Emerging Market Macro Insights

Monthly report

Invesco Fixed Income
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Overview

- We are in the final innings of the global rate hiking cycle.
- Policy divergence is likely to become increasingly prevalent across EM.
- EM central banks will likely oscillate between keeping policy rates unchanged for an extended period or inching toward policy rate easing, depending on the growth outlook.

Global central banks weigh higher rates for longer, or potential cuts

As we near the end of the current global rate hiking cycle, we expect emerging market (EM) central banks to oscillate between keeping policy rates unchanged for an extended period of time or inching toward policy rate easing. This dynamic is despite the expansion in real interest rates and real rate differentials and expectations of a continued disinflationary trend. However, a move to cut may prove to be premature and could raise the risk of policy mistakes. This risk could remain elevated on either side of the hike/cut equation for some time, setting the stage for a broad opportunity set for active EM managers. We believe the medium and long-term catalysts for EM debt will continue to buttress the asset class: an expensive US dollar, favorable EM growth differentials versus developed markets and high EM nominal yields and income potential.

Market pulse

In May, Turkey held presidential and parliamentary elections that determined whether President Erdogan and his ruling AKP party would remain in power, or if the opposition would finally mount a real challenge and end Erdogan's more than 20 years of leadership. Polls leading up to the first round of elections showed a tight race and a potential first round win for the opposition candidate, Kemal Kılıçdaroğlu, with a potential runoff against Erdogan. Markets were hopeful that an opposition victory would lead to an end to the unorthodox economic policies under Erdogan's administration and provide an opportunity for the resumption of foreign investment in Turkey. However, as in previous cycles, the polls proved unreliable. Erdogan's support was stronger than expected and he was elected to another term in office. We remain uninvested in Turkey following the election results and expect the current policies to remain in place for the foreseeable future. Without a true macroeconomic adjustment on the fiscal and monetary fronts, we do not believe current policies are sustainable, as foreign exchange reserves have declined to levels that may require capital controls to maintain.

Country Spotlight: Indonesia | Notes from the ground

Bank Indonesia has kept monetary policy on hold since February. It remained on hold in May, but its tone was more cautious, with a shift toward the stability of the currency amid market volatility caused by the US debt ceiling debate. Bank Indonesia also implicitly reduced its growth forecast from the “top of its range” to “the 3.5-4.5% range.” This may be due to the Q1 GDP growth rate, which at 5%, was somewhat softer than the Bank’s expectations, though in line with market consensus and forward-looking export indicators.[1] The Bank also indicated it would potentially hit its inflation target as early as July, versus a previous expectation of August, which was communicated at its April meeting. Current inflation data confirm that inflation was already down in May, though still at the top of the Bank’s 2%-4% target band. Core inflation also declined to 2.7% in May from 2.8% in April.[2] We think that Bank Indonesia will remain on hold in June and, once there is more clarity on the US Federal Reserve’s rate path, discussion could begin about a potential rate cut, though we do not see one before the middle of Q3 or Q4, depending on incoming data.

1. Source: Indonesia’s Statistical Agency (Badan Pusat Statistik, BPS). Data as of May 5, 2023.
2. Source: Bloomberg L.P. Data as of June 4, 2023.

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The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

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