EMERGING MARKET DEBT AGAINST THE BACKDROP OF A US-CHINA TRADE WAR AND RISING FED RATES

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In 2018, emerging market debt was mainly impacted by the ongoing US central bank rate hike policy and the rise in customs tariffs between the US and China. As a result, the average emerging debt risk premium jumped from 280 bp on 1 January 2018 to 415 bp above US rates at the end of the year, according to the JPMorgan Emerging Market Global Diversified Bond Index in USD.

Following the latest FOMC meeting on 30 January, the Fed commented that:

« In light of global economic and financial developments and muted inflation pressures, the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes". So, at least in the short term, the central bank has decided to take a break from its rate hiking cycle. Meanwhile, the US dollar's surge against the other currencies has come to an end, as the widening gap between interest rates in the US and the rest of the world is no longer growing. This is a major boost for emerging markets: the borrowing cost in US dollars to refinance emerging debt has ceased to increase for the time being and risk perception is improving thanks to the fact that emerging country currencies have at last stabilised. As at 22 February 2019, the risk premium according to the JPEMGD index had increased by 65 basis points since the start of the year, reaching 350bp. We have seen very positive performances from countries in Latin America and Africa, which are generally rated "sub-investment grade" and commonly have significant funding requirements, and this could well continue.

Trade talks between the US and China are edging toward an agreement. President Donald Trump has said the US will delay the tariff rise on USD 200 billion of Chinese goods scheduled for 1 March. He also tweeted on Sunday 24 February that there had been "substantial progress in our trade talks with China on important structural issues including intellectual property protection, technology transfer, agriculture, services, currency, and many other issues". That said, some sources close to the negotiations say the two parties are still a long way apart on issues like technology transfer and enforcing compliance with an eventual deal. We see progress in the talks but are still a long way from a final and definitive agreement. In this environment, emerging market debt has been boosted by the outbreak of mutual understanding. But nothing has been signed yet. It will certainly be a while longer before US/China tensions are finally put to bed.

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