RBC Global Asset Management

Emerging market corporates: the default landscape in 2024

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> **"The tide is changing for EM corporates in 2024, with forecasted default rates, regional dynamics and sectoral risks signalling a more favourable corporate risk environment on the horizon."**

The outlook for emerging market (EM) corporates in 2024 reveals cause for cautious optimism amid shifting economic dynamics. With default rates expected to experience a decline from the peaks of 2023, attention is turning to regional trends and sectoral vulnerabilities.

The tide is changing for EM corporates in 2024, with forecasted default rates, regional dynamics and sectoral risks signalling a more favourable corporate risk environment on the horizon.

The index default rate for EM corporates surged to 6.8% in 2023, marking its highest point in a decade. However, our projections for 2024 paint a more sanguine picture with a rate of 4.3% in our CEMBI HY universe. This drop, albeit still above the 10-year average, suggests a more favourable corporate risk environment in the coming months.

Avoiding potential pitfalls

This projection can be attributed in part to changes in the economies of China, Ukraine, and Russia, which collectively contributed to more than half of last year's defaults. While the Chinese real estate crisis continues and some Ukrainian corporates may grapple with distressed exchanges, we anticipate these defaults to drop to about 20% in their contribution to 2024 defaults for the region.

Thus, excluding these countries, remaining defaults are expected to remain stable year-on-year. Particularly noteworthy is that many of these defaults are likely to manifest as distressed exchanges, rather than outright bankruptcies, or have already been factored into market pricing.

Zooming out to a regional perspective, default rates in Latin America and Africa are projected to hover in the mid-3% range, and in emerging Europe, high-3%. We expect the default rate in the Middle East to be even lower at about 1%.

Breaking the outlook down by sector, aside from the ongoing challenges in Chinese real estate, we are monitoring heightened risks in the Technology, Media, Telecommunications (TMT), Consumer, and Oil & Gas segments. The key downside risks in this regard will be prolonged periods of lower commodity prices or unexpected spikes in inflation.

Where the bulls are hiding

From 2021 onwards, faced with a challenging liquidity landscape, EM corporates have materially lowered leverage while improving their balance sheet liquidity. In both metrics, EM fares better than its developed market peers, making a strong fundamental case for the asset class.

Furthermore, the relative valuation of EM high yield corporates versus US high yield corporates is also very clear, with the BB and B rated segments remaining attractive, in our opinion.

Investors would do well to consider

While the default landscape for EM corporates witnessed turbulence in 2023, the outlook for 2024 appears to be more tempered. Though ongoing challenges in China, Russia, and Ukraine ought to be considered, several other regions and sectors may provide windows of opportunity. On this backdrop, investors would do well to consider a bottom-up approach to asset selection that has the ability to harness value within the asset class and avoid potential pitfalls. With a near 8.5%[1] yield in the high yield corporate segment (at the time of writing), by using an active and strategic approach, investors can capitalise on the upside potential of investing in EMs while mitigating uncertainty.

[1] RBC BlueBay Asset Management

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