Commentary
Fixed Income

February 2024

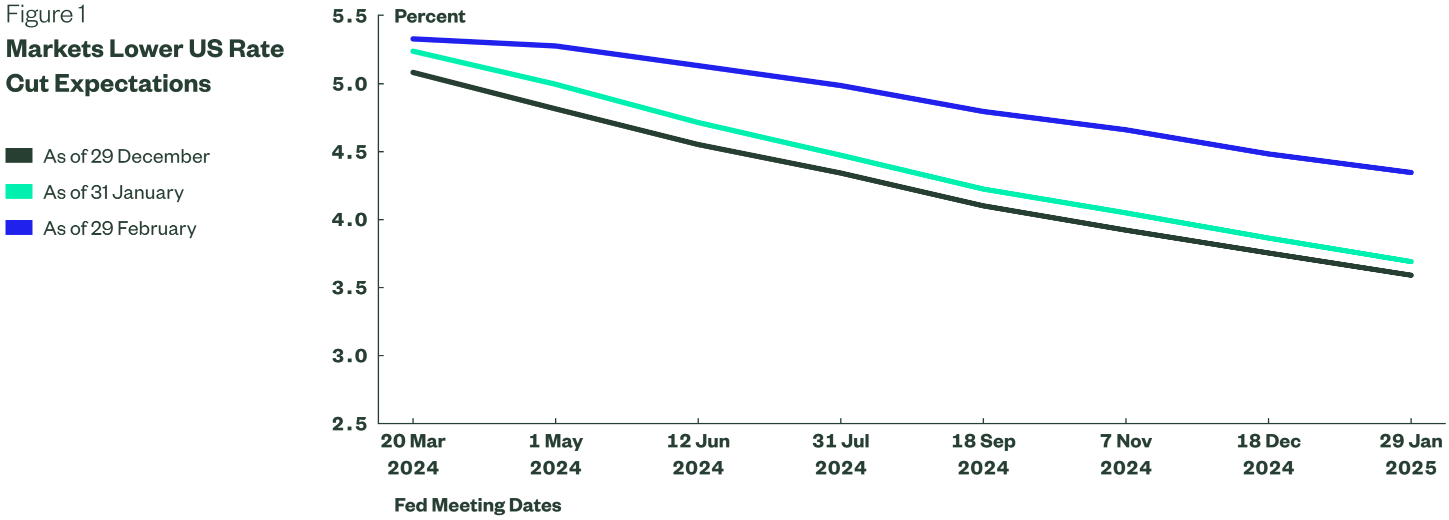
Emerging Market Debt

Market Commentary: February 2024

Chart of the Month: Implied US Rates Up on Sticky Inflation and Resilient Economy

The resilience of the US economy and 'sticky' US inflation prompted markets to price in fewer rate cuts in 2024 by the US Federal Reserve (Fed) than was anticipated at the start of the year. Consequently, the timing for monetary policy convergence between the developed and emerging markets was pushed out to later in 2024.

Figure 1
Markets Lower US Rate Cut Expectations



Source: Bloomberg Finance L.P., as of 29 February 2024.

EMD Commentary — February 2024

Emerging market (EM) debt returns in February continued to be impacted by resilient US economic data and market repricing around the timing of when the US Fed's first rate cut will arrive. Local currency returns were negative in the month, although the significant contribution from spread returns helped drive largely positive returns in hard currency debt. The prospect of US growth being maintained at a higher rate than previously anticipated and the ongoing strength of the US dollar weighed on investor sentiment, especially for EM local bonds. Evolving expectations around the Fed's monetary policy stance had mixed implications for EM central banks. The monetary policy approaches of central banks in Latin America (LatAm) have increasingly decoupled from the Fed, with many having commenced cutting rates in 2023. EM central banks in the EMEA region initially lagged their LatAm counterparts, although policy divergence has narrowed with recent rate cuts in February, notably in Hungary and Czech Republic. Policy divergence was more pronounced for EM central banks in Asia, with markets pushing out the timing of rate cuts to later in the year.

In China, a weak growth outlook prevailed due to sluggishness in the property sector and a lack of meaningful growth stimulus. The economy's medium-term growth challenges continued to be a concern leading up to the annual National People's Congress (NPC) meeting in March. The People's Bank of China (PBoC) lowered the 5-year loan prime rate (reference rate for mortgages) by 25bps to 3.95% in February in an effort to stimulate credit demand and address the property market downturn. The 1-year loan rate was retained at 3.45%, contrary to market expectations for a rate cut. The broad EM inflation outlook for 2024 was positive, as the downtrend in inflation continued despite the spike in commodity prices in February. Improvements in the macroeconomic backdrop, along with the likelihood of a US soft landing in the medium term, contributed to a narrowing of spreads in the month. The resulting compression in EM High Yield/ Investment Grade (HY/IG) spreads benefited EM hard currency bonds.

Net flows in February were negative for both hard currency and local currency funds, amounting to -\$2.0bn and -\$0.2bn, respectively.[1]

Figure 2
Emerging Market Debt Index Returns — As of 29 February 2024

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	-0.57	1.05	2.25	-2.09	9.26	-2.61	-0.13
EMBI GD (EM Hard Currency)	0.98	4.68	6.27	-0.05	10.05	-2.39	0.58
CEMBI BD (EM Corporates)	0.71	4.41	6.06	1.30	8.99	-0.67	2.69
In EUR							
GBI-EM GD (EM Local Currency)	-0.20	1.89	2.56	-0.05	7.08	1.19	0.89
EMBI GD (EM Hard Currency)	1.36	5.54	6.58	2.02	7.85	1.42	1.61
CEMBI BD (EM Corporates)	1.09	5.28	6.38	3.41	6.81	3.20	3.74
In GBP							
GBI-EM GD (EM Local Currency)	0.09	1.13	2.43	-1.33	4.57	0.69	0.88
EMBI GD (EM Hard Currency)	1.66	4.76	6.45	0.72	5.33	0.92	1.60
CEMBI BD (EM Corporates)	1.39	4.50	6.25	2.09	4.31	2.70	3.72

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 February 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable. Performance returns for periods of less than one year are not annualized.

Figure 3
Key EM and Macro Levels as of 29 February 2024

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	5 bps	-29 bps	-1 bps	6.19%
EMBI GD Yield	-2 bps	-46 bps	22 bps	8.07%
EMBI GD Spread	-33 bps	-37 bps	-15 bps	369 bps
CEMBI BD Yield	9 bps	-49 bps	11 bps	7.11%
CEMBI BD Spread	-25 bps	-44 bps	-32 bps	317 bps
CDX.EM 5y	-17 bps	-22 bps	0 bps	166 bps
10y UST	34 bps	-8 bps	37 bps	4.25%
Dollar Index (DXY)	0.85%	0.64%	2.79%	—
DOW 30	2.22%	8.47%	3.47%	38996
Oil (WTI)	3.18%	3.03%	9.23%	\$ 78.26

Source: JP Morgan, Bloomberg as of 29 February 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.

Local Currency Market Highlights

EM local currency debt returned -0.57% (in USD terms) in February 2024, as measured by the JP Morgan GBI-EM Global Diversified Index. A major contribution to the total return outcome came from negative foreign exchange (FX) returns (-0.73%). The prevailing US dollar strength since the start of the year weighed on local currency returns. Total bond returns were positive for February, aided by the macro backdrop of improving real yields and the ongoing monetary easing cycle in some regions. At a regional level, Asia stood out as the only positive contributor. The GBI-EM GD Index yield increased by 5bps in January.

Figure 4
Key Return Drivers of EM Local Government Bond Markets

GBI-EM GD (EM Local Currency)	Monthly Return (%)	3-Month Return (%)	YTD Return (%)
In USD			
Total Return (in $)	**-0.57**	**1.05**	**-2.09**
FX Return (vs $)	-0.73	-1.77	-2.87
Price Return (Local currency)	-0.28	1.48	-0.11
Interest Return (Local currency)	0.44	1.34	0.89
In EUR			
Total Return (in €)	**-0.20**	**1.89**	**-0.05**
FX Return (vs €)	-0.35	-0.93	-0.83
In GBP			
Total Return (in €)	**0.09**	**1.13**	**-1.33**
FX Return (vs €)	-0.06	-1.69	-2.11

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 February 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable. Performance returns for periods of less than one year are not annualized.

Figure 5
Best and Worst Performers Across EM Local Government Bond Markets in USD*

February 2024	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**-0.57**	**0.16**	**-0.73**		
Top 5 Performers	Uruguay	2.0	2.1	-0.1	0.2	0
	Dominican Republic	1.7	1.4	0.2	0.2	0
	Mexico	1.3	0.7	0.6	10.0	13
	Indonesia	0.9	0.5	0.4	10.0	9
	China	0.5	0.7	-0.2	10.0	5
Bottom 5 Performers	Czech Republic	-1.6	0.4	-2.0	6.4	-10
	Turkey	-2.6	0.2	-2.8	0.9	-2
	Hungary	-3.4	-0.7	-2.8	3.2	-11
	South Africa	-3.7	-0.7	-3.0	8.2	-30
	Chile	-4.2	-0.6	-3.6	1.8	-7

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 29 February 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.
*Country and currency performance of JP Morgan GBI-EM Global Diversified Index.
**Index impact is calculated by multiplying the period ending weight by total return.

Chile was the worst performer in February, with negative FX returns a significant detractor in February. The Chilean peso was hit by the central bank's monetary easing cycle and the resulting yield differentials with the US. The peso depreciated against the stronger US dollar by 4.03% in February and closed at 966.50.

South Africa was another underperformer in February. The country's annual inflation rate increased to 5.3% in January, moving above the South African Reserve Bank's preferred midpoint of 4.5% (in a 3%-to-6% target range). The currency's weakness continued in February in the absence of strong data releases and the stronger US dollar. The South African rand weakened against the US dollar by 2.78% in the month and closed at 19.20.

Czech Republic also underperformed in the month. In its February meeting, the Czech National Bank reduced its two-week repo rate by 50bps to 6.25%, a bigger move than the 25bps rate cut expected by markets. The Czech koruna was negatively impacted by the narrowing policy rate gap with the US Fed, and as markets priced in a higher implied Fed funds rate. The koruna depreciated against the US dollar by 2.20% in February and closed at 23.45.

Uruguay was the best performer in the month. Uruguay's annual inflation rate marginally softened to 5.09% in January, from 5.11% in December. In its February meeting, the Central Bank of Uruguay kept its benchmark policy rate at 9%, following a 25 bps cut in January. The central bank aims to lower inflation and maintain it within the target range over the next 24 months. The Uruguayan peso appreciated against the US dollar by 0.19% in February and closed at 39.03.

Mexico was another good performer in February. Mexico's annual core inflation rate decreased for the twelfth consecutive month to 4.76% in January, marking the lowest level since July 2021. The Bank of Mexico held its benchmark policy rate at a record high of 11.25% in its January meeting although markets continued to price in a first rate cut for the near future as the high rate level is constraining consumer demand. The Mexican peso appreciated against the US dollar by 0.92% in February and closed at 17.05.

Hard Currency Market Highlights

EM hard currency sovereign debt returned +0.98% (in USD terms) in February 2024, as measured by the JP Morgan EMBI Global Diversified Index. The spread component (+2.80%) was the major contributor to performance, with the JPM EMBI GD spreads narrowing by 33bps in February. Given the compression in investment grade/high yield (IG/HY) spreads, the high-grade countries in the index were slightly down while most of the high-yield countries were up during the month. On a regional basis, just over 55% of the countries in the index delivered gains. Overall, the treasury returns were negative (-1.77%). Hard currency treasuries were impacted by market repricing of the timing of rate cuts by the US Fed and the volatility in US Treasury yields during February.

Figure 6
Key Return Drivers of EM Hard Currency Government Bond Markets in USD

EMBI GD (EM Hard Currency)	Monthly Return (%)	3-Month Return (%)	YTD Return (%)
Total Return	**0.98**	**4.68**	**-0.05**
Spread Return	2.80	3.08	1.79
Treasury Return	-1.77	1.55	-1.81
IG Sub-Index	-0.60	2.70	-1.95
HY Sub-Index	2.60	6.71	1.90

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 February 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable. Performance returns for periods of less than one year are not annualized.

Figure 7
Best and Worst Performers Across EM Hard Currency Government Bond Markets*

February 2024	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Average Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**0.98**	**2.80**	**-1.77**		
Top 5 Performers	Egypt	20.9	22.5	-1.3	2.7	56
	Ecuador	18.6	20.3	-1.4	1.1	21
	Ukraine	12.3	13.2	-0.8	0.8	10
	Argentina	11.9	13.3	-1.2	1.6	19
	Bolivia	9.2	10.2	-0.9	0.2	2
Bottom 5 Performers	Romania	-1.5	0.4	-1.9	2.6	-4
	Mozambique	-1.9	-0.6	-1.3	0.1	0
	El Salvador	-2.0	-0.3	-1.7	0.7	-1
	Senegal	-2.4	-0.5	-2.0	0.3	-1
	Ghana	-3.4	-2.5	-0.9	0.9	-3

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 29 February 2024. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income as applicable.
*Country and currency performance of JPM EMBI Global Diversified Index
**Index impact is calculated by multiplying the period ending weight by total return.

Egypt was the best performer in February, contributing 56bps to index returns. The rally in Egypt's dollar bonds was driven by news that Abu Dhabi will invest $35 billion in a tourism and financial centre on the Mediterranean coast. The deal will provide a valuable source of hard currency which should help Egypt to liberalise the FX market and secure a new deal with the International Monetary Fund (IMF).

Ecuador was another outperformer in February, contributing 21bps to index returns. A major contribution to the return outcome came from the spread component as the country's hard currency bonds benefited from the HY/IG spread compression in February. Furthermore, optimism grew around Ecuador's debt payment capacity in 2024. Ecuador's Foreign Exchange Reserves increased to US$4488.75 million in January from US$4454.36 million in December.

Argentina was another outperformer in February, contributing 19bps to index returns. In line with other high-yielding LatAm countries in the index, the major contribution to the return outcome came from the spread component. Markets continued to assess the potential for additional fiscal consolidation packages from the new government. Argentina's foreign exchange reserves increased to US$20,866 million in January from US$18,987 million in December.

Ghana was among the underperformers in February, detracting 3bps from index returns. On February 14, the office of President Nana Akufo-Addo announced changes to the cabinet, replacing Finance Minister Ofori-Atta with Mohammed Amin Adam, currently the minister of state at the finance ministry — this move had a negative impact on investor sentiment toward Ghana's bond market.

Romania was another underperformer in February, detracting 4bps from index returns. Romania was one of the high grade countries in the index that posted negative returns. Romania's gross external debt increased to €168.81 billion at the end of 2023, up from €143.89 billion at the end of 2022. Romania's annual inflation rate increased to 7.41% in January, the highest reading since October 2023.

Endnote

1 Source: JP Morgan.

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* Pensions & Investments Research Center, as of December 31, 2022.
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