

## The fundamental picture is looking up for EM sovereigns

Despite plenty of macro volatility in the global economy, the fundamental outlook for Emerging Market sovereigns has stabilised, with credit quality in aggregate starting to improve after a few tough years of major shocks



Source: Upgrades at Moody's, S&P and Fitch outnumber downgrades for EM sovereigns this year. Turkey has been a key improver with multiple upgrades

## EM fundamental heatmap

2024 Data	Economy		Fiscal				External				REER	Classification	
	GDP %YoY	CPI (EOP) %YoY	Gov Debt %GDP	Fiscal Balance %GDP	Primary Balance %GDP	Interest Costs %Revenues	C/A Balance %GDP	FX Reserves %GDP	External Debt %GDP	Net IIP %GDP		Rating	Region
Qatar	1.5%	1.0%	41%	2.0%	3.3%	5%	13.4%	24%	243%	-3.7%	AA	MENA	
United Arab Emirates	4.0%	2.3%	31%	4.8%	5.5%	3%	8.8%	40%	87%	257%	-3.4%	AA	MENA
Czech Republic	1.1%	2.5%	44%	-2.9%	-2.0%	2%	0.1%	44%	61%	-3%	-2.1%	CEE/CIS	Asia
China	4.8%	1.8%	30%	-7.4%	-6.4%	4%	1.4%	18%	16%	-0.6%	A+	MENA	
Kuwait	-2.7%	2.9%	7%	25.6%	5.9%		28.2%	28%	40%	70%	-0.5%	A+	MENA
Saudi Arabia	1.5%	1.7%	28%	-3.0%	-2.9%	0%	0.4%	41%	31%	71%	-2.7%	A+	MENA
Chile	2.5%	4.5%	41%	-2.3%	-1.7%	3%	-2.3%	14%	77%	-20%	-4.2%	A	LatAm
Croatia	3.4%	3.3%	60%	-2.5%	-1.1%	3%	1.5%	-	76%	-29%	2.2%	A-	CEE/CIS
Israel	0.7%	3.4%	68%	-8.0%	-6.3%	8%	3.4%	41%	27%	43%	-1.4%	A-	MENA
Malaysia	4.8%	2.8%	68%	-3.6%	-1.2%	13%	2.6%	27%	63%	-2%	7.3%	A-	Asia
Poland	3.0%	5.1%	56%	-5.7%	-3.4%	5%	0.8%	25%	51%	-32%	11.2%	A-	CEE/CIS
Uruguay	3.2%	5.4%	65%	-3.0%	-0.7%	8%	-2.7%	23%	57%	-16%	-5.9%	BBB+	LatAm
Bulgaria	2.3%	2.7%	24%	-2.9%	-2.8%	0%	-1.0%	40%	44%	-6%	0.2%	BBB	CEE/CIS
Hungary	1.5%	4.1%	73%	-5.0%	-0.8%	10%	1.6%	22%	82%	-37%	-1.0%	BBB	CEE/CIS
Indonesia	5.0%	2.3%	41%	-2.7%	-0.7%	14%	-1.0%	11%	30%	-18%	-2.9%	BBB	Asia
Kazakhstan	3.5%	8.0%	25%	-2.3%	-1.3%	5%	-1.5%	16%	57%	-20%	0.6%	BBB	CEE/CIS
Mexico	1.5%	4.5%	58%	-5.9%	-0.8%	21%	-0.7%	13%	32%	-4%	-18.1%	BBB	LatAm
Peru	3.0%	2.4%	34%	-3.2%	-1.6%	8%	0.3%	29%	37%	15%	1.2%	BBB	LatAm
Philippines	5.8%	3.2%	58%	-3.9%	-1.3%	13%	-2.2%	24%	28%	-12%	-1.1%	BBB	Asia
Colombia	1.6%	5.7%	56%	-4.4%	-0.1%	15%	-2.5%	15%	47%	-45%	-1.9%	BBB-	LatAm
India	7.0%	4.2%	83%	-7.8%	-2.4%	25%	-1.1%	18%	18%	-10%	-1.0%	BBB-	Asia
Panama	2.5%	1.3%	55%	-4.3%	-1.0%	18%	-0.4%	6%	159%	-85%	-4.0%	BBB-	LatAm
Romania	1.9%	4.2%	56%	-7.8%	-5.5%	7%	-7.5%	20%	55%	-4%	3.8%	BBB-	CEE/CIS
Azerbaijan	3.2%	4.6%	20%	1.0%	1.7%	2%	6.1%	11%	20%	89%	-2.8%	BB-	CEE/CIS
Morocco	2.8%	2.2%	69%	-4.3%	-1.9%	8%	-2.0%	23%	45%	-51%	1.2%	BB+	MENA
Oman	1.0%	1.0%	34%	5.0%	5.1%	0%	2.3%	18%	58%	-25%	-3.2%	BB+	MENA
Paraguay	3.8%	4.0%	42%	-2.3%	-0.3%	11%	-0.6%	22%	56%	-36%	-4.5%	BB+	LatAm
Serbia	3.9%	3.9%	49%	-2.6%	-0.6%	4%	-4.2%	42%	62%	-66%	2.7%	BB+	CEE/CIS
Trinidad & Tobago	1.6%	1.8%	59%	-6.7%	-3.2%	15%	5.9%	36%	19%	38%	-2.1%	BB+	LatAm
Brazil	4.0%	4.3%	89%	-6.9%	-0.5%	16%	-1.7%	17%	35%	-39%	-18.5%	BB	LatAm
Guatemala	3.5%	4.0%	27%	-1.1%	0.6%	13%	2.4%	22%	22%	-2%	0.0%	BB	LatAm
Ivory Coast	6.5%	3.0%	59%	-4.0%	-1.6%	14%	-5.4%	-	37%	-35%	2.7%	BB	SSA
North Macedonia	2.2%	3.0%	56%	-5.0%	-3.0%	6%	-2.1%	34%	80%	-58%	1.8%	BB	CEE/CIS
Albania	3.3%	2.1%	58%	-2.2%	0.3%	9%	-0.8%	25%	41%	-43%	7.4%	BB	CEE/CIS
Armenia	6.0%	1.0%	52%	-4.8%	-1.7%	12%	-4.2%	14%	61%	-47%	-0.5%	BB-	CEE/CIS
Costa Rica	4.0%	0.8%	61%	-3.7%	1.3%	34%	-2.2%	15%	41%	-4%	-0.5%	BB-	LatAm
Dominican Republic	5.1%	3.7%	59%	-3.1%	0.4%	21%	-3.4%	11%	32%	-57%	-5.2%	BB-	LatAm
Jamaica	1.3%	5.3%	68%	0.3%	5.6%	17%	1.6%	28%	68%	-116%	0.8%	BB-	LatAm
Jordan	2.4%	2.3%	92%	-7.6%	-2.3%	20%	-5.0%	40%	79%	-101%	-2.5%	BB-	MENA
Montenegro	3.7%	4.1%	62%	-3.1%	-1.0%	5%	-14.5%	23%	123%	-103%	-	BB-	CEE/CIS
South Africa	1.1%	3.9%	75%	-6.2%	-0.9%	20%	-1.6%	16%	41%	28%	6.1%	BB-	SSA
Turkey	3.0%	43.0%	25%	-5.2%	-2.8%	8%	-2.2%	11%	38%	-24%	11.6%	BB-	CEE/CIS
Uzbekistan	5.5%	10.4%	34%	-3.5%	-2.7%	3%	-6.3%	38%	57%	12%	0.2%	BB-	CEE/CIS
Bahrain	3.0%	1.4%	127%	-7.7%	-2.8%	24%	5.3%	9%	214%	59%	-3.6%	B+	MENA
Mongolia	5.5%	7.5%	42%	0.4%	1.8%	4%	-6.9%	20%	147%	-176%	5.1%	B+	Asia
Senegal	6.0%	8.0%	84%	-7.5%	-3.8%	18%	-12.7%	-	95%	-88%	1.3%	B+	SSA
Angola	2.4%	28.0%	59%	1.6%	6.2%	26%	3.3%	13%	49%	-16%	11.7%	B-	SSA
Egypt	2.7%	27.5%	91%	-10.1%	2.0%	73%	-6.6%	12%	40%	-74%	-24.2%	B-	MENA
Kenya	5.0%	4.5%	70%	-5.0%	0.2%	30%	-4.1%	1%	36%	-48%	13.5%	B-	SSA
Nigeria	2.9%	29.0%	51%	-4.6%	-0.9%	27%	-0.5%	20%	49%	-33%	-41.3%	B-	SSA
Gabon	3.1%	2.2%	73%	-3.9%	-0.8%	16%	5.1%	6%	38%	-103%	0.9%	CCC+	SSA
Ecuador	0.3%	2.8%	56%	-2.0%	-0.9%	3%	2.8%	7%	50%	-16%	-2.3%	CCC+	LatAm
El Salvador	3.0%	2.0%	85%	-4.5%	0.0%	17%	-2.2%	9%	63%	-52%	-2.3%	CCC+	LatAm
Mozambique	4.3%	3.6%	96%	-4.2%	-0.1%	15%	-29.9%	17%	285%	-310%	-4.5%	CCC+	SSA
Pakistan	2.4%	12.6%	69%	-6.7%	0.9%	61%	-0.2%	5%	36%	-35%	9.9%	CCC+	Asia
Tunisia	1.6%	6.8%	84%	-5.9%	-1.9%	14%	-3.5%	18%	80%	-147%	5.0%	CCC+	MENA
Argentina	-3.5%	139.7%	91%	-0.1%	1.8%	6%	0.6%	4%	47%	13%	9.4%	CCC-	LatAm
Ghana	3.1%	15.0%	83%	-4.7%	0.5%	31%	-2.5%	10%	41%	-31%	-17.1%	Co	SSA
Zambia	2.3%	15.0%		-6.1%	-0.7%	25%	-0.2%	15%	92%	-109%	-12.3%	Co	SSA

Source: National Sources, IMF, World Bank, Brookings, Bruegel, Macrobond, ING; IMF WEO data for 2024 used for Economy & Fiscal variables, External Balance Sheet data is latest available.

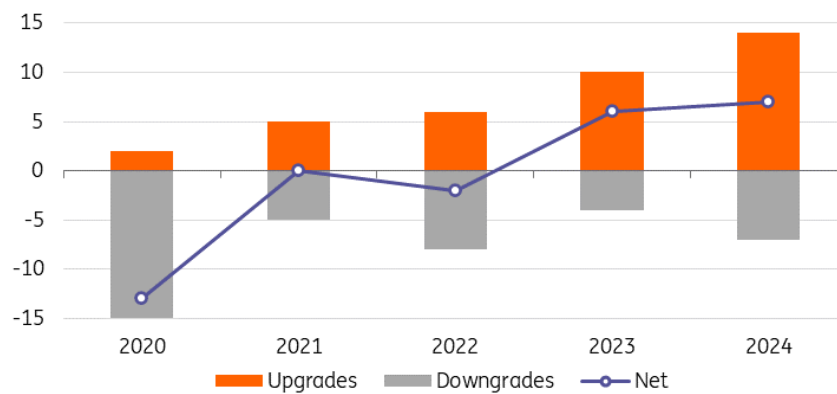
\*Azerbaijan IIP is estimate of sovereign net foreign assets (FX reserves and SOFAZ assets, net of government external debt).

## EM sovereigns are more resilient to external shocks

Much of the discussion following Donald Trump's US presidential victory has focused on the potential for higher US rates and a stronger US dollar, amid lower global trade volumes, which is likely to produce a tough environment for EMFX. However, despite the external headwinds and global macro uncertainty, the fundamental picture for many EM sovereigns has shifted more positive, with reforms being successfully implemented and balance sheets strengthened despite the significant twin shocks of Covid and the war in Ukraine in recent years. This should help to keep EM sovereign credit markets well supported, despite relatively expensive valuations in terms of tight credit spreads.

This trend has started to be reflected by improvements in sovereign credit ratings, with the trend of net downgrades seen from 2020 to 2022 shifting to net upgrades, first in 2023 and looking even more positive this year. This is true for all three largest rating agencies – Moody's, S&P and Fitch, where upgrades outnumber downgrades for EM sovereigns this year. Significant upgrades have included Turkey (multiple times), Qatar, Egypt, Ivory Coast, Brazil, Argentina, Azerbaijan, Kazakhstan, Serbia, Croatia, Montenegro, Albania, Pakistan, and Mongolia.

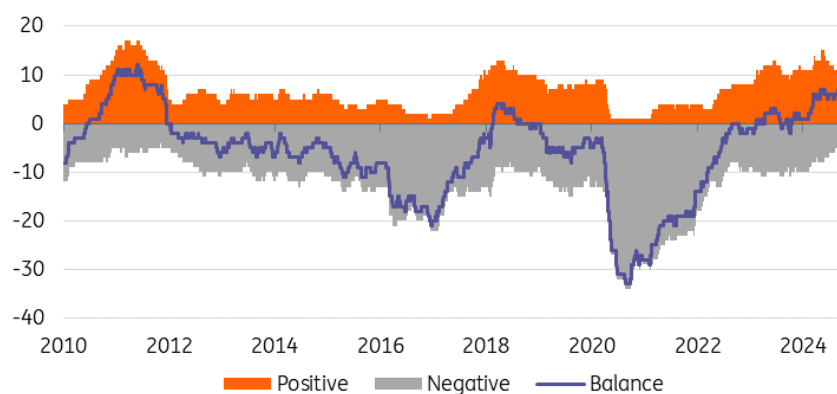
## Annual EM sovereign rating changes – Fitch



Source: Fitch, ING

When looking ahead, an even more encouraging signal is the shift in the balance of outlooks to positive (more positive than negative rating outlooks), highlighting the potential for further upgrades over the next 12 months. By this measure, both Fitch and S&P’s rating outlook balances are hovering near their most positive level for the past decade, with a negative skew seen for much of this historical period.

## EM sovereign rating outlook balance – Fitch

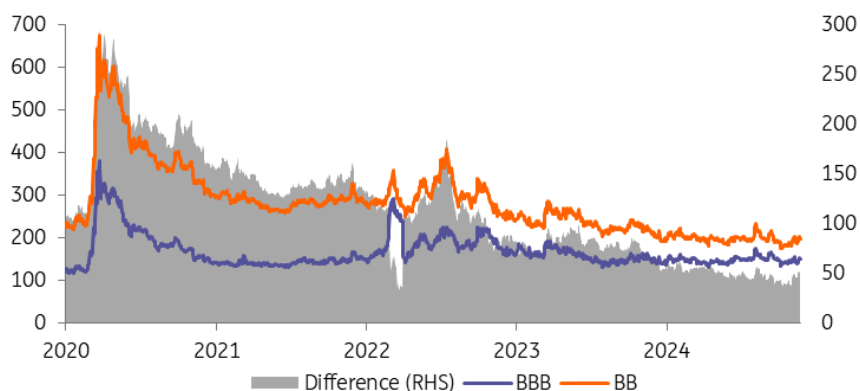


Source: Fitch, ING

## Rising stars in focus for investors

Of particular interest for investors is likely to be the transition from High Yield (HY) to Investment Grade (IG) ratings as a potential technical trigger for strong performance, with potential ‘rising star’ candidates within the EM universe including the BB+ rated Azerbaijan, Oman, Serbia, and Morocco. This dynamic of narrowing the gap in fundamentals between the BB-tier of EM sovereigns and the BBB-tier (where ratings momentum is broadly heading the opposite way, in a more negative direction) is starting to play out in the market, with a compression in the spread differential between the two tiers. Indeed, on a country level, some of these upgrade candidates (Oman, Serbia in particular) are already trading at tighter spread levels than higher rated peers, with market-implied ratings nearer BBB, although we expect a further short-term bounce if the composite rating (average of three major agencies) eventually reaches IG.

## EM USD sovereign spreads by rating (bp)



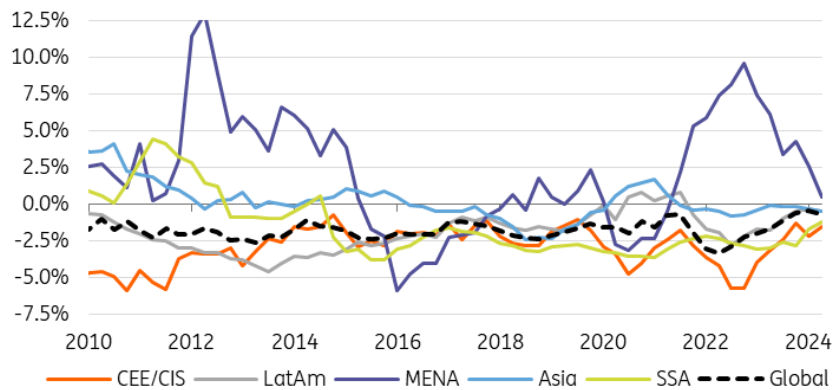
Source: ICE, Refinitiv, ING

Other big stories for investors have been the multi-notch shift for Turkey from B- to BB- given the return to orthodox monetary policy (although we expect the upwards momentum in ratings may take a pause for now), and the first signs of a reversal in South Africa's long-term down trend, with a positive outlook now at S&P. Among higher-risk frontier names, Egypt and Nigeria also look to have recovered from the brink, with multiple positive outlooks and ratings almost entirely lifted out of the CCC bucket and back towards B- or B. In the IG space eurozone members/hopefuls such as Croatia and Bulgaria have seen upgrades and positive outlooks, along with some improvements in the GCC for Saudi Arabia and Qatar. Overall, it is clear that EM governments are being rewarded for decisive reform efforts, while negative shifts have largely come from political pressures, such as in Kenya, Georgia, and Panama (although not limited to EM countries, as seen with France in the developed world).

## Debt levels rising but lower external vulnerabilities

An important area of fundamental improvement in the EM world is reduced vulnerability to external shocks. In aggregate, EM current account deficits have reduced, with the median EM deficit near its narrowest in the past decade, meaning generally lower external financing needs across the world. By region, the large surpluses for oil exporters in the Middle East have moderated over the past year but are still in a strong position compared to much of the past decade, while EM Europe has seen a recovery from the energy and terms of trade shock of 2022. At the same time, most economies have been steadily accumulating FX reserves, monetary policy has generally been orthodox and conservative, and more governments have been gradually adopting more flexible exchange rates. Lower foreign holdings of local currency debt represent another area of reduced external vulnerability.

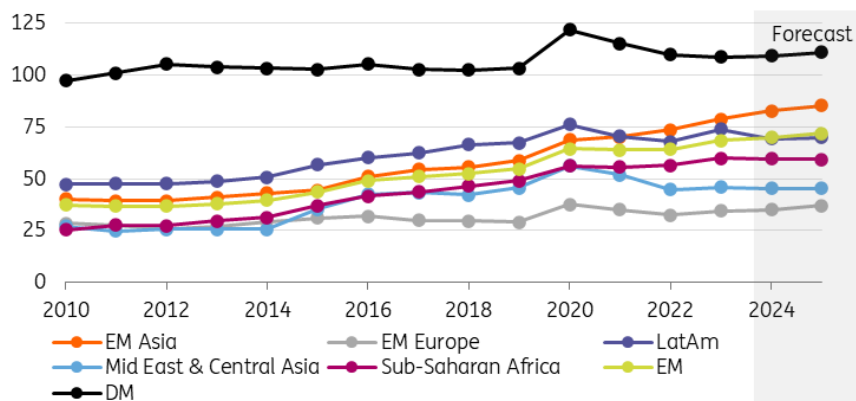
## EM median current account by region (% of GDP)



Source: National sources, Macrobond, ING

It's not all good news for EM sovereigns however, as fiscal accounts are still showing some signs of strain. Fiscal balances have deteriorated relative to the pre-Covid era, and government debt ratios are elevated, even more so when compared to a decade ago. Debt levels in Developed Markets are still higher, but that differential has narrowed and looks set to narrow further. For EM Europe, government spending is likely to remain high on military expenditure and the green energy transition, while in the Middle East most are focused on shifting their economies away from hydrocarbon dependence.

## EM gross government debt by region – IMF WEO (% of GDP)



Source: IMF WEO Oct 2024, Macrobond, ING

Overall, the key question is how fiscal deficits are likely to be funded across EM economies. Countries with deep capital markets can be content with local currency funding, although a return of foreign investors to local currency EM debt markets would be helpful here. In EM Europe, many countries have returned as significant international bond issuers since Covid, in contrast to the previous decade of net negative supply, although can also count on financing support from the EU. For frontier and higher-beta names, bilateral and multilateral official funding sources should remain an important safety net, with IMF programmes often the catalyst for a wider range of official financing, as seen this year with the likes of Egypt and Pakistan, although domestic political considerations can often clash with the reform conditionality that comes with such support.

Among stronger BB names, we expect further ratings upgrades are likely for Serbia, Oman and Azerbaijan, with the latter offering the most potential for spread tightening in the event of upgrade to IG. In the IG tier, Bulgaria would likely see upgrades in the event of eventual eurozone accession, although the timing remains unclear, while Saudi Arabia could also see further gains if oil prices remain elevated and production normalises. For lower rated credits we are sceptical of multiple upgrades for South Africa, although investor sentiment may well move to price in this potential, while Turkey should see a pause in momentum at BB-. The likes of Egypt and Pakistan will also likely see further progress amid strong external support. In contrast, Panama is teetering on the edge of a full downgrade to HY, while some pressures could re-emerge on Romania next year if fiscal consolidation expectations are not met, with market pricing already pointing towards this potential. In the HY space, Senegal is at risk of further downgrades, while Kenya looks most vulnerable among lower rated B-/CCC credits.

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