



Schroders Emerging Markets Lens: Emerging Market Debt

Strategic Research Unit

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Summary

Emerging market (EM) bonds registered robust gains in 2023. The asset class benefitted from a strong rally in the final quarter of the year, as US bond yields fell sharply, and the US dollar weakened on optimism towards a US soft landing scenario.

Hard currency emerging market debt (EMD):

- Both the sovereign EM bond index yield (slide 10) and, to a lesser extent, spread are elevated versus their long-term history.
- The above-median hard EMD spread is driven by the high yield (HY) sovereign index. The spread on the investment grade (IG) sovereign market is below its historical average and at a 15-year low (slide 11).
- In corporate EMD, both the IG and HY corporate spreads are below their historical median (slide 17).

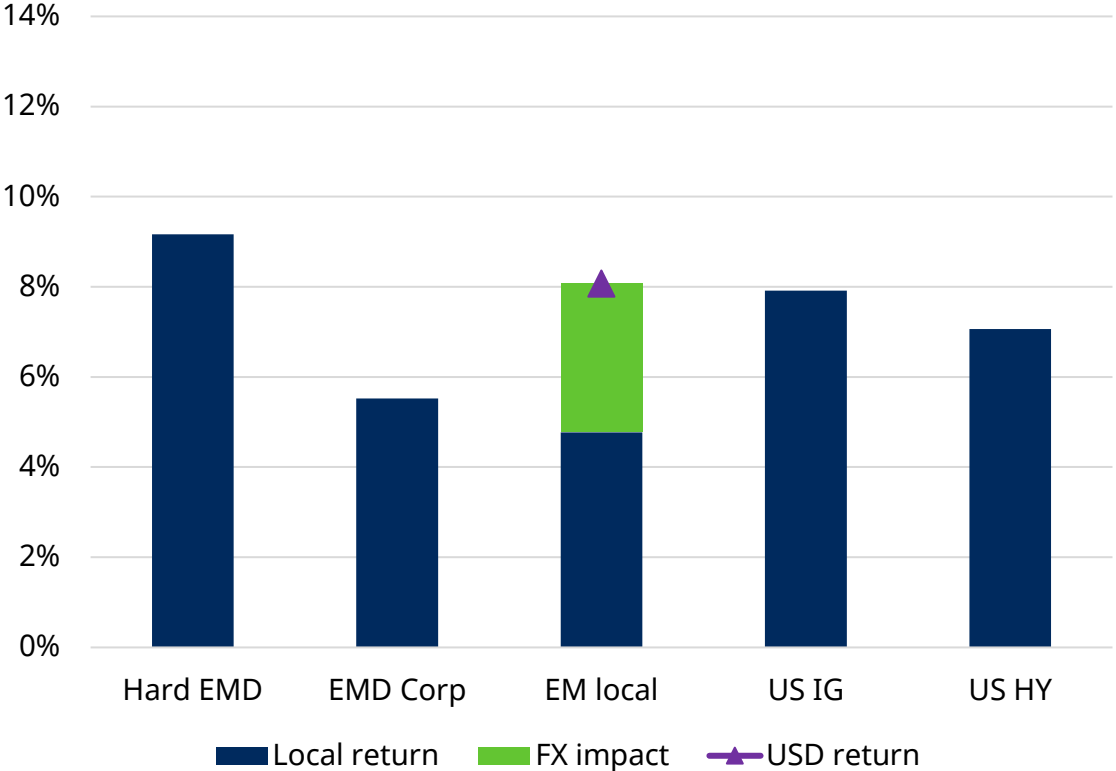
Local currency EMD:

- The average real yield premium of EM over DM has moved up from its trough. Both the average EM and DM real yields have lifted, with EM well into positive territory again; the average DM real yield is still negative.
- The average local EM ex Turkey yield curve is no longer inverted (slide 32).
- There are undervalued **currencies** in all three EM regions (slide 38), but the degree of value varies significantly.

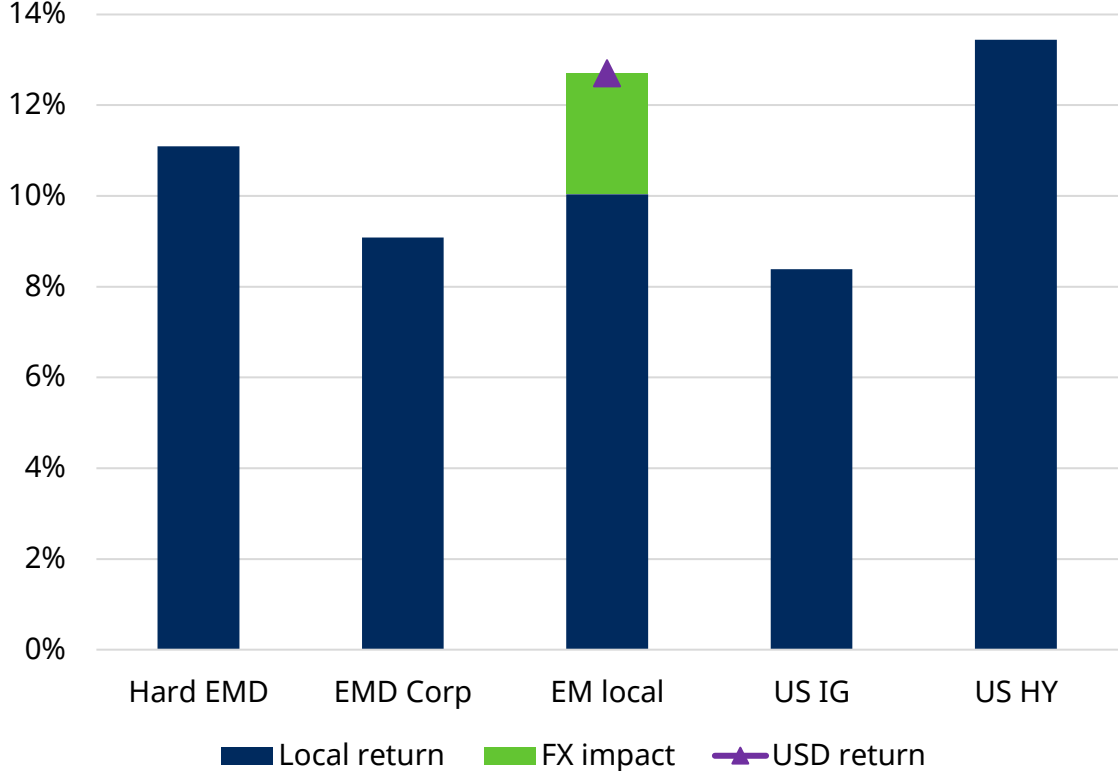
EM bonds generated positive returns in 2023

...helped by a strong rally in Q4

Total return Q4 2023



Total return 2023

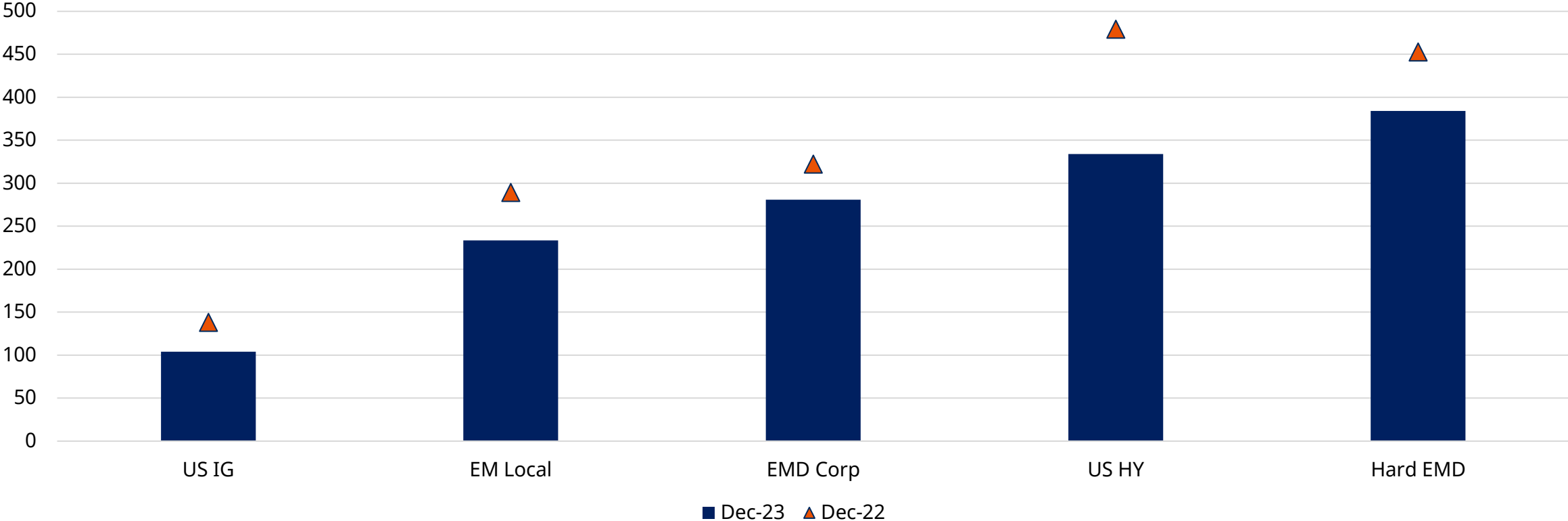


Note: Local currency = US dollar for all apart from local EMD which is in the relevant local EM currency.
 Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 29 December 2023.
 Please see relevant disclaimers on page 43.

Headline EMD spreads fell in 2023

Within EM, spread narrowing was greatest in hard currency EMD

Spreads of key indices (basis points) as at end 2022 versus 2023

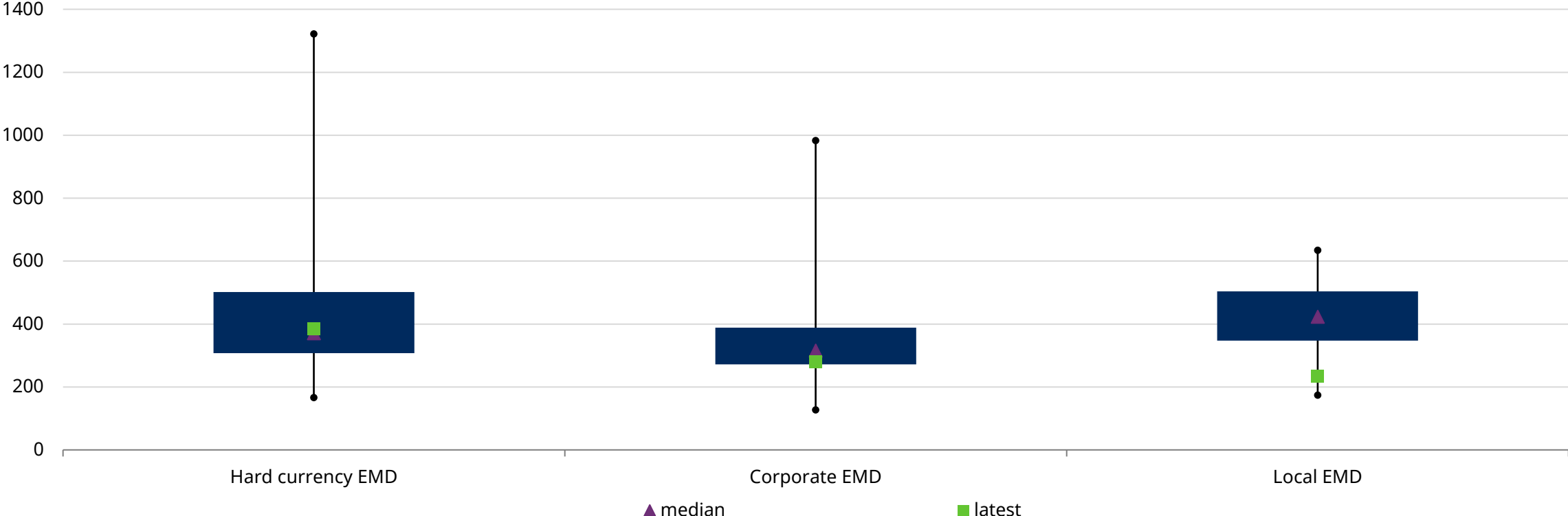


Source: Schroders, LSEG Datastream, J.P. Morgan. Data as at 31 December 2023. Hard EMD =stripped spread, Local EMD =Spread to 5 year UST, Corporate EMD = spread to worst. Please see relevant disclaimers on page 43.

EMD headline valuations

Spread percentiles

Spreads of key EMD indices (basis points)



Hard currency valuations remain cheapest versus history, but there is more to this story (slides 12-13)

Source: Schroders, LSEG Datastream, J.P. Morgan. Data as at 31 December 2023. Percentiles shows where the current spread is relative to the historical range of spreads, within a range of 0 to 100. The greater the percentile the higher the spread compared to history. Hard EMD =stripped spread, Local EMD =Spread to 5 year UST, Corporate EMD = spread to worst. Please see relevant disclaimers on page 43.



Emerging market debt:

Hard currency

Summary: hard emerging market debt

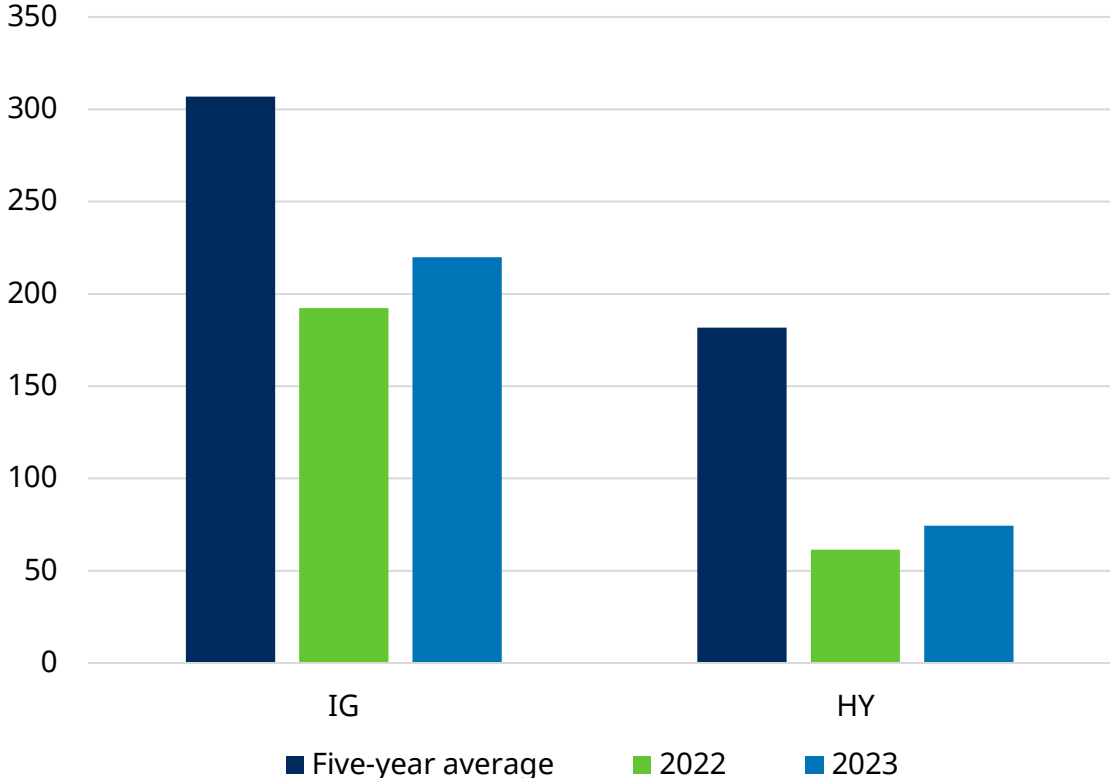
- Hard currency EMD recorded a strong gain in 2023, the majority of which was generated in Q4. Within hard currency EMD, the HY component outperformed IG by a wide margin.
- The hard currency sovereign EMD index yield is elevated versus history. The slightly above-median spread is driven by the high yield (HY) index; HY has become the dominant driver of index spread over time (slide 10).
- Sovereign EMD spreads declined in 2023, primarily driven by the HY component, but dispersion between countries remains wide. This is evident at the regional level; despite its small size, Africa is the second largest contributor to spread after Latin America. (slide 11).
- In corporate EMD, both the IG and HY corporate spreads are below their historical median, albeit to differing degrees.
- Credit quality has worsened since the pandemic. This was compounded by the 2022 challenges for issuers included in major sovereign and corporate EMD benchmarks. Market access continues to be a problem for EM HY issuers.

Source: Schroders, LSEG Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

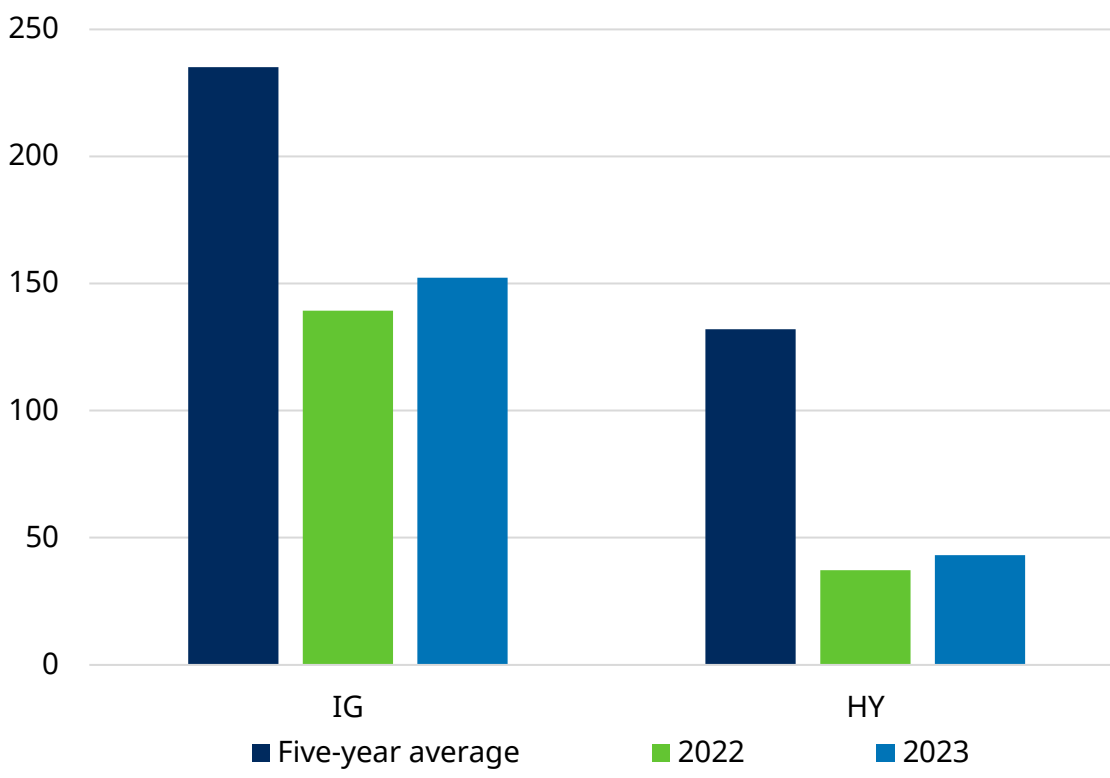
Hard EMD issuance remains muted versus history

Overall hard currency HY issuance was just 41% of the five-year average in 2023

Overall hard EMD (USD billion)



Hard corporate EMD (USD billion)



Market access for non-IG issuers remains challenged

Five-year average is 2018-2022. Total sovereign and Corporate hard EMD. BAML, data as at 31 December 2023. Please see relevant disclaimers on page 39.

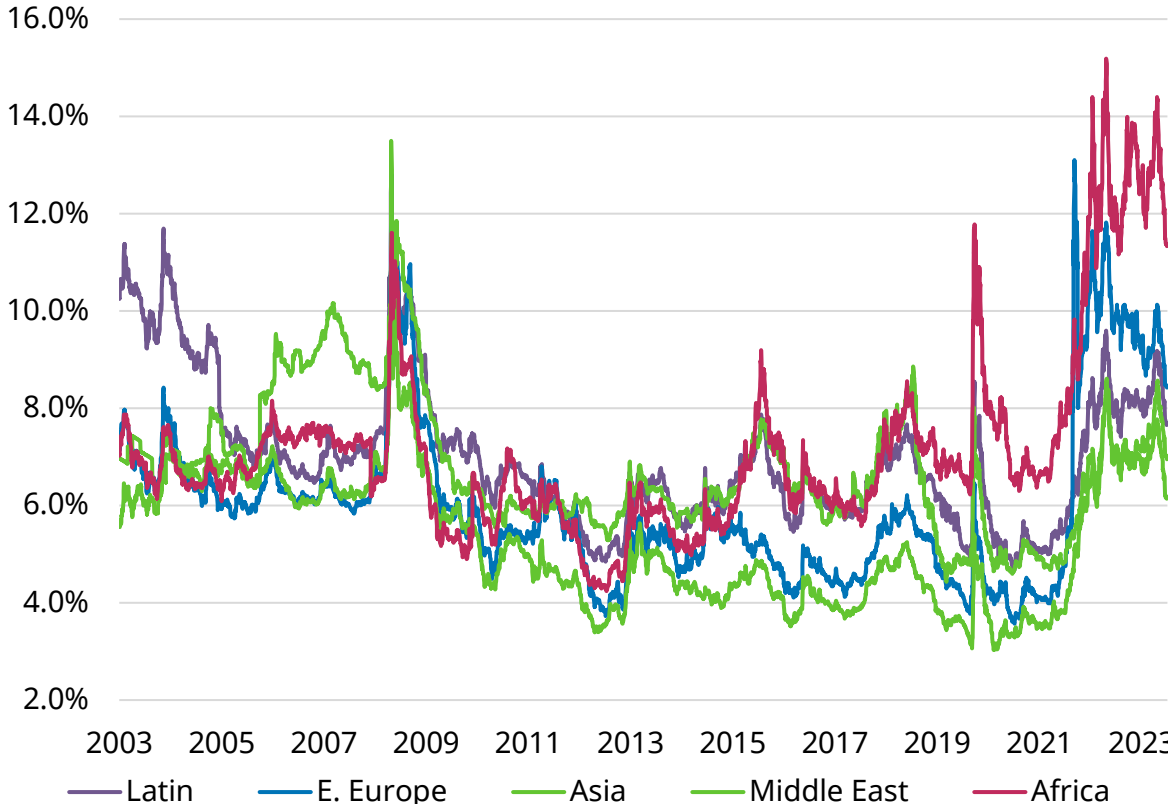
Hard EMD index yield fell to 7.8% in 2023

...but is elevated when compared to the last 15 years

Hard currency sovereign EMD index yield



Hard currency sovereign EMD index yield by region



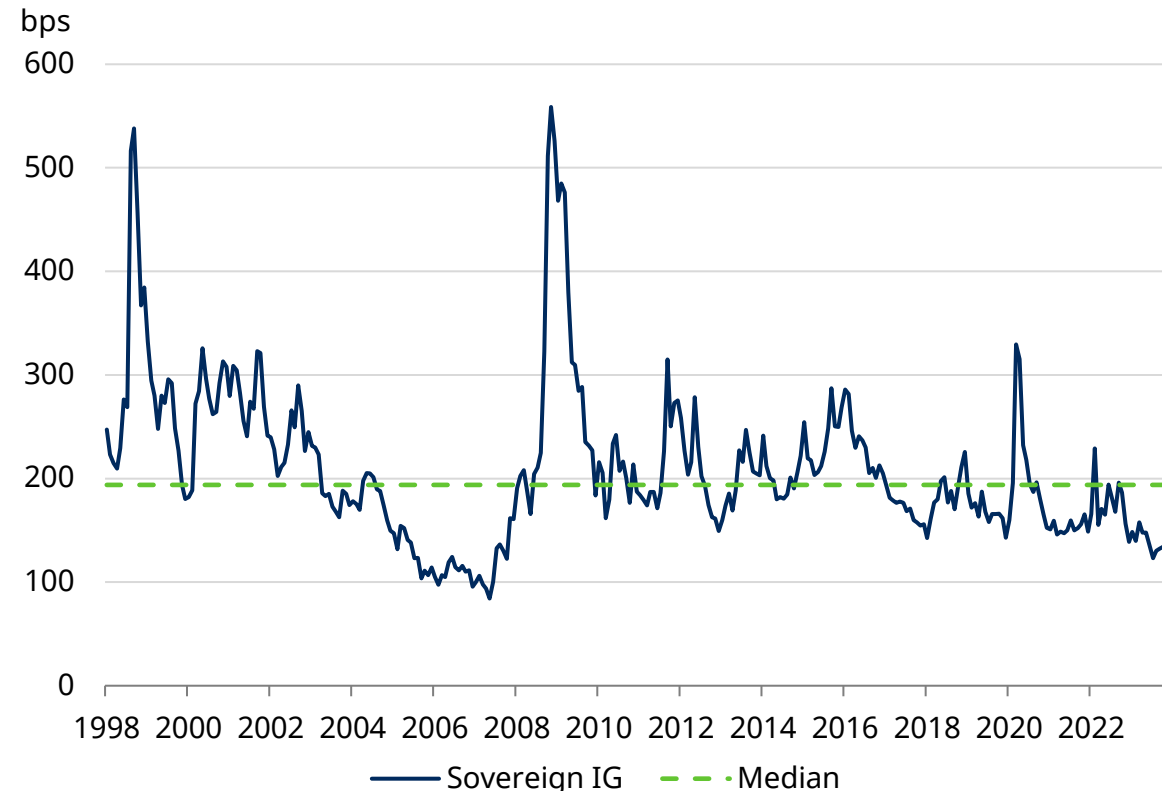
On a regional basis, yields are highest in Africa and Eastern Europe

Russia was removed from all JP Morgan EMD indices from 31 March 2022.
Source: Schroders, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

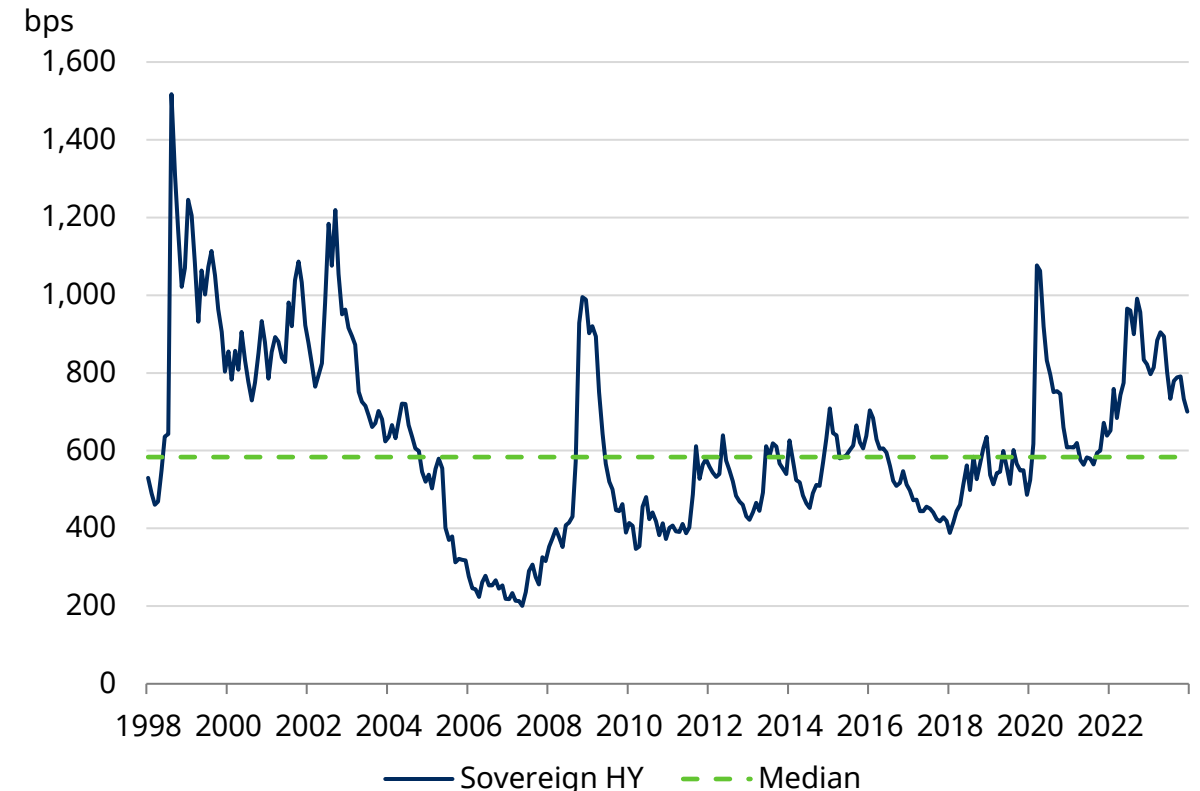
A contrasting picture in hard currency sovereign EMD...

IG and HY spreads fell in 2023: but IG is well below its historical median and HY above

Hard currency sovereign EMD IG spread



Hard currency sovereign EMD HY spread



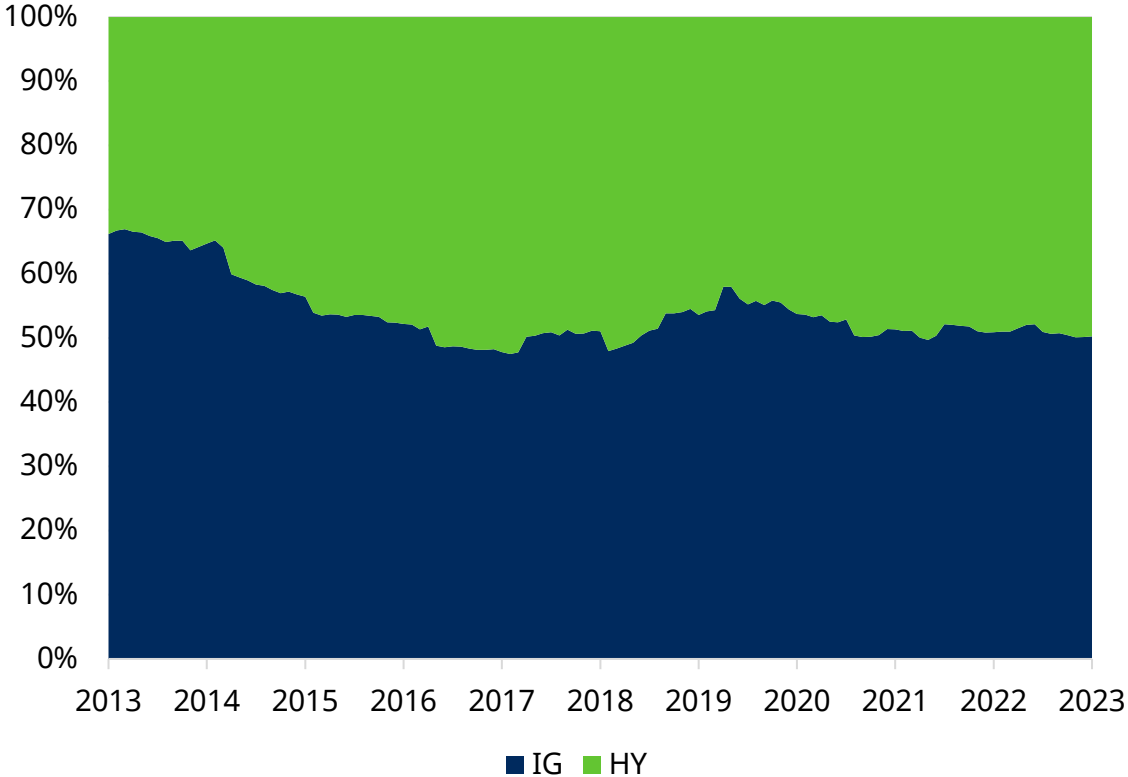
The IG spread is close to 15-year lows

Source: LSEG Datastream, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

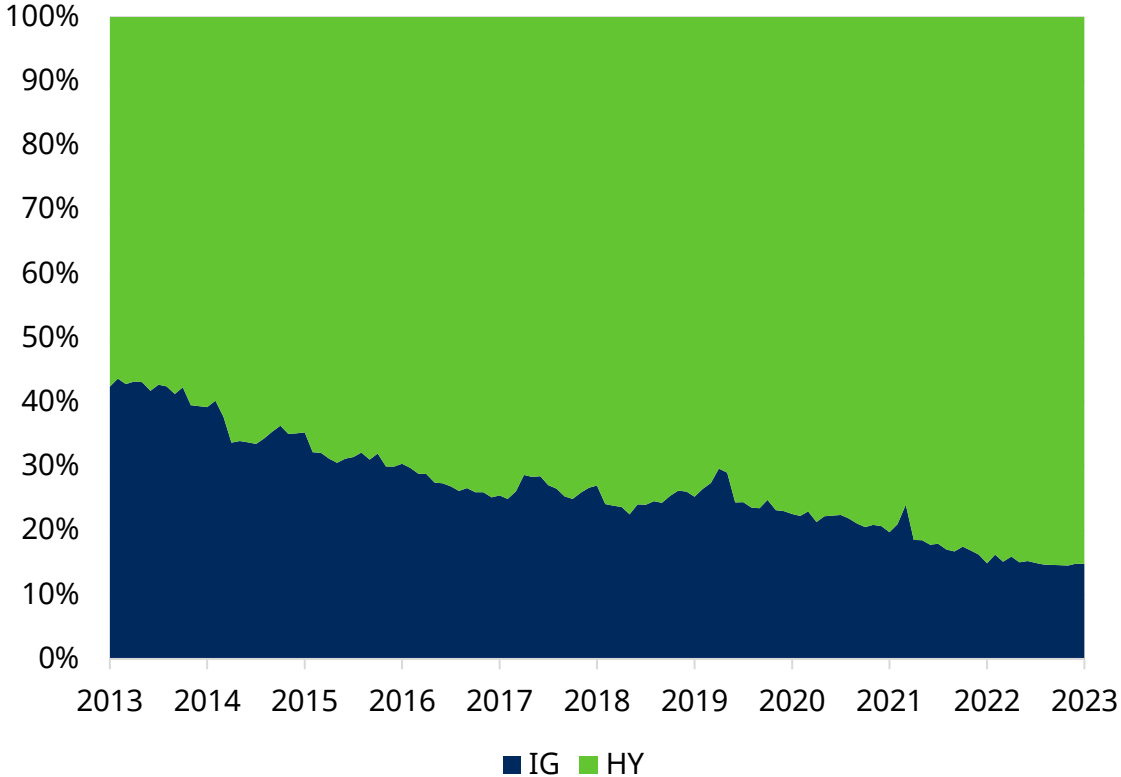
Hard currency spreads increasingly driven by HY component

Despite HY and IG index weights remaining relatively stable over the past decade

HY and IG index weights relatively stable over time



HY share of spread contribution has increased

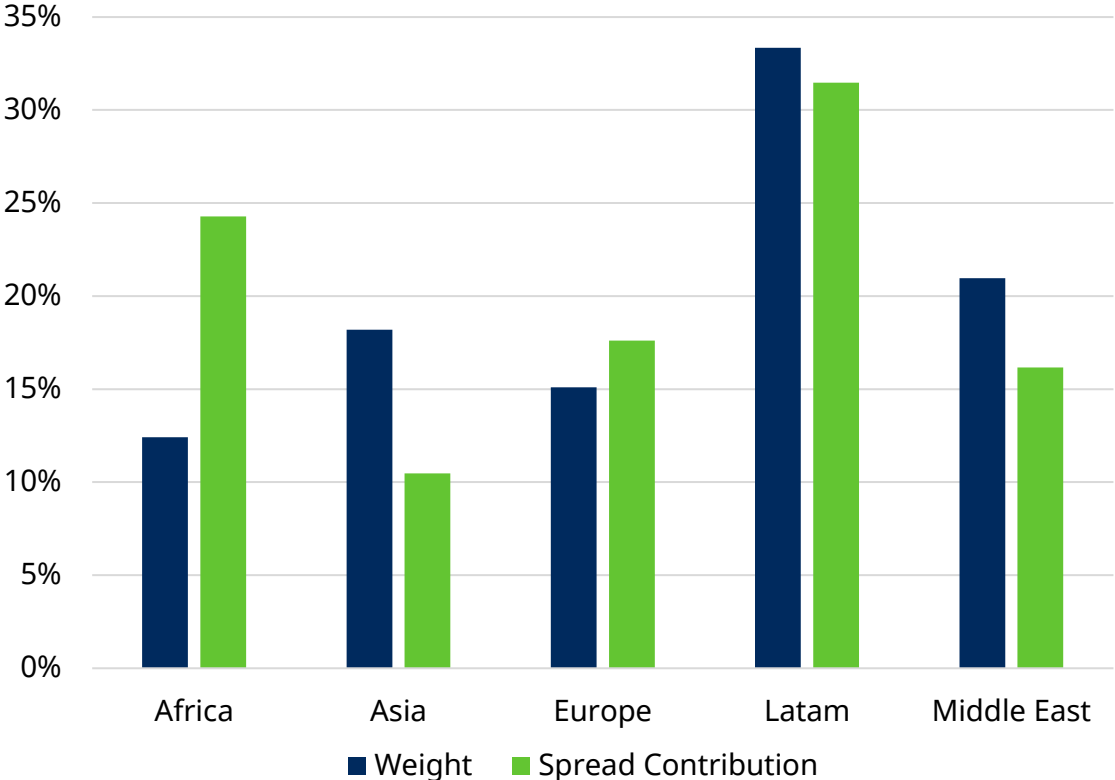


Source: LSEG Datastream, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43. Spread contribution calculated as HY spread multiplied by index weight, and equivalent for IG. Percentage contribution for IG and HY shown as share of total spread contribution (IG and HY).

Latin America dominates the sovereign hard currency index

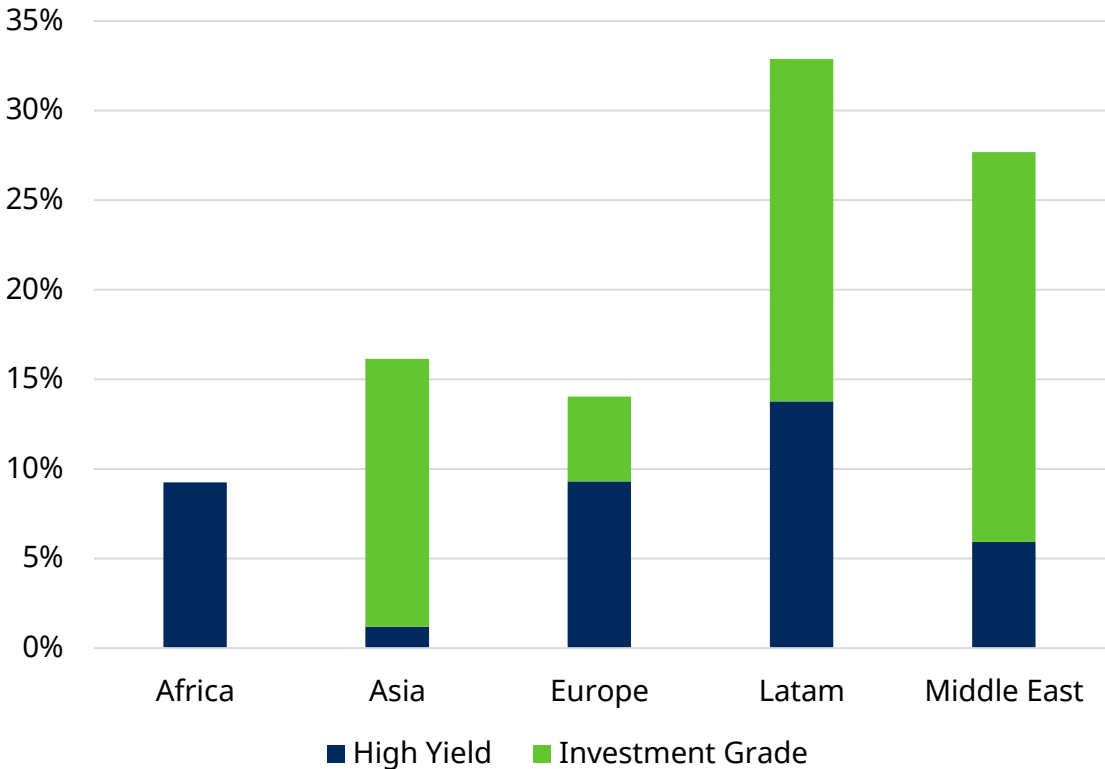
But Africa punches above its weight when it comes to spread contribution...

Hard currency index weights and spread contributions



Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43. Spread contribution calculated as weight of the region multiplied by the spread of that region.

Hard currency weights split by HY/IG



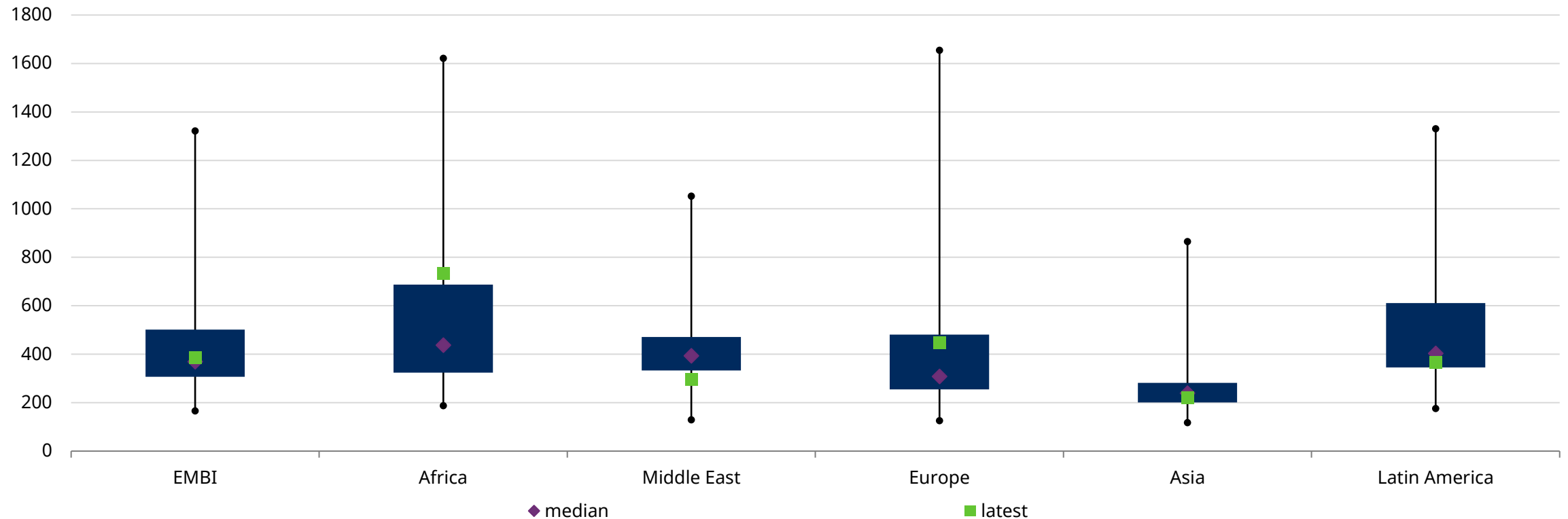
Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

This is explained by the fact that Africa is all HY; Asia/Middle East is largely IG and LatAm more balanced

Where are the cheap valuations in hard currency EMD?

Africa and Europe offer the highest spreads versus history

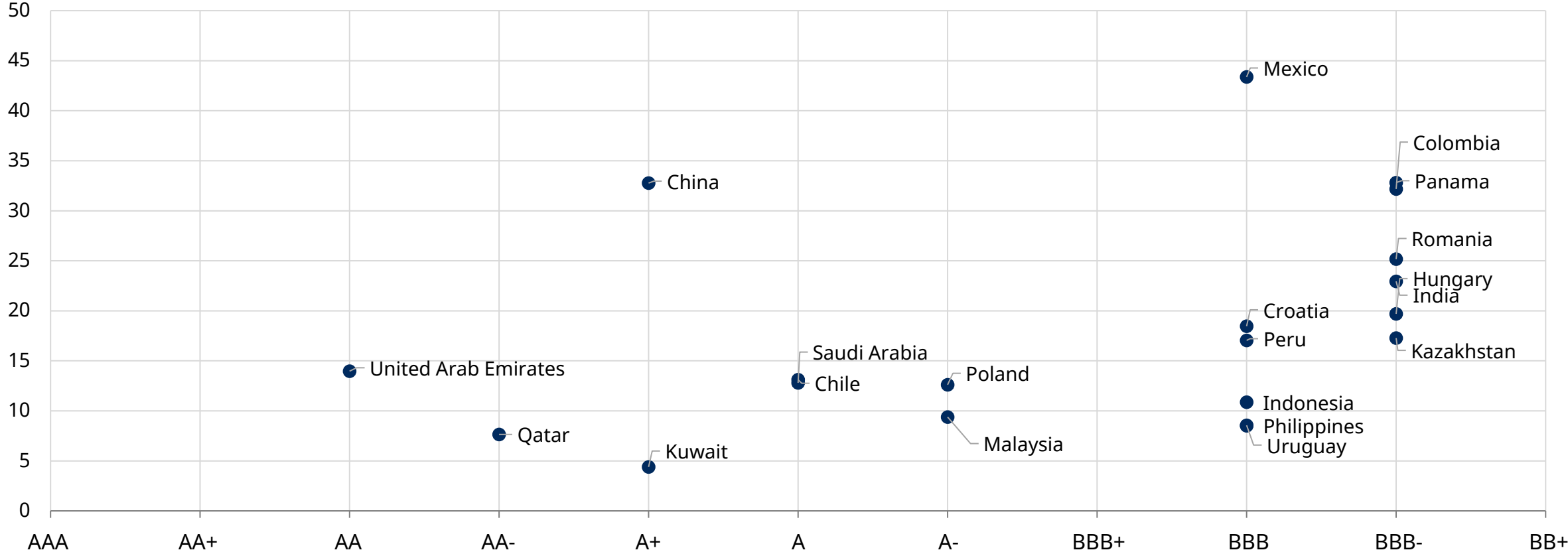
Spreads of key regional hard currency EMD indices (basis points)



Percentiles shows where the current stripped spread is relatively to the historical range of spreads, within a range of 0 to 100. The greater the percentile the higher the spread compared to history.
Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Duration adjusted spreads of IG countries

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

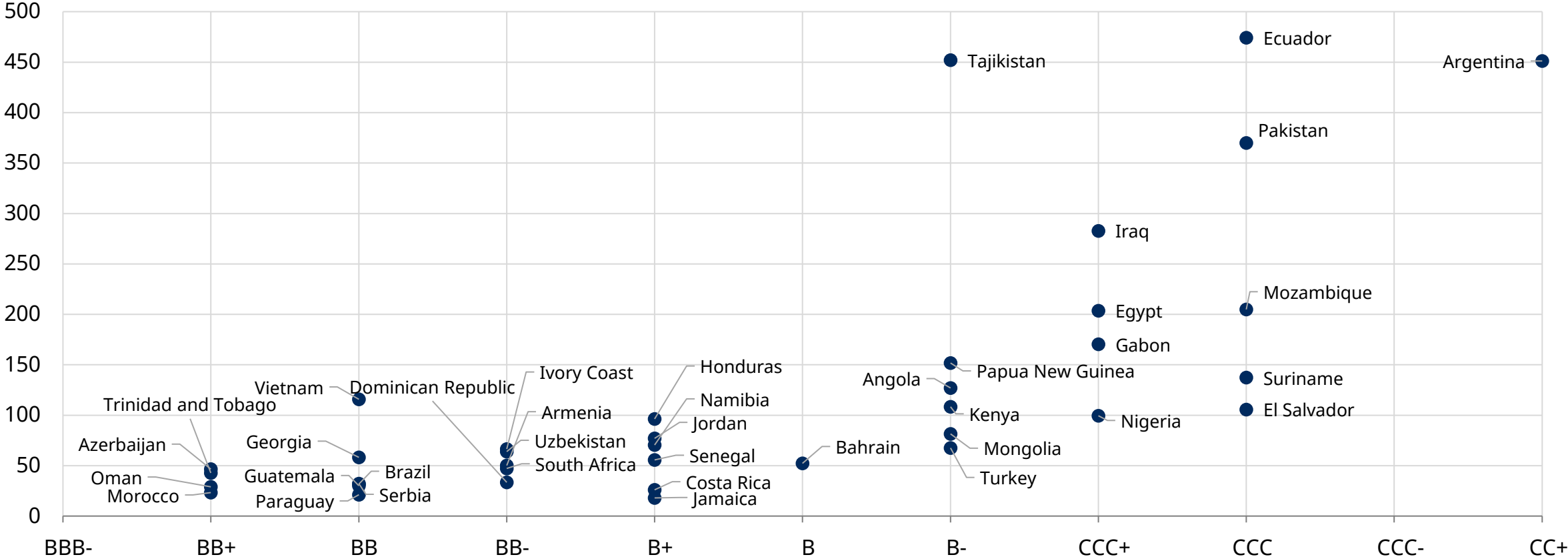


¹The JPMorgan EMBI Global Diversified Index includes both sovereign and quasi-sovereign bonds.
 The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, LSEG Datastream, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Duration adjusted spreads of HY countries

Significant variability between the countries

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

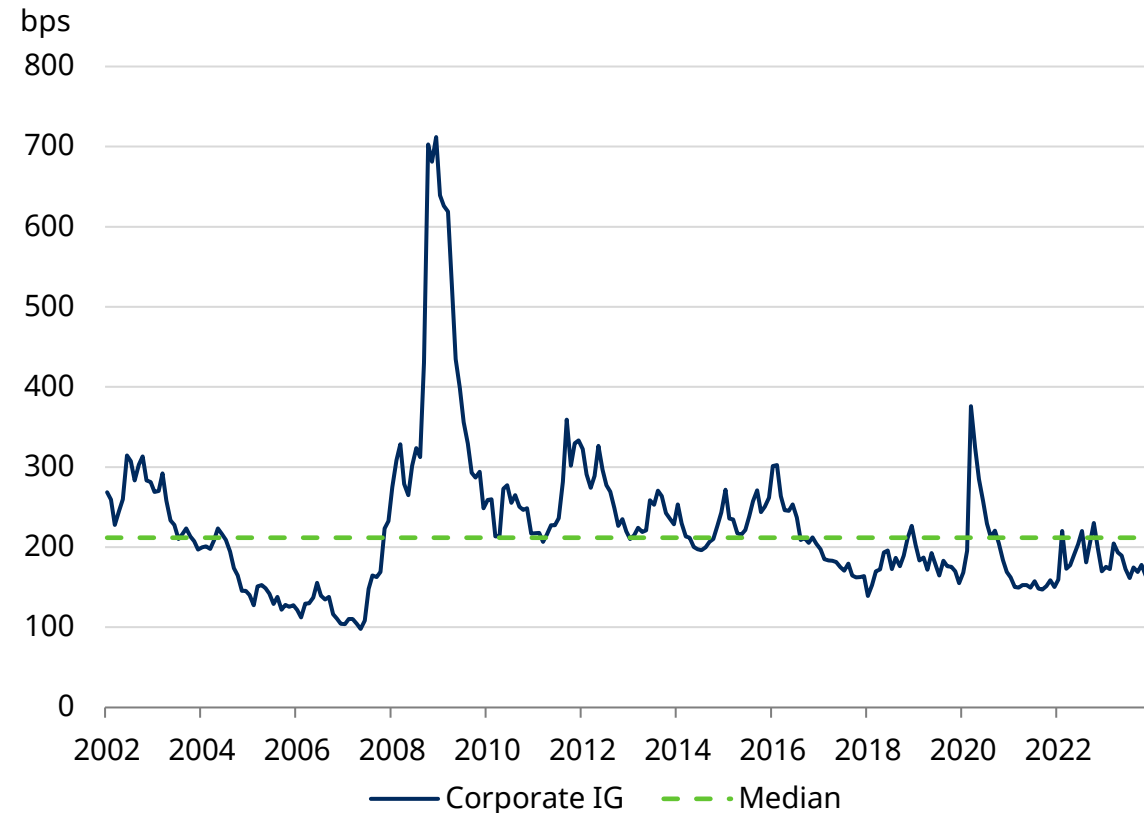


The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, LSEG Datastream, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

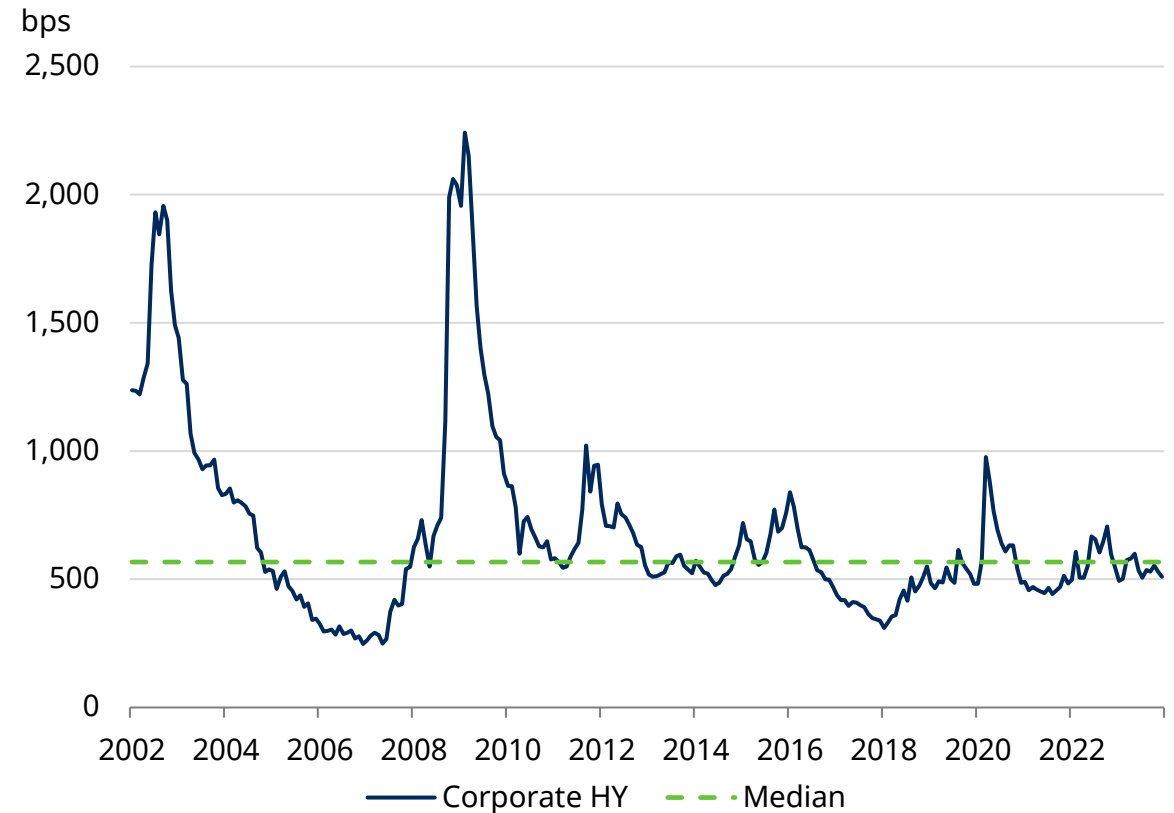
Valuation of hard currency corporate EMD

The IG and HY corporate spreads are below the historical median

Hard currency corporate EMD IG spread



Hard currency corporate EMD HY spread

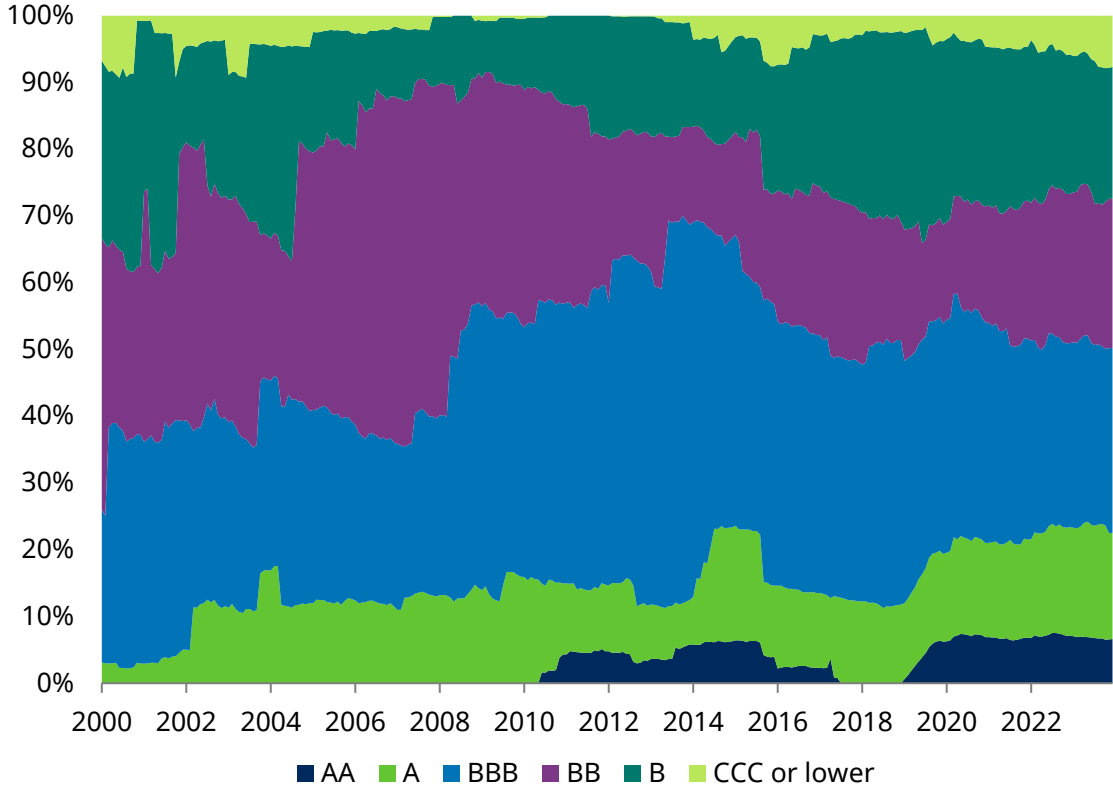


Source: LSEG Datastream, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

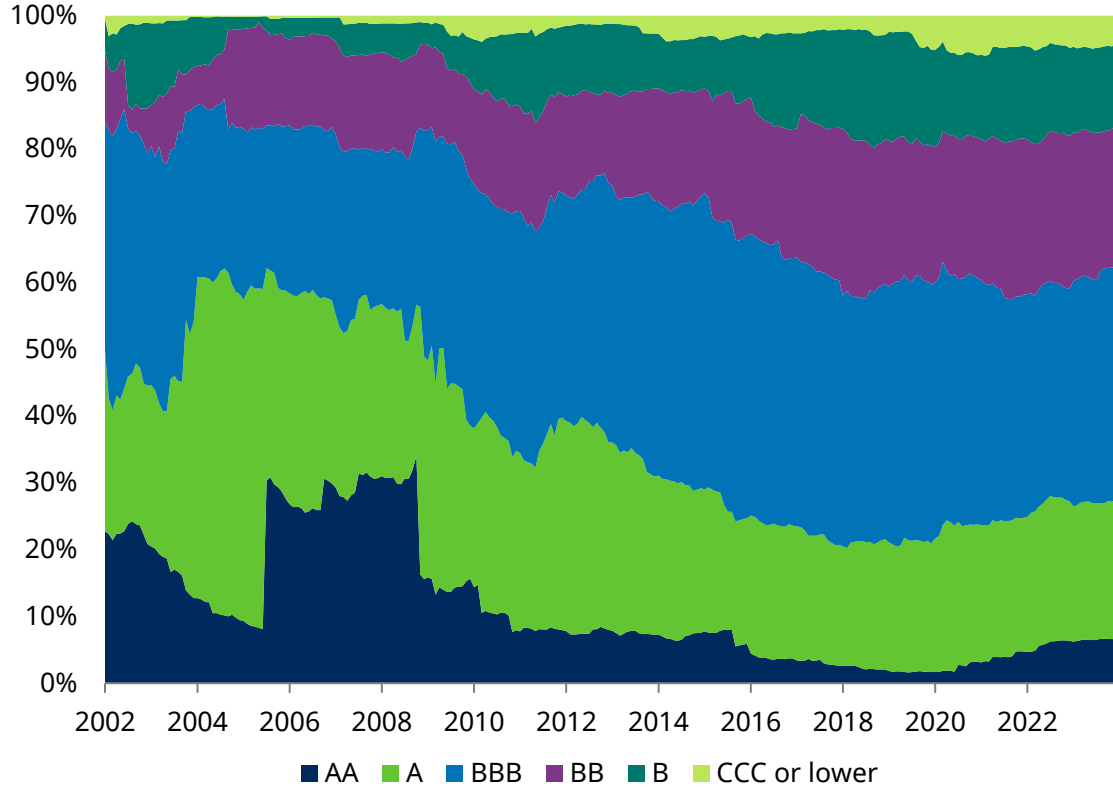
EMD historical ratings split

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

Sovereign EMD ratings split



Corporate EMD ratings split



Source: Schroders, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Characteristics of EM hard currency issuers

Hard currency corporate issuers



■ Financials ■ Nonfinancials

Hard currency sovereign issuers



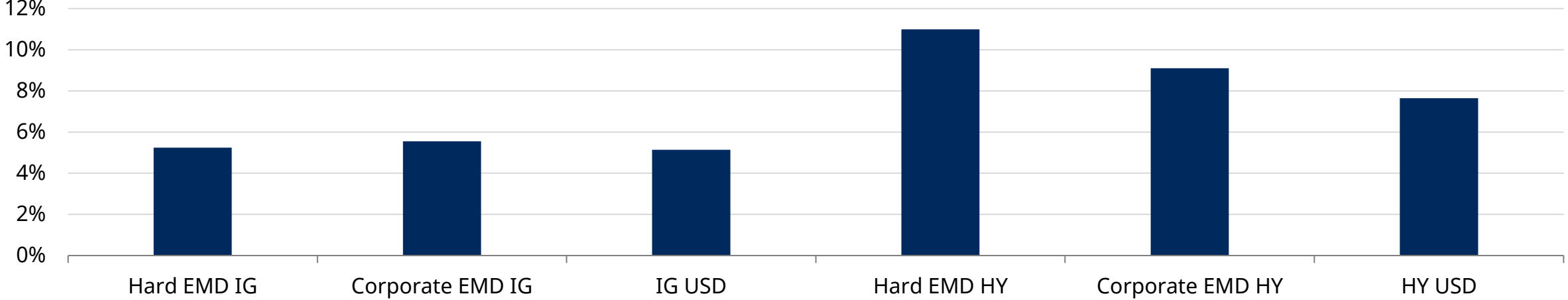
■ Sovereign ■ Quasi Sovereign

Source: LSEG Datastream, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

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	5.2%	5.6%	5.1%	11.0%	9.1%	7.7%
Spread (bps)	120	154	104	700	510	334
Duration	7.9	4.9	7.0	5.6	3.3	4.0
Rating	A3	A3	A3	B1	B1	B1
Percentage of EMD index	50.2%	59.9%	-	49.8%	40.1%	-

EM vs. DM yields

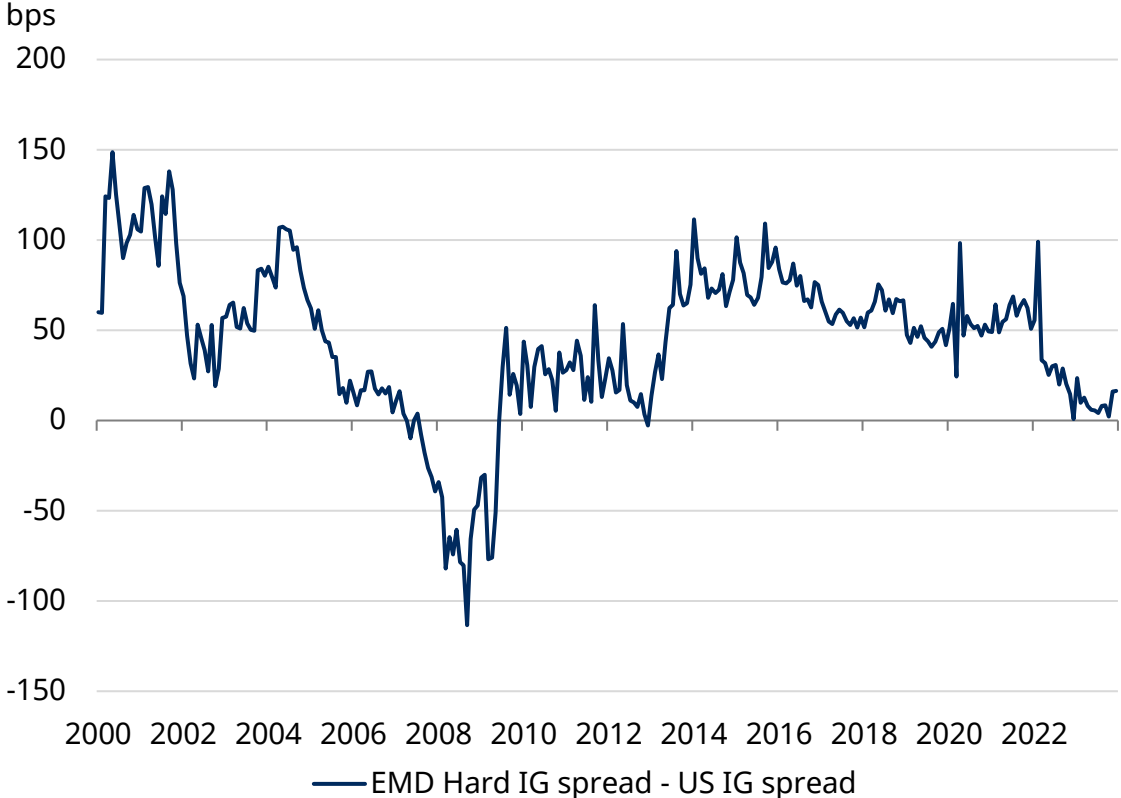


Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

EM dollar debt: sovereign EMD vs. US corporates

Sovereign EMD IG offers a small spread premium to the US

Sovereign EMD IG spread minus US IG spread



Sovereign EMD HY spread minus US HY spread

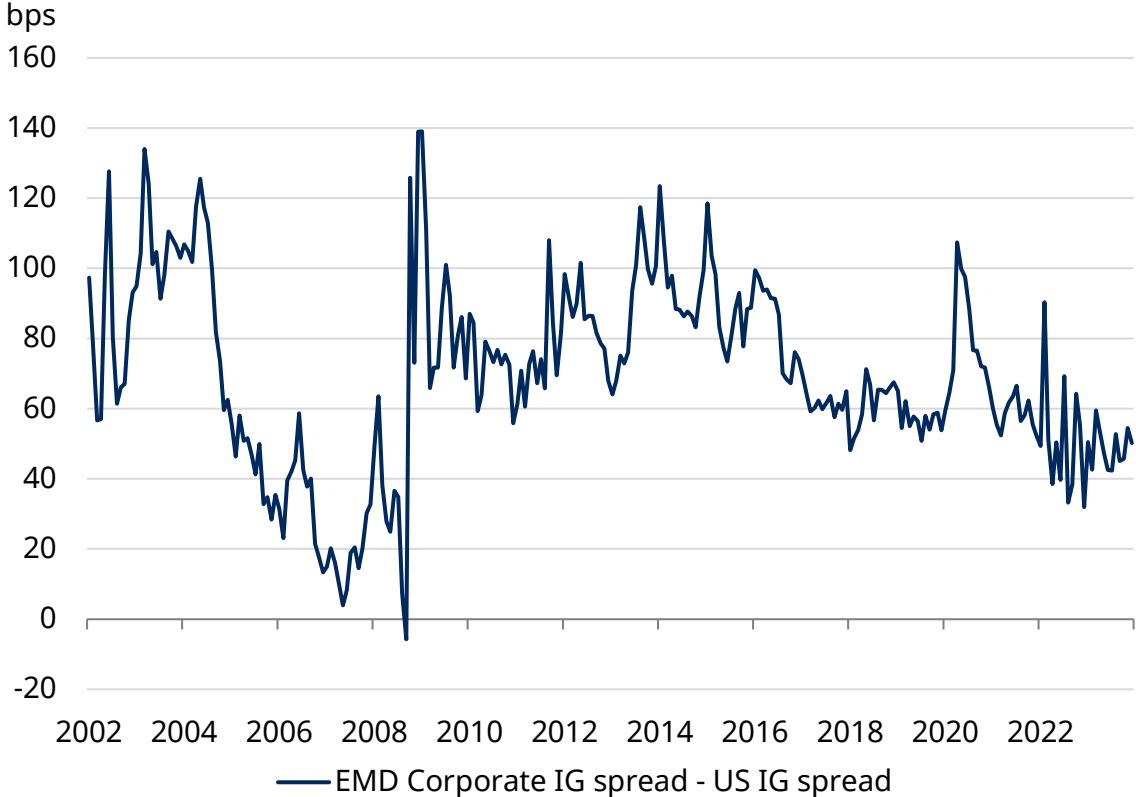


Sovereign HY spread premium versus US has fallen from peak

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

EM dollar debt: corporate EMD vs. US corporates

Corporate EMD IG spread minus US IG spread



Corporate EMD HY spread minus US HY spread



Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.



Emerging market debt:

Local currency

Summary: local currency emerging market debt

- Local EM bonds delivered strong gains in 2023, amplified by currency appreciation versus the US dollar.
- The yield on the local EM bond index eased to 6.2%, but there remains significant variation between regions. Yields in Latin America are markedly higher than in EM Asia.
- EM ex Turkey inflation fell significantly in 2023, opening the door to interest rate cuts, led by Latin America but these are also underway in EM Europe. Turkey is the exception, where a renewed vein of orthodoxy has persisted, with rate hikes totalling more than 30 percentage points since June.
- The average local EM ex Turkey yield curve is no longer inverted.
- The average real yield premium of EM over DM has moved up from its trough. Both the average EM and DM real yields have lifted, with EM well into positive territory again; the average DM real yield is still negative.

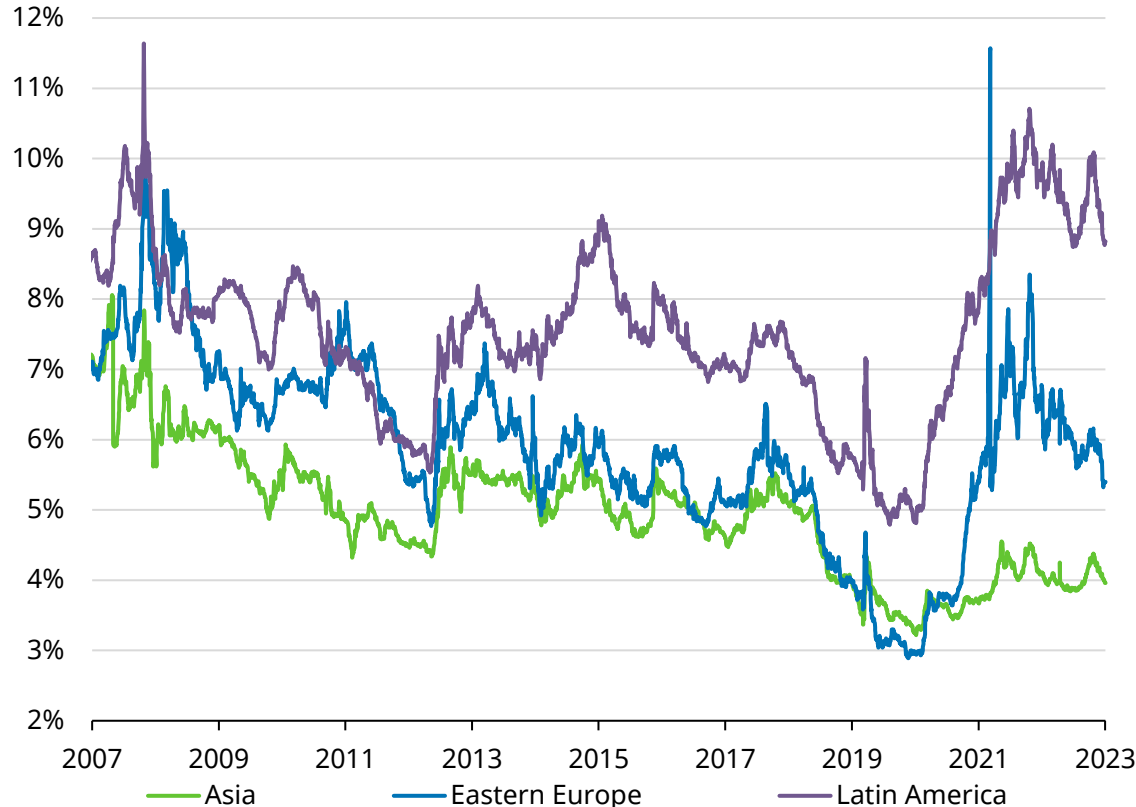
EM local currency index yield fell to 6.2% in 2023

Yields vary by region, but are notably higher in Latin America

Local EMD index yield



Local EMD yield by region

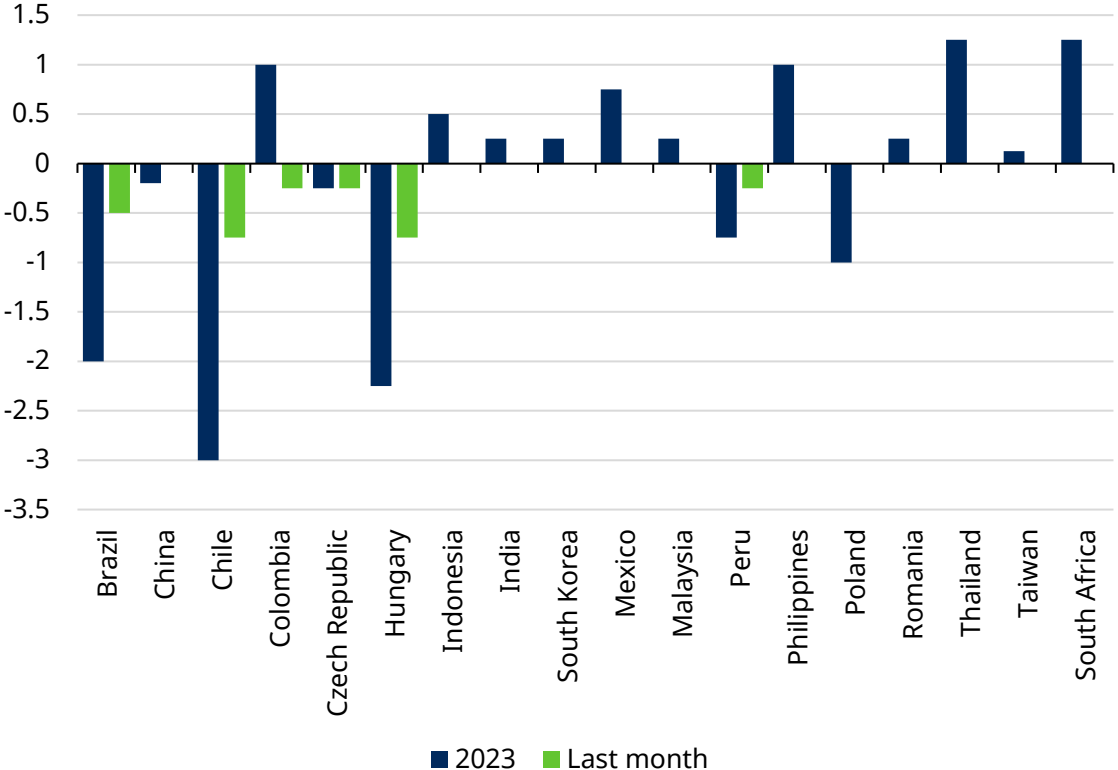


Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Russia was removed from all JP Morgan EMD indices from 31 March 2022. Please see relevant disclaimers on page 43.

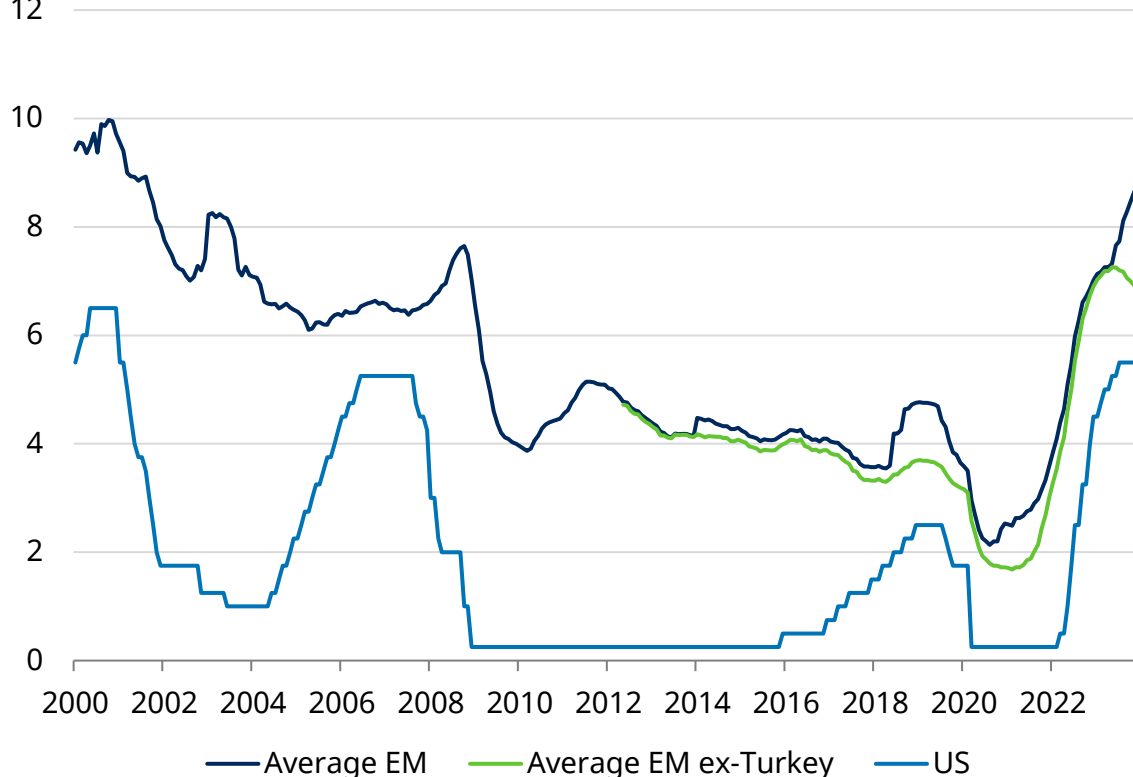
EM ex Turkey policy rates are elevated, but now falling

Various EM central banks have begun easing cycles...

Change in EM policy rates YTD/last month (%)*



Average EM policy rate¹ (%)



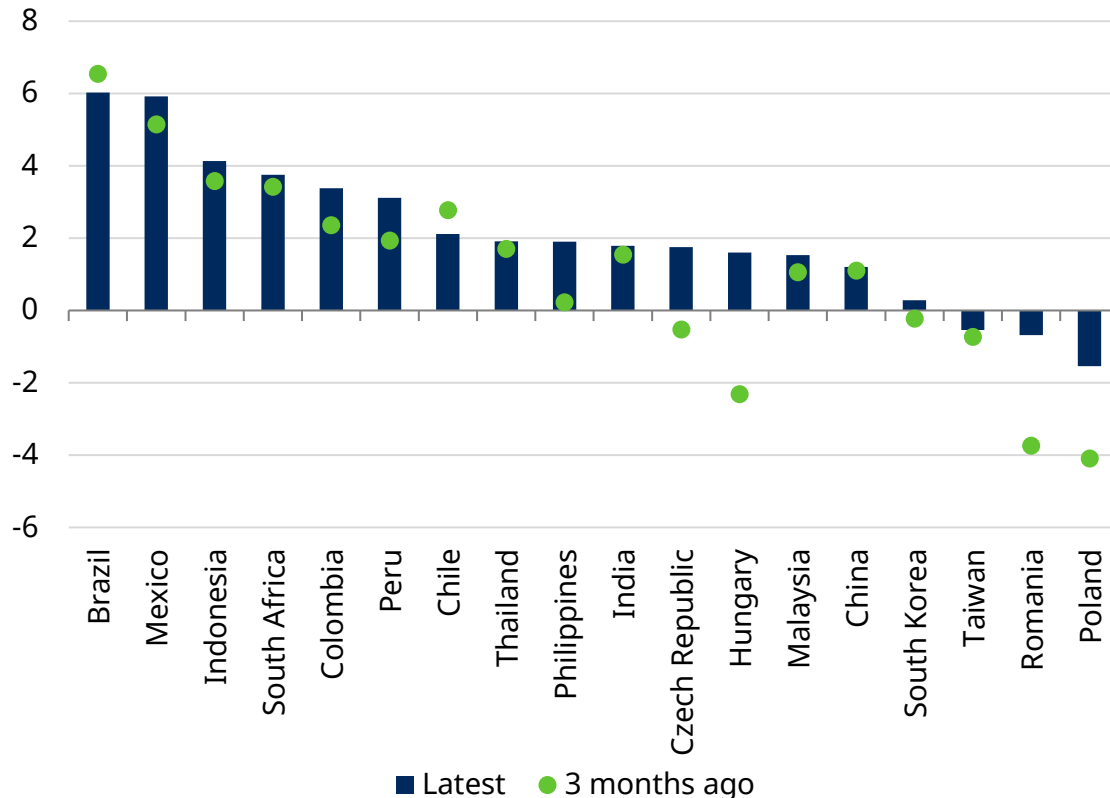
After changing course in June, Turkey's central bank has now hiked rates by over 30 percentage points

Source: Schroders, LSEG Datastream. Data as at 31 December 2023. ¹Based on 19 major EM countries. Please see relevant disclaimers on page 43. *Turkey is excluded from the bar chart due to scale of hikes compared to the rest of EM. Its central bank raised the policy rate by another 2.5% in December.

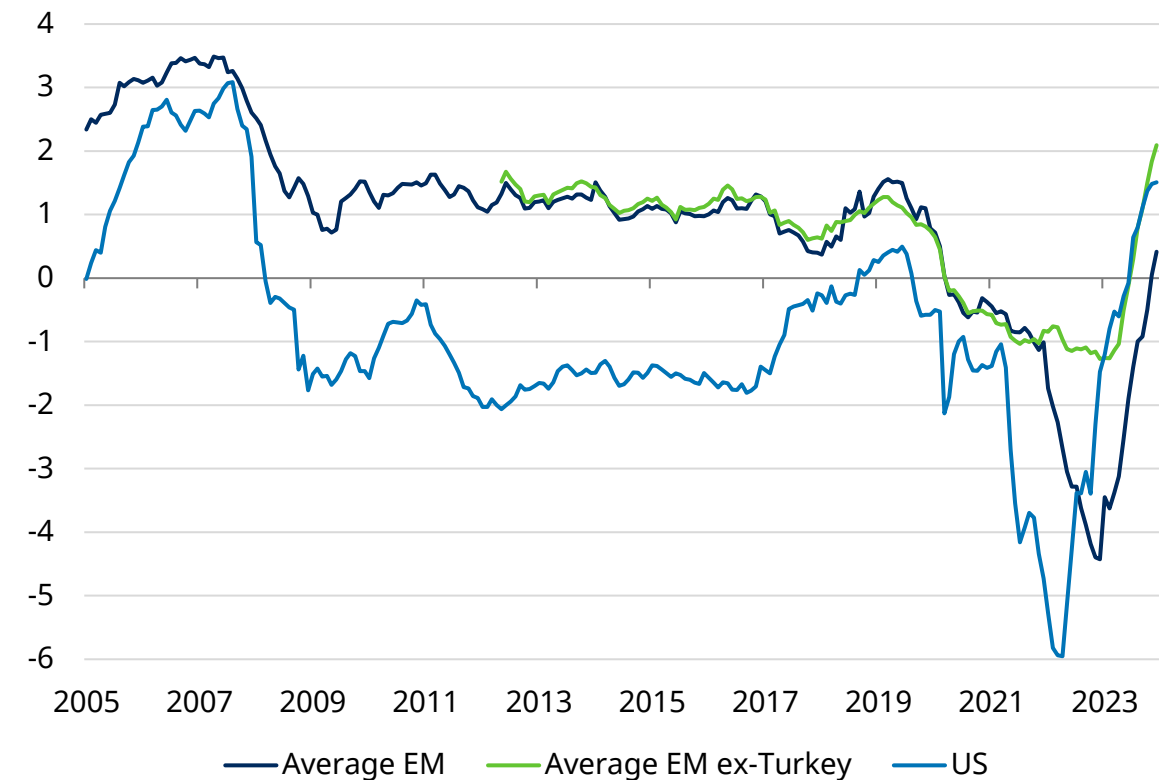
Majority of EM real policy rates have turned positive

Eastern Europe real rates have lagged, but are catching up

EM real policy rates (%)



Average EM real policy rate¹ (%)



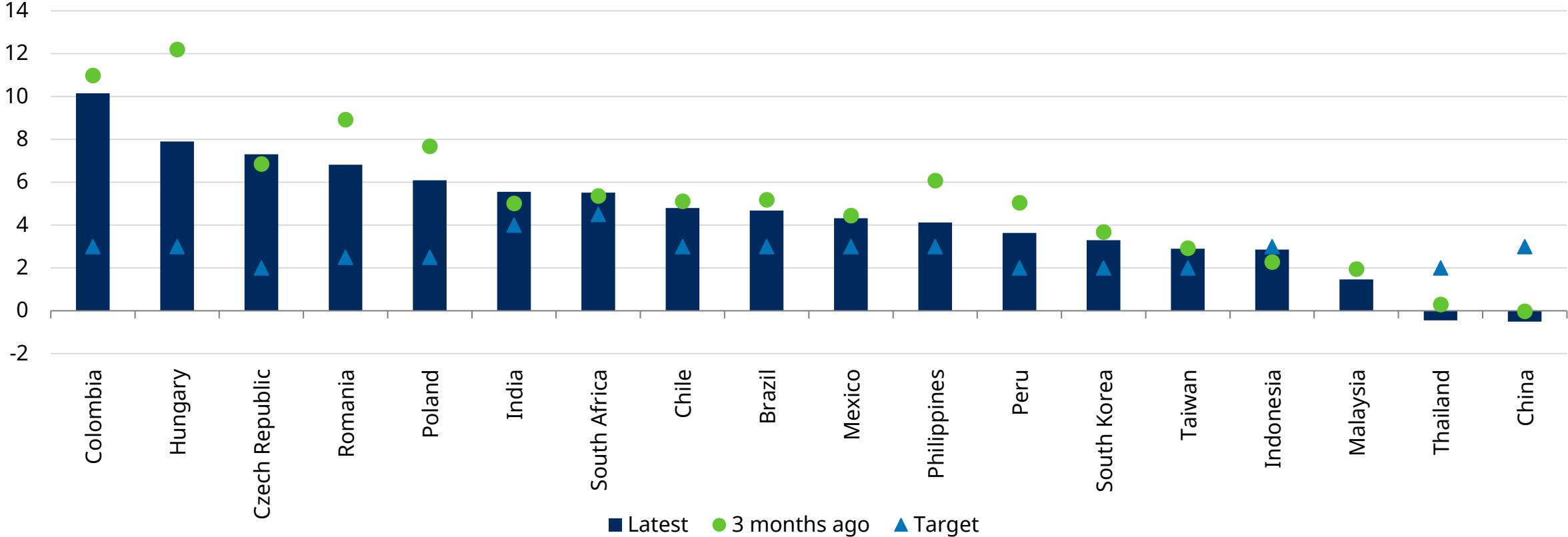
¹Based on 19 major EM countries. Turkey has very high inflation at the moment, with the annual core inflation at 71%. Despite large rate hikes recently, Turkey's policy rate is well below core inflation at 42.5%. Hence, Turkey's real policy rate is very negative at -29%, skewing the EM average.

Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Nominal policy rate minus annual core inflation. Please see relevant disclaimers on page 43.

EM headline inflation is moving towards target in most EM

China and Thailand are notable exceptions where inflation is below target

Headline inflation (%)

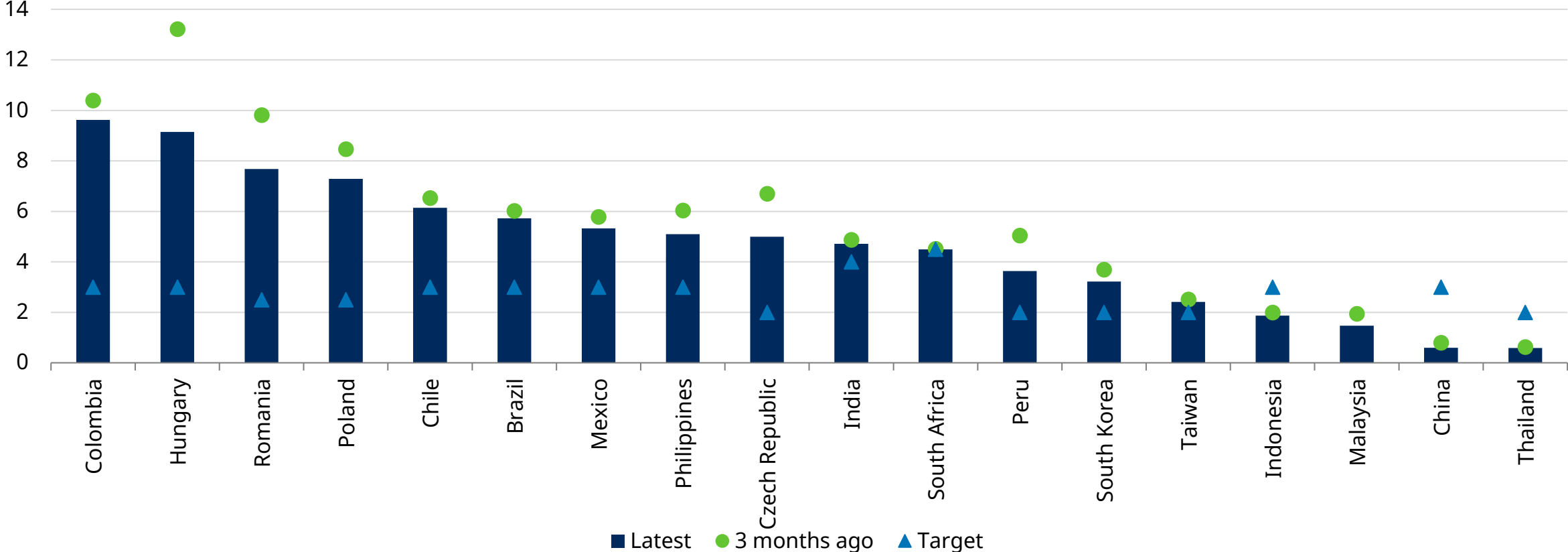


Turkey's annual headline inflation (70%) omitted from the figure.
Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Core inflation is also falling in most EM

Core inflation in China, as well as in Thailand and Indonesia, is below target

Core inflation (%)

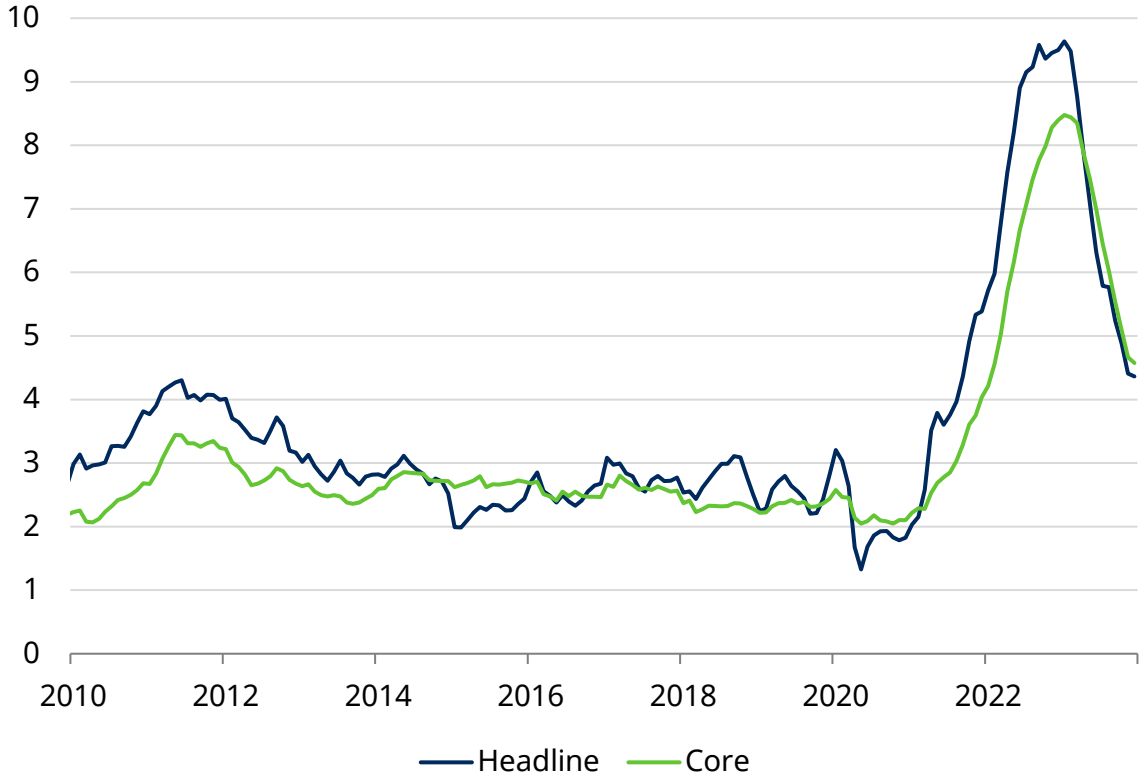


Turkey's annual core inflation (65%) omitted from the figure.
 Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

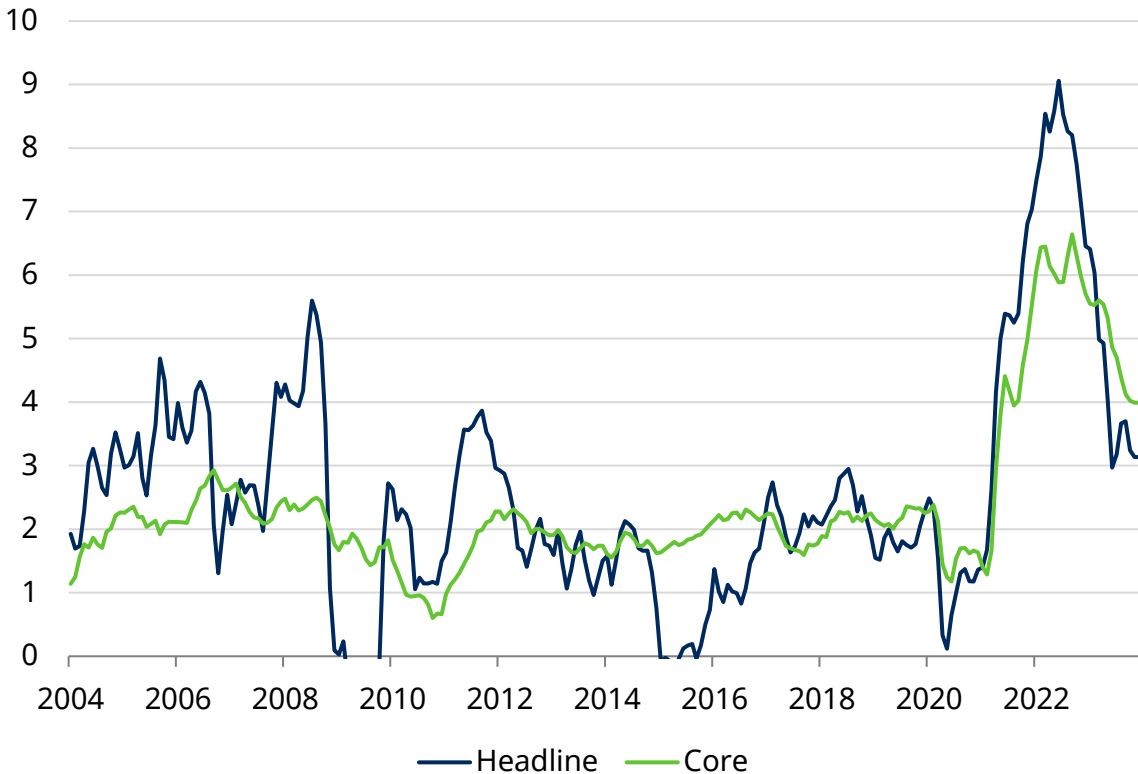
Headline and core EM inflation has fallen significantly

...even if it remains above the range seen over the past decade

Average EM inflation ex Turkey¹ (%)



US inflation (%)

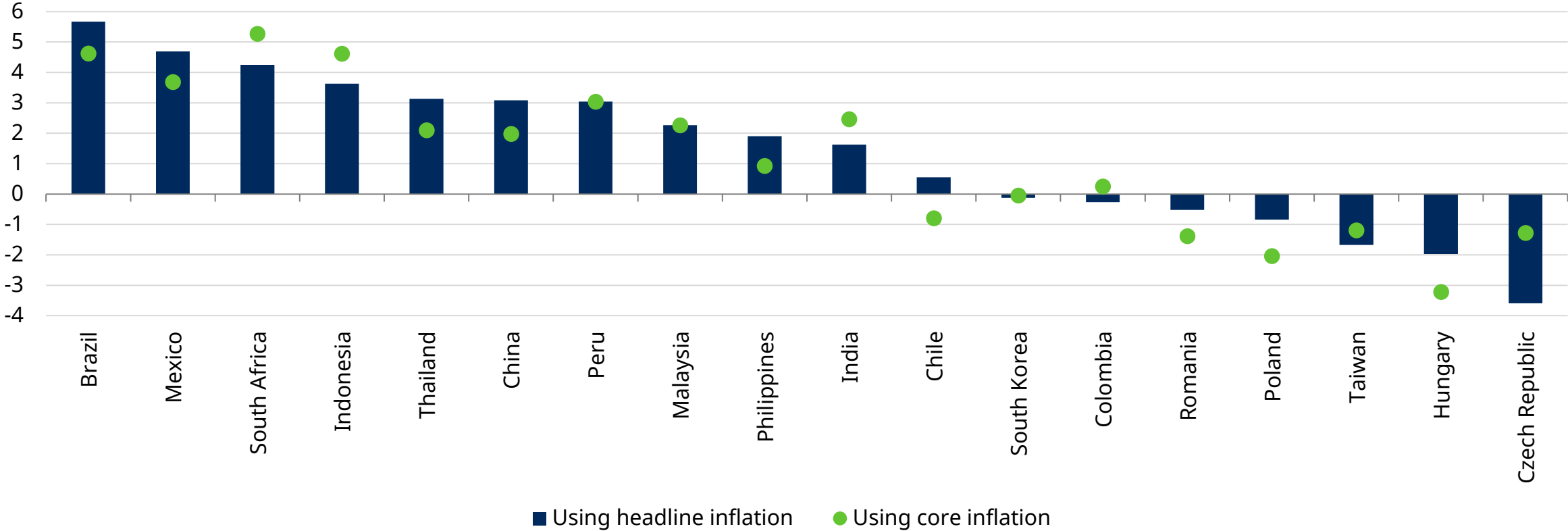


¹Based on 19 major EM countries. Turkey excluded because of significantly higher inflation in the country compared to the rest of the EM. Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Real bond yields are positive in most EM...

EM Europe and Taiwan are the exceptions

Real 10-year yield

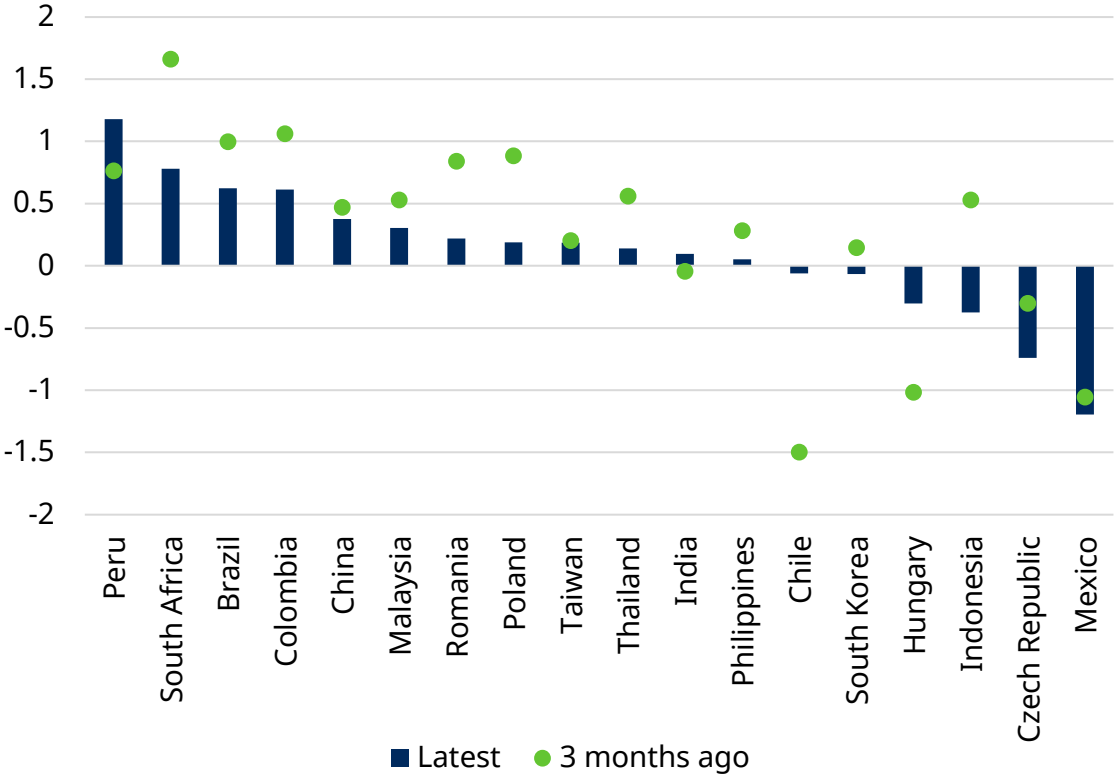


Real bond yields are highest in Brazil, Mexico, and South Africa

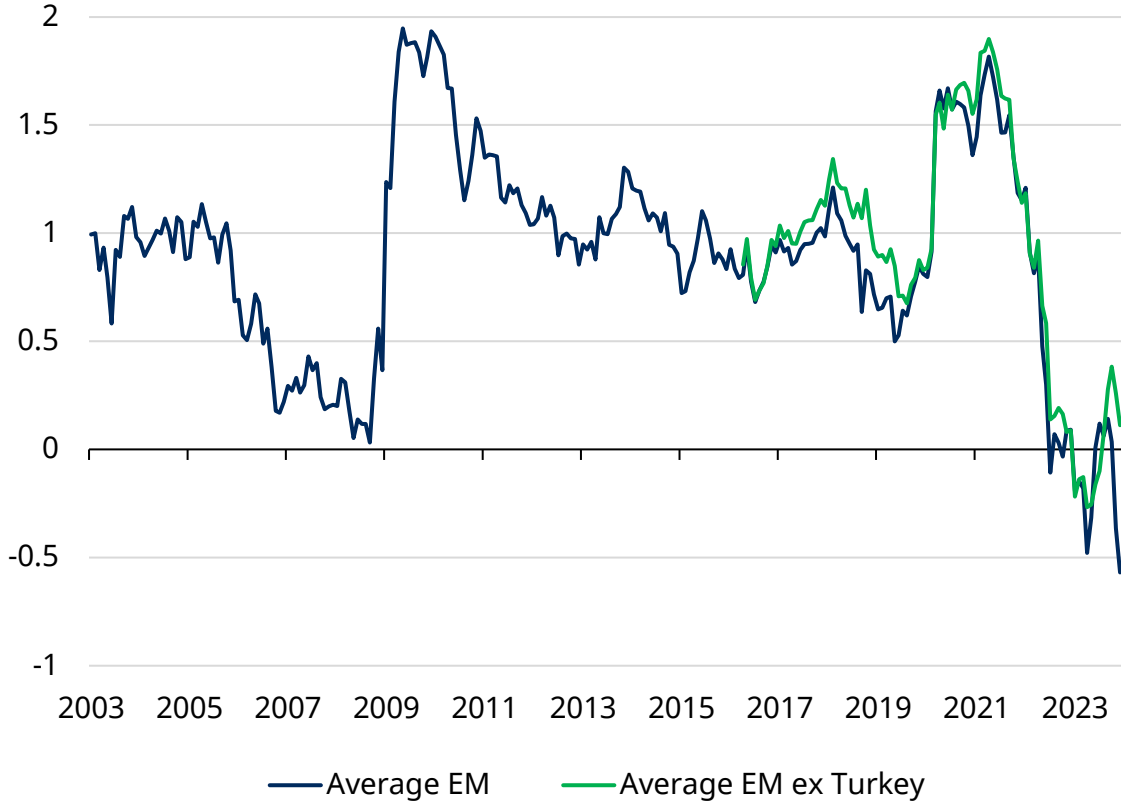
Nominal 10 year yield minus annual headline or core inflation.
Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

EM yield curve shape

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



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



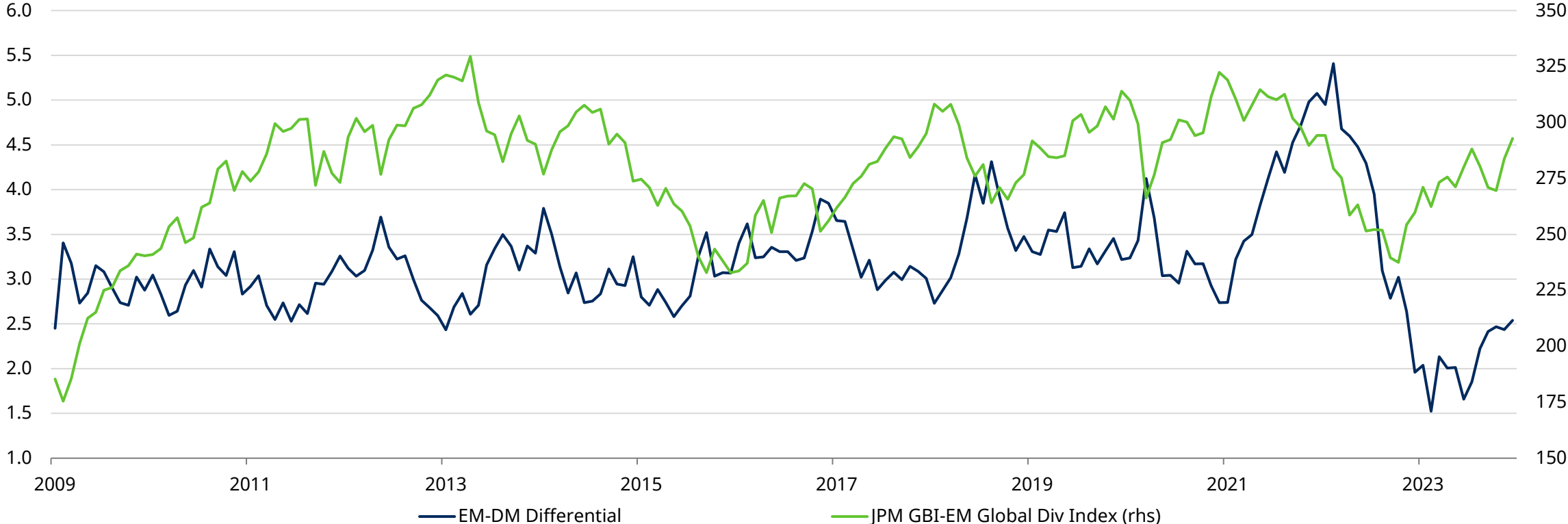
The average local EM ex Turkey yield curve is no longer inverted

¹Based on 19 major EM countries. Turkey omitted from chart on left due to degree of inversion - latest yield curve steepness is -11.6 percentage points. Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Real yield differential has moved off long term lows

EM local currency bond valuation

EM-DM real yield differential (%)



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

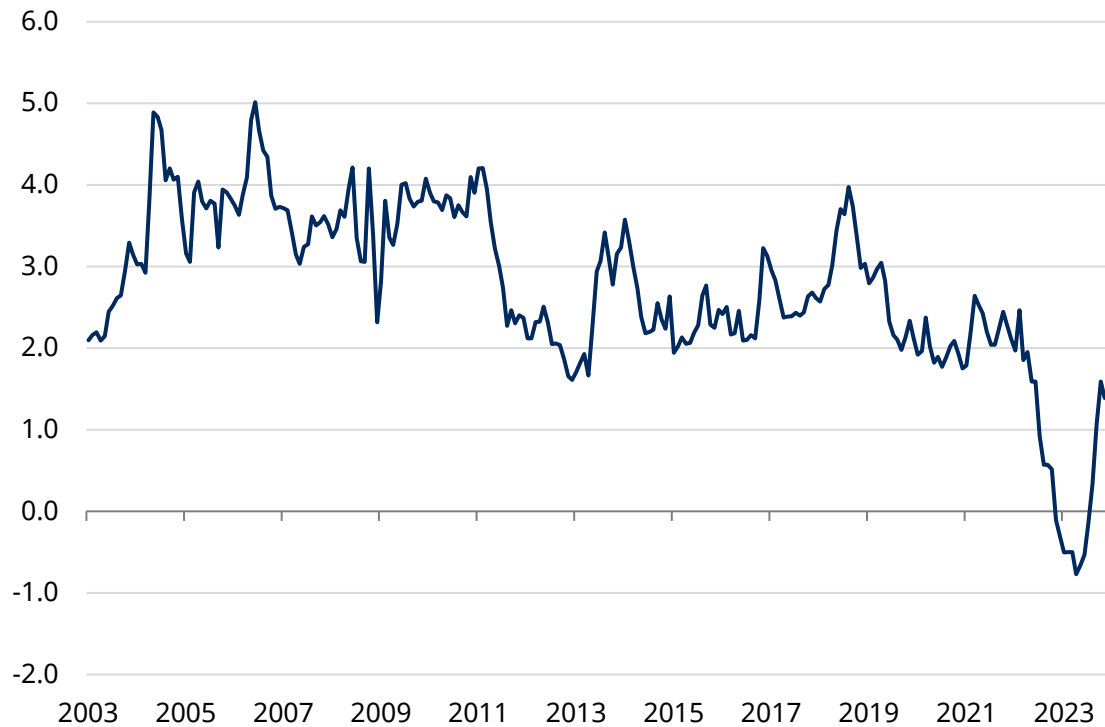
EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, Euro zone, Japan deflated by core inflation, weighted by the size of individual government bond market.

Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Average EM and DM real yields have picked up

Individual drivers of the real yield differential

EM real yield (%)



DM real yield (%)



Source: Schroders, LSEG Datastream, ICE Data Indices, JP Morgan. Data as at 31 December 2023. 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 43.



Emerging market currencies

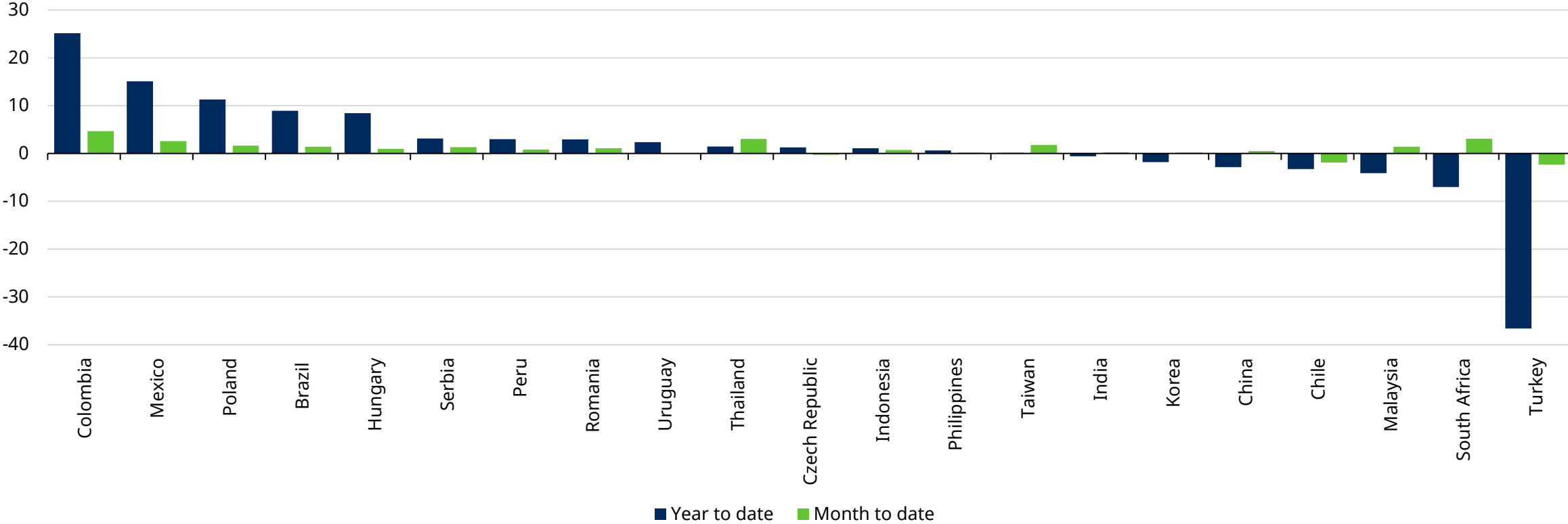
Summary: emerging market currencies

- EM currency performance versus the US dollar was mixed in 2023
- There are undervalued currencies in all three EM regions, though the degree of value in EM currencies varies significantly
- The Czech koruna is notably above its long term and five-year averages. Currencies in Uruguay, and Romania are also expensive versus history. Turkey, Serbia, and South Africa are among the cheapest EM currencies relative to the long-term average
- EM FX carry, the strategy of buying higher-yielding EM currencies against lower-yielding currencies to earn the interest rate differential, made a comeback in 2022 because of EM rate hikes but has faded

EM currency performance was mixed in 2023

EM currency performance vs. US dollar

EM currency returns (%)



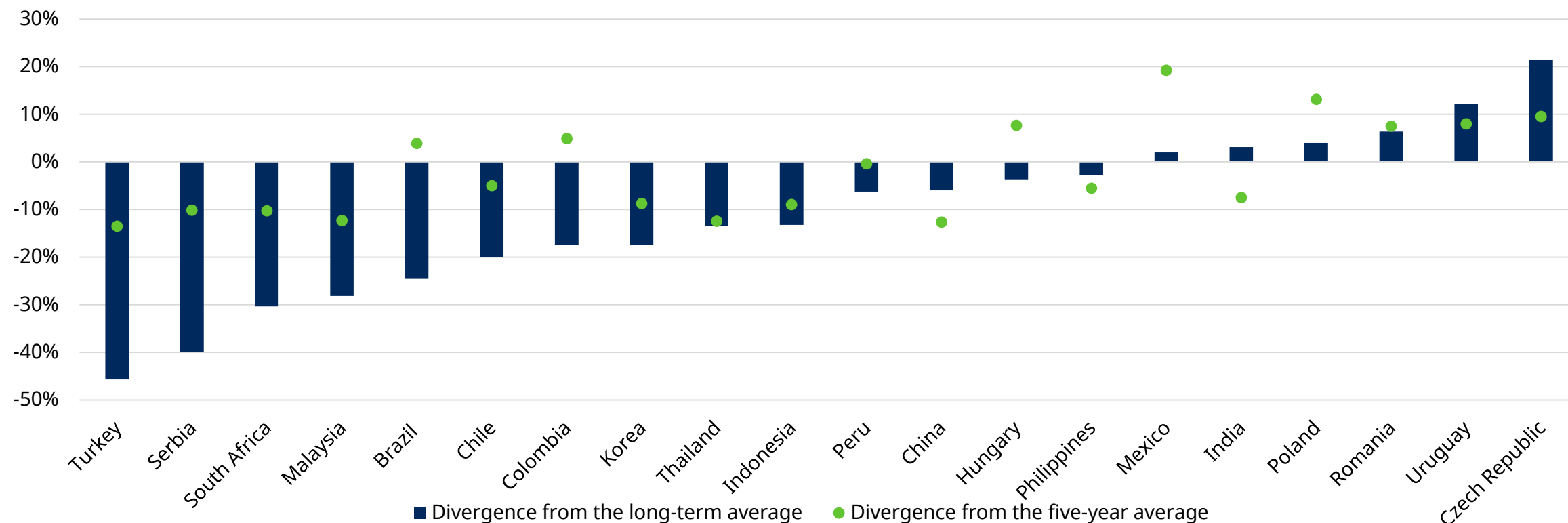
Latin currencies were among the top performing last year

Past performance is not a guide to future performance and may not be repeated.
 Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

Some currencies are significantly undervalued

Notably EMEA and Latin American currencies

Real exchange rate: deviation from average



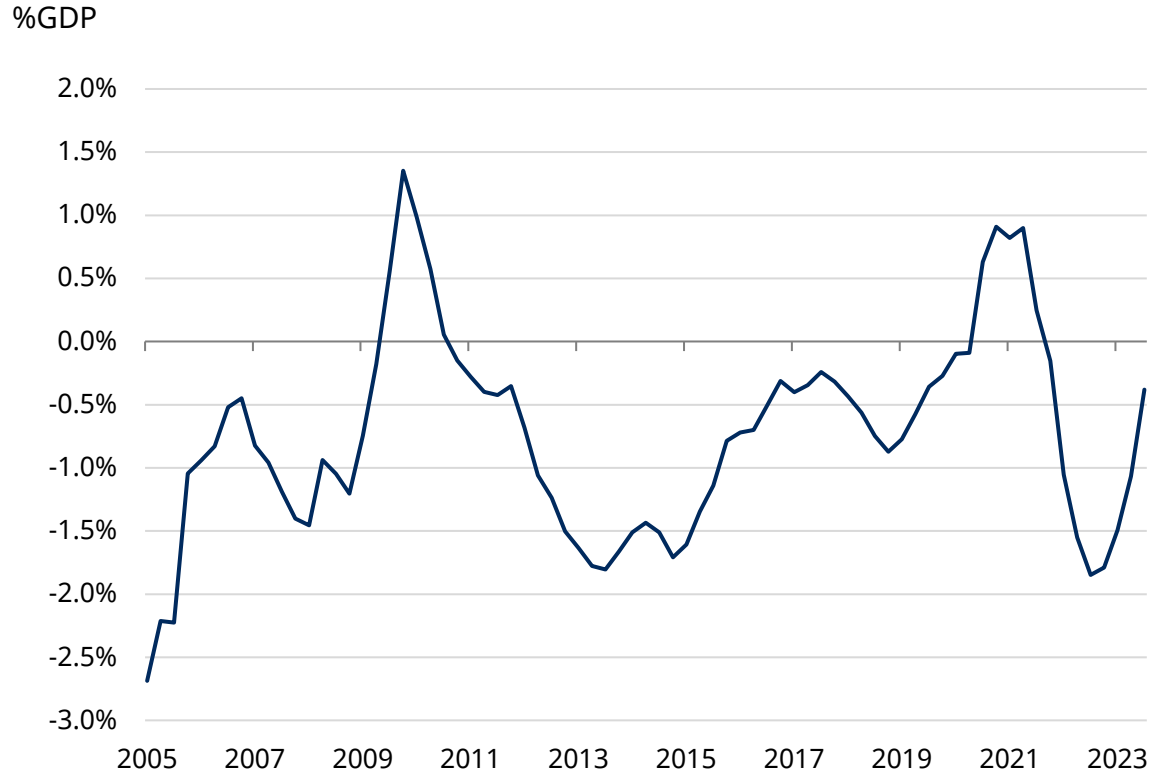
Czech Republic, Uruguay and Romania have real exchange rates well above the long-term average

Source: Schroders, LSEG Datastream. Data as at 31 December 2023. 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 43.

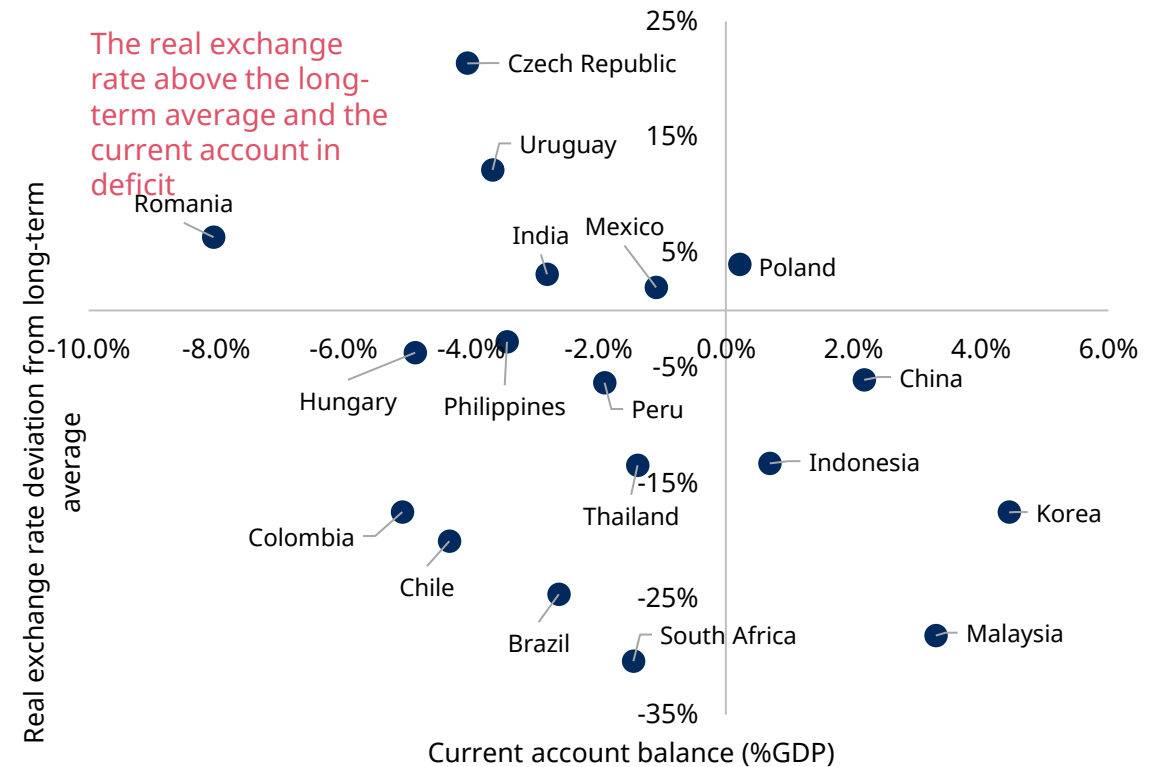
EM fundamentals: current account vs. currency valuation

Romania, Czechia, and Uruguay are among most vulnerable to currency weakness

Average EM current account balance¹



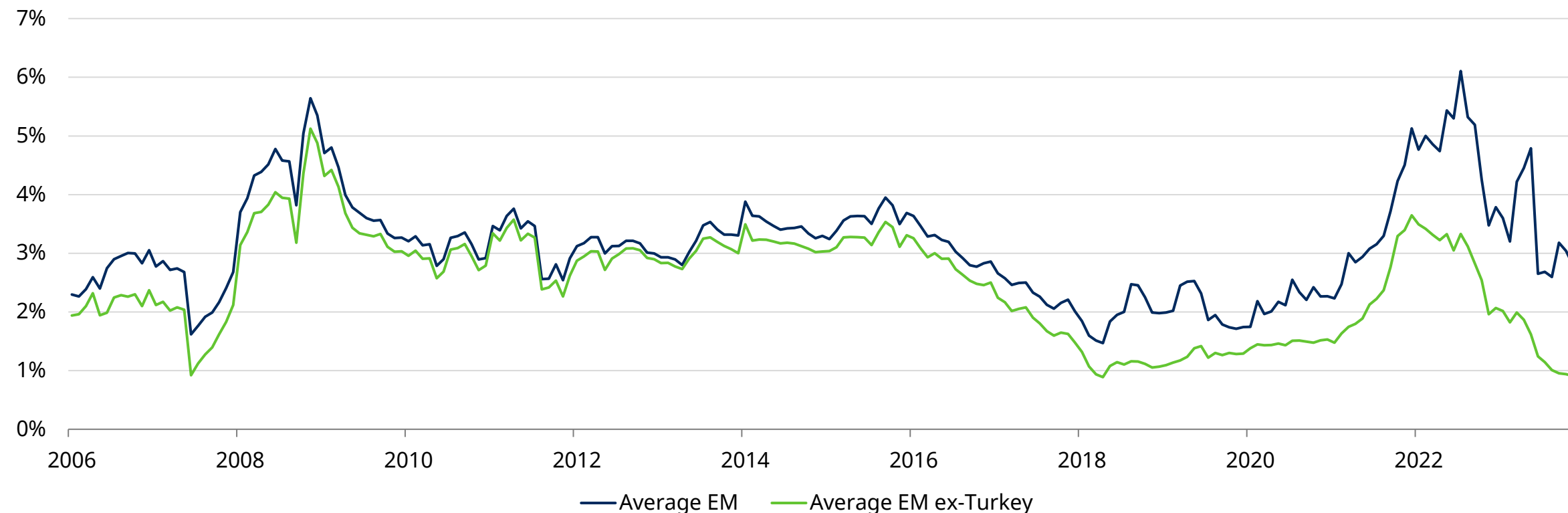
EM currency value² vs. current account balance



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 Q3 2023, currency value data as at 31 December 2023. Please see relevant disclaimers on page 43.

The EM FX carry trade made a comeback on the back of EM rate hikes but has faded

Average EM carry¹



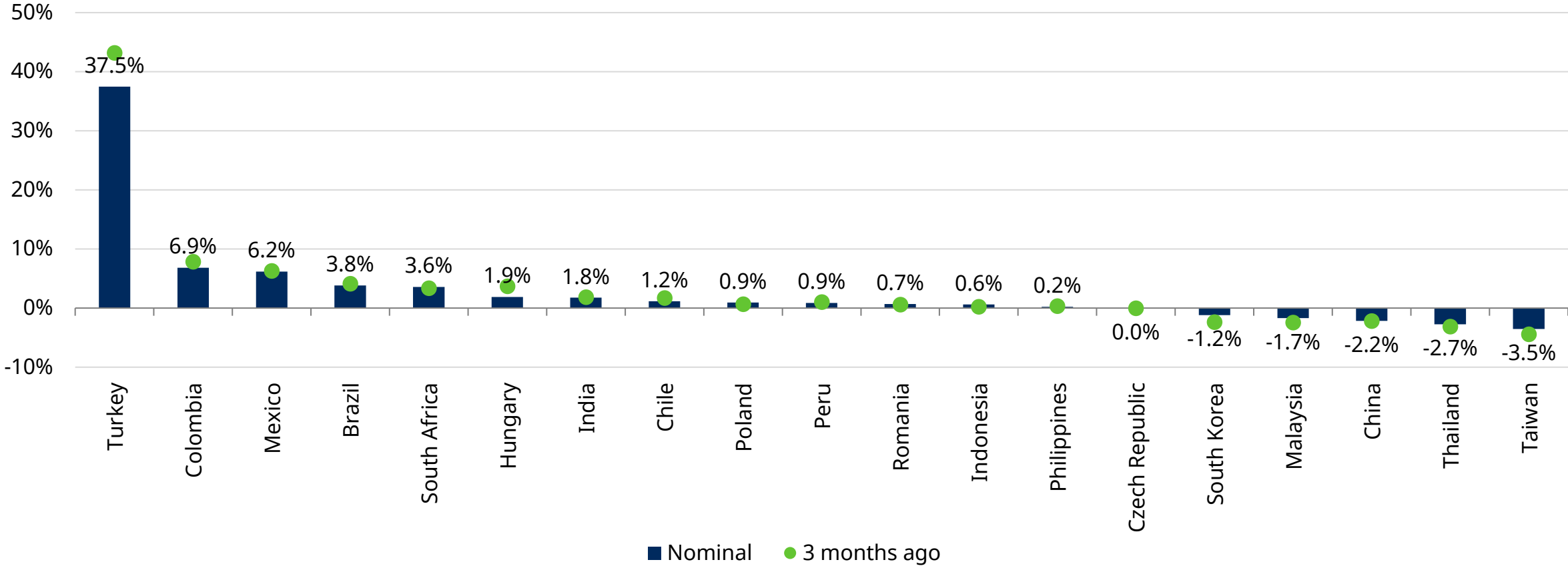
Average EM ex-Turkey carry is close to multi-decade lows

¹The return of holding 1-year FX forward vs. US dollar to maturity. Based on 19 major EM countries.
Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

FX Carry varies significantly between the countries

FX carry trade in Turkey remains elevated, despite recent decrease

EM FX carry¹



¹The return of holding 1-year FX forward vs. US dollar to maturity.
 Source: Schroders, LSEG Datastream. Data as at 31 December 2023. Please see relevant disclaimers on page 43.

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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