RBC Global Asset Management

# Trump 2.0: the themes driving EM Debt

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## Polina Kurdyavko, Head of BlueBay EM Debt, discusses how asset prices have had a muted reaction to Trump's victory, the current narratives of the EMD sub-asset classes, and three key themes set to shape the outlook.

### Key takeaways:

- Markets have reacted as expected in emerging economies.
- Strong fundamentals are driving EM credit spreads.
- Local rates outperformance is set to continue; FX is more differentiated.
- Commodities is a key EM theme but the outlook is mixed.
- Risks associated with Trump's foreign policy could create volatility in EM.

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In emerging markets (EM), the market reaction to this week's margin of victory in the U.S. election has played out largely as anticipated, with spreads tighter in the credit world offsetting much of the weakness in U.S. rates. Argentina and Ukraine have been notable performers, given the apparent rapport between the Argentine President and President-Elect Trump, and the anticipation that Trump will aim to end the conflict in Ukraine.

In local markets, USD strength is the prevailing theme against both low beta and high beta currencies. There are, of course, other nuances to the market's response, but it seems that the volatility in the run-up to the election was, in part at least, driven by uncertainty around potential outcomes rather than the result itself.

Looking ahead, the extent of any further moves is likely to be dictated by the initial focus of the Trump team. Trump's emphasis on protectionist trade policies and large tariffs could create headwinds for global trade flows, especially if major U.S. trade partners introduce retaliatory tariffs. On the other hand, the administration's pro-growth, deregulation and tax cut agenda speaks initially to USD strength.

While other countries may accept some level of FX weakness, low beta currencies, such as the EUR, stand out as obvious depreciation candidates, as the ECB may be emboldened to cut rates at a faster pace as tariffs impact the growth outlook.

In EM fixed income, we expect three main themes to shape the outlook:

### 1. Strong fundamentals are driving EM credit spreads

Despite the heightened volatility in recent weeks, hard currency markets have proven to be resilient, as the benign default rate acts as a strong fundamental anchor, while still high all-in yield levels act as a cushion to returns. We expect spreads will continue to be driven by the underlying default outlook, which is likely to remain at zero for sovereigns and 2.7% for corporates in 2025[1]. This would be a touch below DM default rates, where 3% is expected in both US and European high yield bonds[2]. In addition, the key focus will be on identifying bottom up, turnaround stories, such as Argentina, Turkey and Egypt, which have proved to be resilient against the uncertain environment.

The possibility of unexpected headlines and policy uncertainty in the coming months can create periods of volatility in the liquid markets, potentially making demand for new issues less reliable for EM corporates. This could generate more interesting opportunities in the loans and illiquid space, where performing, healthy corporates choose the private credit route for funding shorter maturity financing requirements or smaller amounts – even if it requires paying a premium – with a view to refinancing, once the market appetite has fully returned. Credit managers who are in a position to take advantage of these dislocations can generate attractive returns, while still focusing on higher credit quality names.

### 2. Local rates outperformance is set to continue; FX is more differentiated

EM local markets bore the brunt of the repricing heading into the elections, driven by the stronger USD. On the whole, with interest rates in the U.S. likely to remain higher for longer under Trump's fiscal and economic policies, EM currencies could see broad pressure.

In EM FX, we are being cautious and prefer a more selective approach. A clearer focus on tax cuts and deregulation may play out via relative outperformance in high beta EM currencies against low beta currencies such as the EUR. If there is more focus on protectionism, then the opposite will be true.

In either case, the USD does not appear to be a great funding currency in the current setup, and therefore investors are likely to approach local markets from the perspective of other funding currencies away from the US dollar.

On the local rates side, we remain constructive. EM rates have outperformed year-to-date. We expect this trend to continue as they – especially across LatAm – offer significant pick-up relative to developed market (DM) peers, with regard to average real rates. We believe they should offer better risk-adjusted returns over the medium term. CEE is another region that remains attractive, with the likes of Poland and Romania offering attractive relative value, supported by tight fiscal policies and robust growth prospects.

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On the other hand, we have a more cautious outlook on Asia. In addition to potential tariffs, the broader region faces a number of headwinds, particularly in China where low growth and deflation remain a concern. That said, we would note that higher tariffs on China could encourage bolder China stimulus and could be positive for other Asian countries related to Chinese consumer demand.

### 3. Commodities – a mixed outlook

China's challenged growth outlook continues to play a major role in shaping global commodity demand and price movements. In addition, Trump has vowed to increase production of oil and natural gas, despite the U.S. already producing those fuels at record levels. We are also mindful that a resolution or normalisation with Russia and a possible easing of sanctions could create further pressure on oil prices. In the absence of another serious escalation in the Middle East, we would expect oil prices to weaken from here. Alternatively, Trump's stance on trade and infrastructure investment could drive demand for industrial metals, which may provide tailwinds for commodity exporters in LatAm and Africa.

Finally, looking at geopolitics, risks associated with Trump's foreign policy – particularly in relation to China and the Middle East – could create volatility in these markets. Alternatively, if a Trump administration is able to engineer a resolution to ongoing conflicts in the Middle East and Russia/ Ukraine, this could stabilise global markets, improve sentiment and benefit emerging economies, in particular.

[1,2] Bloomberg.

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