Invesco

Strategy Insights | Fixed Income

Global growth could be the best in over a decade; emerging markets will likely benefit

Wim Vandenhoeck
Senior Portfolio Manager,
Invesco Fixed Income

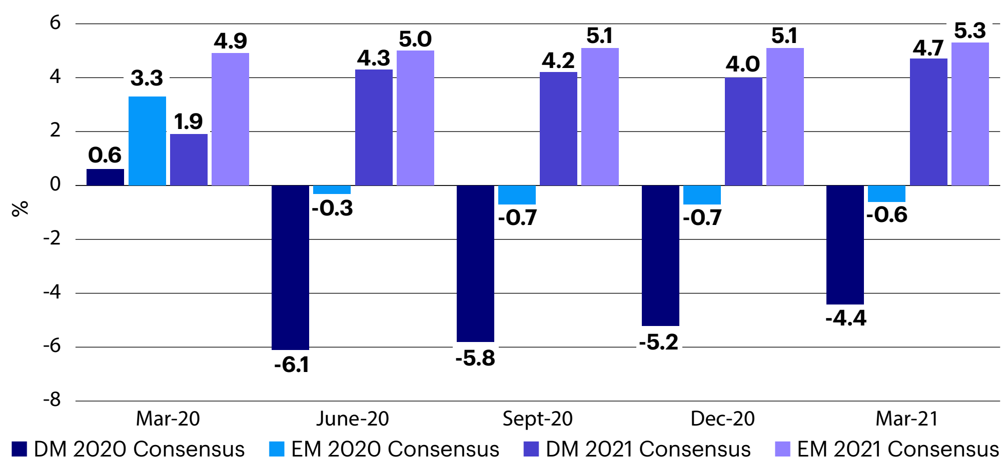
Gerald Evelyn
Client Portfolio Manager,
Invesco Fixed Income

Overview

- Our estimate for global growth is at the top of our forecast range, but inflation should remain tempered.
- We expect emerging market central banks to become less accommodative, but any changes should not exceed market expectations.
- We maintain a cautious view on Peru's rates and currency due to its uncertain election outlook and economic challenges posed by the pandemic.

A global recovery is well under way with 2021 growth estimates being raised across global regions. Our own estimates for the US, eurozone and selected emerging market countries are near the upper end of our economists' forecast ranges. This indicates our growing confidence that this year's global growth could be the highest in over a decade. While the initial upswing is likely to be led by China, followed by the US and emerging markets, especially Asia, Europe could rebound in the second half of the year, extending the recovery to a truly global reflationary boom. These improved global growth forecasts would, however, still leave the global economy below its trend output until 2022. Inflation, therefore, should be tempered and not of significant concern. While recent inflation has been dominated by goods prices, the coming boom is likely to be services-led, where the output gap is still too large to result in any near-term inflationary concerns.

Figure 1: GDP consensus forecasts – developed markets versus emerging markets



Source: Bloomberg L.P. Data from March 30, 2020, to March 22, 2021. EM is emerging market. DM is developed market.

We continue to expect emerging market central banks that were providing extraordinary stimulus to become less accommodative. This change should be limited and unlikely to exceed market expectations already priced in. We believe the path of rate increases will be key to extracting excess returns from markets.

In emerging markets, mainly due to recency bias, there is a persistent apprehension that global growth will lead to policy responses that will result in negative asset performance. We believe this relatively pervasive apprehension has kept emerging market term premia elevated, and will allow them to be extracted within our investment horizon of nine to 18 months. The emerging markets of today are not the emerging markets of 2013. Their external accounts have meaningfully improved, currencies remain at compelling valuations, in our view, and capital flows, though negative in 2020, have turned moderately positive.

The theme underlying our investment strategy in the short and medium term will remain reflation and growth. Additionally, in the absence of tightening financial conditions, all growth will likely be "good" growth for reflationary assets.

Market Pulse

The absolute April performance of the benchmark (JPM GBI-EM Global Diversified Index) was driven by stronger emerging market currencies, somewhat lower interest rates, with the balance from income.[1] From a high-level perspective, we favor the front end of some rates curves (Mexico, Czech Republic, Colombia), specifically around the five-year point, given its attractive carry and roll potential, while we are cautious on the long end, as fiscal pressures continue. The main change during the month was in Russia, where we have become more cautious based on fundamental macro performance (growth and inflation) and the possibility of more severe sanctions by the Biden administration. In currencies, we favor Asia and are cautious on Latin America.

Except for Russia and Ukraine, central banks have been on hold, either looking through high and rising inflation and/or benefiting from a pause in the upward march of higher US interest rates and steeper yield curves. After hiking 25 basis points in March, the Russian central bank hiked by 50 basis points in April. The bank's hawkish message solidified the market's expectations of a front-loaded cycle spurred by demand-driven inflation pressures - not only in food but in core inflation too, fueled by growing wage pressures. The bank's hawkish message was supported by its new policy rate forecast range, showing a midpoint benchmark rate of 5.1% for 2021 and 5.8% for 2022.[2] Assuming the central bank tightens by 25 basis points at its next two meetings, the 2021 average rate would reach the 2021 midpoint. The bank's hawkish tone continues.

Country spotlight: Peru

From the start of the year, Peru has been one of the few countries we have viewed negatively from both a rates and currency perspective. Our early bearish view was predicated on politics and the difficult electoral dynamics in a discordant social and institutional environment made worse by the pandemic. The pandemic has had a lasting negative impact on Peru's population and its economy. While Brazil received most of the negative headlines about the pandemic, Peru has one of the lowest ratios of ICU beds per capita in Latin America. The lack of vaccines and preparedness by the current administration led to a severe third wave of the virus. In our view, the impact of the recent third wave could delay Peru's economic recovery until the second half of 2021. One of the government's major responses was to allow for early pension withdrawals. At the beginning of April, the congress approved the third round of withdrawals but it was vetoed by the president and may take months to settle, putting further pressure on the country's yield curve and exchange rate. In addition to the renewed health crisis, Peru held the first round of its presidential elections on April 11. Pedro Castillo of the leftist Free Peru party finished first in the voting, in what seemed to be the voters' response to the poor handling of the pandemic by the government. Castillo will now face a second-round runoff against the more moderate, but highly controversial, Keiko Fujimori of the Popular Force party. In our view, Castillo's stated policies are quite radical, and could impact the long-term recovery and investment thesis in Peru. We maintain a cautious view on Peru's rates and currency heading into the June 6 second-round runoff. Castillo holds a lead with a large number of undecided votes, and so heightened political instability is a risk factor.[3]

1. Source: Bloomberg L.P. Data from April 1, 2021 to April 30, 2021.
2. Source: Central Bank of Russia. Data as of April 23, 2021.
3. Source: JPM. Data as of May 12, 2021.

About risk

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. Past performance is not a guide to future returns.

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.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

You should note that this information:

- may contain references to dollar amounts which are not Australian dollars;
- may contain financial information which is not prepared in accordance with Australian law or practices;
- may not address risks associated with investment in foreign currency denominated investments; and does not address Australian tax issues.
- Issued in **Australia** by Invesco Australia Limited (ABN 48 001 693 232), Level 26, 333 Collins Street, Melbourne, Victoria, 3000, Australia which holds an Australian Financial Services Licence number 239916.

Canada

This document is restricted to accredited investors as defined under National Instrument 45-106. All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This is not to be construed as an offer to buy or sell any financial instruments and should not be relied upon as the sole factor in an investment making decision. As with all investments there are associated inherent risks. Please obtain and review all financial material carefully before investing.

- Issued in **Canada** by Invesco Canada Ltd., 120 Bloor Street East, Suite 700, Toronto, Ontario, M4W 1B7.

Continental Europe, Dubai, Ireland, the Isle of Man, Jersey and Guernsey and the UK

The document is intended only for Qualified Investors in Switzerland and Professional Clients in Continental Europe, Dubai, Ireland, the Isle of Mane, Jersey, Guernsey, and the UK and is not for consumer use. Marketing materials may only be distributed without public solicitation and in compliance with any private placement rules or equivalent set forth in the laws, rules and regulations of the jurisdiction concerned. This document is not intended to provide specific investment advice including, without limitation, investment, financial, legal, accounting or tax advice, or to make any recommendations about the suitability of any product for the circumstances of any particular investor. You should take appropriate advice as to any securities, taxation or other legislation affecting you personally prior to investment. No part of this material may be copied, photocopied or duplicated in any form by any means or redistributed without Invesco's prior written consent.

Further information is available using the contact details shown:

- Issued in **Belgium, Denmark, Finland, France, Greece, Italy, Netherlands, Spain, Sweden, Luxembourg, Norway** and **Portugal** by Invesco Management S.A., President Building, 37A Avenue JF Kennedy, L-1855 Luxembourg, regulated by the Commission de Surveillance du Secteur Financier, Luxembourg.
- Issued in **Dubai** by Invesco Asset Management Limited. PO Box 506599, DIFC Precinct Building No 4, Level 3, Office 305, Dubai, UAE. Regulated by the Dubai Financial Services Authority.
- Issued in **Austria** and **Germany** by Invesco Asset Management Deutschland GmbH, An der Welle 5, 60322 Frankfurt am Main, Germany.
- Issued in **Switzerland** by Invesco Asset Management (Schweiz) AG, Talacker 34, 8001 Zurich, Switzerland.
- Issued in **Ireland, the Isle of Man, Jersey, Guernsey** and the **United Kingdom** by Invesco Asset Management Limited which is authorised and regulated by the Financial Conduct Authority. Invesco Asset Management Ltd, Perpetual Park, Perpetual Park Drive, Henley-on-Thames, RG9 1HH, UK.

Hong Kong

This document is provided to professional investors (as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules) only. It is not intended for and should not be distributed to, or relied upon, by the members of public or the retail investors.

- Issued in **Hong Kong** by Invesco Hong Kong Limited 景順投資管理有限公司, 41/F, Champion Tower, Three Garden Road, Central, Hong Kong.

Japan

This document is only intended for use with Qualified Institutional Investors in Japan. It is not intended for and should not be distributed to, or relied upon, by members of the public or retail investors.

- Issued in **Japan** by Invesco Asset Management (Japan) Limited, Roppongi Hills Mori Tower 14F, 6-10-1 Roppongi, Minato-ku, Tokyo 106-6114; Registration Number: The Director-General of Kanto Local Finance Bureau (Kin-sho) 306; Member of the Investment Trusts Association, Japan and the Japan Investment Advisers Association, and/or 2) Invesco Global Real Estate Asia Pacific, Inc., Roppongi Hills Mori Tower 14F, 6-10-1 Roppongi, Minato-ku, Tokyo 106-6114; Registration Number: The Director-General of Kanto Local Finance Bureau (Kin-sho) 583; Member of the Investment Trusts Association, Japan and Type II Financial Instruments Firms Association.

New Zealand

This document is issued in New Zealand only to wholesale investors (as defined in the Financial Markets Conduct Act). This document has been prepared only for those persons to whom it has been provided by Invesco. Information contained in this document may not have been prepared or tailored for a New Zealand audience.

This document does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for, an opinion or guidance on Interests to members of the public in New Zealand. Any requests for information from persons who are members of the public in New Zealand will not be accepted.

- Issued in **New Zealand** by Invesco Australia Limited (ABN 48 001 693 232), Level 26, 333 Collins Street, Melbourne, Victoria, 3000, Australia, which holds an Australian Financial Services Licence number 239916.

Singapore

This document may not be circulated or distributed, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 304 of the Securities and Futures Act (the "SFA"), (ii) to a relevant person pursuant to Section 305(1), or any person pursuant to Section 305(2), and in accordance with the conditions specified in Section 305 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

This document is for the sole use of the recipient on an institutional offer basis and/ or accredited investors and cannot be distributed within Singapore by way of a public offer, public advertisement or in any other means of public marketing.

- Issued in **Singapore** by Invesco Asset Management Singapore Ltd, 9 Raffles Place, #18-01 Republic Plaza, Singapore 048619.

Taiwan

This material is distributed to you in your capacity as Qualified Institutions/Sophisticated Investors. It is not intended for and should not be distributed to, or relied upon, by members of the public or retail investors.

- Issued in **Taiwan** by Invesco Taiwan Limited, 22F, No.1, Songzhi Road, Taipei 11047, Taiwan (0800-045-066). Invesco Taiwan Limited is operated and managed independently.

United States

- Issued in the **US** by Invesco Advisers, Inc., Two Peachtree Pointe, 1555 Peachtree Street, N.E., Suite 1800, Atlanta, GA 30309.