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MONEYBEAT

Emerging Markets Sour on Dollar Debt Amid Currency Volatility

Companies are pulling back on dollar debt as their currencies come under pressure. **PHOTO:** MURAD SEZER/REUTERS

By Julie Wernau

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Companies in the emerging world are on a dollar-debt diet.

Issuance of dollar-denominated bonds from emerging-market companies is down 14% year-to-date versus the same period last year, according to Dealogic. Local currency debt is on the rise, up 4% year-to-date versus the same period last year, as corporates turn inward for financing amid widespread selling among foreign investors.

The decline comes as rising U.S. interest rates are lifting borrowing costs for emerging markets and making their assets seem less attractive to global investors. That's sparked big selloffs in the currencies of countries like Argentina, Hungary, Turkey, Poland and Chile, making it more difficult for them to pay back dollar debts.

Corporate defaults in emerging markets have tripled so far in 2018, according to S&P Global Ratings.

"We lived so long in a declining interest rate environment that banks could say we can issue more cheaply this year than we did last year," said Roger Horn, executive director in fixed income sales and trading on the emerging markets desk at SMBC Nikko Securities America. "That's not the case right now."

Just a few months ago, investors were eager to reach for yield in the farthest reaches of the world. Currencies in the developing world were enjoying a period of relative strength against the dollar, which had its worst performance in 14 years in 2017.

Relatively low U.S. rates and rising currencies encouraged emerging-market governments and companies to issue new debt in the U.S. currency. Dollar-debt issuances among corporates in the emerging world reached a record high in 2017, according to Dealogic. Hard currency debt in emerging markets peaked in the first quarter of 2018 at $5.5 trillion, with corporates accounting for 78% of that, according to the Institute of International Finance.

"The quantitative easing years have been a remarkable environment for opportunity to finance growth and the rates have been so low for so long that the accumulation of debt has been very significant," said Sonja Gibbs, senior director of global capital markets at the IIF.

While recent money flows data shows that investors are continuing to steer clear of corporate bonds in the emerging world, there are signs that risk appetite could be returning. In the week ended July 11, emerging markets bond funds snapped their longest run of outflows since the third quarter of 2015, according to EPFR Global.

"While the global landscape is clearly shifting and markets appear somewhat less complacent we don't believe that we are shifting to a later stage in the economic cycle and default rates over the coming few quarters should remain relatively low," said Michael Scott, credit fund manager at Schroeders.

And not all markets are alike, opening up opportunities for discerning investors, some analysts said. In the past year, Colombia, Argentina, and Philippines have seen a sharp increase in corporate debt-to-GDP ratios; in contrast, Turkey and China have seen some decline, according to the IIF.

While China has implemented policies aimed at lowering a 202% debt-to-GDP ratio by tightening controls on its shadow banking system, investors have been closely watching for signs that China could choose to devalue its currency as it exchanges blows with the United States over trade policy.

Such a move would partially offset the effect from recent tariffs the U.S. has placed on its exports. But it would also exacerbate China's more than $11 trillion in dollar loans, says Michael Pento, president and founder of Pento Portfolio Strategies and put further pressure on other emerging market countries to devalue in order to remain competitive with China.

Meanwhile, there are signs that the dollar's rally may be running out of steam, which could encourage companies in the developing world to return to borrowing in the U.S. currency. The WSJ dollar index, which measures the U.S. currency against a basket of currencies, is still hovering near a one-year high but has been treading water for the last three weeks.

“If you see the dollar stabilizing here, I would expect issuance to pick up,” said Shamaila Khan, director of emerging market debt at asset manager AB.

Chelsey Dulaney contributed to this article.

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