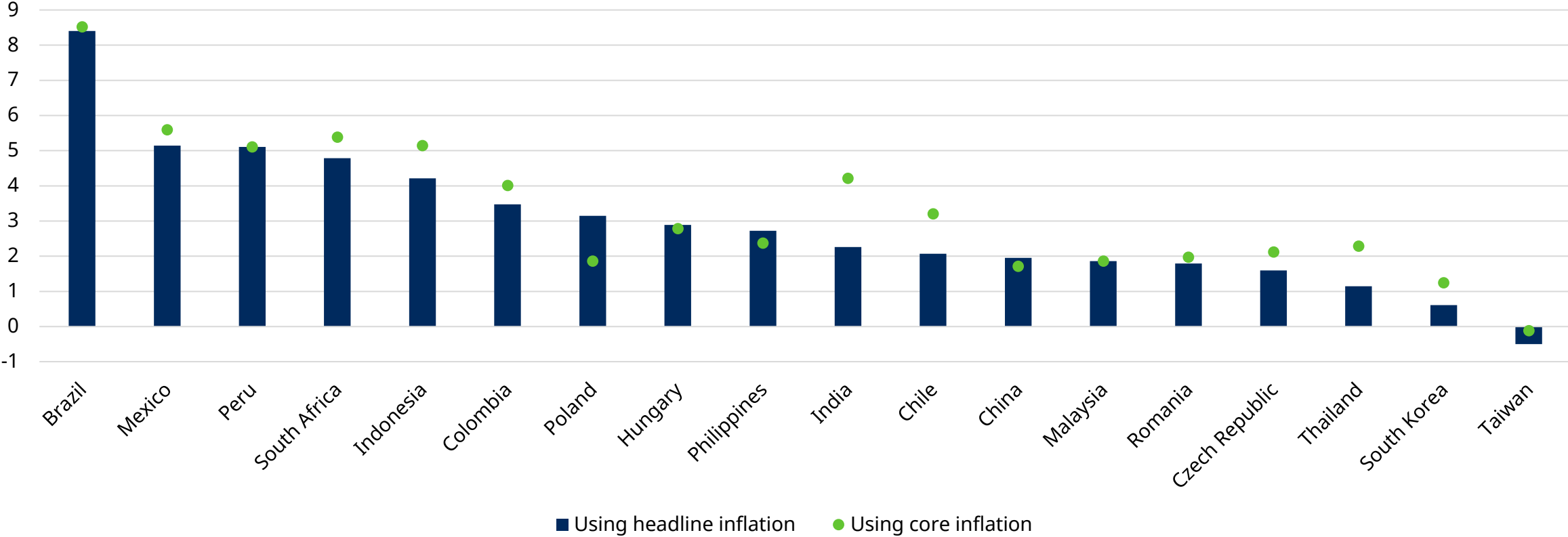
US inflation (%)



¹Based on 19 major EM countries. Turkey excluded because of significantly higher inflation in the country compared to the rest of the EM. Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Real bond yields are positive in most EM – Taiwan is the exception

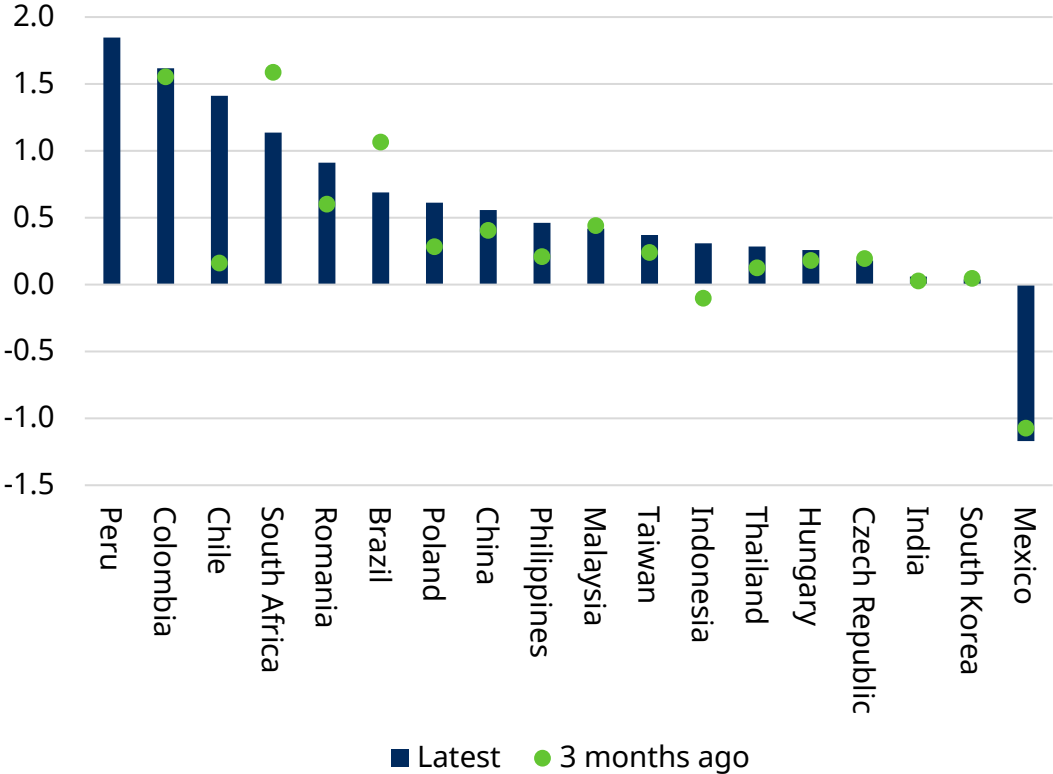
Real 10-year yield



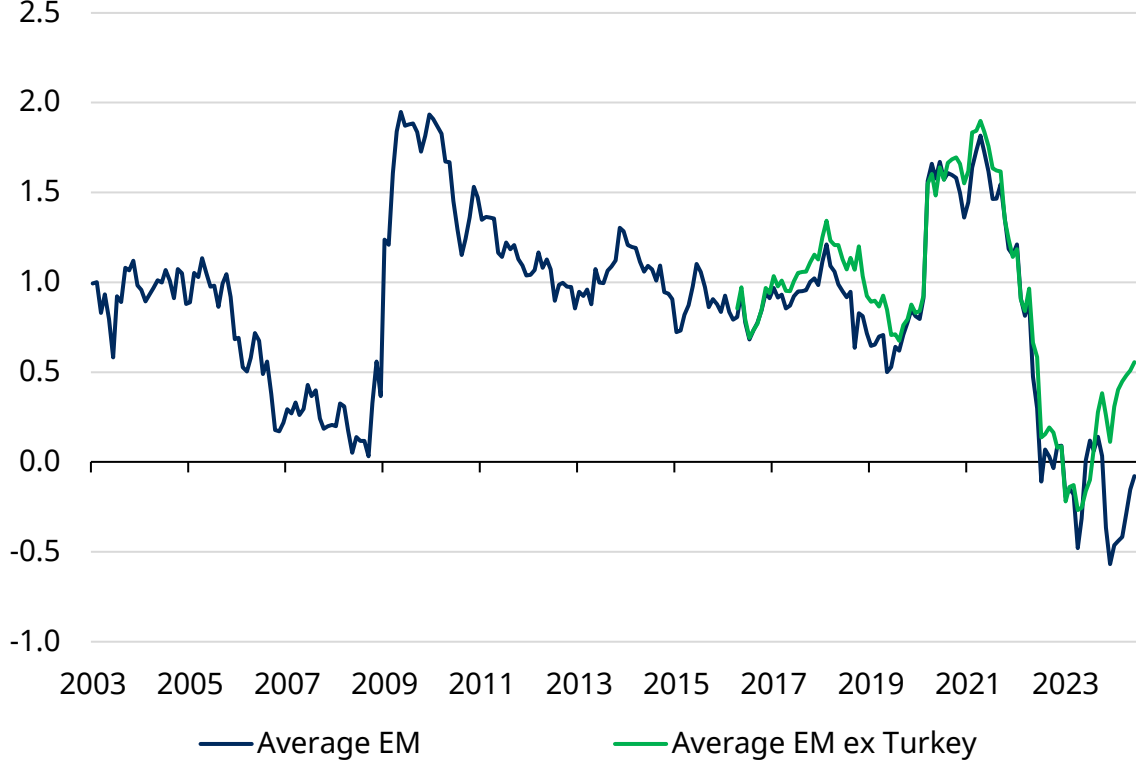
Nominal 10 year yield minus annual headline or core inflation. Turkey's real 10-year yield omitted from the figure. Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

EM ex Turkey yield curve now upward sloping – Mexico the exception

Yield curve steepness (10y yield – 2y yield)



Average EM yield curve steepness (10y yield – 2y yield)¹

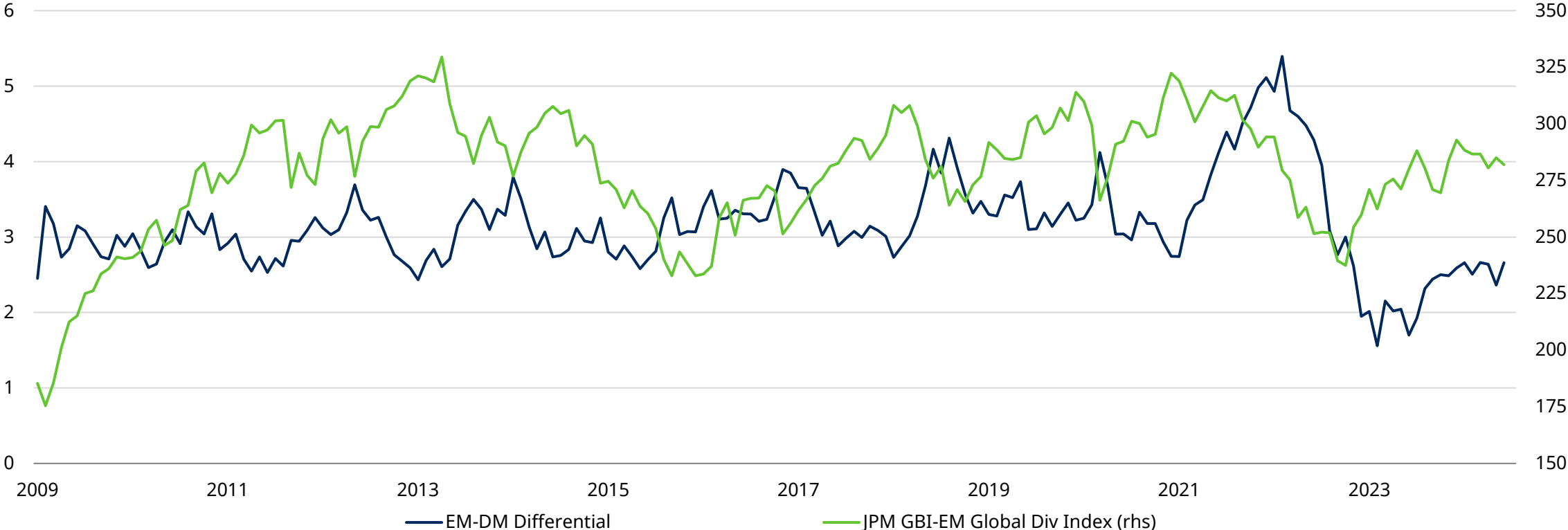


¹Based on 19 major EM countries. Turkey omitted from chart on left due to degree of inversion – latest yield curve steepness is -12.1 percentage points. Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Real yield differential continues to rise from 15-year low

EM local currency bond valuation

EM-DM real yield differential (%)



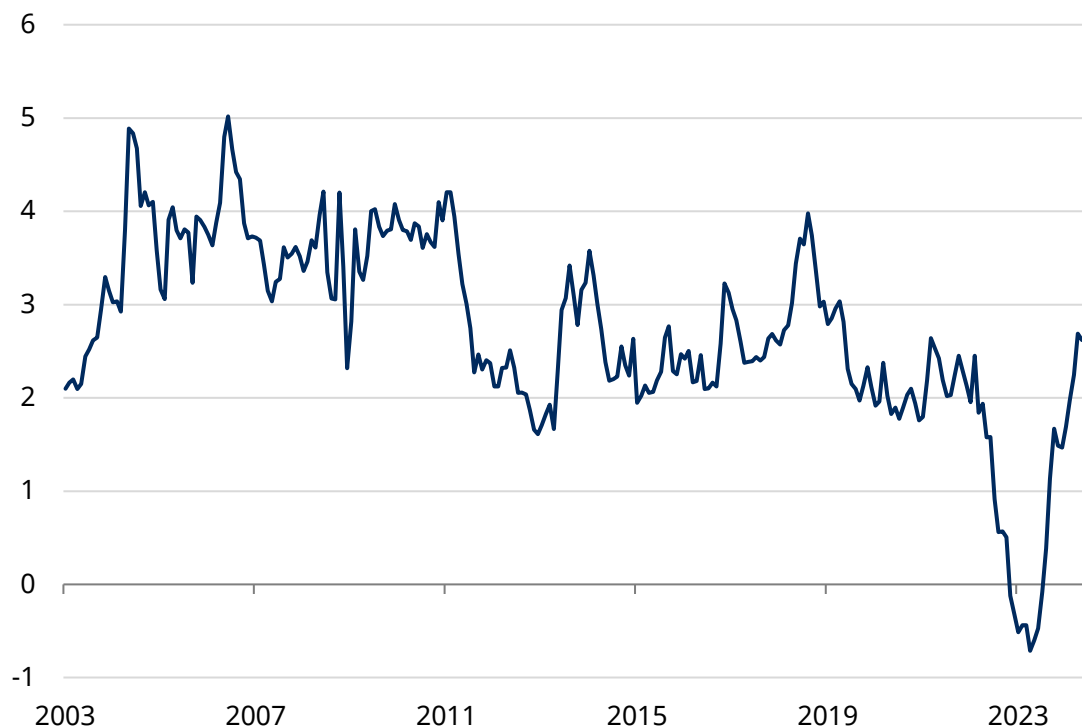
Past performance is not a guide to future performance and may not be repeated.

EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, Euro zone, Japan deflated by core inflation, weighted by the size of individual government bond market.

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Average EM real yield now through 2.6%, with DM real yield close to zero

EM real yield (%)



DM real yield (%)



Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 30 June 2024. EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, eurozone, Japan deflated by core inflation, weighted by the GDP PPP of each country. Please see relevant disclaimers on page 45.



Emerging market currencies

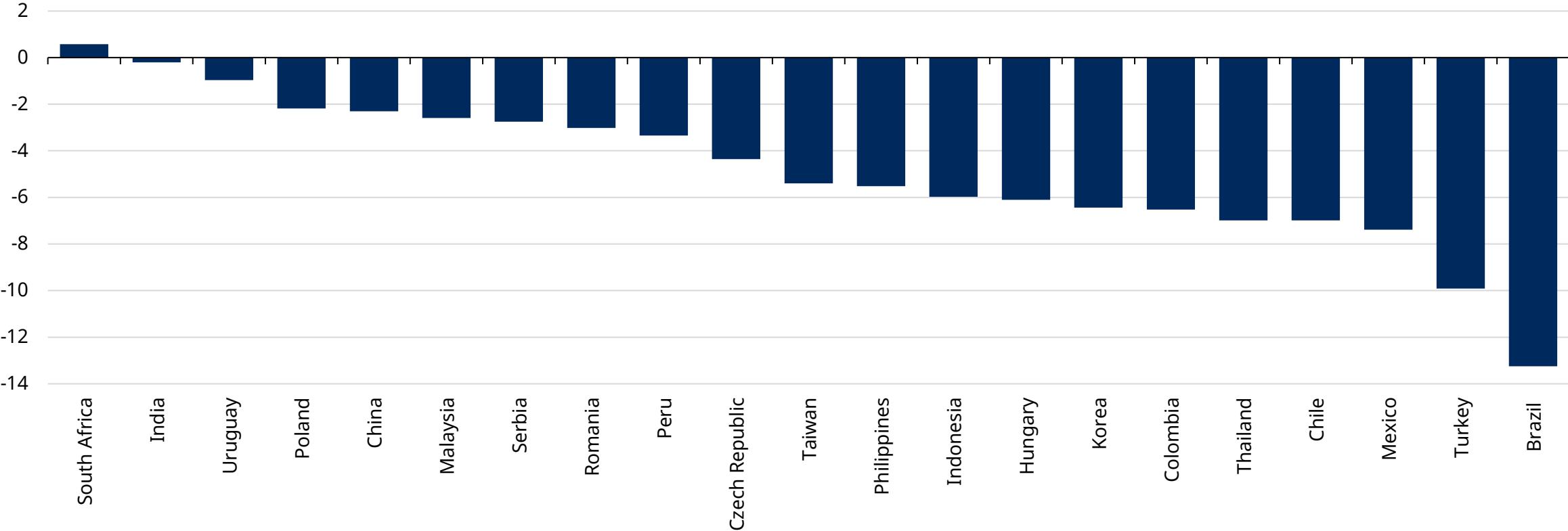
Summary: emerging market currencies

- EM currencies have been broadly weak versus the US dollar YTD, most notably the Brazilian real and the Turkish lira. The Mexican peso has also seen a notable depreciation following June elections. [***Read more***](#)
- There are undervalued currencies in all three EM regions, though the degree of value in EM currencies varies significantly.
- The Czech koruna, Uruguayan peso, and to a lesser extent Romanian leu and Polish zloty, are above their long term and five-year averages. Turkey, Brazil, Malaysia and South Africa, are among the cheapest EM currencies relative to the long-term average.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 30 June 2024.
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EM FX broadly weak YTD to end June vs. US dollar

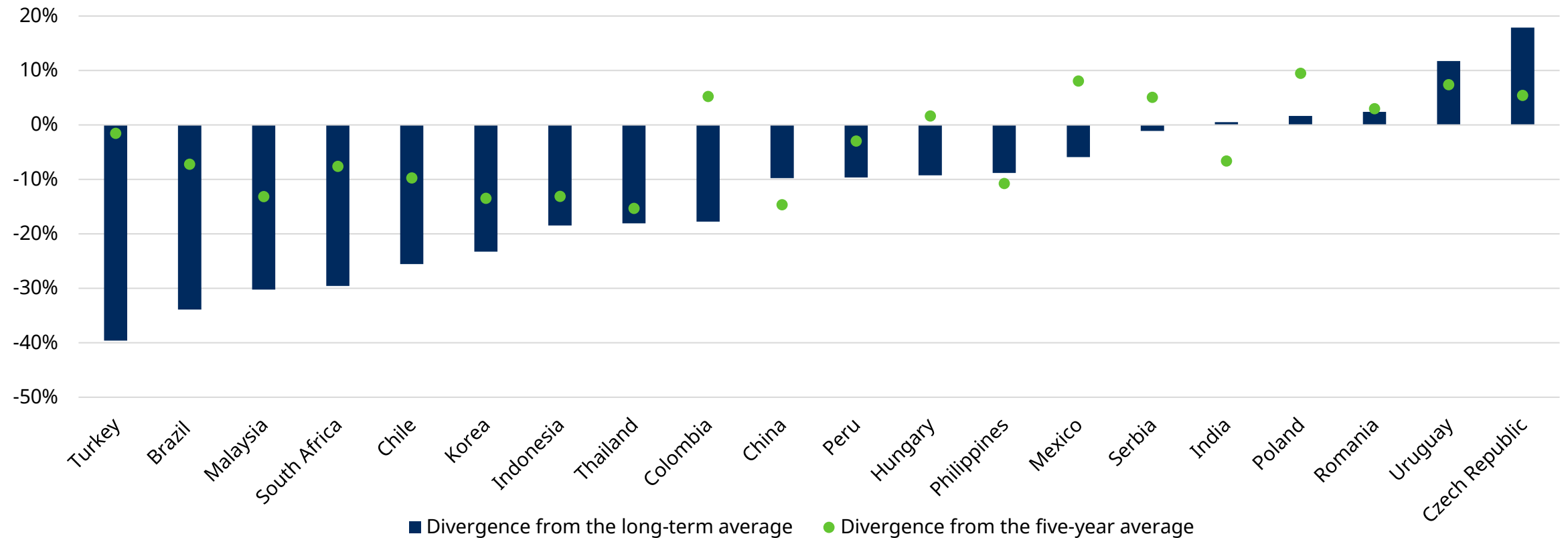
EM currency returns year-to-date (%)*



Past performance is not a guide to future performance and may not be repeated.
 Egyptian pound (-36%) not shown.
 Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Please see relevant disclaimers on page 45.

Some currencies are significantly undervalued

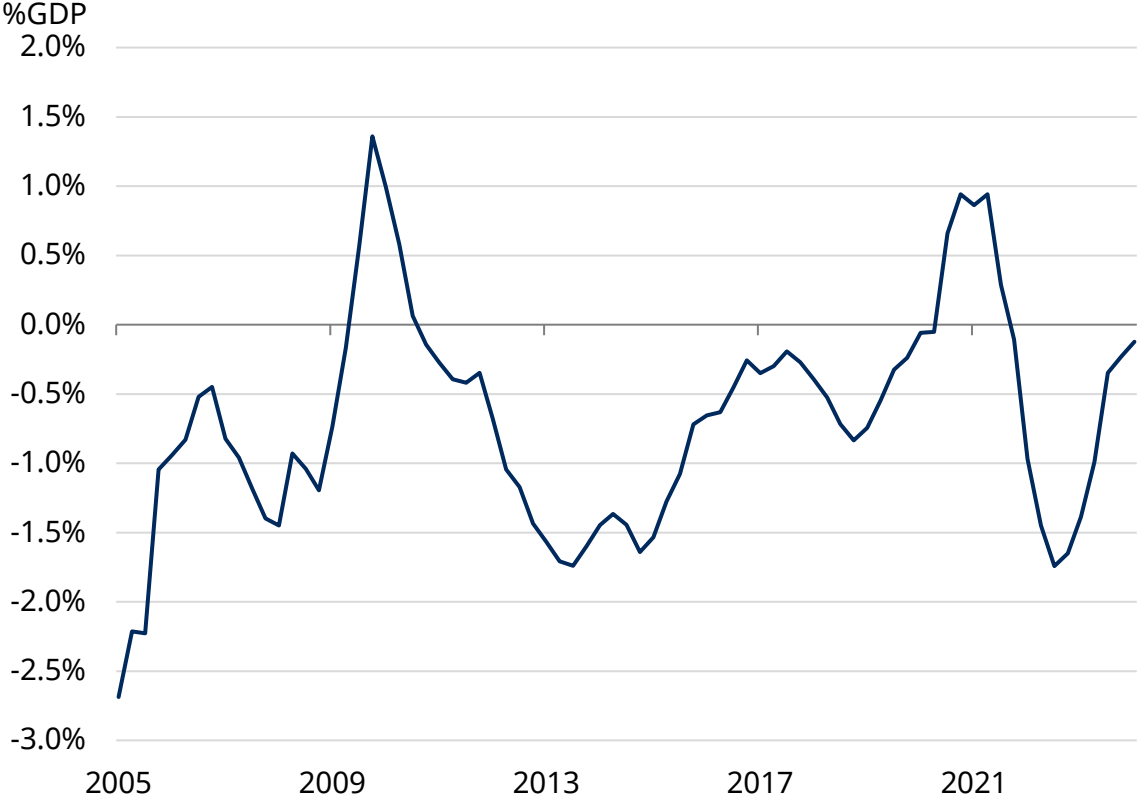
Real exchange rate: deviation from average



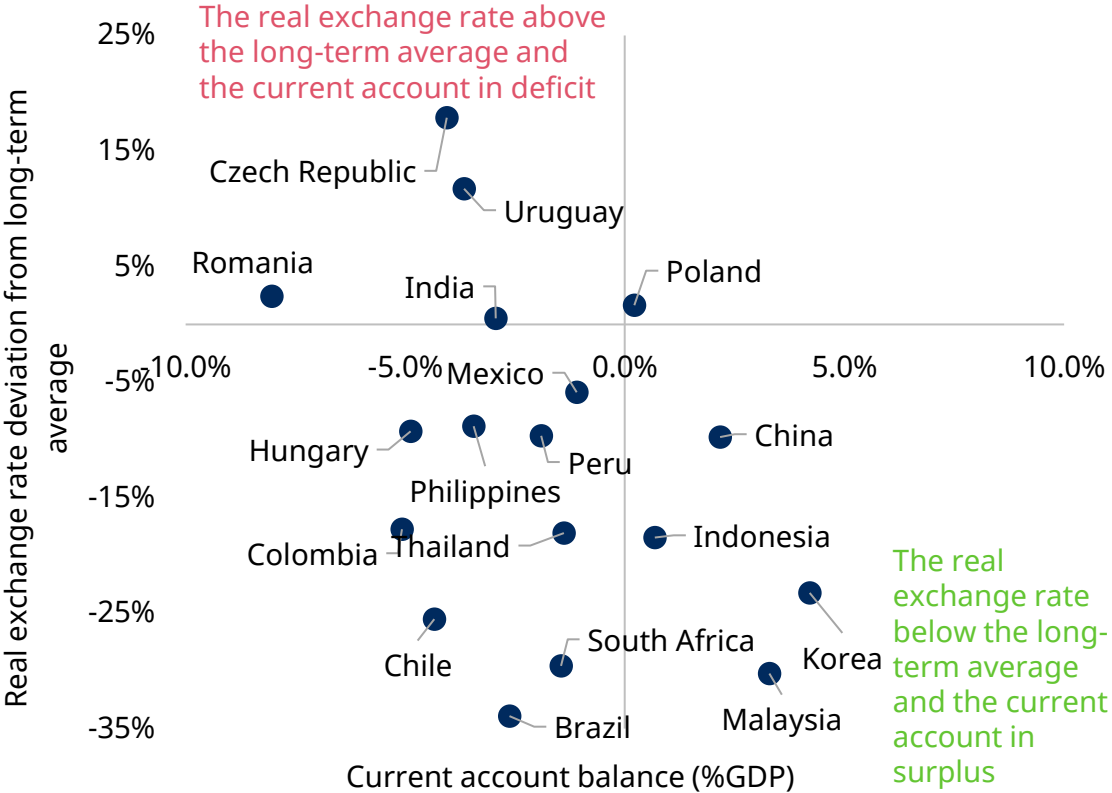
Source: Schroders, LSEG Datastream. Data as at 30 June 2024. Real exchange rate is the nominal dollar exchange rate deflated by the consumer price index (CPI) of each EM country vs. US. Long-term average is since January 1995. Please see relevant disclaimers on page 45.

EM fundamentals firm: average EM current account close to balance, EM currencies generally not stretched

Average EM current account balance¹



EM currency value² vs. current account balance



¹Based on the historical country weights of the JPM GBI-EM Global Diversified Index. ²Currency value is the deviation of the real exchange rate from the long-term average since 1995. Source: Schroders, LSEG Datastream. Current account data as at Q1 2024, currency value data as at 30 June 2024. Please see relevant disclaimers on page 45.

List of indices

- **Sovereign EMD** – The JPM EMBI Global Diversified Composite Index
- **Corporate EMD** – The JPM CEMBI Broad Diversified Index
- **Local EMD** – The JPM GBI-EM Global Diversified Index
- **US IG** - ICE BofA US High Yield Index
- **US HY** - ICE BofA US Corporate Index

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