Global Asset Management

Emerging markets are undergoing the biggest reshuffle in two decades

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"We have seen emerging markets generally outperform their developed market counterparties through the course of this year so far."

Emerging market debt expert Polina Kurdyavko, Managing Director, Head of BlueBay Emerging Markets and Senior Portfolio Manager, discusses the risks and opportunities for the rest of 2023.

We have seen emerging markets generally outperform their developed market counterparties through the course of this year so far. Looking ahead, we have certain geopolitical and market risks and opportunities to highlight for the asset class for the rest of the year.

The biggest geopolitical reshuffle in two decades

We believe that we need to focus on China when discussing potential headwinds for the rest of the year. Looking at the relationship between US and China, the trend is, unfortunately, quite clear that this relationship is more likely to deteriorate than improve over the medium to long term. That said, the interlinkages between the economies are relatively high; therefore, we are unlikely to see blanket 'Russia-style' sanctions imposed on China.

The silver lining is that the US will need as many allies globally as possible when this relationship continues to deteriorate. And that's where larger, more established emerging market countries like Indonesia, Brazil, India, and Mexico are set to benefit. We expect further trade deals to be revised in favour of some emerging market countries, like Chile. We expect to be more tolerant of some of the monetary policy and fiscal policies and emerging markets, for example, Turkey, and we expect several emerging market countries to take advantage of the biggest geopolitical reshuffle we have faced for the last 20 years.

Local markets volatility to remain elevated

We have seen outperformance of local currency markets for the last 18 months relative to dollar-denominated fixed income. And we would expect that to continue in absolute terms. However, we expect the volatility regime to stay elevated in the local currency markets compared to hard currency markets. And in particular, we would stress that the volatility in the local currency market is less likely to be driven by inflation surprises but more likely to be driven by headline risks, if you will, bipolar governments and negative headlines both on fiscal as well as on the political side, which could translate into the volatility of the local currency assets.

Looking ahead

Looking at the environment we are in today, and the drivers of performance between now and year-end, a big part of those drivers will be more distressed stories that have gone through credit restructuring and are now delivering outsized returns regarding fixed income.

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On the macroeconomic side, the US’s recent slowing in core inflation was significant, reflecting the likelihood that the Federal Reserve will have to do less hiking in the near term. While it is still too early to say whether this move down in US inflation will be sustainable, it nevertheless has implications for emerging markets. In particular, it is constructive for emerging market local markets, with expected US dollar weakness likely to help FX markets at a time when many emerging market central banks are independently expected to begin their rate-cutting cycles.

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