

## Market Commentary

December 16, 2020

Macro & Market Research, Generali Insurance Asset Management S.p.A. SGR

### EM Issuance: from frenzy to busy January

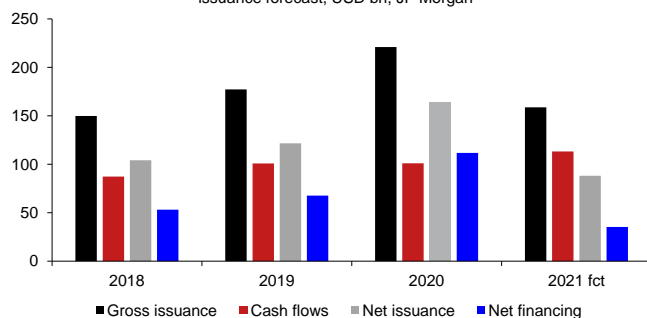
- EM sovereign external debt issuance reached new highs in 2020 at c. USD225bn. Past weeks were frenzy with exotic names and very long issuance. Indonesia can still come to the market until year-end.
- Gross issuance will decline next year at USD150bn in the wake of tighter fiscal deficits. GCC and Latin America are likely to remain the largest issuers, albeit declining, followed by Asia. We do not expect the large issuance surprises to repeat again in 2021.
- The main striking change will be the rise of EM HY issuance from countries which were reluctant to issue in 2020 on poor idiosyncratic market conditions. We then expect EM HY issuance to gradually normalise in 2021 and it could reach 40% of total issuance, just below its post-GFC average.
- The rise in EM HY issuance does not affect our positive EM BB view. Indeed, EM net issuance will decline substantially and it could be in the sub USD50bn region, its lowest level since 2015.
- January will be busy in terms of issuance given the still large financing needs. Sovereigns will try to benefit from a positive EM environment, spread compression and significant cash inflows to investors.

EM sovereign external debt issuance has been frenzy over the past three weeks with November and December total gross issuance reaching highs at USD56bn and USD25bn respectively. Likewise, we saw very long issuance with the new Peru 100Y and weak credit rating names came to the market like Uzbekistan, Ukraine, Montenegro or even Laos (CCC), meeting a significant investors' demand. EM Treasuries have been opportunistic in taking advantage of the very positive EM environment, supported by better growth prospects and low global real yields. EMs are in a sweet spot currently and supply has been very well absorbed by a strong appetite for external debt, be it IG or HY.

Market should almost close in the next two weeks and given the low liquidity environment we do not expect major issuance from HY or small EM countries. There is a small chance for South Africa to come while it is possible for Indonesia, which uses to be a December issuer, to pre-fund its 2021 needs.

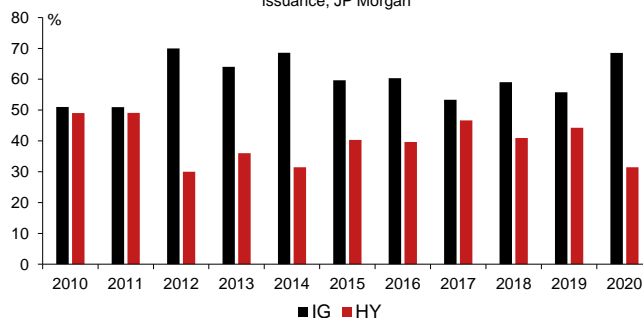
**Gross issuance to decline but to remain high**

issuance forecast, USD bn, JP Morgan



**EM HY share in issuance close to its lows**

issuance, JP Morgan



Going forward, 2021 gross issuance will likely be lower at c. USD150bn, albeit hovering close to its highest level, declining from c. USD225bn in 2020. Issuance has been supported by a significant rise of funding needs in the wake of the Covid crisis and even if financing needs will stay at high levels, it is expected to decline. Based on IMF projections, EM fiscal deficit for EMBI names is due to decrease by 2.6pp next year.

Most of the 2020 issuance was driven by IG representing c. 70% and conversely EM HY issuance was low by historical standards, the lowest level since 2015. This can be explained by the weak market conditions and various supports from the official sector like the Debt Service Suspension Initiative (DSSI) or the use of the IMF's Rapid Credit Facility/Rapid Financing Instrument. We then expect EM HY issuance to gradually normalise in 2021; it could reach 40% of total issuance, just below its post-GFC average (48%).

Geographically, GCC and Latin America are likely to remain the largest issuers, albeit declining, followed by Asia. We do not expect this year's large issuance surprises to repeat again in 2021:

- In Israel, most of the support was coming from the fiscal side than monetary side. We expect it to change
- In the UAE, better oil prices should reduce funding needs
- Hungary has repeated that it wants to reduce its reliance on FX debt while it will be more difficult for Romania to issue if it loses its IG rating in 2021
- Large countries like Mexico and Indonesia can tap more easily the local market than in 2020 given better market conditions and abundant portfolio inflows into EM, reducing *de facto* external issuance.

This rise in EM HY issuance does not affect our positive view on EM BB :

- Cash flows to bond holders are expected to increase significantly while coupons are set to decrease. It means that on a net basis, EM issuance could be in the sub USD50bn region, its lowest level since 2015
- We expect most of the spread tightening to take place in Q1 and Q2 which should attract further portfolio inflows. January will be busy but cash inflows to investors could reach USD50bn in total until April.
- Sub-BB names, out from the market in 2020, will relatively increase the most their issuance
- The IMF has committed to more funded programs to countries drawing on their RCF/RCI lines.

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