Commentary
Fixed Income

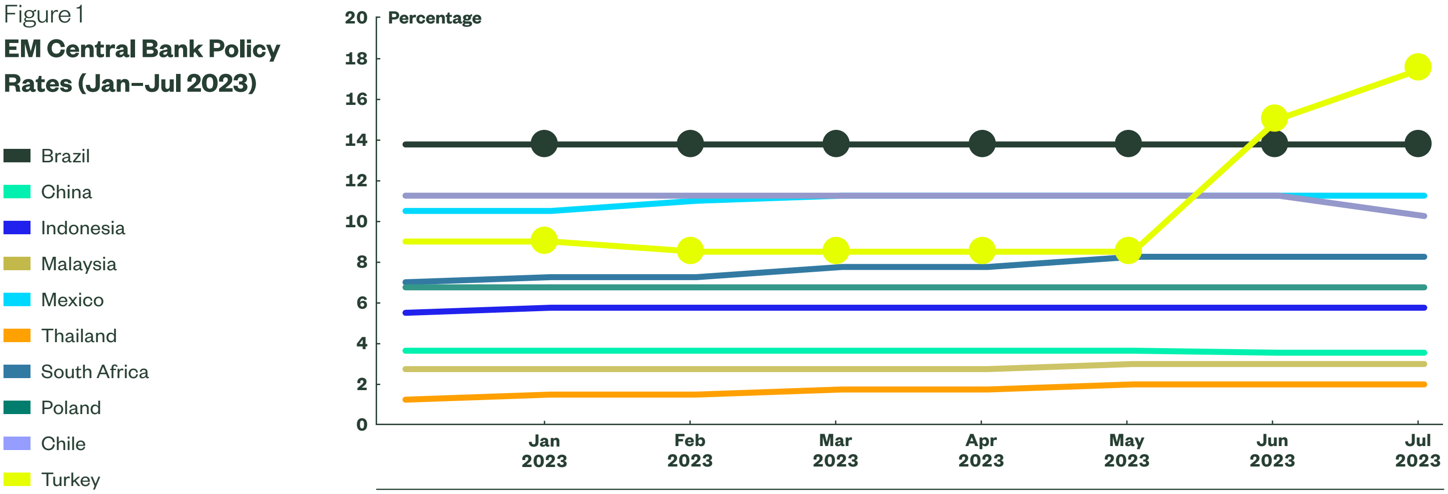
July 2023

Emerging Market Debt
Market Commentary: July 2023

Chart of the Month: Interest Rate Dynamics in Emerging Markets

Chile was one of the first major EM central banks to start easing monetary policy, announcing an interest rate cut in July. Other EM central banks have kept rates unchanged through recent meetings against the backdrop of retreating inflation. Turkey was an exception, with recent rate hikes reflecting a shift away from its unorthodox monetary policy that attempted to rein in high inflation with lower interest rates. Overall, amid signs that interest rate policies have dampened economic activity and inflation expectations, markets have started to price in the probability of interest rate cuts.

Figure 1
EM Central Bank Policy Rates (Jan–Jul 2023)



Source: Bloomberg Finance L.P., as of 31 July 2023. Past performance is not a reliable indicator of future performance.

EMD Commentary — July 2023

The second half of 2023 began on a positive note for emerging market (EM) debt amid global disinflation and tightening credit spreads. The regional inflation prints for June were softer than expected across the board. Despite a few inflation data surprises, real yields in most EM economies remained on an upward trajectory. Having been ahead of their developed market (DM) counterparts in the monetary tightening cycle, EM central banks (especially in the Latin America region) are increasingly expected to commence rate cuts later in 2023. In contrast, the US Federal Reserve raised rates by another 25 basis points (bps) in July. However, rising demand for duration within EM local bonds was reflective of investor expectations that a hawkish Fed has a lesser impact on emerging markets.

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EM local bond yields were resilient throughout the month, despite the fluctuations in US Treasury yields and markets pricing in the probability of a US soft economic landing. In China, weaker-than-expected GDP data for Q2 added to policymakers' determination to bolster the economy with initiatives to improve consumption. In the Politburo meeting in July, new policy measures were announced in the interest of stabilizing the economy, real estate sector, and the local currency yuan. The contagion risks from a Chinese slowdown, however, were considered limited and did not materially detract from overall EM performance in the month. Oil prices rallied in July (gaining 15.8%, as shown in Figure 3), fueled by signs of tightening global supply and growing demand. This contributed to a favorable backdrop for outperformance by some EM economies in LatAm that have a higher beta to commodity prices.

The prospect of narrowing spreads bolstered investor sentiment in July, supporting inflows towards hard currency bonds — this followed a series of monthly outflows. Net flows in July for hard currency and local currency funds were +0.5bn and -0.5bn, respectively.[1]

Figure 2
Emerging Market Debt Index Returns — As of 31 July, 2023

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	2.88	4.55	6.33	10.89	14.25	-1.46	0.49
EMBI GD (EM Hard Currency)	1.91	3.59	2.82	6.08	6.37	-3.67	0.43
CEMBI BD (EM Corporates)	0.98	1.47	1.57	4.66	5.59	-0.95	2.30
In EUR							
GBI-EM GD (EM Local Currency)	1.80	4.69	4.74	7.34	5.66	0.86	1.69
EMBI GD (EM Hard Currency)	0.84	3.72	1.28	2.68	-1.63	-1.39	1.63
CEMBI BD (EM Corporates)	-0.08	1.61	0.05	1.31	-2.35	1.39	3.53
In GBP							
GBI-EM GD (EM Local Currency)	1.65	2.14	1.74	3.68	8.06	-0.81	0.88
EMBI GD (EM Hard Currency)	0.70	1.19	-1.62	-0.83	0.60	-3.03	0.82
CEMBI BD (EM Corporates)	-0.22	-0.87	-2.82	-2.16	-0.14	-0.29	2.70

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 July 2023. 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 31 July 2023

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	-3 bps	-24 bps	-56 bps	6.29%
EMBI GD Yield	-24 bps	-33 bps	-42 bps	8.13%
EMBI GD Spread	-35 bps	-85 bps	-55 bps	398 bps
CEMBI BD Yield	-7 bps	11 bps	-10 bps	7.30%
CEMBI BD Spread	-17 bps	-45 bps	-29 bps	347 bps
CDX.EM 5y	-22 bps	-47 bps	-47 bps	191 bps
10y UST	12 bps	54 bps	8 bps	3.96%
Dollar Index (DXY)	-1.03%	0.19%	-1.61%	—
DOW 30	3.35%	4.29%	7.28%	35560
Oil (WTI)	15.80%	6.54%	1.92%	$81.8

Source: JP Morgan, Bloomberg as of 31 July, 2023. 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.

Local Currency Market Highlights

EM local currency debt returned 2.88% (in USD terms) in July 2023, as measured by the JP Morgan GBI-EM Global Diversified Index. A major contribution to the returns came from foreign exchange (FX) outperformance (+2.12%). Broader US dollar depreciation (-1.03%) in July was triggered by disinflation in the US and speculation that the Fed may have reached its peak rate level. This helped 14 out of the 20 currencies in the benchmark deliver positive returns in July. The local bond yields were relatively flat (falling 3bps), while markets continued to factor in the timing of when EM central banks will move to cut rates.

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 $)	**2.88**	**4.55**	**10.89**
FX Return (vs $)	2.12	1.47	4.40
Price Return (Local currency)	0.33	1.76	3.40
Interest Return (Local currency)	0.42	1.32	3.09
In EUR			
Total Return (in €)	**1.80**	**4.69**	**7.34**
FX Return (vs €)	1.04	1.61	0.85
In GBP			
Total Return (in €)	**1.65**	**2.14**	**3.68**
FX Return (vs €)	0.90	-0.94	-2.82

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 July, 2023. 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*

July '23	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**2.88**	**0.75**	**2.12**	—	—
Top 5 Performers	South Africa	8.6	2.2	6.4	8.5	73
	Colombia	6.5	-0.9	7.5	4.7	30
	Malaysia	3.9	0.3	3.5	10.0	39
	Thailand	3.6	0.1	3.5	9.7	35
	Poland	3.5	1.8	1.7	7.5	26
Bottom 5 Performers	Indonesia	-0.2	0.4	-0.6	10.0	-2
	Dominican Republic	-1.0	0.6	-1.5	0.2	0
	Hungary	-2.7	-0.1	-2.6	2.9	-8
	Chile	-3.9	0.5	-4.5	2.1	-8
	Turkey	-7.3	-4.3	-3.0	0.8	-6

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 31 July 2023. 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.

South Africa was the best performer in July. Post a series of ten consecutive hikes, the South African Reserve Bank kept its key repo rate unchanged at 8.25% at its July 2023 meeting, in line with expectations. The inflation print for June eased to 5.4%, marking a 19-month low. The South African rand appreciated against the US dollar by 5.3% in the month to close at 17.85.

Malaysian local bonds performed well in July. Backed by falling food prices, the annual inflation rate published for June slowed for a fourth consecutive month to 2.4%. The central bank of Malaysia left its overnight policy rate unchanged at 3% in July, acknowledging that the monetary policy will remain supportive of the economy. The Malaysian ringgit appreciated against the US dollar by 3.4% in July and closed at 4.51.

Thailand was another outperformer. In the midst of post-election events, the annual inflation rate slowed to 0.23% in June. The Thai economy showed signs of growth, bolstered by improved tourism and private consumption. The central bank reiterated that policy tightening will be gradual as the recovery continues. The Thai baht appreciated against the US dollar by 3.5% in July and closed at 34.22.

Turkey was the worst performer in July. Following a 650bps hike in its previous meeting, the Central Bank of Turkey raised its benchmark one-week repo rate by 250bps to 17.5%. The markets, however, had expected a larger hike (to 20%). Inflation continued to climb and reached 47.83% in July, from 38.21% in June. The Turkish lira depreciated against the US dollar by 3.5% in July and closed at 26.93.

Chile was another underperformer in July. The Central Bank of Chile commenced its monetary easing cycle in July, lowering its benchmark interest rate by 100bps to 10.25%. Markets factored in the probability of further rate cuts of the same magnitude by the central bank. The interest rate decision weighed on the Chilean peso, which depreciated against the dollar by 4.6% and closed at 838.75.

Hard Currency Market Highlights

EM hard currency sovereign debt returned 1.91% (in USD terms) in July 2023, as measured by the JP Morgan EMBI Global Diversified Index. The Spread component (+2.36%) was the major contributor to outperformance. The JPM EMBI GD spreads narrowed 35bps in July. Easing investor concerns and downward revisions to medium-term recession projections likely contributed to this spread-tightening. A constructive macro environment and inflation dynamics favored EM high yield in the month. Hard currency high yield bonds contributed 3.52% to the JPM EMBI GD return in July.

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 (in $)	**1.91**	**3.59**	**6.08**
Spread Return	2.36	6.34	5.00
Treasury Return	-0.44	-2.59	1.02
IG Sub-Index	0.37	-0.41	3.82
HY Sub-Index	3.52	7.98	8.48

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 July 2023. Past performance is not a reliable indicator of future performance. ndex 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.

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

July '23	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Average Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**1.91**	**2.36**	**-0.44**		
Top 5 Performers	Ukraine	28.0	27.5	0.3	0.9	25
	Lebanon	12.6	12.1	0.4	0.2	2
	Pakistan	10.8	10.5	0.3	0.7	8
	El Salvador	10.0	10.3	-0.3	0.6	6
	Egypt	9.4	9.4	0.0	2.3	22
Bottom 5 Performers	Peru	0.0	1.0	-1.0	2.8	0
	Zambia	-0.1	-0.5	0.4	0.3	0
	Uruguay	-0.1	1.0	-1.1	2.4	0
	Kuwait	-0.2	-0.5	0.2	0.7	0
	Malaysia	-0.7	0.2	-1.0	2.7	-2

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 31 July 2023. 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.

Ukraine was the best performer, with its dollar bonds gaining in a month when the country made steady advances with its military counteroffensives against Russian forces. The yield on Ukraine's 10-Year sovereign US dollar bond ended July at 27.6%, down from 32.8% in June. The country attracted flows on the back of an improved growth forecast for this year (range of 1% to 3%) by the International Monetary Fund (IMF).

Pakistan was another outperformer, contributing 8bps to the index return. Pakistan's dollar bonds rallied in July after the official $3 billion bailout by the IMF. The country, which was on the verge of default, also received $1 billion from the United Arab Emirates and $2 billion from Saudi Arabia. The reduced probability of a near-term default helped boost gains on the country's dollar bonds.

Egypt was another outperformer, contributing 22bps to the index return. In an effort to revive the struggling economy, the country agreed to sell $1.9 billion of state assets to local firms and to the Abu Dhabi wealth fund ADQ (Abu Dhabi Developmental Holding Company). The divestments were steps towards meeting the broad plan announced in February to raise billions of dollars. The nation's dollar bonds extended their rally as a result of these developments.

Malaysia was the worst performer in July, detracting 2bps from the index return. A minor contribution from the flat spread component (0.2bp) was more than offset by the negative treasury component (-1bp). The country's dollar bonds, which have a higher beta towards the Fed's tightening cycle, were impacted by the Fed's 25bps hike in July. This skewed the total returns towards the negative side.

Peru was another underperformer in July, making no contribution to the index return. Peru witnessed a fresh wave of anti-government protests in July calling for the resignation of President Dina Boluarte. The ongoing political unrest weighed on investor sentiment towards the country's external debt in the month.

Endnote

1 Source: JP Morgan.

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