RBC Global Asset Management

Emerging markets are riding the tailwinds

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Emerging market debt expert Polina Kurdyavko, Managing Director, Head of BlueBay Emerging Markets and Senior Portfolio Manager, discusses the tailwinds that have helped emerging markets outperform their developed market peers.

Over the year, emerging markets fixed income benchmarks have delivered positive returns and have generally outperformed their developed market peers. And the two main tailwinds that enabled this win for the asset class for the good part of the last two years are still present. Namely, an orthodox monetary policy translated into numerous hikes across emerging markets, with central banks taking a more hawkish stance, as well as commodity prices that have helped emerging markets with the current account dynamic.

Orthodox monetary policy

Emerging markets have been early regarding rate hiking cycles, partially because, unlike major global developed market economies, they can't rely on central banks to hold the role as the lender of last resort. Consequently, we've seen the majority of emerging market central banks starting to hike at least a year or, in some cases, two years before the Federal Reserve started hiking. Now that orthodoxy has paid off, we've seen inflation in most emerging market countries starting to come down from the middle of last year. In some cases, inflation has reduced by more than 10%. And now, we are at the juncture where we expect the central banks to start cutting rates, supporting this move by prudent fiscal policy which should help emerging markets cope better in the low-growth environment.

Commodities helping the current account deficit

Commodity prices have been highly beneficial for emerging markets regarding the current account dynamic. Looking at the universe of over 70 countries, broadly speaking, two-thirds of those countries are commodity exporters. The exposure to commodities in emerging market countries is relatively high regarding its export focus. Notably, many emerging market countries have used this surplus from commodities to reinvest and diversify their economies, making the fiscal dynamic much less reliant on the volatility of commodity prices.

Interestingly, we are witnessing quite a significant transition in emerging markets away from traditional commodities to commodities more focused on renewable energy. A move that requires a lot of funding. Hence, we have seen a lot of issuance in that space across the three regions in emerging markets.

Looking ahead

We believe emerging markets outperformance over developed markets is set to continue. However, the drivers of outperformance might be slightly different over the rest of the year. The orthodoxy of the monetary policy is still firmly in place. However, the commodity price dynamic could become more volatile.

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