EM issuers are broadening out financing options into growing international support

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2024 in emerging markets was defined by several geopolitical events including a record number of elections. Markets remain volatile, but International Financial Institutions (IFIs) like the World Bank, EU and the UNDP have stepped up to provide support to issuers in emerging countries to help speed up the flow of private ESG-oriented capital into the region. We look at how issuers and investors are evolving as they cope with the world's challenges.

Key Points

- Both corporate and sovereign EM hard currency bonds have continued to see healthy demand.
- EM ESG-labelled bond market continues to grow, especially in hard currency, as issuance of Green and Sustainability bonds continued to rise.
- 2025 will be important for further advances in the nascent market for EM transition finance.

EM hard currency bonds continued to see healthy demand in 2024

Despite ongoing outflows from the EM asset class, EM hard currency bonds continued to see healthy demand in 2024, boosted by increasing allocations from U.S. and European HY/IG investors. Primary markets have reflected these trends: gross corporate supply increased in 2024, with the greatest delta coming from Asia, whilst issuance out of EM Europe lagged levels seen in 2023.

In sovereigns, gross (and net) supply also increased. Here however, EM Europe has been the major contributor, with issuance outstripping 2023 levels as well as 2024 expectations, mainly in Romania and Poland, where fiscal policies underperformed and spending needs (on military, in particular) increased.

We expect to see corporate hard currency supply plateauing in 2025

Next year we expect to see corporate hard currency supply plateauing (having normalised from depressed 2022/23 levels), with IG issuers still dominating, whilst sovereigns should see a reduction of both gross and net issuance compared to this year, partly due to a pick-up in amortizations and more active buyback operations[1].

[1] JPMorgan, December 2024.

Given the outperformance of EUR duration, issuers have increasingly taken the opportunity of lower financing costs via EUR-denominated issuance last year, and we would expect this trend to remain firmly in place in 2025, with the share of EUR issuance increasing. Issuers are also exploring funding in other currencies – such as JPY and GBP for diversification purposes.

In local markets, issuance trends remain driven by local factors with the funding mix between hard and local currency largely determined by the funding preference of the respective debt management offices. Issuance of retail bonds remains a popular diversifier in countries, with plentiful domestic liquidity.

EM ESG-labelled bond market continues to grow, especially in hard currency

For many years now, more and more EM issuers have been entering the ESG-labelled bond market. This last year was another buoyant year for the hard currency ESG-labelled bond market, as issuance of Green and Sustainability bonds, in particular, continued to rise.

Local currency denominated-ESG labelled bond issuance dropped somewhat however, whilst sustainability-linked bond issuance lagged in both HC and LC terms[2], despite advances in the market's ability to price these securities and efforts to standardise key performance indicators (KPIs). Nevertheless, 2024 saw another breakthrough, with Thailand joining Uruguay and Chile and issuing the first local SLB in Asia.

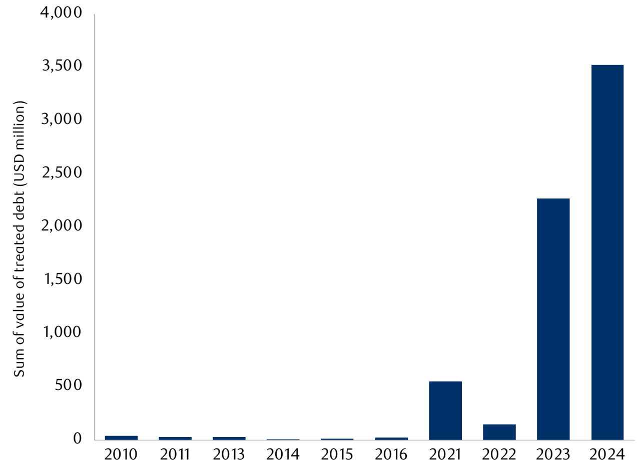
In the corporate space, trends have been mixed. However, there has been a noteworthy pick-up in the ESG-labelled bond issuance from the pulp & paper sector, a trend to watch in 2025.

> **"Outside of conventional liquid primary markets, a growing number of EM countries have been accessing alternative sources of funding."**

The greenium across EM ESG-labelled bonds remains volatile

USD-denominated ESG bonds, in particular, continue to offer little valuation advantage for issuers, whilst EUR paper typically trades within a modest 10-20bps greenium range over conventional bonds[3].This fact continues to present headwinds to a faster growth of the market, although IFIs such as World Bank, ADB, UNDP and, most recently the EU, are stepping up to provide technical assistance to issuers in emerging countries to help speed up the flow of private ESG-oriented capital into the region.

Chart 1: EM markets have seen a sharp pick-up in utilisation of DFN/DFD swaps



Source: RBC GAM, CarbonBrief, Reuters, as at December 2024.

A growing number of EM countries have been accessing alternative sources of funding

Outside of conventional liquid primary markets, a growing number of EM countries have been accessing alternative sources of funding. The IMF remains an important anchor behind a range of improving HY stories in the sovereign universe. In 2024, it extended new funding commitments to Ecuador, Pakistan and Ivory Coast, to name but a few, whilst approving policy reforms and bolstering the Fund's ability to support some of the least developed EM countries[4].

China, the GCC, and commercial creditors are also increasingly relied upon as a source of funding and, here again, we expect to see these trend to continue in the year ahead.

Debt for nature/development transactions are gaining more traction

A growing number of countries also started to utilise debt-for-nature (DFN)/debt-for-development (DFD) transactions in a much more meaningful size than previously (Chart 1). This trend is providing hope to many high yield countries needing cheaper sources of funding and struggling with debt capacity/access to international capital markets and commercial loans.

Debt for nature swaps deliver on many fronts – reducing cost of funding, reducing debt, and providing funds for much needed conservation/developmental causes whilst offering investors attractive carry over similarly rated securities.

[2] HSBC, December 2024.
[3] Morgan Stanley, December 2024.
[4] IMF.

Outside of Ecuador, which completed its second transaction recently, Barbados and the Bahamas have done similar swap transaction in the last few months whilst the Ivory coast completed a first ever debt for development swap supported by the World Bank.

We believe this market has much greater potential in terms of unlocking finance for climate and development, and we look for further expansion of these transactions in 2025.

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2025 will be important for further advances in the nascent market for EM transition finance

Whilst appetite for transition-labelled issuance has been limited so far, Japan has been leading the way and industry wide initiatives, as well as countries – including the UK – are focusing resources to facilitate greater utilisation of this potentially highly impactful financing channel.

This topic is also a key priority for us for 2025 as we explore ways to facilitate funding to support EM countries and companies on their transition path, provide climate solutions and engage with key EM issuers to accelerate transition to a low carbon economy in a just manner.

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