

Schroders



Schroders Emerging Markets Lens: Emerging Market Debt

Strategic Research Unit

February 2023

Marketing material for professional clients only.

Table of contents

01 [Emerging market debt: hard currency](#)

02 [Emerging market debt: local currency](#)

03 [Emerging market currencies](#)

Summary

EM local and dollar debt have made a strong start to 2023, with yields falling as risk appetite improved.

Hard currency emerging market debt (EMD):

- The hard currency sovereign EMD index yield continued to fall, but remains elevated relative to its long term history.
- However, the spreads of the investment grade (IG) sovereign and corporate indices are now below their historical medians.
- The spread of the HY sovereign index is still elevated, despite a recent fall. Conversely, the high yield (HY) corporate index spread is below its historical median.

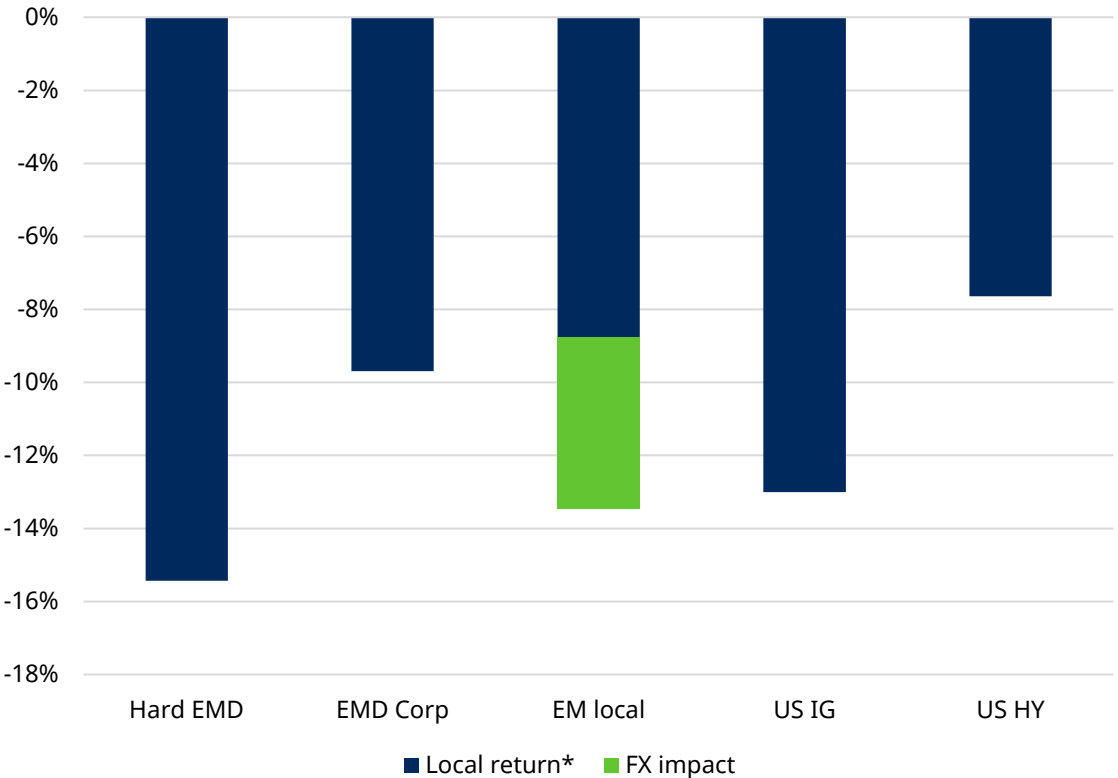
Local currency EMD:

- Local EM bonds have started the year with strong performance as a result of falling yields and EM currency gains.
- The real yield pickup over developed market (DM) bonds is at the bottom of its post-GFC range. This is primarily due to the sharp decrease in EM real yields in the past 12 months, as inflation has increased by more than nominal yields.
- There are undervalued **currencies** in all three EM regions. The degree of value in EM currencies varies significantly.

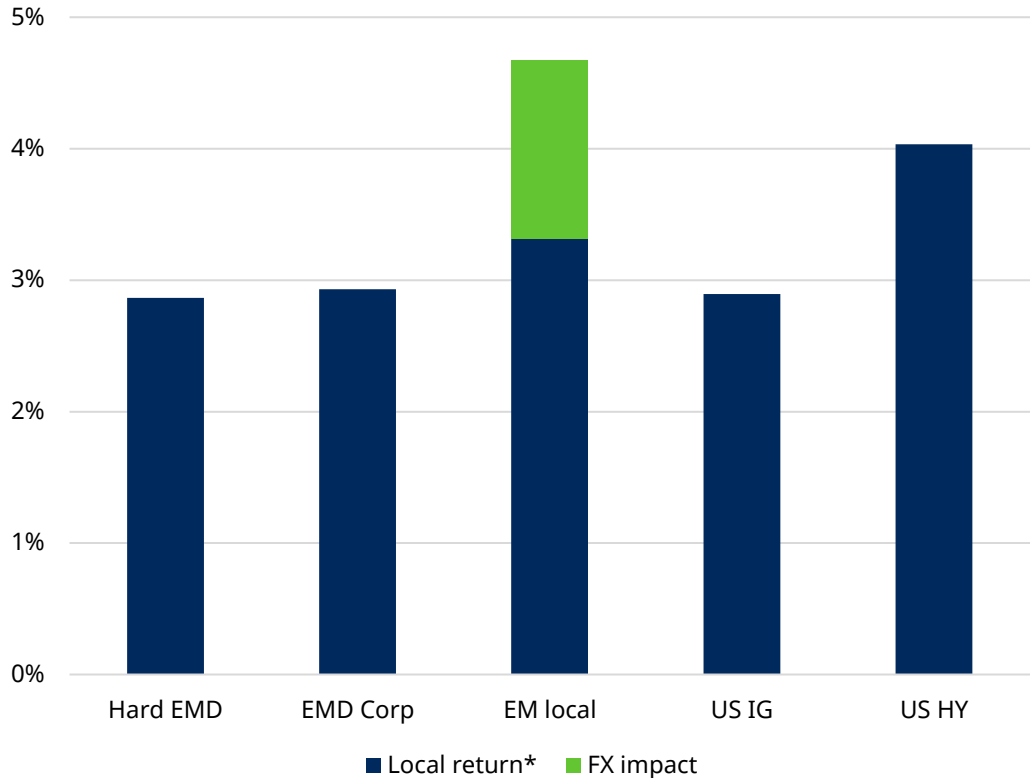
EM debt has continued to rebound in early 2023

Local EMD has generated a strong gain YTD, amplified by FX impact

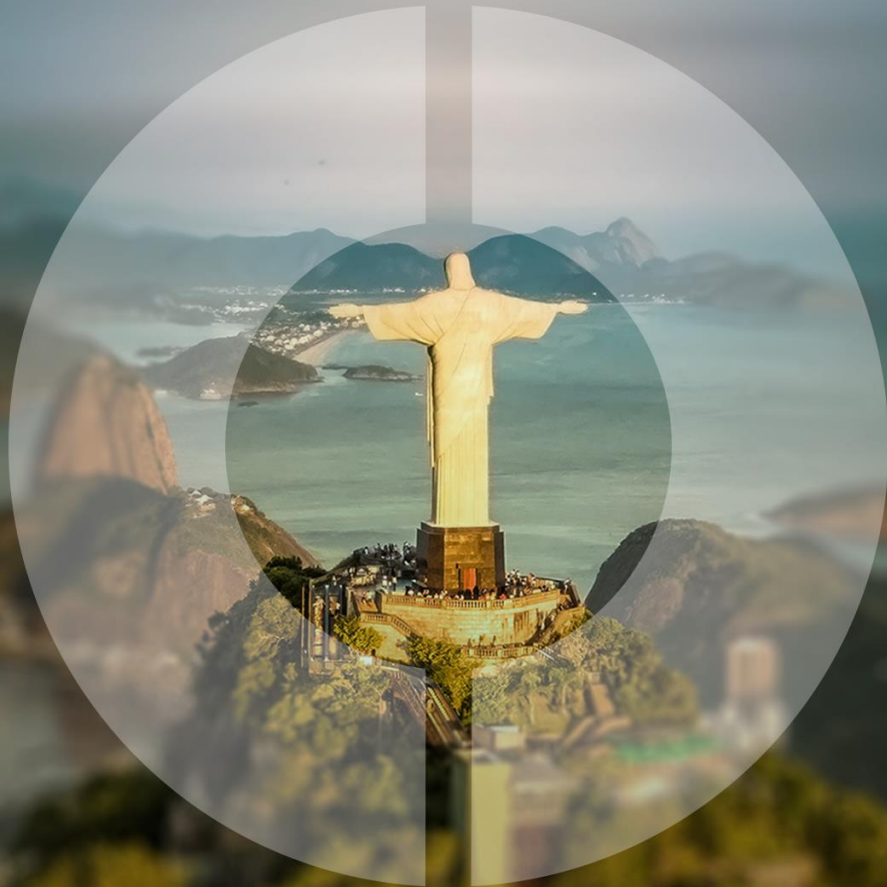
Total return since end 2021



Total return YTD



*Local currency = US dollar for all apart from local EMD which is in the relevant local EM currency
 Source: Schroders, Refinitiv Datastream, JP Morgan, Schroders Strategic Research Unit. Data as at 9 February 2023.



Emerging market debt: hard currency

Summary: hard currency emerging market debt

- The hard currency sovereign EMD index yield has fallen to 7.8% in early 2023; but remains elevated relative to its long term history.
- In sovereign EMD, the spread dispersion between countries remains wide. While most commodity exporters and larger countries are doing fine, some commodity importers and smaller countries are feeling the pain.
- Higher US yields have increased the cost of debt for EM issuers and the sovereign HY index spread remains at an elevated level. The IG spread is below its historical median.
- In corporate EMD, the high yield (HY) index spread and the IG spread are both below their historical medians.
- Credit quality has worsened since the pandemic, and has been compounded by the challenges seen in 2022 for issuers included in major sovereign and corporate EMD benchmarks.

EM hard currency index yield has fallen in early 2023

....led by Eastern Europe

Hard currency sovereign EMD regional index yield

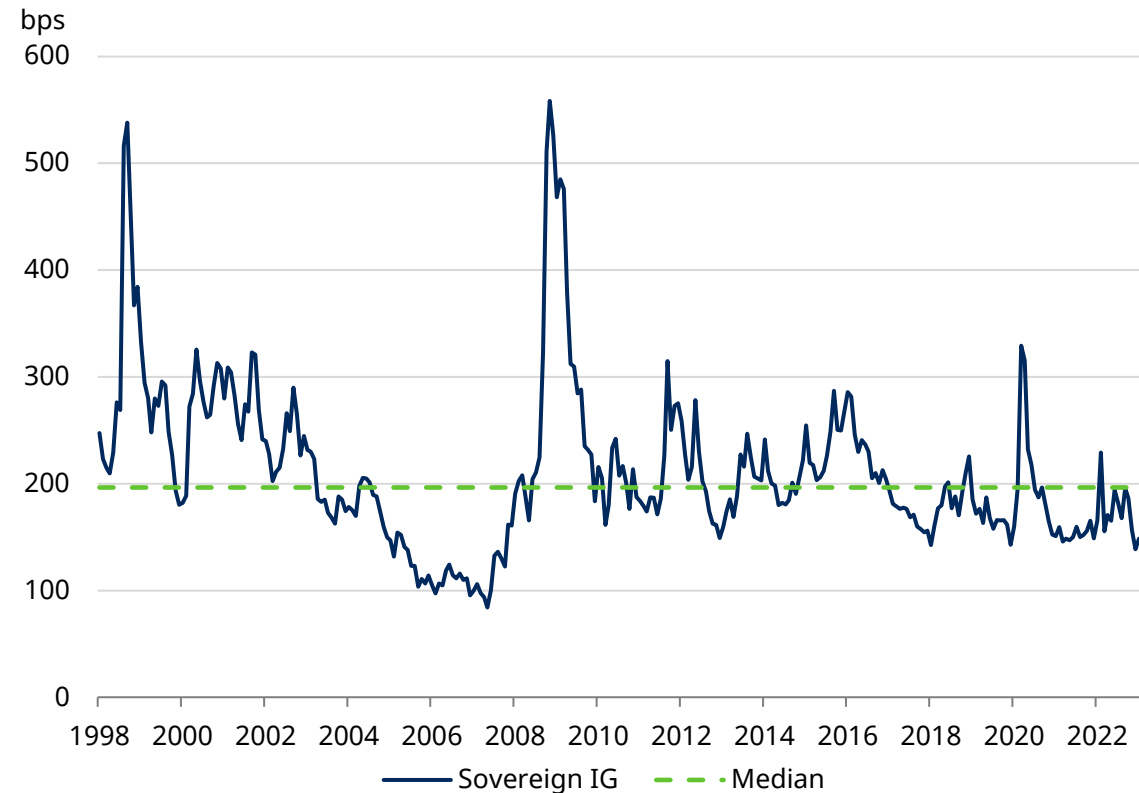


The EM hard currency index yield has fallen by 2.2% since 20 October

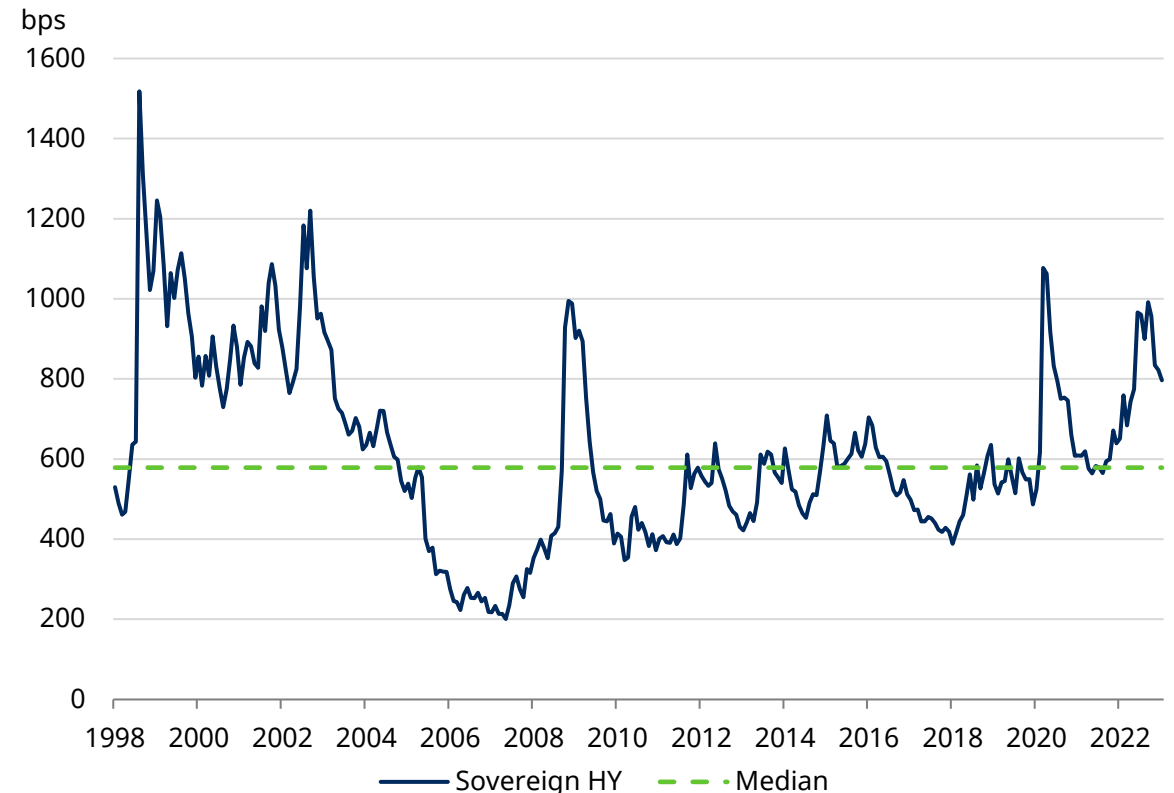
Russia was removed from all JP Morgan EMD indices from 31 March 2022.
Source: Schroders, JP Morgan. Data as at 2 February 2023.

Valuation of hard currency sovereign EMD

Hard currency sovereign EMD IG spread



Hard currency sovereign EMD HY spread

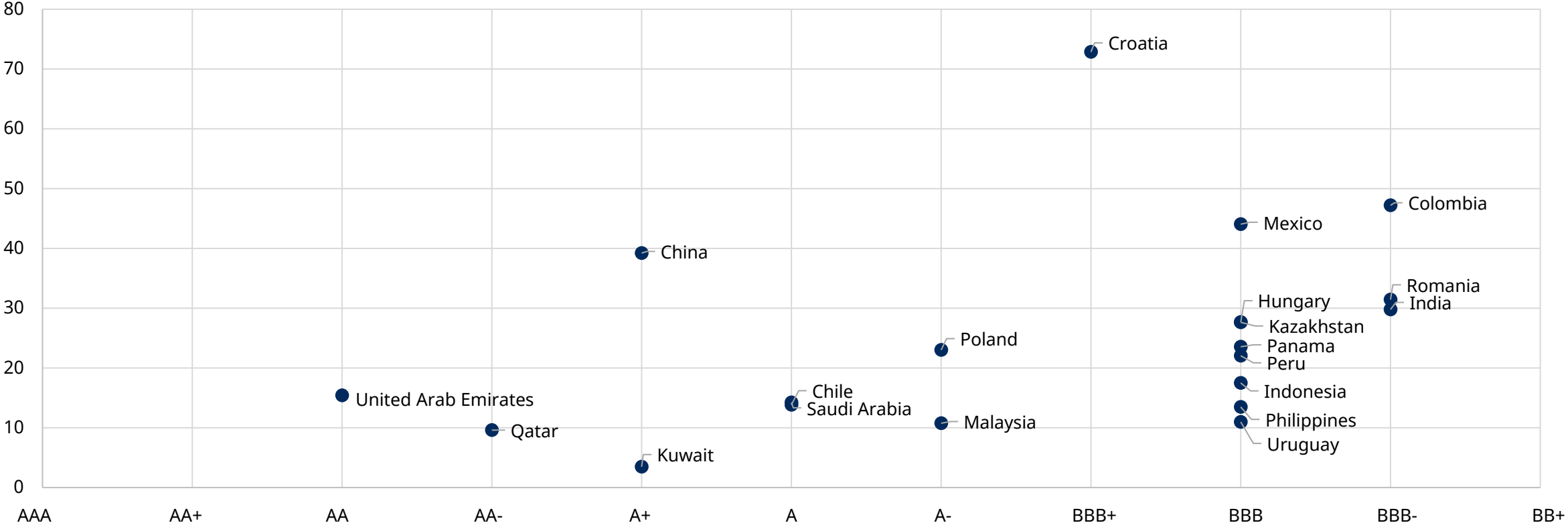


IG spread is below the historical median; despite a recent fall the HY spread remains elevated

Source: Refinitiv Datastream, J.P. Morgan. Data as at 31 January 2022.

Duration adjusted spreads of IG countries

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

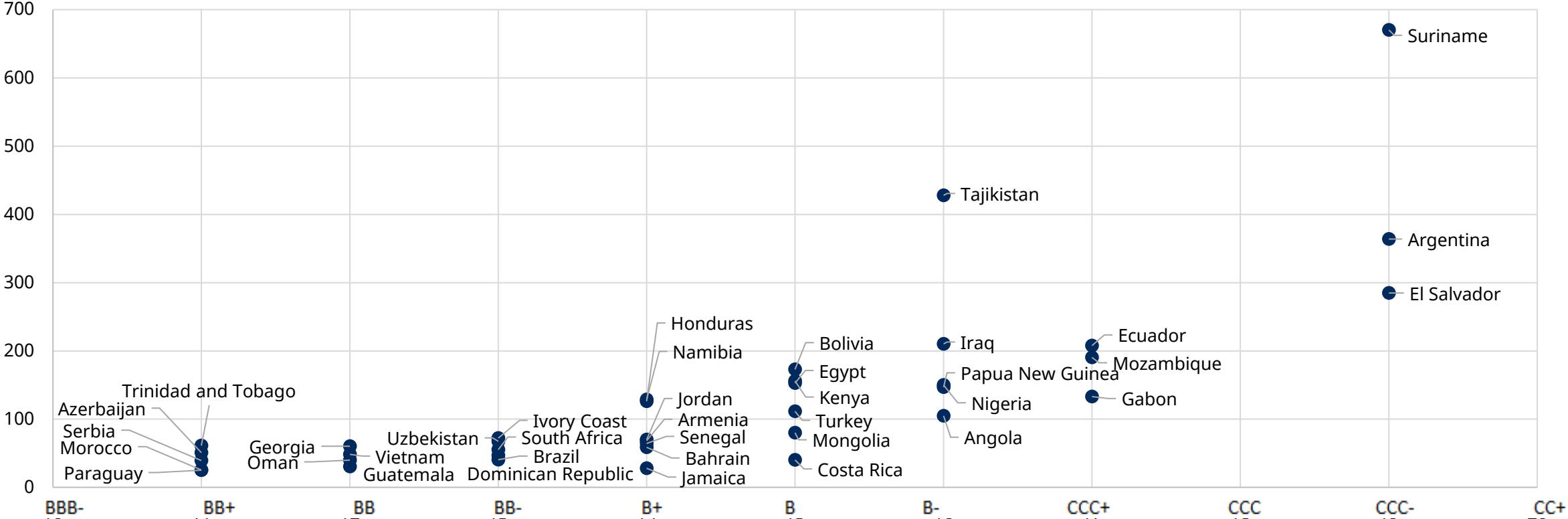


¹The JPMorgan EMBI Global Diversified Index includes both sovereign and quasi-sovereign bonds. The y-axis shows spread per unit of duration, in basis points. Source: Schroders, Refinitiv Datastream, J.P. Morgan. Data as at 31 January 2022.

Duration adjusted spreads of HY countries

Significant variability between the countries

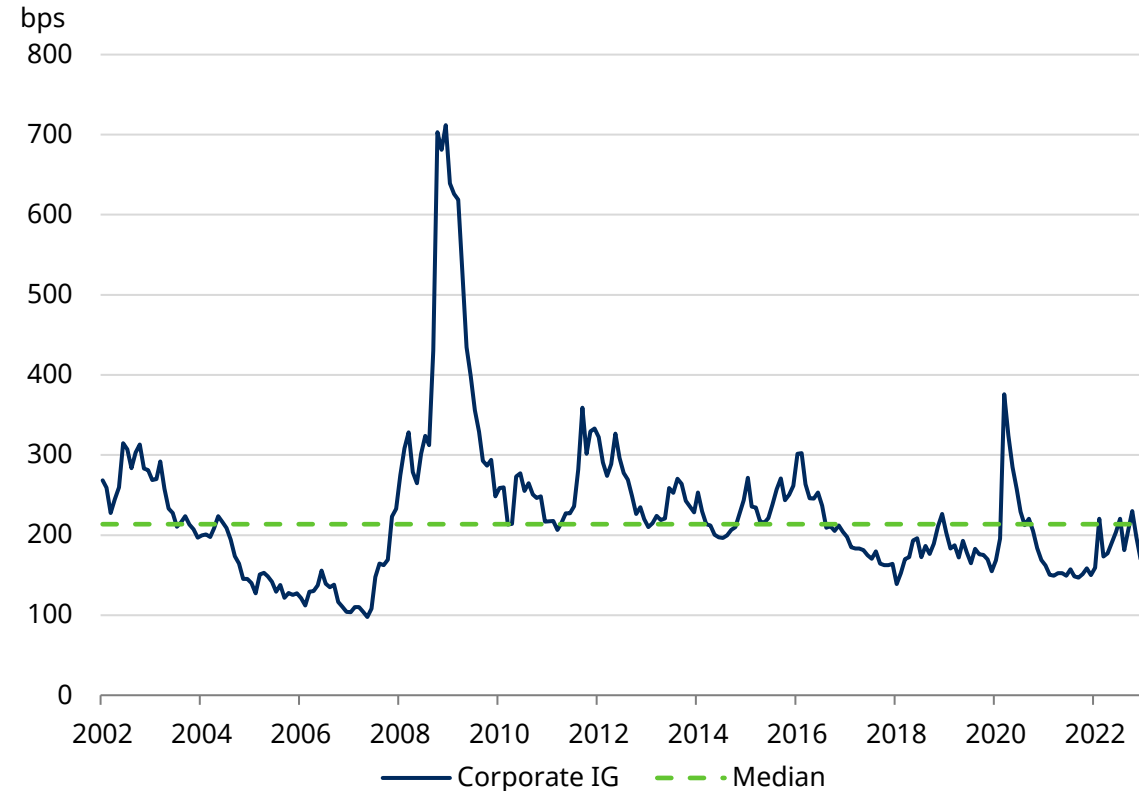
Hard currency sovereign EMD HY: spread vs. duration vs. credit rating



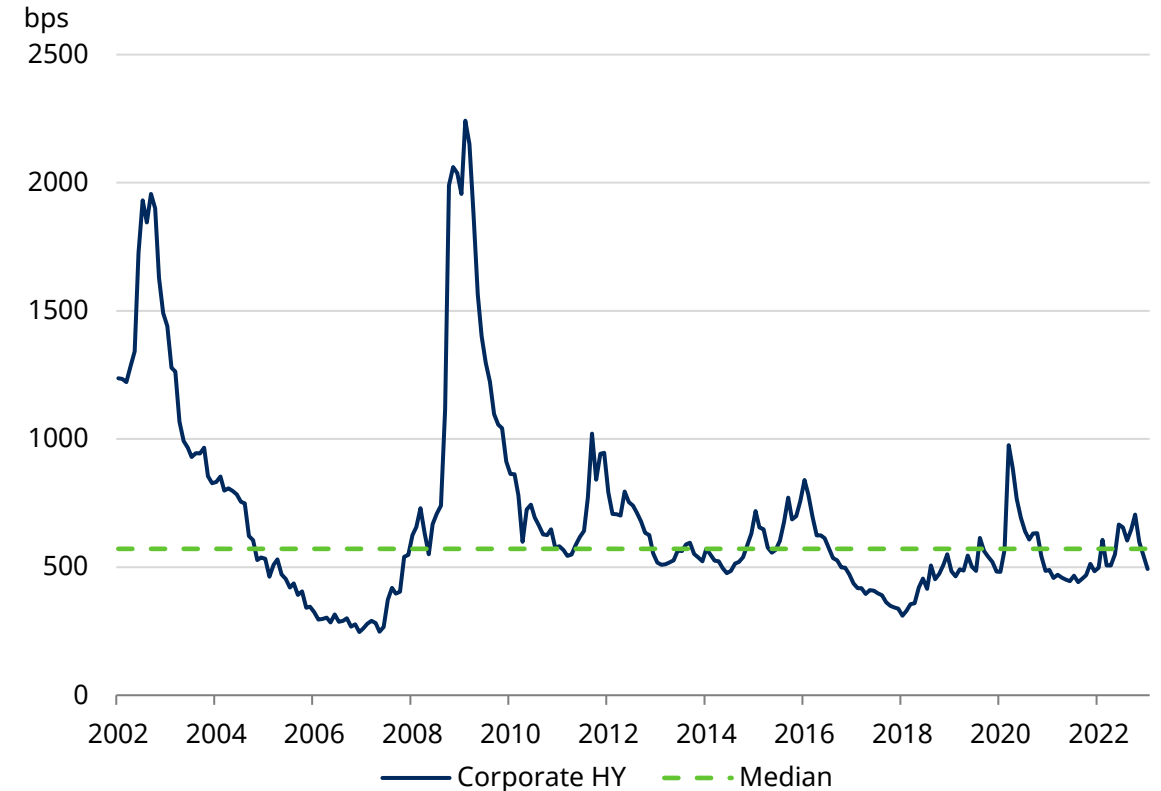
The y-axis shows spread per unit of duration, in basis points.
 Source: Schroders, Refinitiv Datastream, J.P. Morgan. Data as at 31 January 2022.

Valuation of hard currency corporate EMD

Hard currency corporate EMD IG spread



Hard currency corporate EMD HY spread



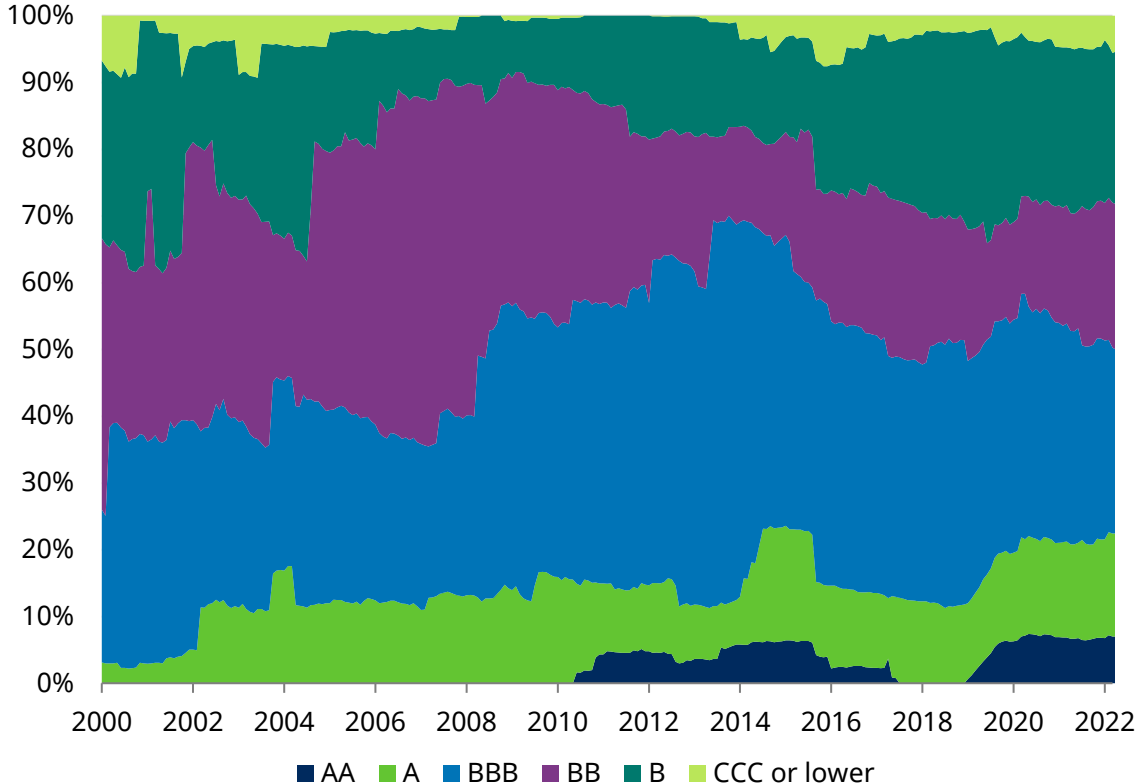
EM IG corporate and HY spreads are below the historical median

Source: Refinitiv Datastream, J.P. Morgan. Data as at 31 January 2022.

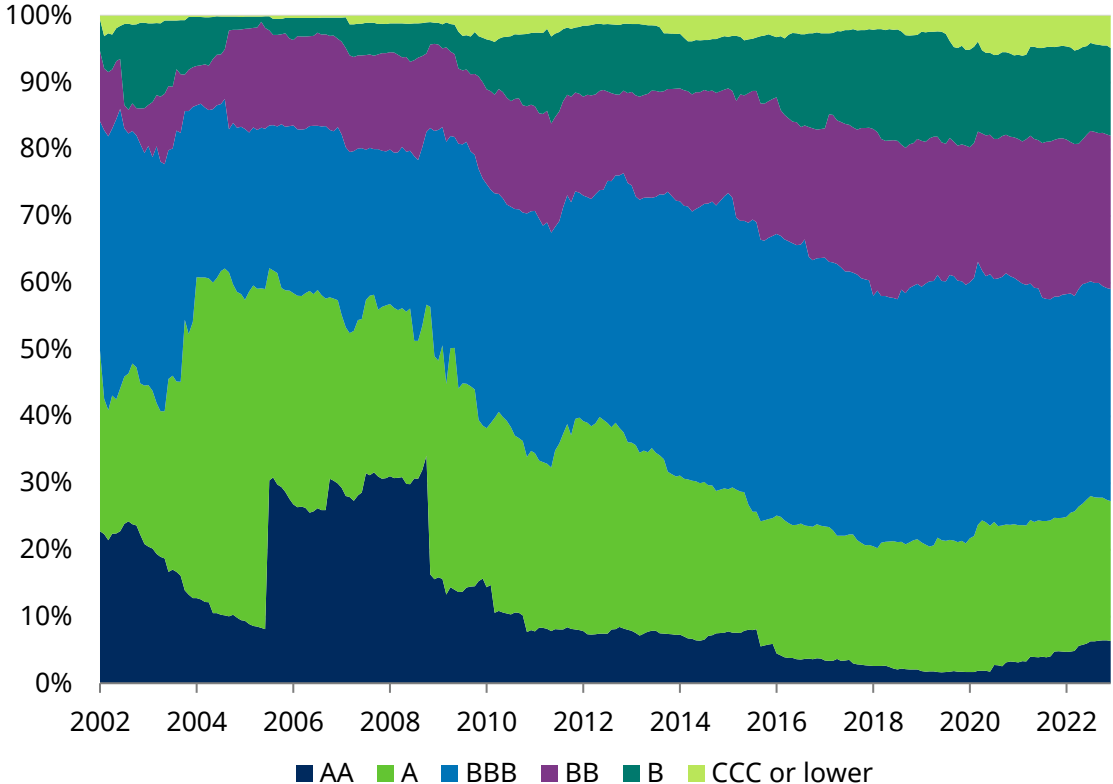
EMD historical ratings split

Share of IG bonds has fallen in the sovereign and corporate indices in the last 10 years

Sovereign EMD ratings split



Corporate EMD ratings split



Source: Schroders, J.P. Morgan. Data as at 31 January 2022.

Characteristics of EM hard currency issuers

Hard currency corporate issuers



■ Financials ■ Nonfinancials

Hard currency sovereign issuers



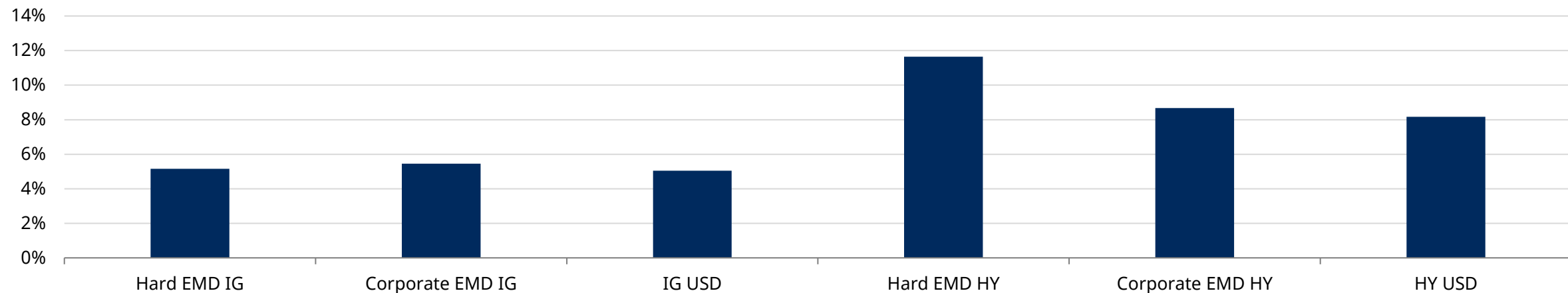
■ Sovereign ■ Quasi Sovereign

Source: Refinitiv Datastream, J.P. Morgan. Data as at 31 January 2022.

Hard and corporate EMD offer a spread and yield 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%	5.5%	5.1%	11.6%	8.7%	8.2%
Spread (bps)	149	175	125	796	493	430
Duration	8.1	5.1	7.2	5.7	3.4	4.5
Rating	A3	A3	A3	B1	B1	B1
Percentage of EMD index	51.0%	57.7%	-	49.0%	42.3%	-

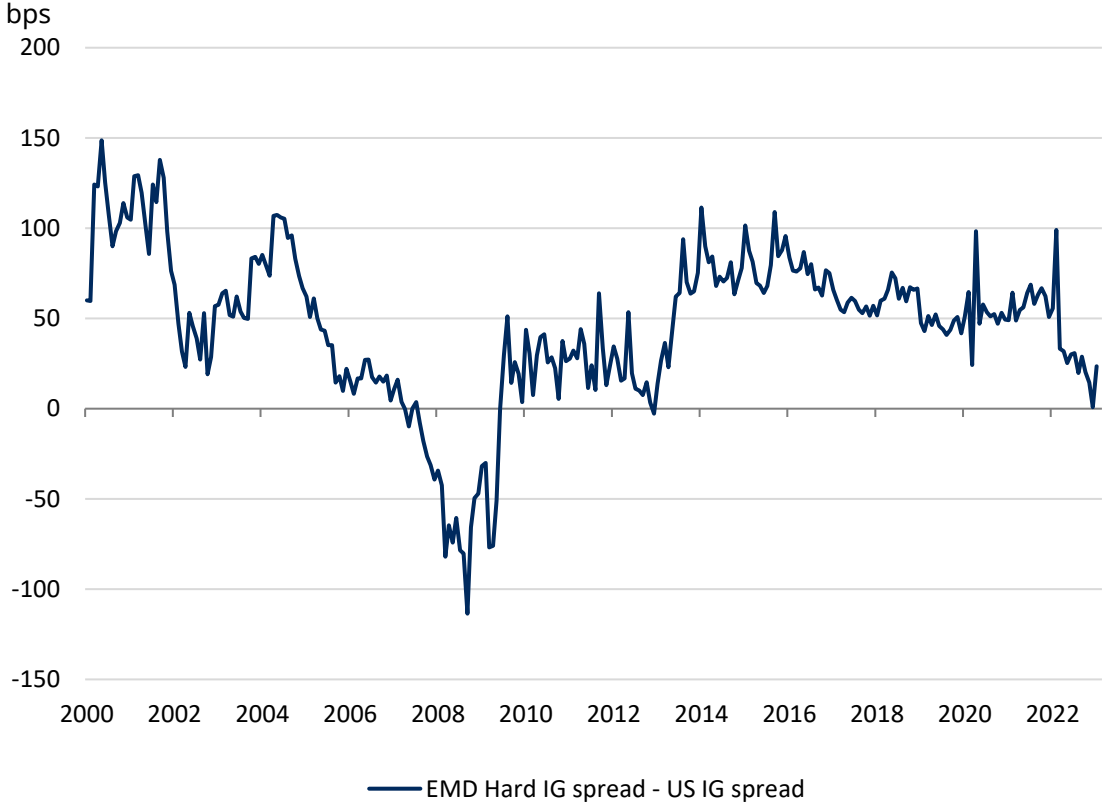
EM vs. DM yields



Source: Schroders, Refinitiv Datastream, ICE Data Indices, J.P. Morgan. Data as at 31 January 2022.

EM dollar debt: sovereign EMD vs. US corporates

Sovereign EMD IG spread minus US IG spread



Sovereign EMD HY spread minus US HY spread

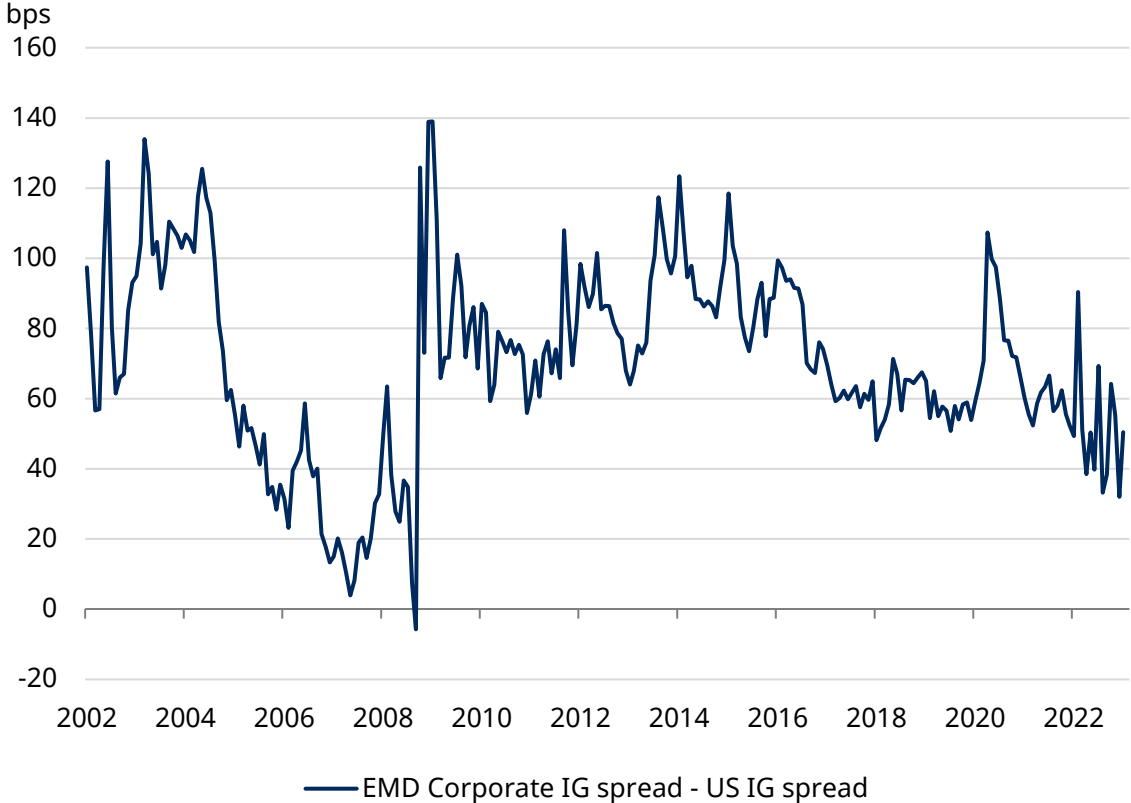


The sovereign EMD IG spread minus US IG spread has bounced from a decade low

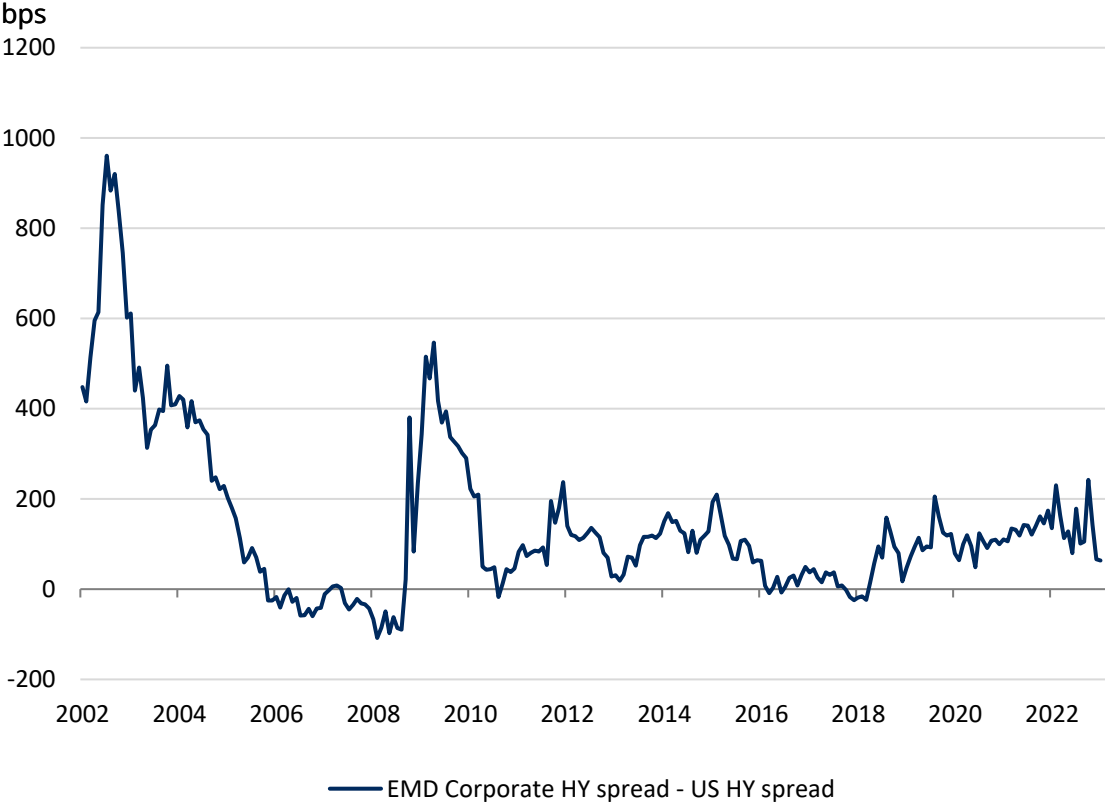
Source: Schroders, Refinitiv Datastream, ICE Data Indices, J.P. Morgan. Data as at 31 January 2022.

EM dollar debt: corporate EMD vs. US corporates

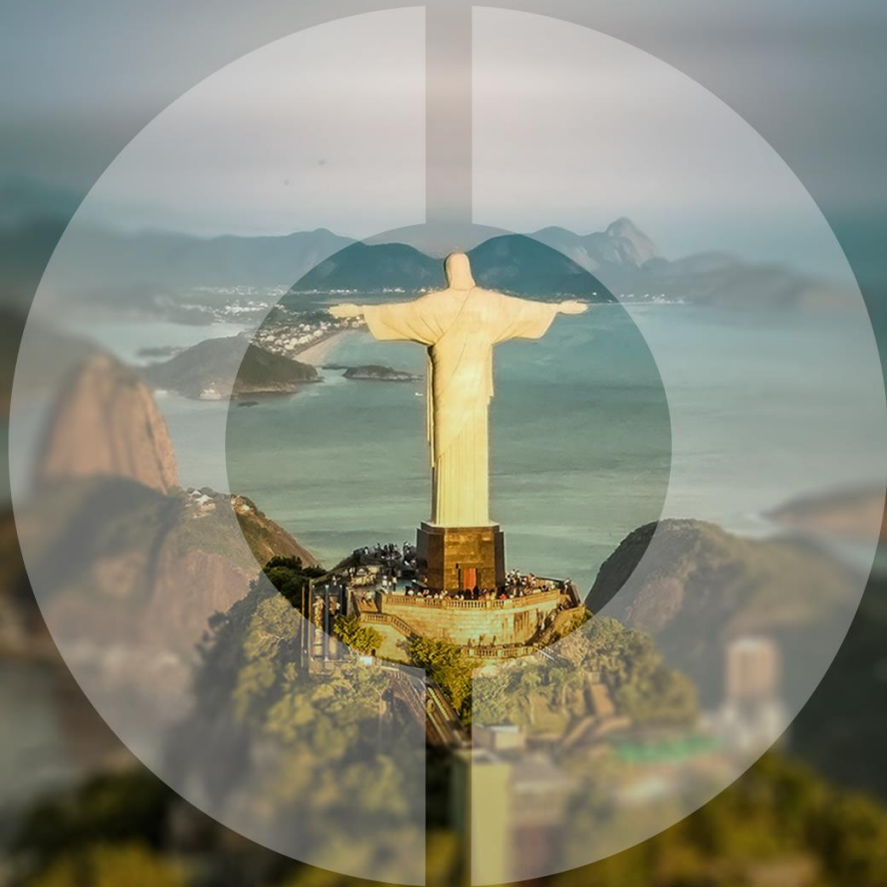
Corporate EMD IG spread minus US IG spread



Corporate EMD HY spread minus US HY spread



Source: Schroders, Refinitiv Datastream, ICE Data Indices, J.P. Morgan. Data as at 31 January 2022.



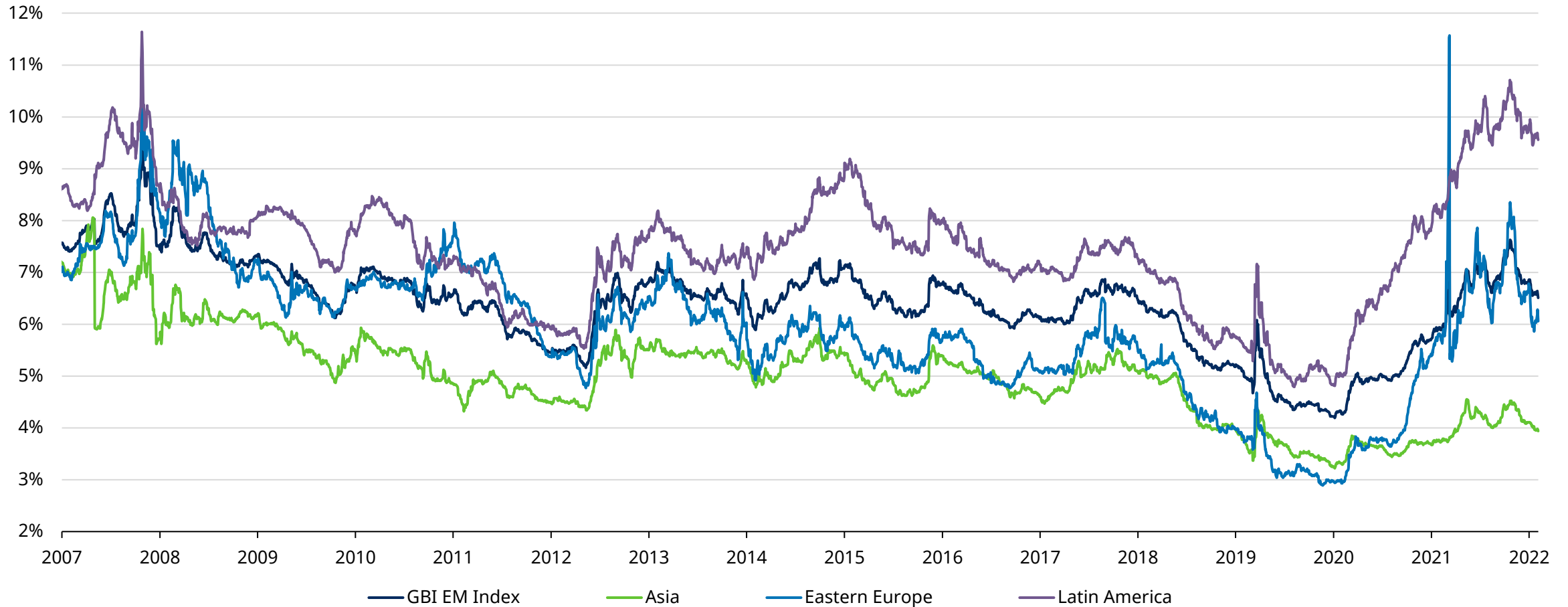
Emerging market debt: local currency

Summary: local currency emerging market debt

- The local currency EM index yield has continued to fall in early 2023, with yields in all three regions moving lower. Since 21 October it has decreased by 1.1%. Currencies have also rallied (see currency section), driving strong performance from local EMD.
- Various EM central banks have continued rate hiking cycles this year. The average EM policy rate is at its highest level since 2008.
- Both headline and core EM inflation remain above target everywhere ex China. However, there are signs of disinflation in certain markets such as Brazil, India and Mexico.
- The real yield premium of EM over DM is at the bottom-end of its post-GFC range. This is primarily due to the sharp decrease in EM real yields over the past 12 months, as inflation has increased by more than nominal yields.

EM local currency index yield has fallen further in early 2023

Yields of EM regions

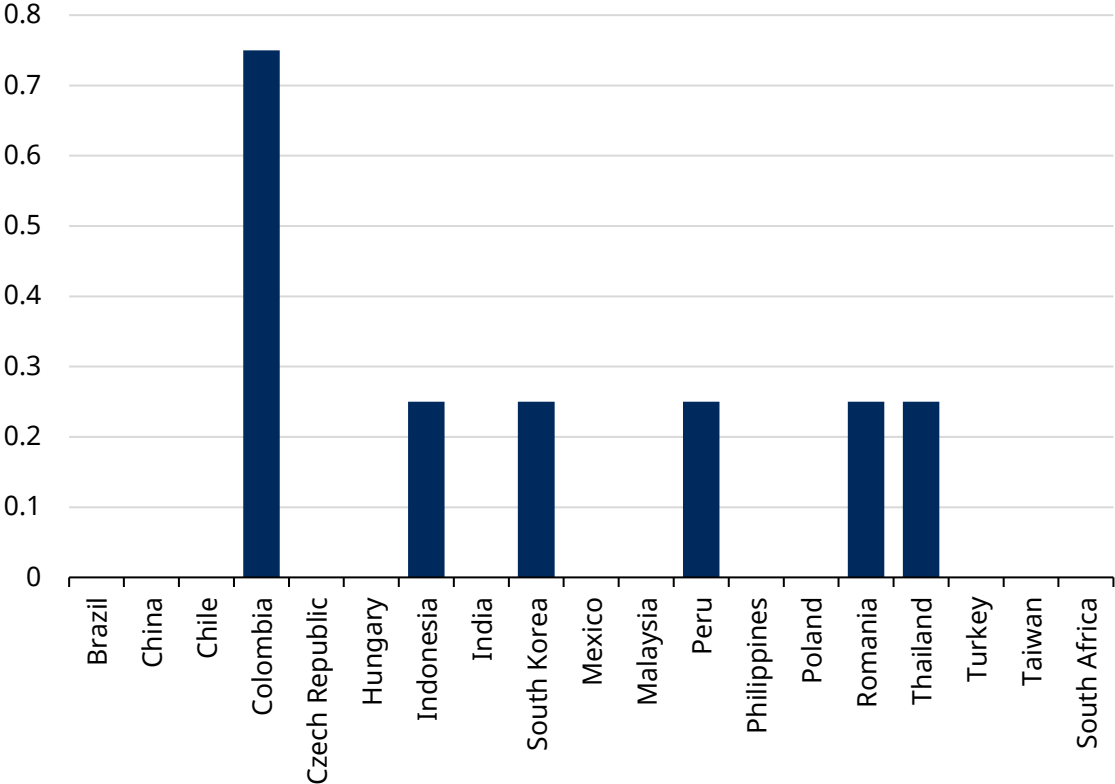


Source: Schroders, Refinitiv Datastream. Data as at 2 February 2023. Russia was removed from all JP Morgan EMD indices from 31 March 2022.

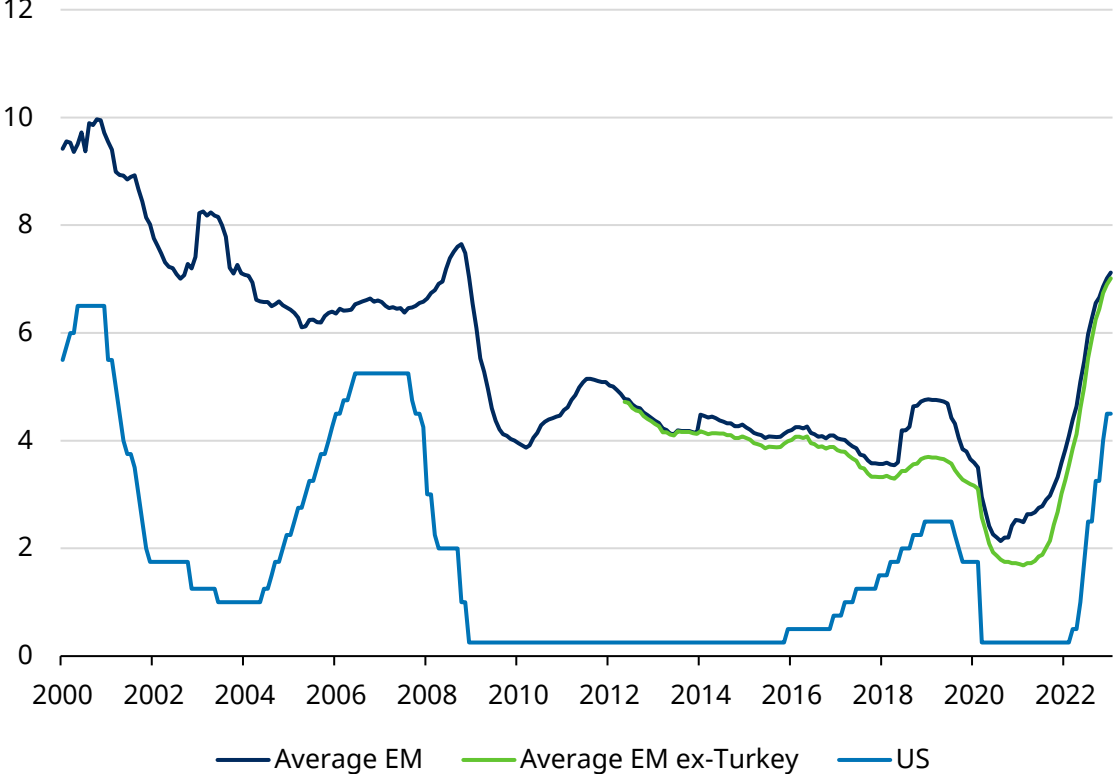
EM policy rates

Average EM policy rate is at its highest since 2008

Change in EM policy rates YTD (%)



Average EM policy rate¹ (%)

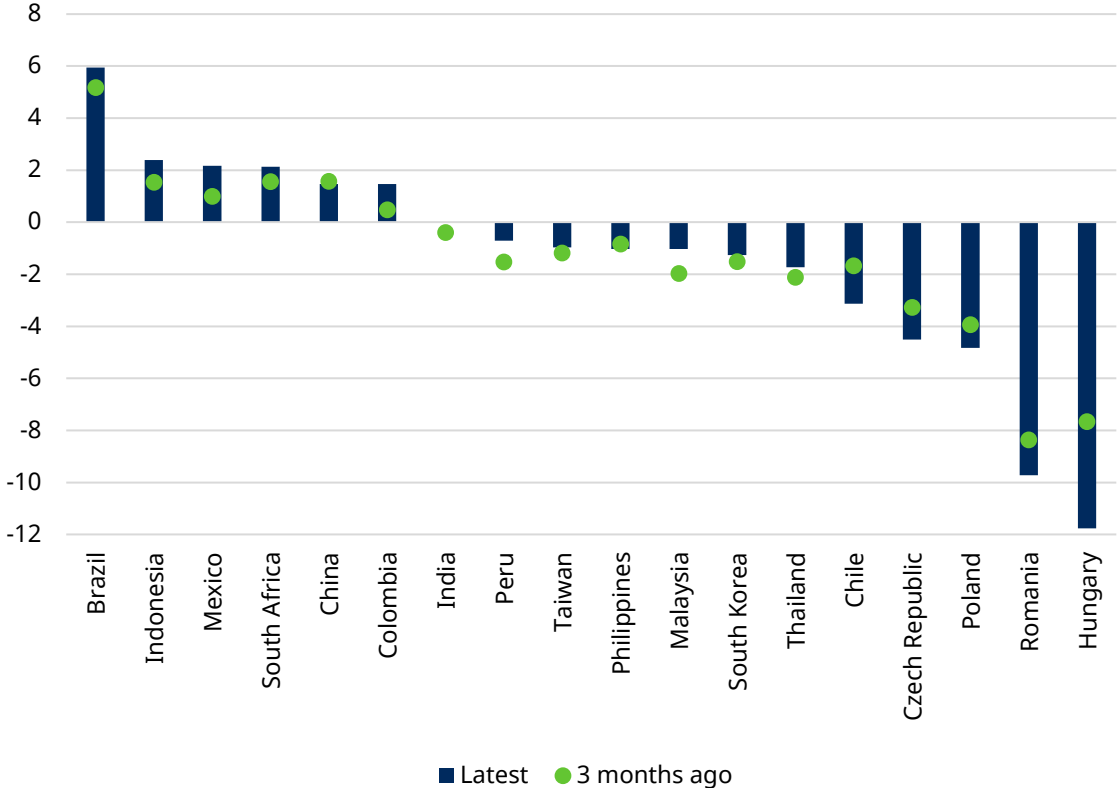


Various EM have continued hiking cycles in early 2023

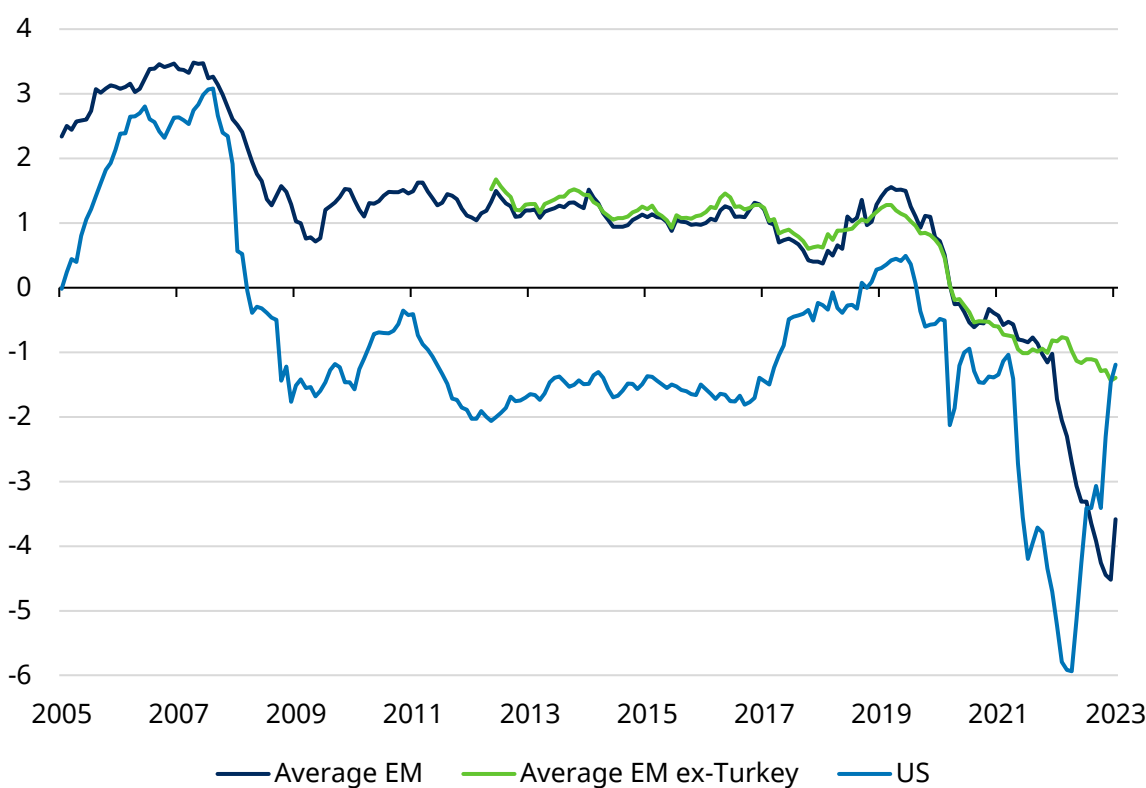
Source: Schrodgers, Refinitiv Datastream. Data as at 31 January 2022. ¹Based on 19 major EM countries.

Many EM real policy rates are still negative

EM real policy rates (%)



Average EM real policy rate¹ (%)



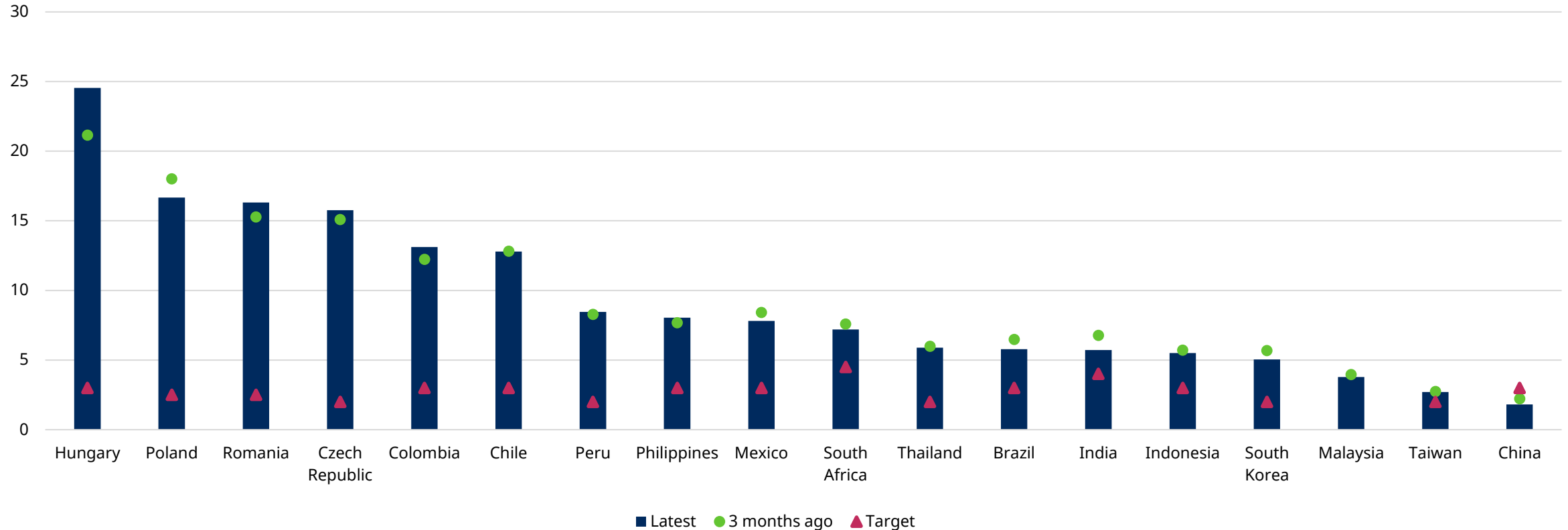
¹Based on 19 major EM countries. Turkey has very high inflation at the moment, with the annual core inflation at 53%. At the same time, Turkey's policy rate is well below inflation at 9%. Hence, Turkey's real policy rate is very negative at -44%, skewing the EM average.

Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022. Nominal policy rate minus annual core inflation.

EM inflation

Headline inflation is above target everywhere ex China

Headline inflation (%)



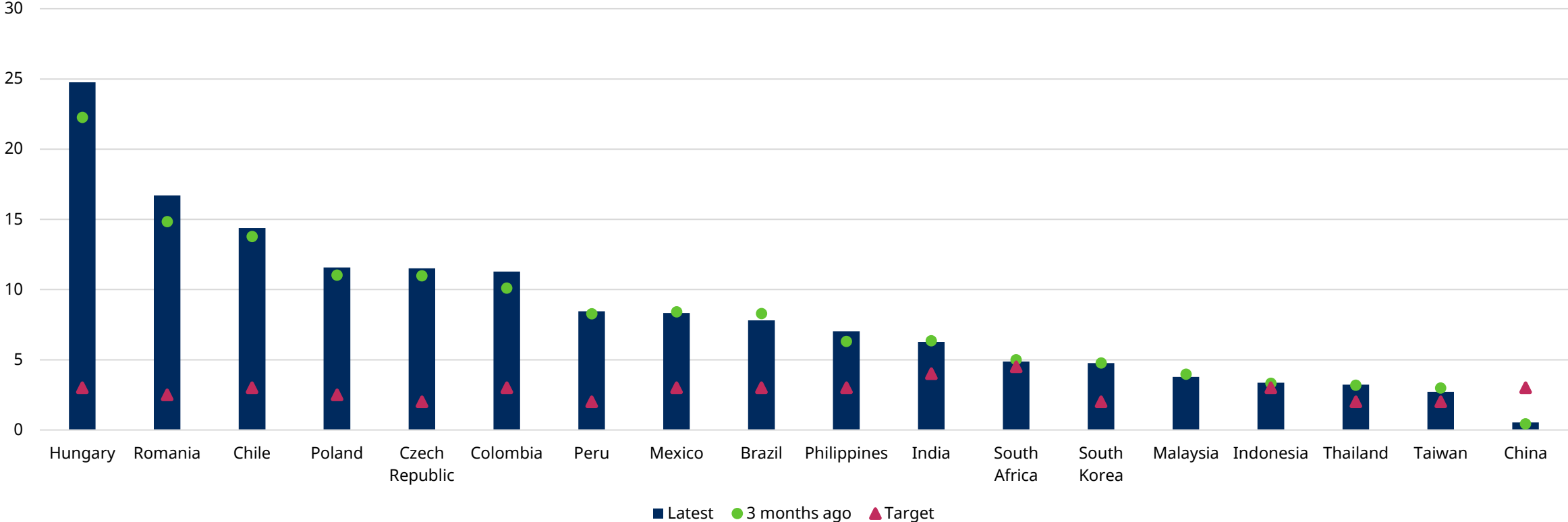
Inflation in EM Asia has been lower compared to other EM regions

Turkey's annual headline inflation (58%) omitted from the figure.
Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

EM core inflation

Core inflation is also above target in most EM ex China

Core inflation (%)

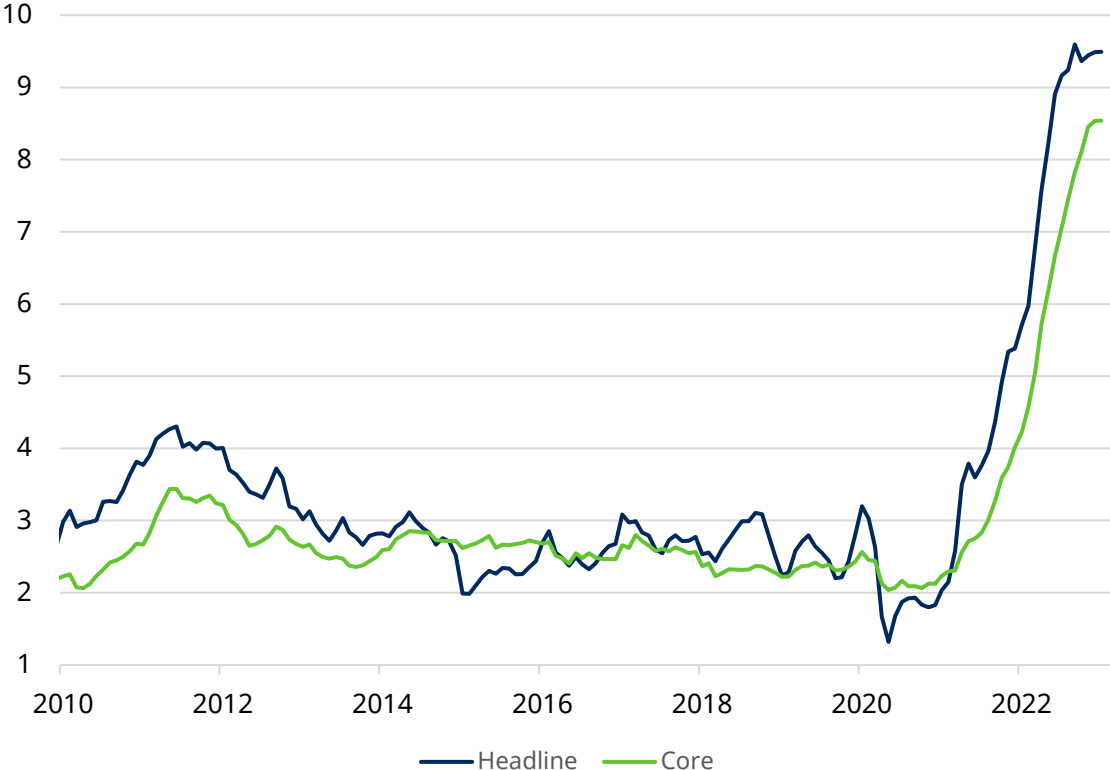


Turkey's annual core inflation (53%) omitted from the figure.
Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

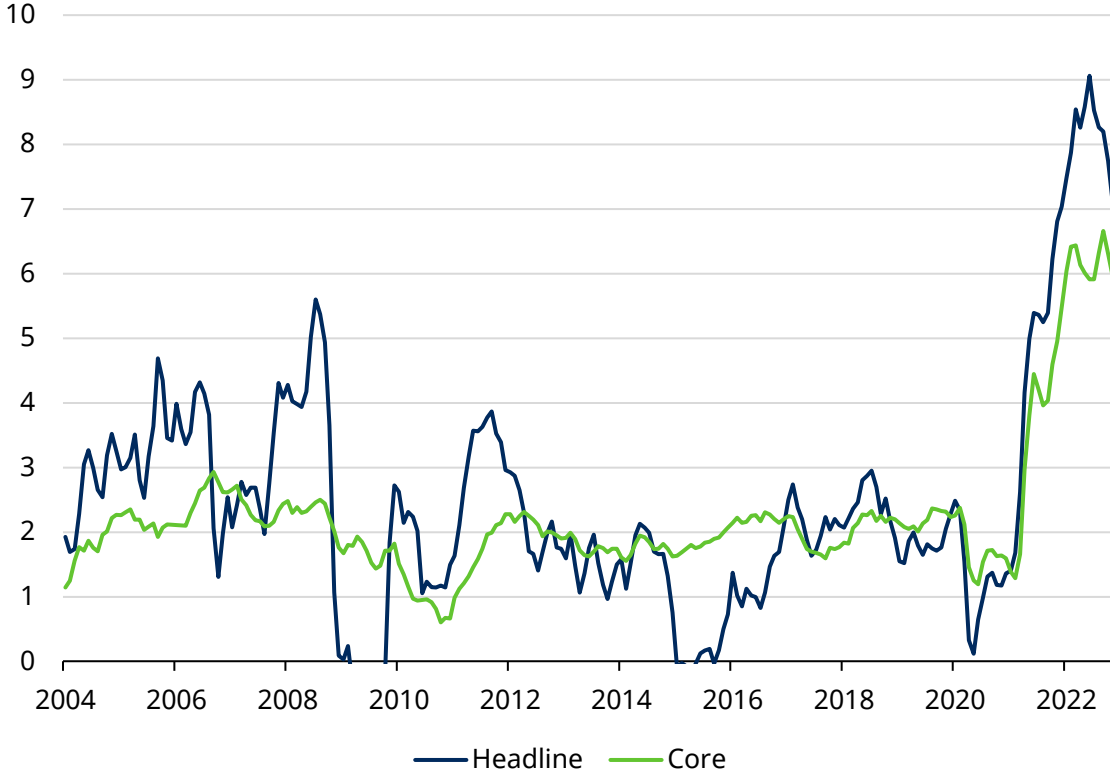
Is EM inflation peaking?

Headline US inflation has peaked, is EM inflation also set to moderate?

Average EM inflation ex Turkey¹ (%)



US inflation (%)

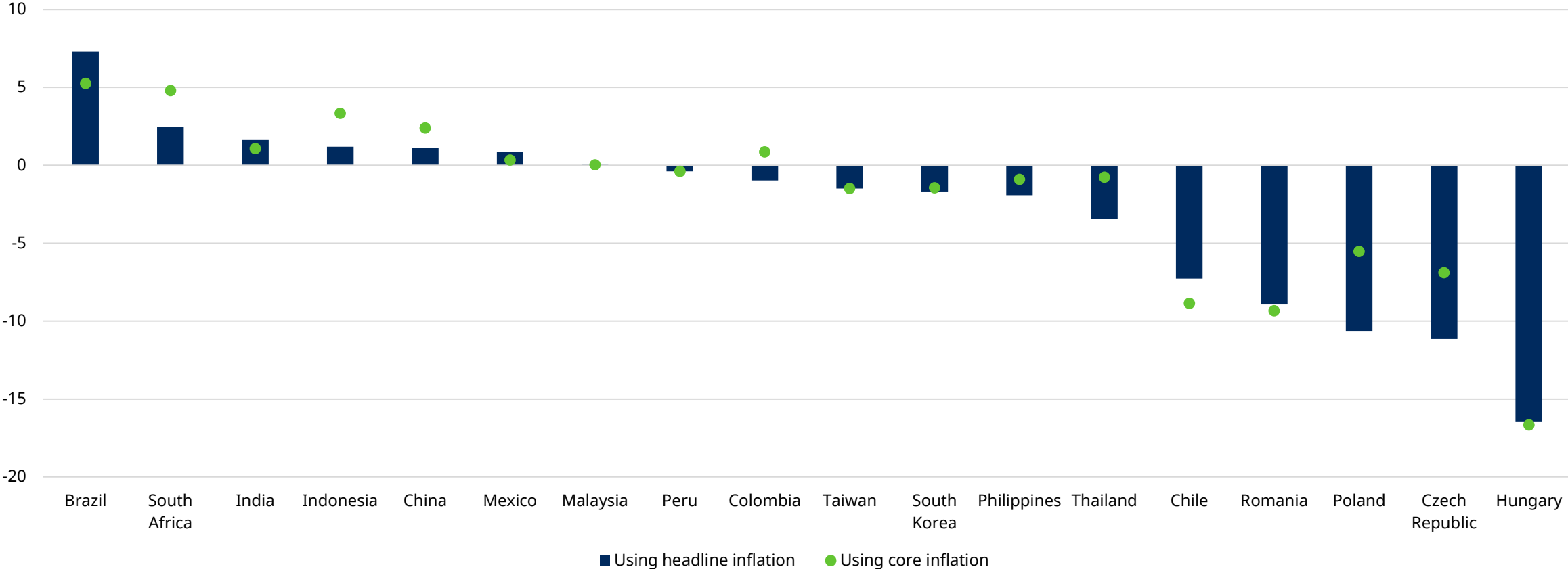


¹Based on 19 major EM countries. Turkey excluded because of significantly higher inflation in the country compared to the rest of the EM. Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

Real bond yields are deeply negative in certain EM

EM Europe real bond yields are firmly negative relative to core inflation

Real 10 year yield



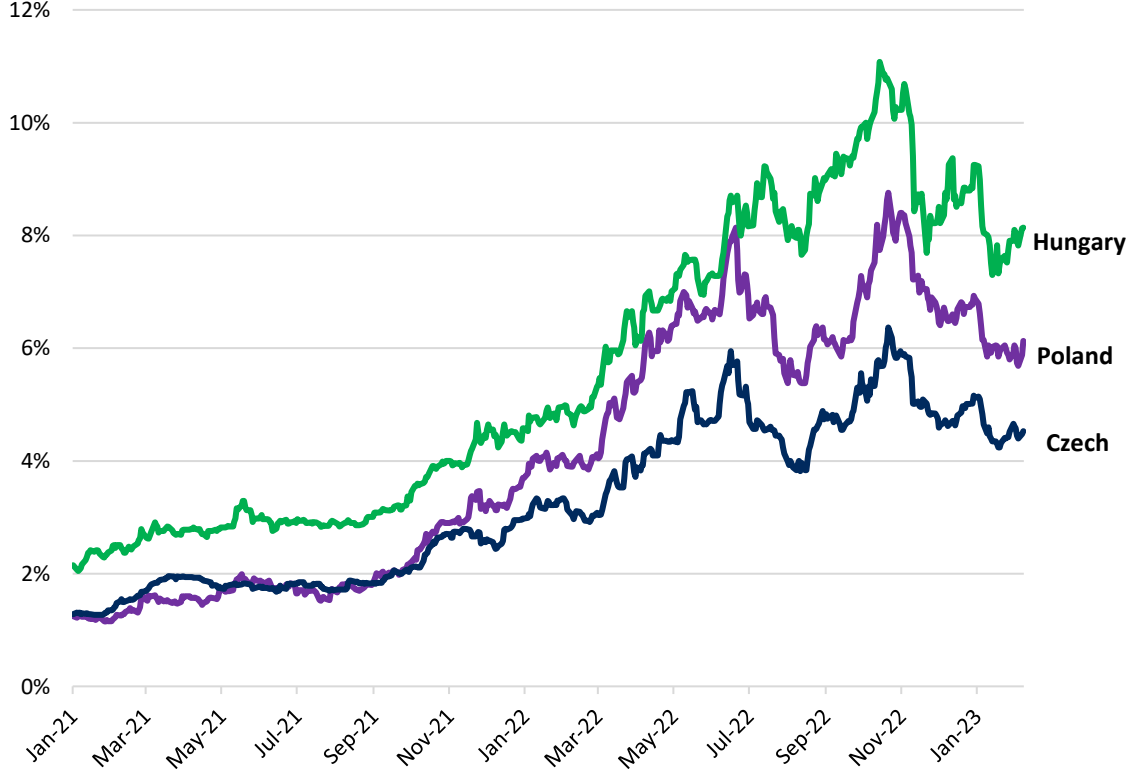
Real bond yields are notably positive in Brazil

Nominal 10 year yield minus annual headline or core inflation
Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

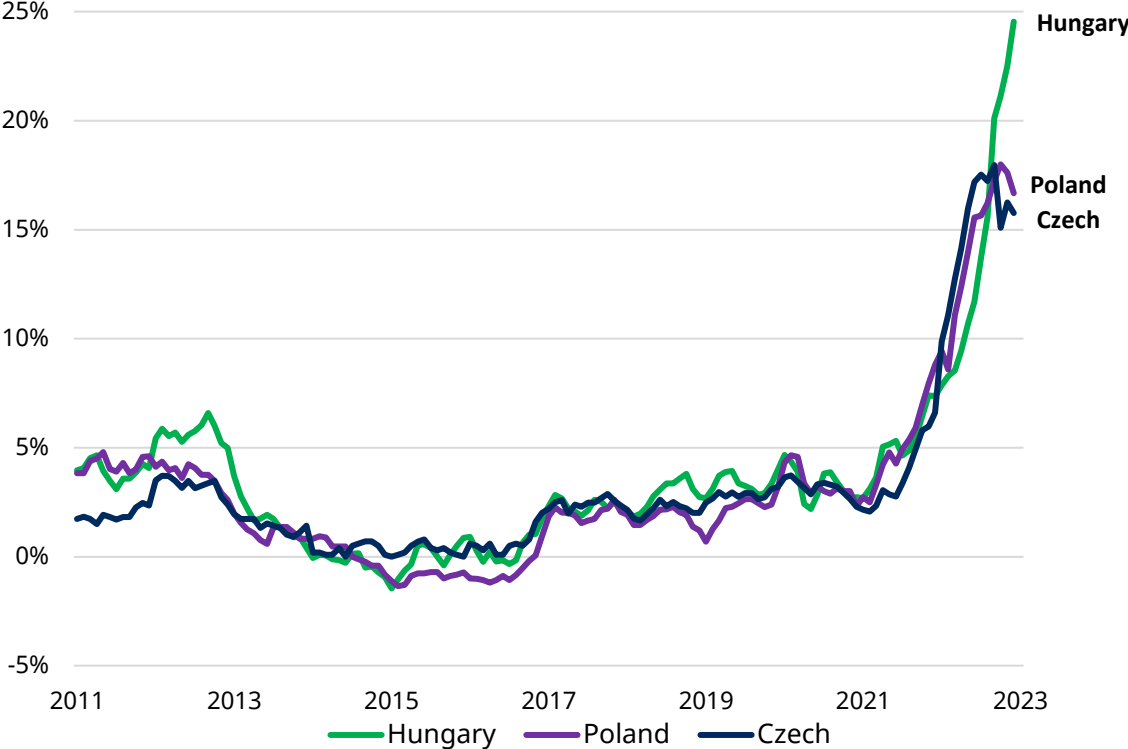
Inflation is much higher than bond yields in EM Europe

Signs of headline inflation peaking in some EM Europe markets, but not in Hungary

Poland, Hungary, Czech 10 year yields



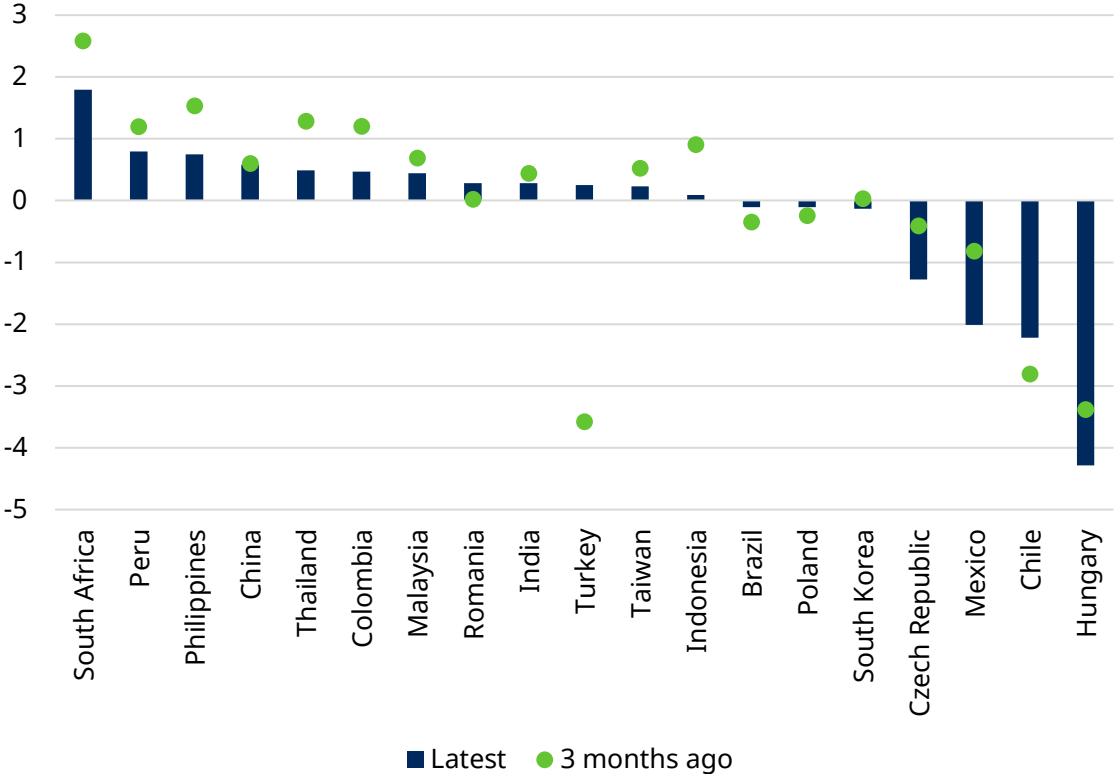
Poland, Hungary, Czech headline inflation



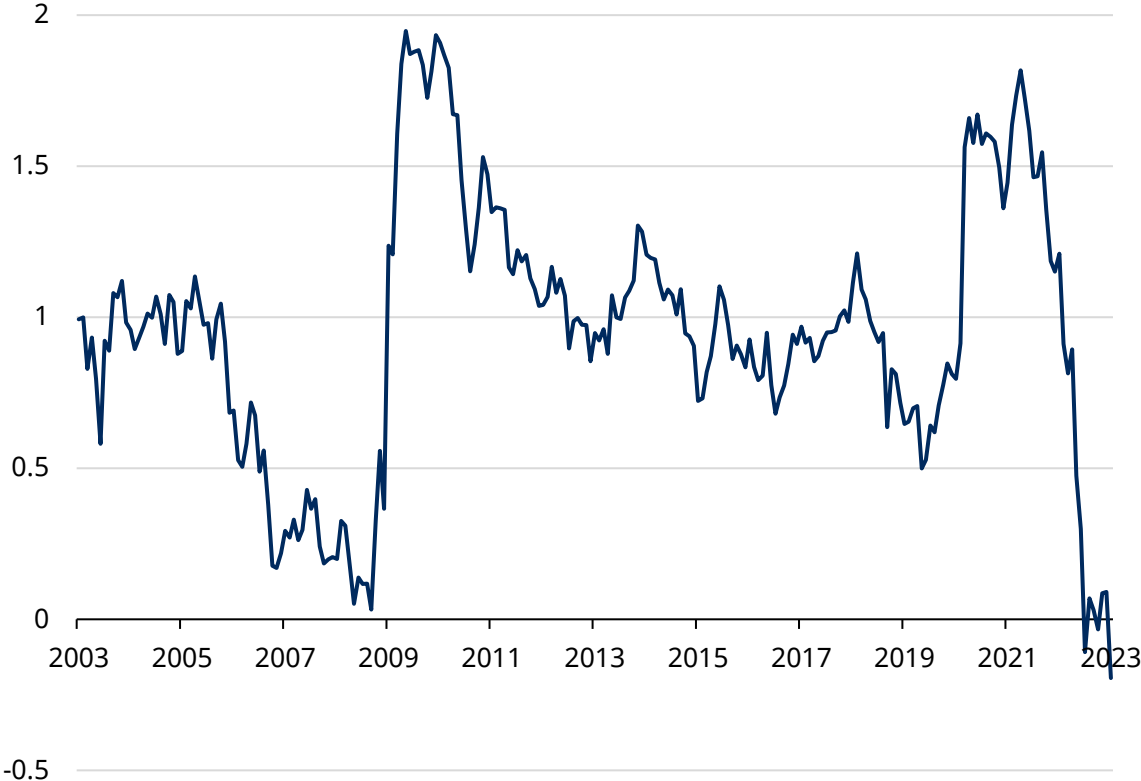
Source: Schroders, Refinitiv Datastream. Data as at 7 February 2023.

EM yield curve shape

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



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



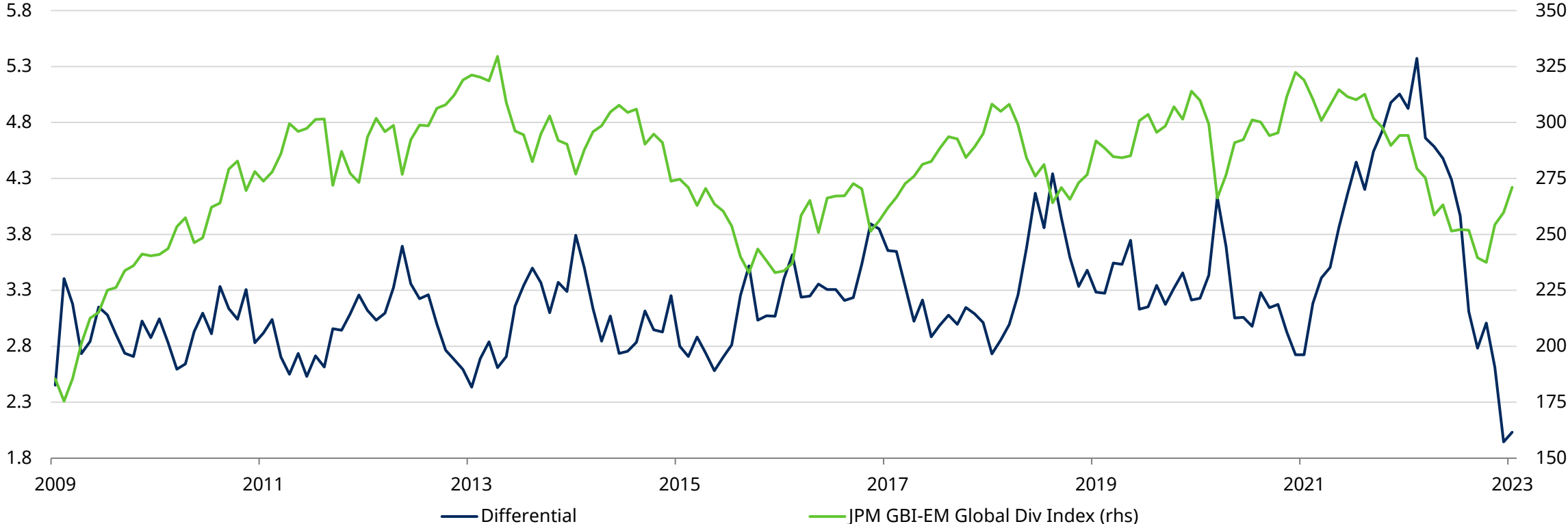
Most EM yield curves are flattening as central banks are hiking short-term interest rates

¹Based on 19 major EM countries.
Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

EM/DM real yield differential

EM local currency bond valuation

EM/DM real yield differential (%)



Real yield differential has fallen to a post-GFC low

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

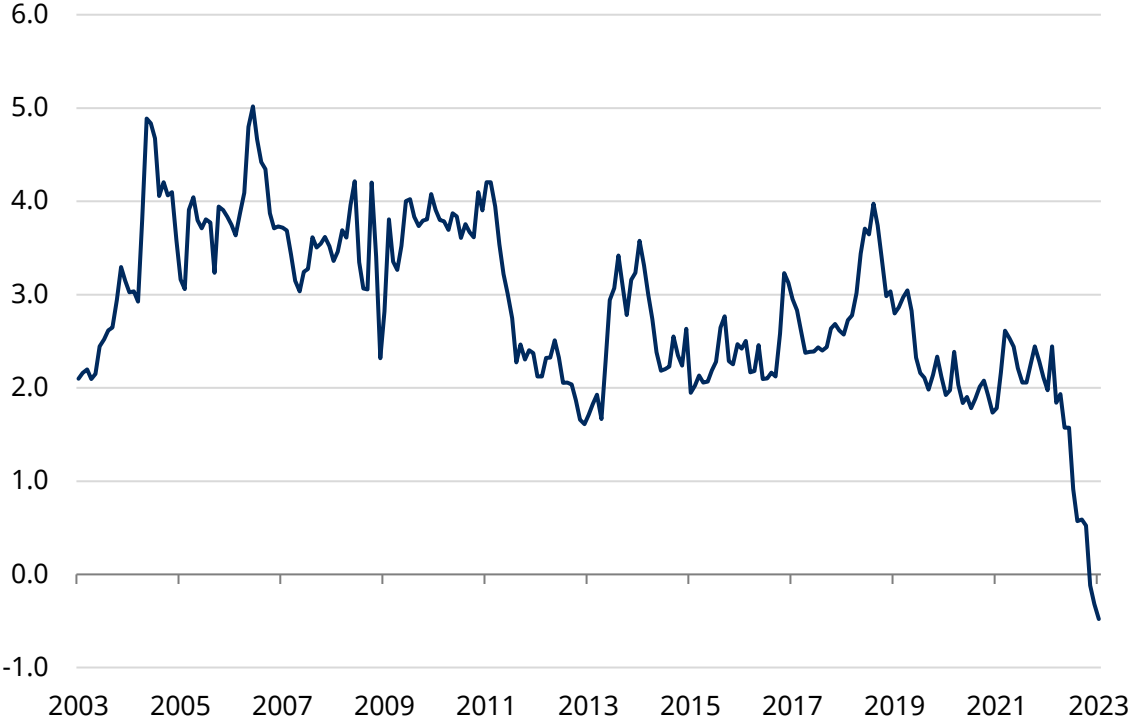
EM real yield is weighted average of individual JPM GBI-EM index nominal yields deflated by core inflation. DM real yield is 5Y government bond yields of US, UK, Euro zone, Japan deflated by core inflation, weighted by the size of individual government bond market.

Source: Schroders, Refinitiv Datastream, ICE Data Indices, J.P. Morgan. Data as at 31 January 2022.

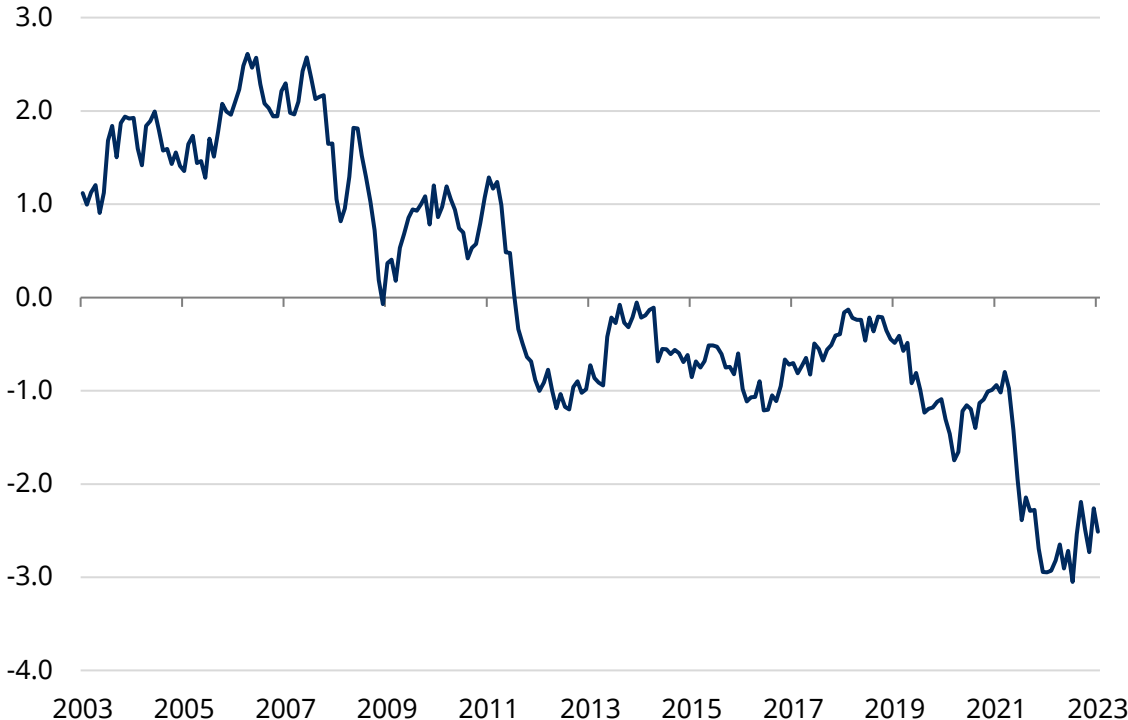
EM and DM real yields

Individual drivers of the real yield differential

EM real yield (%)

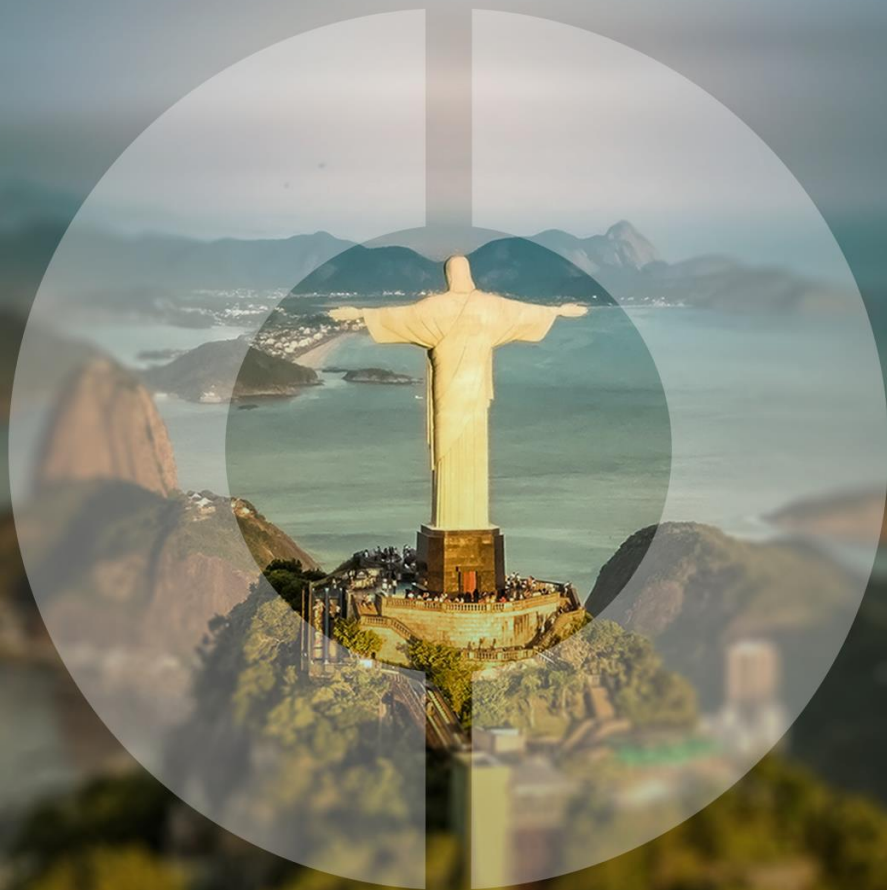


DM real yield (%)



EM real yield has moved into negative territory; despite a move up DM real yield remains negative

Source: Schroders, Refinitiv Datastream, ICE Data Indices, J.P. Morgan. Data as at 31 January 2022. 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.



Emerging market currencies

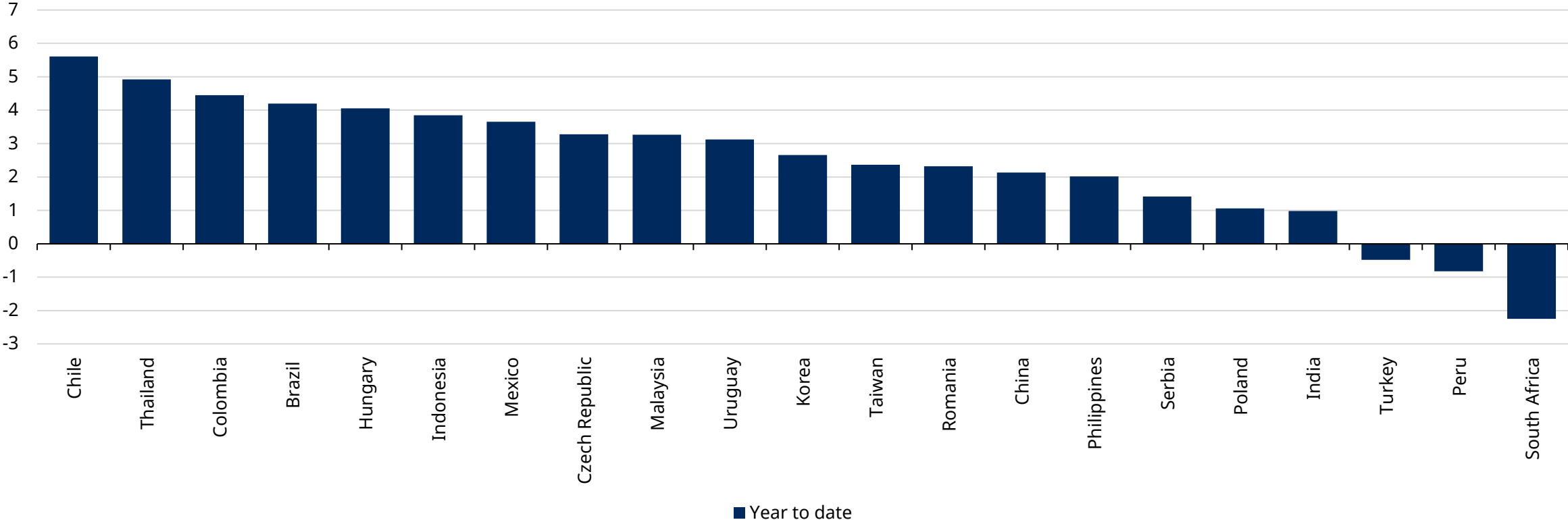
Summary: emerging market currencies

- A majority of EM currencies have appreciated against the US dollar YTD. Even so, a number of EM currencies remain significantly undervalued.
- The degree of value in EM currencies varies significantly. There are undervalued currencies in all three EM regions.
- The Czech koruna is notably above its long term average. Currencies in India, Romania and China are slightly expensive versus history. Uruguay, Serbia, and Colombia are the cheapest EM currencies.
- EM FX carry, the strategy of buying higher-yielding EM currencies against lower-yielding currencies to earn the interest rate differential, made a comeback because of EM rate hikes but is now fading.

EM currency performance vs US dollar

Most EM currencies have appreciated against the US dollar YTD

EM currency returns (%)



A contrast to 2022 when most depreciated

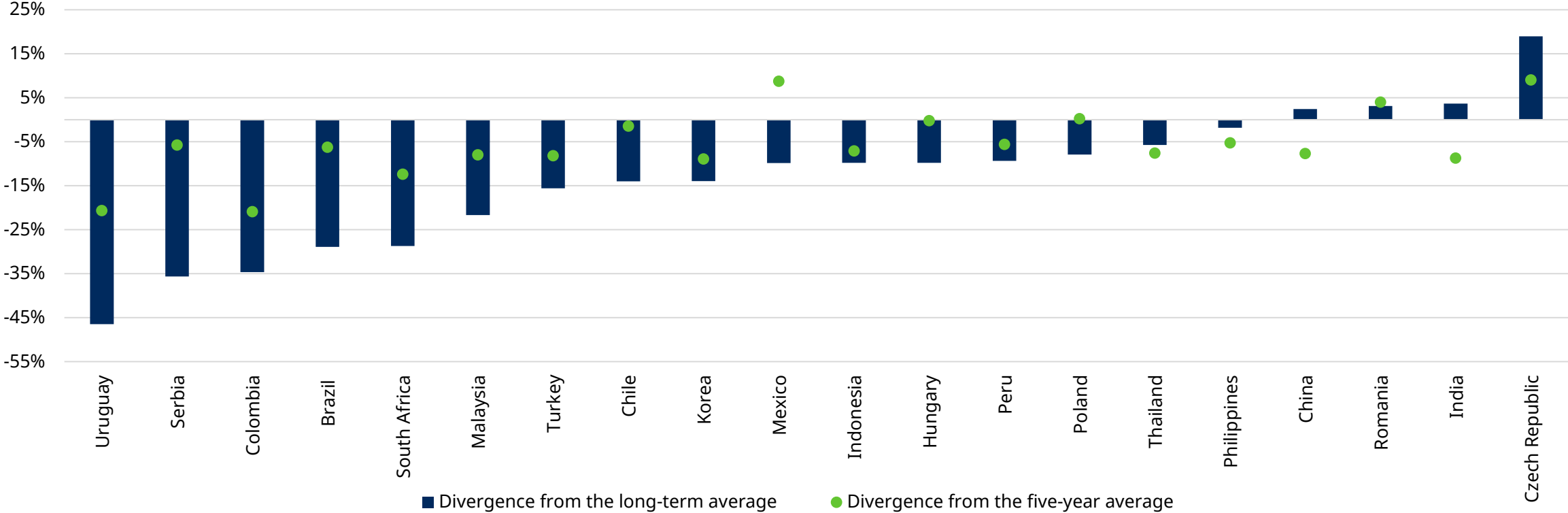
Past performance is not a guide to future performance and may not be repeated.

Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

EM currency value

Some currencies are significantly undervalued

Real exchange rate: deviation from average



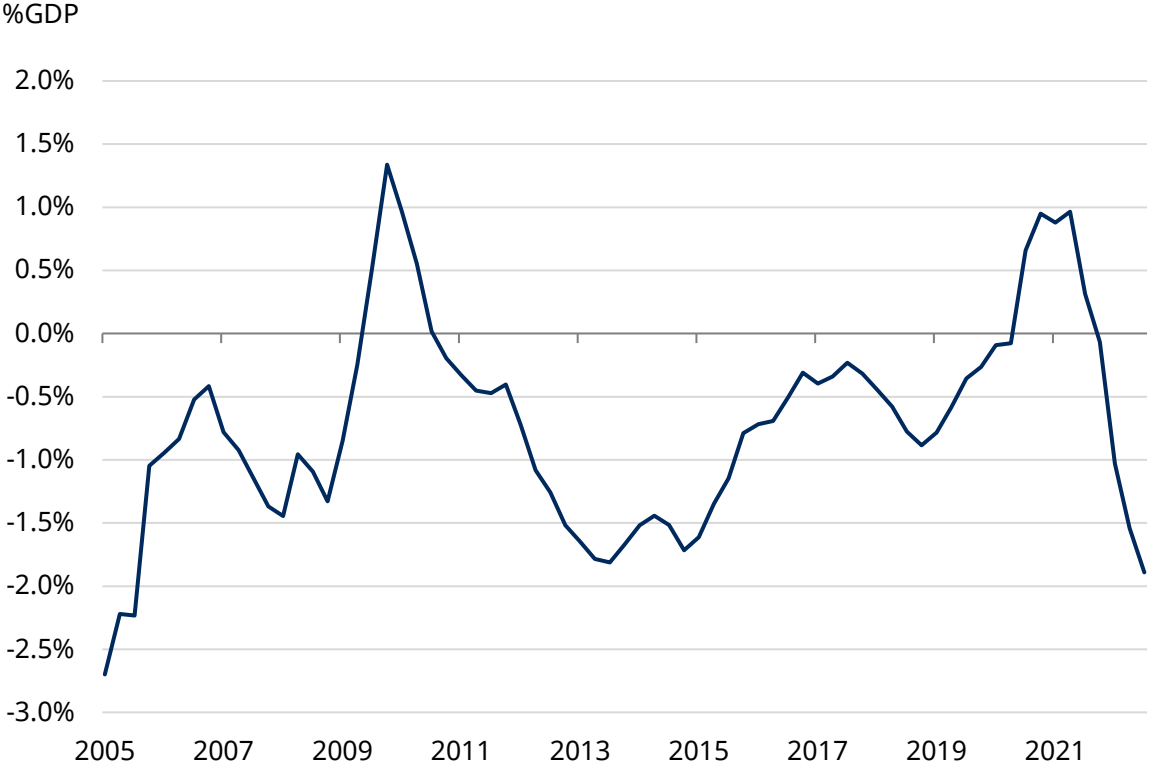
Uruguay, Serbia, and Colombia have the cheapest currencies

Source: Schroders, Refinitiv Datastream. Data as at 31 January 2021. 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.

EM fundamentals: current account vs. currency valuation

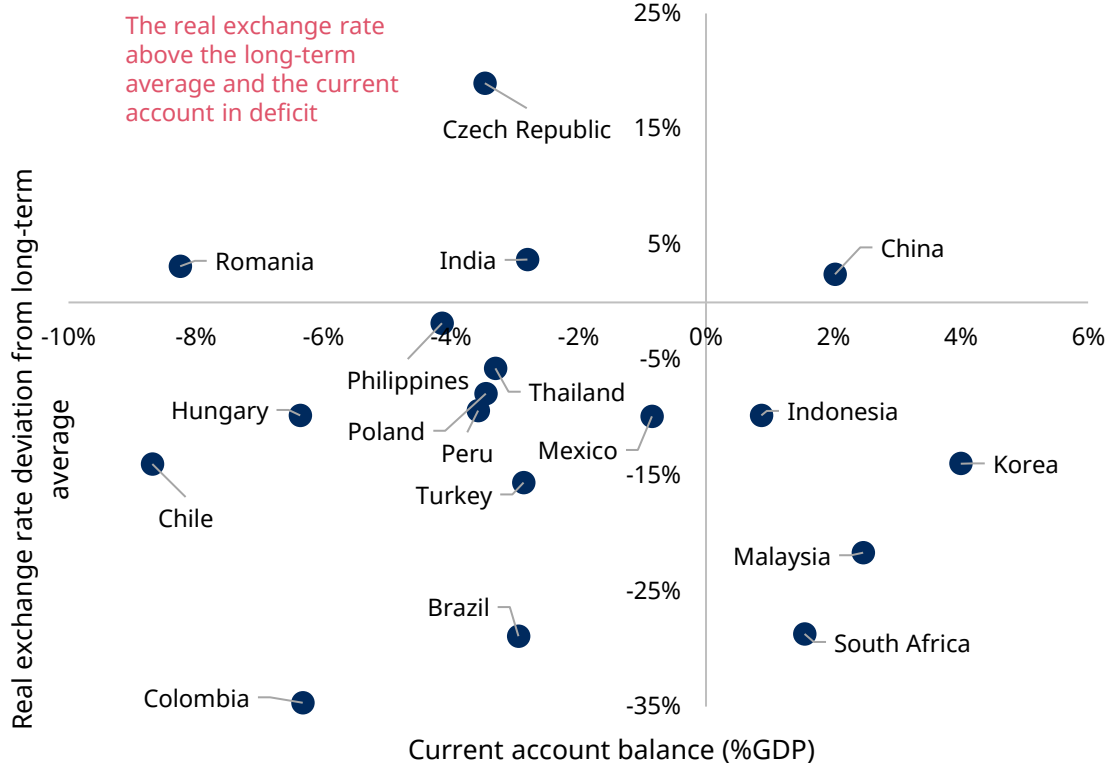
Current accounts of commodity importers have deteriorated

Average EM current account balance¹



EM currency value² vs. current account balance

Real exchange rate deviation from long-term average

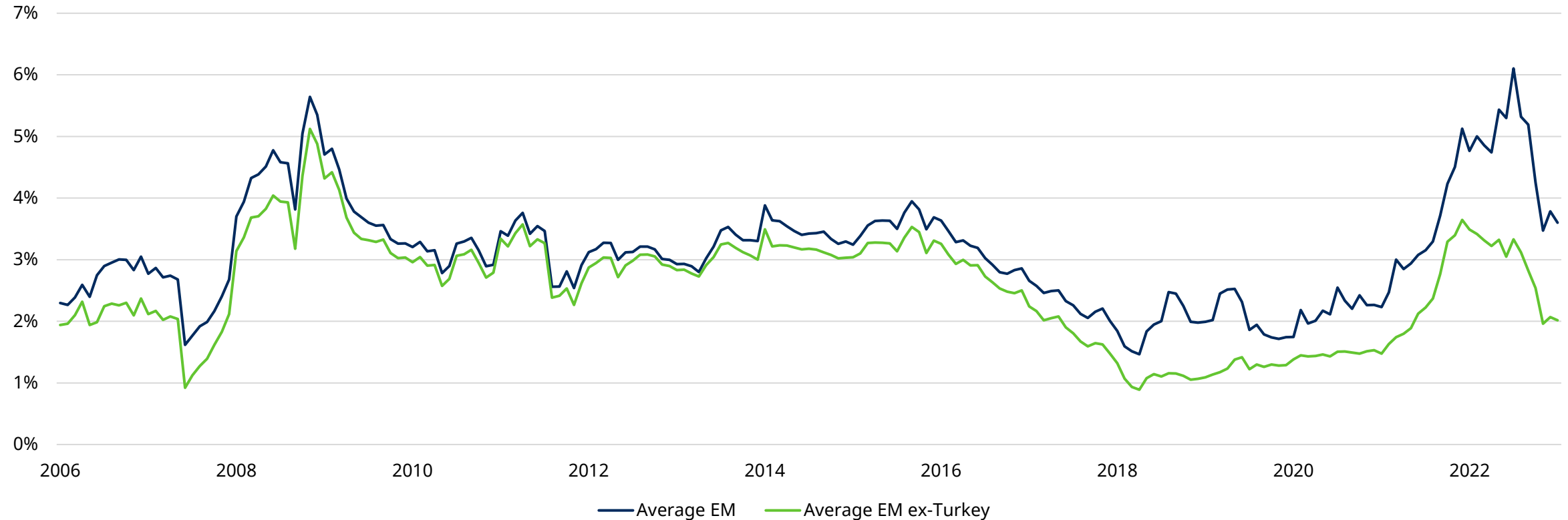


Czech Republic, Romania, and India are most vulnerable to currency weakness

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, Refinitiv Datastream. Current account data as at Q3 2022, currency value data as at 31 January 2022.

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

Average EM carry¹

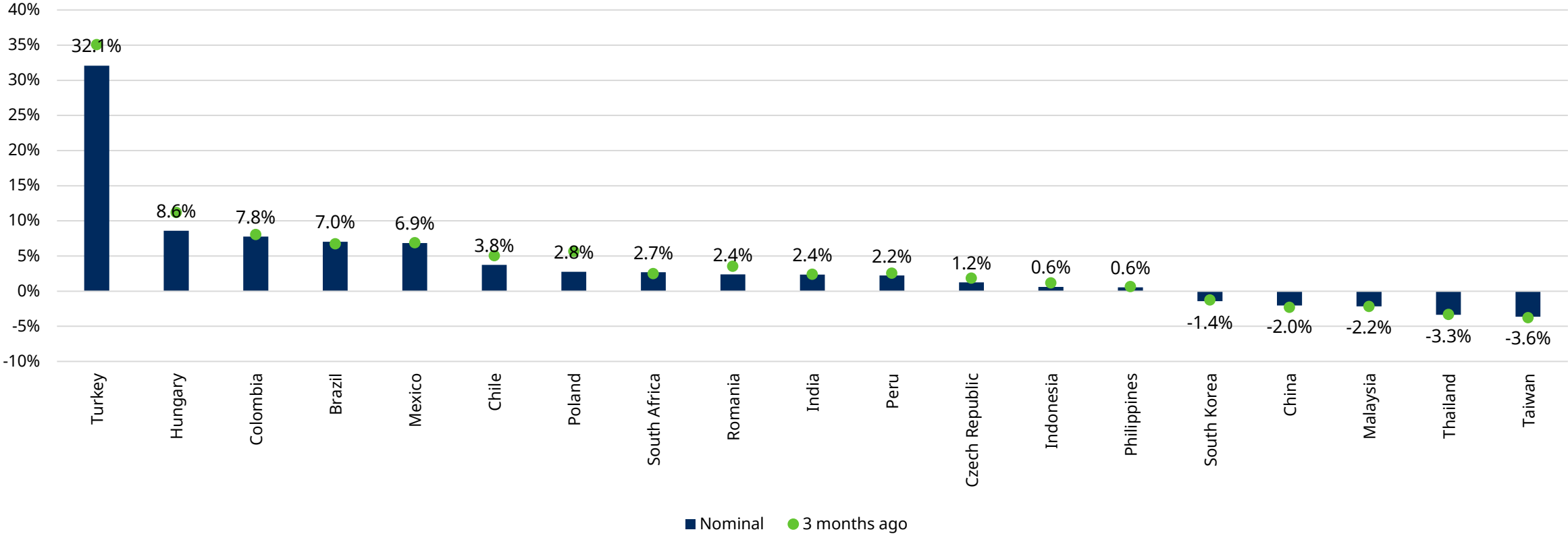


EM carry has stabilised in recent months

¹The return of holding 1-year FX forward vs US dollar to maturity. Based on 19 major EM countries. Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

FX Carry varies significantly between the countries

EM FX carry¹



¹The return of holding 1-year FX forward vs. US dollar to maturity.
Source: Schroders, Refinitiv Datastream. Data as at 31 January 2022.

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

Important information (1 of 3)

Marketing material for professional investors or advisers only. It is not to be provided to retail clients.

The views and opinions contained herein are those of the authors as at the date of publication and are subject to change due to market and other conditions. Such views and opinions may not necessarily represent those expressed or reflected in other Schroders communications, strategies or funds.

This presentation is intended to be for information purposes only. The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument or security or to adopt any investment strategy. The information provided is not intended to constitute investment advice, an investment recommendation or investment research and does not take into account specific circumstances of any recipient. The material is not intended to provide, and should not be relied on for, accounting, legal or tax advice. Any references to securities, sectors, regions and/or countries are for illustrative purposes only.

Information herein is believed to be reliable but Schroders does not represent or warrant its completeness or accuracy. No responsibility or liability is accepted by Schroders, its officers, employees or agents for errors of fact or opinion or for any loss arising from use of all or any part of the information in this document. No reliance should be placed on the views and information in the document when taking individual investment and/or strategic decisions. Schroders has no obligation to notify any recipient should any information contained herein change or subsequently become inaccurate. Unless otherwise authorised by Schroders, any reproduction of all or part of the information in this document is prohibited.

Any data contained in this document have been obtained from sources we consider to be reliable. Schroders has not independently verified or validated such data and they should be independently verified before further publication or use. Schroders does not represent or warrant the accuracy or completeness of any such data.

All investing involves risk including the possible loss of principal.

This material has not been reviewed by the regulators.

Exchange rate changes may cause the value of any overseas investments to rise or fall. Past Performance is not a guide to future performance and may not be repeated. This document may contain “forward-looking” information, such as forecasts or projections. Please note that any such information is not a guarantee of any future performance and there is no assurance that any forecast or projection will be realised. For your security, communications may be taped or monitored.

Third party data is owned or licensed by the data provider and may not be reproduced or extracted and used for any other purpose without the data provider's consent. Third party data is provided without any warranties of any kind. The data provider and issuer of the document shall have no liability in connection with the third party data. The Prospectus and/or www.schroders.com contains additional disclaimers which apply to the third party data.

The forecasts stated in this presentation are the result of statistical modelling, based on a number of assumptions. Forecasts are subject to a high level of uncertainty regarding future economic and market factors that may affect actual future performance. The forecasts are provided to you for information purposes as at today's date. Our assumptions may change materially with changes in underlying assumptions that may occur, among other things, as economic and market conditions change. We assume no obligation to provide you with updates or changes to this data as assumptions, economic and market conditions, models or other matters change.

Important information (2 of 3)

For readers/viewers in Argentina: Schroder Investment Management S.A., Ing. Enrique Butty 220, Piso 12, C1001AFB - Buenos Aires, Argentina. Registered/Company Number 15. Registered as Distributor of Investment Funds with the CNV (Comisión Nacional de Valores). Nota para los lectores en Argentina: Schroder Investment Management S.A., Ing. Enrique Butty 220, Piso 12, C1001AFB - Buenos Aires, Argentina. Inscripto en el Registro de Agentes de Colocación y Distribución de PIC de FCI de la Comisión Nacional de Valores con el número 15.

Note to readers/viewers in Australia: Issued by Schroder Investment Management Australia Limited Level 20, Angel Place, 123 Pitt Street, Sydney NSW 2000 Australia ABN 22 000 443 274, AFSL 226473

For readers/viewers in Brazil: Schroder Investment Management Brasil Ltda., Rua Joaquim Floriano, 100 – cj. 142 Itaim Bibi, São Paulo, 04534-000 Brasil. Registered/Company Number 92.886.662/0001-29. Authorised as an asset manager by the Securities and Exchange Commission of Brazil/Comissão de Valores Mobiliários (“CVM”) according to the Declaratory Act number 6816.

For readers/viewers in the European Union/European Economic Area: Schroders will be a data controller in respect of your personal data. For information on how Schroders might process your personal data, please view our Privacy Policy available at www.schroders.com/en/privacy-policy or on request should you not have access to this webpage. Issued by Schroder Investment Management (Europe) S.A., 5, rue Höhenhof, L-1736 Senningerberg, Luxembourg. Registered No. B 37.799

Note to readers/viewers in Hong Kong S.A.R.: Issued by Schroder Investment Management (Hong Kong) Limited. Level 33, Two Pacific Place, 88 Queensway, Hong Kong. This material has not been reviewed by the Securities and Futures Commission.

Note to readers/viewers in Indonesia: Issued by PT Schroder Investment Management Indonesia Indonesia Stock Exchange Building Tower 1, 30th Floor, Jalan Jend. Sudirman Kav 52-53 Jakarta 12190 Indonesia PT Schroder Investment Management Indonesia is licensed as an Investment Manager and regulated by the Indonesian Financial Services Authority (OJK). This material has not been reviewed by the OJK.

For readers/viewers in Israel: Note regarding the Marketing material for Qualified Clients or Sophisticated Investors only. This communication has been prepared by certain personnel of Schroder Investment Management (Europe) S.A (Registered No. B 37.799) or its subsidiaries or affiliates (collectively, ‘SIM’). Such personnel are not licensed by the Israeli Securities Authority. Such personnel may provide investment marketing, to the extent permitted and in accordance with the Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management Law, 1995 (the ‘Investment Advice Law’). This communication is directed at persons (i) who are Sophisticated Investors (ii) Qualified Clients (‘Lakoach Kashir’) as such term is defined in the Investment Advice Law; and (iii) other persons to whom it may otherwise lawfully be communicated. No other person should act on the contents or access the products or transactions discussed in this communication. In particular, this communication is not intended for retail clients and SIM will not make such products or transactions available to retail clients.

Note to readers/viewers in Japan: Issued by Schroder Investment Management (Japan) Limited 21st Floor, Marunouchi Trust Tower Main, 1-8-3 Marunouchi, Chiyoda-Ku, Tokyo 100-0005, Japan Registered as a Financial Instruments Business Operator regulated by the Financial Services Agency of Japan (“FSA”). Kanto Local Finance Bureau (FIBO) No. 90 This material has not been reviewed by the FSA.

Note to readers/viewers in Singapore: For Accredited and or Institutional Clients only, where appropriate Issued by Schroder Investment Management (Singapore) Ltd (Co. Reg. No. 199201080H) 138 Market Street #23-01 CapitaGreen, Singapore 048946 This advertisement or publication has not been reviewed by the Monetary Authority of Singapore

Important information (3 of 3)

Note to readers/viewers in South Korea: Issued by Schroders Korea Limitedn26th Floor, 136, Sejong-daero, (Taepyeongno 1-ga, Seoul Finance Center), Jung-gu, Seoul 100-768, South Korea . Registered and regulated by Financial Supervisory Service of Korea (“FSS”)This material has not been reviewed by the FSS.

For readers/viewers in Switzerland: This document has been issued by Schroder Investment Management (Switzerland) AG, Central 2, CH-8001 Zurich, Switzerland a fund management company authorised and supervised by the Swiss Financial Market Supervisory Authority FINMA, Laupenstrasse 27, CH-3003 Bern.

Note to readers/viewers in Taiwan: Issued by Schroder Investment Management (Taiwan) Limited 9F., No. 108, Sec. 5, Xinyi Road, Xinyi District, Taipei 11047, Taiwan. Tel +886 2 2722-1868 Schroder Investment Management (Taiwan) Limited is independently operated. This material has not been reviewed by the regulators.

Note to readers/viewers in Thailand: This presentation has not been approved by the Securities and Exchange Commission which takes no responsibility for its contents. No offer to the public to purchase any fund will be made in Thailand and this presentation is intended to be read for information only and must not be passed to, issued to, or shown to the public generally. Schroder Investment Management (Singapore) Ltd does not have any intention to solicit you for any investment or subscription in any fund and any such solicitation or marketing will be made by an entity permitted by applicable laws and regulations.

Note to readers/viewers in Malaysia: This presentation has not been approved by the Securities Commission Malaysia which takes no responsibility for its contents. No offer to the public to purchase any fund will be made in Malaysia and this presentation is intended to be read for information only and must not be passed to, issued to, or shown to the public generally. Schroder Investment Management (Singapore) Ltd does not have any intention to solicit you for any investment or subscription in any fund and any such solicitation or marketing will be made by an entity permitted by applicable laws and regulations.

For readers/viewers in the People’s Republic of China: Issued by Schroder Investment Management (Shanghai) Co., Ltd. Unit 33T52A, 33F Shanghai World Financial Center, 100 Century Avenue, Pudong New Area, Shanghai, China, AMAC registration NO. P1066560. Regulated by Asset Management Association of China (“AMAC”) This material has not been reviewed by the AMAC

For readers/viewers in the United Arab Emirates: Schroder Investment Management Limited, located on 1st Floor, Gate Village Six, Dubai International Financial Centre, PO Box 506612 Dubai, United Arab Emirates. Regulated by the Dubai Financial Services Authority. This document is not subject to any form of regulation or approval by the DFSA. The DFSA has no responsibility for reviewing or verifying any Prospectus or other documents in connection with this Fund. Accordingly, the DFSA has not approved any associated documents nor taken any steps to verify the information set out in the Prospectus for the fund, and has no responsibility for it. This document is intended to be for information purposes only and it is not intended as promotional material in any respect. This document is intended for professional investors only as defined by the DFSA rules which can be accessed from their website www.dfsa.ae

For readers/viewers in the United Kingdom: Schroders will be a data controller in respect of your personal data. For information on how Schroders might process your personal data, please view our Privacy Policy available at www.schroders.com/en/privacy-policy or on request should you not have access to this webpage. Issued by Schroder Investment Management Limited, 1 London Wall Place, London EC2Y 5AU. Registered Number 1893220 England. Authorised and regulated by the Financial Conduct Authority.