



Emerging markets leaders drive fiscal policy improvements

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Mohammed Elmi, CFA
Senior Portfolio Manager,
Emerging Market Debt

Jason DeVito, CFA
Senior Portfolio Manager,
Emerging Market Debt



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With sovereign and corporate credit spreads at multi-year lows, we remain constructive on Emerging Market Debt (EMD) in 2025. In our view, the tight valuations are largely justified considering how the asset class has successfully navigated both the covid inflationary burst and the resultant prolonged period of tight global monetary policy, while experiencing minimal defaults.

From a debt, budgetary and external position perspective, a number of core and frontier EM economies have seen material improvements recently. According to Bank of America Merrill Lynch, almost three-quarters (73%) of new EM ratings actions in 2024 moved in a positive direction, compared to the near-total spate of downgrades (93%) witnessed in 2020.

Despite the increased geopolitical risks, including an unpredictable new US administration and anemic growth in China, we believe a combination of frontier and core EM countries have the potential to outperform in 2025. As examples, we examine a diverse range of fundamentals presenting in Argentina, El Salvador, Pakistan, Sri Lanka and Turkey.

Argentina

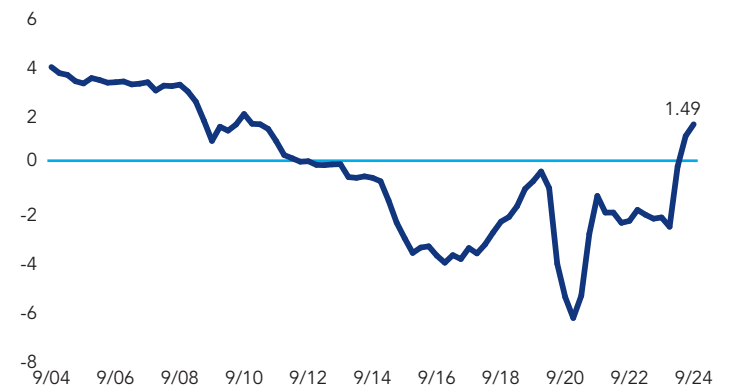
Milei remains popular

Although he has implemented harsh changes in social spending and regulated pricing, President Milei's popularity has remained robust, a fact which reiterates support for his administration. President Milei's popularity should also support bond prices.

Fiscal consolidation

President Milei has aggressively addressed red tape issues in the fiscal accounts, resulting in significant fiscal savings. Over the past few years, the primary fiscal balance was consistently negative, however, in June 2024, a positive 1% surplus was posted. Tame inflation, higher reserves, a healthy investment regulatory framework, and policy continuity are the drivers behind foreign exchange (FX) unification and the removal of capital controls.

Argentina budget balance (% GDP)



Source: Bloomberg as of 9/30/24.

Repatriation

The Amnesty and Repatriation program has provided banks with capital. With large amounts of money repatriated and subsequently deposited into the banking system, banks now have adequate funds to lend. Additionally, the success of the program has boosted confidence and loan demand is rising. Increased lending should support economic growth.

Inflation slowing

Monthly inflation has declined to low single digits, from highs in the mid 20% area at the end of 2023. Control of inflation and the resumption of investment and foreign direct investment (FDI) flow should form the cornerstone of investment. Markets have applauded the recent success on the inflation front.

Dollar outflows decreased

The economic slowdown has allowed a reprieve in dollar outflows. Consumer spending may subsequently increase as the economy improves, but we expect economic output to increase as well, which will increase dollars accumulated via exports.

El Salvador

Expectation of IMF funding

With the International Monetary Fund (IMF) mission currently on the ground in El Salvador, President Bukele may minimize the country's stance on Bitcoin to help allow IMF funding to close in the near term. Bukele will likely point to ratings upgrades and higher bond prices as a validation of his policies and administration. An IMF \$1.4bn staff-level agreement is expected in the near term.

Security and the economic recovery

The government has made aggressive efforts to confront violence and violent crime incidences have decreased. The improvement has been critical in increasing tourism dollar flows, and the business climate has improved given the improved security backdrop.

High presidential approval rating

Economic growth potential has improved. Furthermore, the country is seeing a balance of payments improvement on foreign direct investment (FDI) resumption along with higher tourism flows. Bukele's approval remains high, and higher than past administrations at similar point of tenure. His efforts on domestic security have been well received by voters.



Pakistan

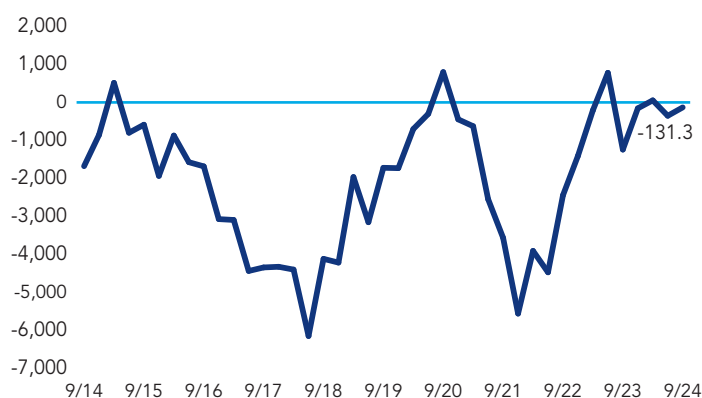
Continuing fiscal improvements

We remain constructive on Pakistan, as the government has demonstrated a commitment to reform implementation (including improved fiscal discipline, currency flexibility and tight monetary policy) under two consecutive IMF programs. The external position has stabilized with the current account deficit shrinking and FX reserves forecast to double in under three years' time.

Stability and structural reforms

We expect the new 3-year Extended Fund Facility (EFF) of \$7bn approved in September, will function as an anchor of reforms and unlock further external financing from bilateral and multilateral partners. The program is more geared toward structural reforms, whereas the previous 9-month \$3bn Stand-By Arrangement (SBA), which expired in April, was primarily focused on restoring economic stability.

Pakistan current account balance (USDm)



Source: Bloomberg as of 12/31/24.

Upgrade potential

Under the EFF, Pakistan is expected to broaden its tax base and remove tax exemptions, increase its energy tariffs, phase out agricultural subsidies, privatize some state owned enterprises (SOE) and improve the management of others as well as enhance governance, tackle corruption, and liberalize some trade policies. Progress under the EFF will be reviewed six times with the first semi-annual review this past December. If we see a continuation of the current trajectory we believe Pakistan could see a rating upgrade in 2025.

Turkey

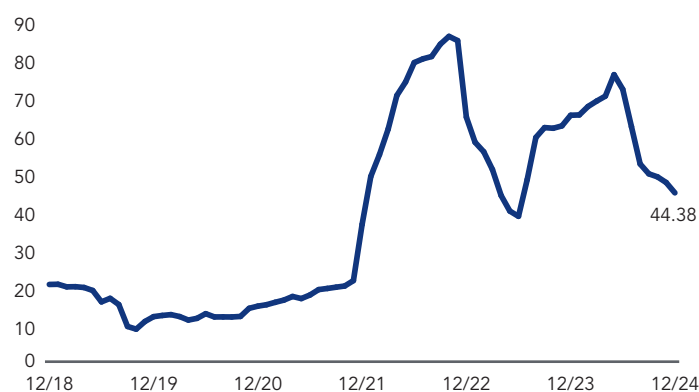
Commitment to disinflation

In Turkey, inflation is the single biggest source of unease, creating income inequality and eroding support for the ruling party. Significant political capital has already been invested in the process and it will continue. Policymakers are committed to disinflation (from top to bottom). Inflation slowed to 49.4% annually in September from a peak of 75.5% in May, and it's not just base effects. Monthly inflation indicators stripping away food and energy are all coming down. Services inflation remains sticky, but food has been improving thanks to FX appreciation and slowing demand. Items with backward indexation are still pushing up services inflation, particularly rent and education, but leading indicators suggest rent inflation should start slowing down.

Slowing growth has been tolerated

Firms' pricing behavior has also improved with the share of firms planning to increase prices falling to 35% and the share of those not planning to increase prices increasing to 60%. Turkish policymakers believe that given that demand is slowing and FX is appreciating, it should not have a dramatic impact on inflation. Turkey's Minister of Treasury and Finance, Mehmet Simsek, is leading efforts on several fronts. Average real growth in Turkey from 2003-2023 was 5.5% and it is forecast to slow to 3.5% in 2024. Mr. Simsek believes that in the long run lower inflation will spur on growth and it will come back to 5%. Positively, the unemployment rate is at a decade low of 8.5%, and political tolerance for slower growth has historically been there when the unemployment rate is low.

Turkey Consumer Price Index year-on-year



Source: Bloomberg as of 9/30/24.

Fiscal deficit falling

Ministry of Finance forecasts fiscal deficit in 2024 to be 4.9% and falling to 3.1% in 2025, 2.8% in 2026 and 2.5% in 2027. Mr. Simsek is pushing for additional fiscal adjustment despite additional earthquake spending in order to support disinflation. At the same time, fuel subsidies are not being phased out as quickly as he'd prefer. While there has been a minimum wage hike at the end of the year, Mr. Simsek believes that the level would not compromise the disinflationary process because elections are not until 2028. Imports continued to contract as the main driver of imports were unanchored inflation expectations and imports of gold and capital goods had been declining with improving expectations. Gold imports are back down to their long-term average.



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Sri Lanka

We are also constructive on Sri Lanka after the country finally emerged from its protracted external debt restructuring having defaulted back in April 2022. In the lead up to the sovereign default the country suffered from rampant inflation and a full-blown currency crisis which triggered shortages in essential imports such as fuel and medicines. Faced with a high level of civil instability and public anger, the then President Gotabaya Rajapaksa fled the country two months after the debt standstill was announced, leaving a caretaker government to stabilise the situation.

Sri Lanka estimated macro outlook is constructive

	Real GDP (%YoY)	Inflation (% YoY)	FX Rate to USD	Nominal GDP (\$bn)
2024	5.3	1.6	302	98
2025	3	3.2	310	101
2026	3.5	4.5	319	106
2027	3.5	5.0	329	111

Source: J.P. Morgan forecast as of 12/31/24.

After a protracted couple of years in which the IMF and bilateral creditors were also engaged, a landmark \$12.6bn debt restructuring was agreed late last year. The agreement should ensure a stabilization and gradual improvement in the country's credit profile. The complex deal has seen a number of unique bonds issued with equity like features. The macro-linked bonds (MLB) allow for the uprating of both coupon payments and principal in 2029 and beyond if certain growth and revenue targets are met. We believe these MLBs could offer interesting capital appreciation opportunities.

Current account balance is flows of goods, services, primary income, and secondary income between residents and nonresidents of a given country.

Consumer Price Index (CPI) is a measure of inflation at the retail level.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Forward-looking statements or projections are subject to certain risks and uncertainties. Actual results may differ from those expressed or implied.

Past performance is no guarantee of future results.

Views are as of 1/15/25 and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Investments are subject to risks and fluctuate in value.

International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards.

Prices of emerging-market and frontier-market securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

High yield, lower-rated securities generally entail greater market, credit/default and liquidity risks, and may be more volatile than investment-grade securities.