

3 Reasons to Allocate to EM Bonds in 2023



Eric Fine
Portfolio Manager, Emerging Markets Fixed Income

Relative to developed markets, emerging markets responded quicker to inflation, remain in better shape financially, and benefit from higher commodity prices.

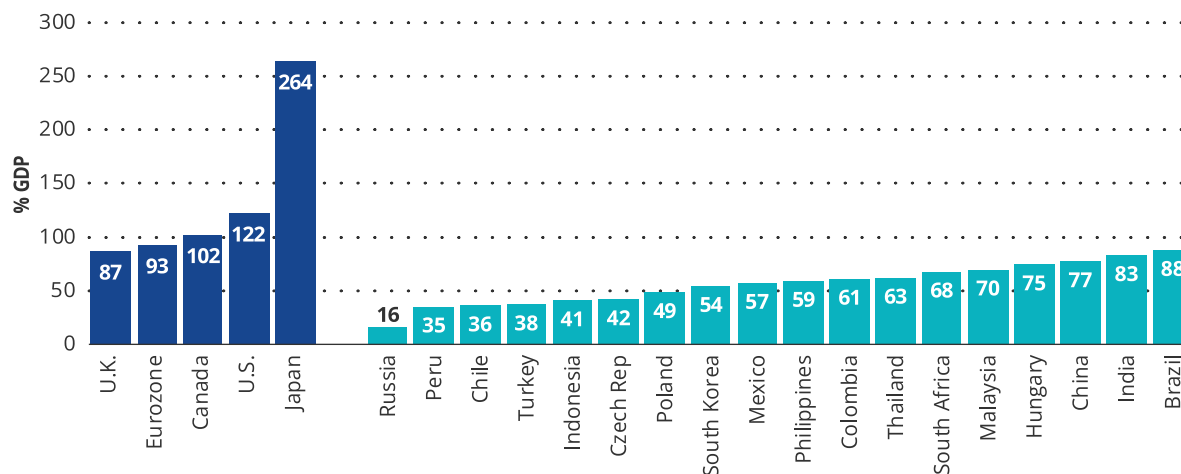
In our [2023 outlook](#), we highlighted emerging markets bonds as a compelling opportunity. Below we explore three reasons investors should consider allocating to emerging market (EM) bonds in the current market environment.

1. Emerging Markets Have Lower Debt

Notwithstanding China's more recent policy direction, [emerging markets, in general, have moved much more quickly to increase interest rates compared to the U.S.](#) and other developed market (DM) rates in order to stay ahead of inflation. For investors, this fundamental backdrop means less issuance and rolling over of debt, a favorable supply/demand dynamic that should help support EM bonds. In addition, if needed, EM central banks can hike interest rates without bankrupting the government (like we saw in the United Kingdom).

Debt Levels of EM Countries Are Relatively Attractive

General Government Gross Debt (% GDP)



Source: VanEck Research; Bloomberg LP. Data as of December 2022.

Past performance is not indicative of future results. Please see important disclosures and definitions at the end of the blog.

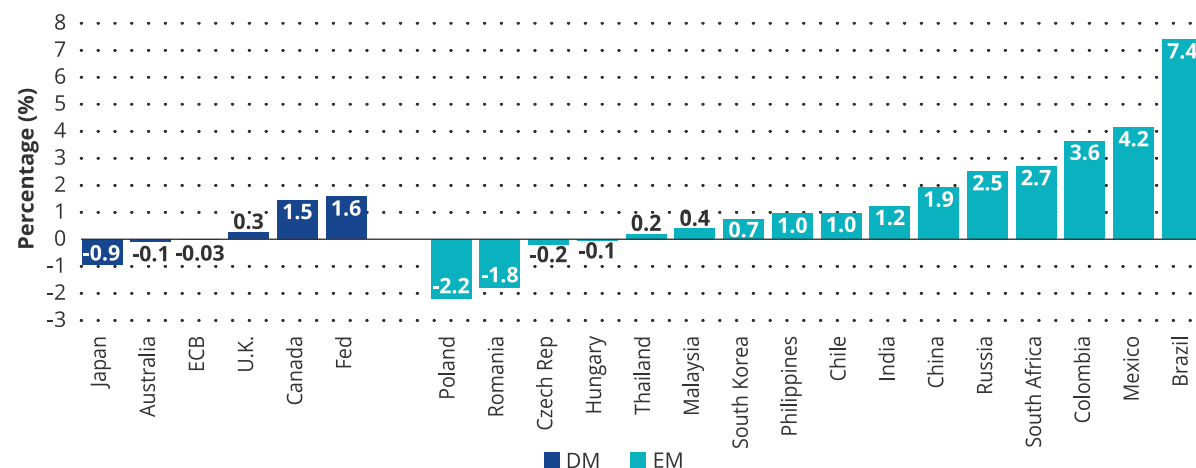
2. EM Has Independent Central Banks

The primary focus of EM central banks is to focus on controlling inflation, and they do this by maintaining high real interest rates. For investors, the result has been not only higher nominal yields but higher real yields. The benefits to EM local currency investors are a more substantial level of income that is not eroded by the loss of purchasing power (through a potentially weaker currency). Additionally, if the central bank's actions are successful in controlling inflation, it can lead to a stronger and more stable economy.

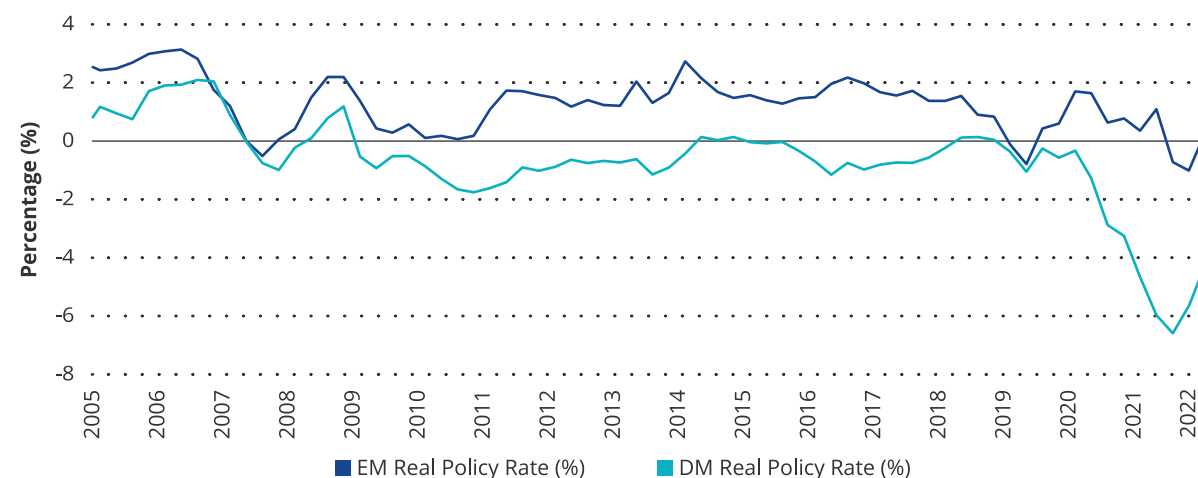
EM Central Banks' Focus on Inflation Means Higher Income for Investors

Real Policy Rates in EM and DM (%)

12m from now if current expectations for rates and inflation materialize



Real Policy Rates (Trailing) in EM and DM (%)



Source: VanEck Research; Bloomberg LP. Data as of November 2022.

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3. EM Benefits from Higher Commodity Prices (with a Boost from China's Reopening)

Unlike developed markets, which experience higher commodity prices as a price shock, emerging markets export more commodities than they import, which means they benefit from higher prices. This dynamic means emerging markets are good creditors in dollar terms and have dollars on hand to stabilize their local currency if needed.

And for investors choosing between equity and debt exposure in emerging markets, keep in mind that net commodity exporters make up a much more significant portion of most EM local debt indexes than they do of EM equity indexes, which tend to be much more concentrated in the Asian export-led economies.

As it relates to China, global markets spent 2022 digesting the property sector collapse and strategic divorce with the U.S., and are only slowly waking up to China reopening. This is very supportive of commodity prices. After rumors and hints of a change in China's Zero-Covid policy, it now looks like China has significantly loosened controls; this is a clear change in policy. It is also accompanied by an increasingly accommodative macro policy. EM debt stands out as having asset prices that can benefit directly from China reopening with its high-carry bonds that can generate returns in a potentially sideways, choppy or bumpy bond world. Many EMs stand out as beneficiaries of higher commodity prices, not victims of them.

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666 Third Avenue | New York, NY 10017
vaneck.com | 800.826.2333

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