

August 2023

# Emerging Market Debt

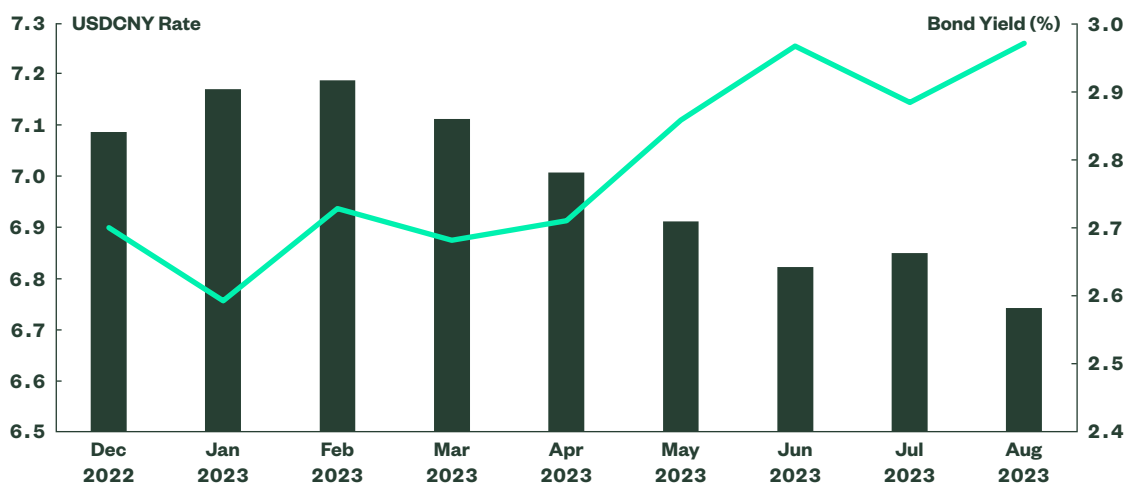
## Market Commentary: August 2023

### Chart of the Month: China's Economic Challenges Reflected in CNY and Bond Yield Moves

Worsening economic growth data from China and an increasing need for stimulus from the Politburo impacted the Chinese local currency, which depreciated against the US dollar to 7.26. The currency is down 5.2% year-to-date. Meanwhile, China's 10-year government bond yield has fallen by 26 basis points since the start of 2023, recently touching the lowest yield level since the second quarter of 2020.

Figure 1  
CNY Weakens, 10-Year  
Yields Keep Falling  
(Dec 2022–Aug 2023)

■ China 10Y Local  
Government Bond Yield  
■ USDCNY



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

### EMD Commentary — August 2023

Emerging market (EM) debt in August produced negative returns, marking a reversal in momentum that prevailed earlier in July on the back of EM investment grade/high yield (IG/HY) compression. Despite softening inflation prints across the board, EM assets witnessed weaker risk sentiment, caused by surge in US Treasury yields and negative growth headlines from China. Growth data released in China highlighted the real estate sector's drag on the economic recovery. The need for targeted policy measures by the Politburo was magnified by slower-than-expected consumption recovery in China and soaring unemployment. Uncertainties around China's growth forecasts weighed on investor sentiment as markets continued to analyze possible opportunities contingent on Chinese stimulus packages.

In an effort to bolster the shaky economy and weakening local currency yuan, the People's Bank of China (PBoC) lowered its one-year loan prime rate (LPR) by 10bps to 3.45%, which is a record low. The PBoC, however, held its five-year rate (mortgage reference rate) at 4.2%, contrary to expectations. The central bank of Brazil commenced monetary easing with a 50bps rate cut in August, taking the key Selic rate to 13.25%. A disinflationary trend was observed in central Europe, with Poland and Czech Republic reporting softer inflation data in August. Oil prices increased in August by 2.24%, a move reflective of a dip in inventory levels reported in the US and ongoing OPEC+ production cuts. Some EM economies with a higher beta towards oil prices (especially South Africa) were impacted as a result.

Cascading effects from China's growth prospects, relatively more resilient US economic data, and widening spreads lead to heavy outflows, especially for EM hard currency funds. Net flows in August for hard currency and local currency funds were -\$6.7bn and -\$2.3bn, respectively (source: JP Morgan).

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

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
<b>In USD</b>							
GBI-EM GD (EM Local Currency)	-2.69	3.38	6.85	7.92	11.34	-2.25	1.20
EMBI GD (EM Hard Currency)	-1.50	2.62	3.56	4.48	5.77	-4.32	0.47
CEMBI BD (EM Corporates)	-0.44	1.61	2.76	4.19	4.93	-1.39	2.43
<b>In EUR</b>							
GBI-EM GD (EM Local Currency)	-1.14	1.54	4.41	6.12	3.15	0.97	2.62
EMBI GD (EM Hard Currency)	0.06	0.80	1.19	2.74	-2.01	-1.17	1.88
CEMBI BD (EM Corporates)	1.13	-0.19	0.41	2.45	-2.78	1.85	3.87
<b>In GBP</b>							
GBI-EM GD (EM Local Currency)	-1.19	1.11	2.09	2.44	2.24	-0.43	1.72
EMBI GD (EM Hard Currency)	0.01	0.37	-1.06	-0.82	-2.88	-2.54	0.99
CEMBI BD (EM Corporates)	1.09	-0.61	-1.82	-1.09	-3.64	0.43	2.95

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

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	10 bps	-5 bps	-47 bps	6.39%
EMBI GD Yield	37 bps	-12 bps	-5 bps	8.51%
EMBI GD Spread	24 bps	-55 bps	-31 bps	422 bps
CEMBI BD Yield	25 bps	9 bps	15 bps	7.54%
CEMBI BD Spread	16 bps	-35 bps	-13 bps	363 bps
CDX.EM 5y	11 bps	-45 bps	-36 bps	202 bps
10y UST	15 bps	47 bps	23 bps	4.11%
Dollar Index (DXY)	1.73%	-0.68%	0.09%	—
DOW 30	-2.36%	5.51%	4.75%	34722
Oil (WTI)	2.24%	22.82%	4.20%	\$ 83.63

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## Local Currency Market Highlights

EM local currency debt returned -2.69% (in USD terms) in August 2023, as measured by the JPMorgan GBI-EM Global Diversified Index. A major detractor to the return outcome came from foreign exchange (FX) underperformance (-2.58%). Broader US dollar appreciation (+1.73%) in August, fueled by a resilient US economy, dampened foreign exchange (FX) returns. Steepening pressures and reassessment of terminal rates in certain EM economies impacted local bond yields. The GBI-EM GD Index yield increased by 10bps in August.

Figure 4  
**Key Return Drivers of  
EM Local Government  
Bond Markets**

GBI-EM GD (EM Local Currency)	Monthly Return (%)	3-Month Return (%)	YTD Return (%)
<b>In USD</b>			
<b>Total Return (in \$)</b>	<b>2.88</b>	<b>4.55</b>	<b>10.89</b>
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
<b>In EUR</b>			
<b>Total Return (in €)</b>	<b>1.80</b>	<b>4.69</b>	<b>7.34</b>
FX Return (vs €)	1.04	1.61	0.85
<b>In GBP</b>			
<b>Total Return (in £)</b>	<b>1.65</b>	<b>2.14</b>	<b>3.68</b>
FX Return (vs £)	0.90	-0.94	-2.82

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 August, 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\***

August '23	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
<b>GBI-EM GD</b>		<b>-2.69</b>	<b>-0.10</b>	<b>-2.59</b>	—	—
<b>Top 5 Performers</b>	Hungary	2.3	2.5	-0.2	3.1	7
	Egypt	1.9	1.8	0.1	1.0	2
	Uruguay	0.7	0.2	0.5	0.2	0
	Indonesia	-1.0	0.0	-1.0	10.0	-10
	China	-1.4	0.6	-2.0	10.0	-14
<b>Bottom 5 Performers</b>	Philippines	-3.6	-0.7	-3.0	0.1	0
	Colombia	-3.9	1.3	-5.3	4.5	-18
	Chile	-3.9	-2.0	-2.0	2.0	-8
	Turkey	-4.0	-4.9	1.0	0.7	-3
	South Africa	-6.2	-0.2	-6.1	8.1	-51

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 31 August 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 worst performer in August. The local currency rand was volatile in the month and continued to depreciate in reaction to the widening budget deficit, which stood at \$7.74 billion. Slower-than-expected growth in the country's private sector added to the pessimism. The rand depreciated against the US dollar by 5.8% in August to close at 18.88.

**Turkey** was another underperformer in August. The annual inflation rate rose to 58.9% in August 2023 from 47.8% in July, topping consensus market forecasts of 55.9%. In its August meeting, the Central Bank of Turkey raised its benchmark one-week repo rate by 750bps, taking it to 25%, which is its highest level since January 2004. The Turkish lira appreciated against the US dollar by 0.88% in August and closed at 26.70.

**Colombia** was also among the underperformers. The local currency peso continued to depreciate against the dollar amid increasing expectations of a rate cut by the central bank as a result of easing inflationary pressures. The annual inflation rate eased to 11.78% in July, driven by disinflation in food prices. The Colombian peso depreciated against the US dollar by 5.3% in August and closed at 4,095.81.

**Hungary** was the best performer in August. In line with market expectations, the National Bank of Hungary lowered its one-day deposit rate by 100bps to 14% in its August meeting. The annual inflation rate in Hungary plummeted to 17.6% in July 2023, marking an 11-month low. The core inflation rate slowed to 17.5% in July, below market forecasts. The Hungarian forint was relatively flat against the US dollar in August and closed at 351.48.

**Egypt's** local bonds performed well in August. Contrary to consensus expectations, the Central Bank of Egypt surprised markets by raising its key overnight deposit rate by 100 bps to 19.25% in its meeting in August. The future path of the policy rates is expected to be dependent on inflation forecasts rather than on prevailing inflation rates. The Egyptian pound was flat against the US dollar in August and closed at 30.90.

## 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 (%)
<b>Total Return (in \$)</b>	<b>-1.50</b>	<b>2.62</b>	<b>4.48</b>
Spread Return	-0.93	4.69	4.02
Treasury Return	-0.58	-1.98	0.44
IG Sub-Index	-1.30	-0.45	2.47
HY Sub-Index	-1.72	5.94	6.62

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

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

August '23	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Average Index Weight (%)	Index Impact (bps)**
<b>EMBI Global Diversified</b>		<b>-1.50</b>	<b>-0.93</b>	<b>-0.58</b>		
<b>Top 5 Performers</b>	Venezuela	35.3	34.7	0.4	0.0%	0
	El Salvador	9.6	10.1	-0.4	0.7%	6
	Lebanon	7.5	7.1	0.4	0.2%	1
	Ecuador	5.6	5.7	-0.1	0.9%	5
	Honduras	4.4	4.4	0.0	0.2%	1
<b>Bottom 5 Performers</b>	Egypt	-7.1	-7.0	-0.1	2.1%	-15
	Ukraine	-7.6	-7.8	0.2	0.9%	-7
	Bolivia	-7.7	-7.8	0.1	0.2%	-2
	Zambia	-9.3	-9.6	0.3	0.2%	-2
	Gabon	-13.2	-13.1	-0.1	0.2%	-3

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

**Egypt's** hard currency bonds were one of the poorest performers in August, detracting 15bps from index returns. The country's dollar bonds took a hit in the midst of a broader sell-off in EM hard currency debt. The spreads widened in August, reflecting investor sentiment on the country's ability to manage its external debt.

**Ukraine** was another underperformer in August, detracting 7bps from index returns. Ukraine's foreign exchange reserves dropped by 3.2% in August to around \$40.4 billion, as stated by the National Bank of Ukraine. The yield on Ukraine's 10-year USD-denominated government bond increased by 10.63%, closing at 30.56%.

**Gabon** was another underperformer, detracting 2bps from index returns. Gabon's dollar bonds fell in value after the military coup in August, when the army took control of the nation immediately after the state election results. Worries about the potential risk of sanctions that could constrain coupon payments weighed on sentiment.

**El Salvador** was one of the best performers in August, contributing 6bps to index returns. President Nayib Bukele's commitment to debt repayment through buybacks contributed to improving investor optimism, as reflected in narrowing of spreads. El Salvador's dollar bonds rallied after Google's announcement of plans to establish an office in the country.

**Ecuador** was another outperformer in August, contributing 5bps to index returns. The country's presidential candidate Fernando Villavicencio was assassinated on the 9 August. Despite the political uncertainties, Ecuador's dollar bonds rallied. Narrowing spreads indicated investor optimism on the upcoming government's ability honor the existing debt.

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

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ID1774500-3437638.391.GBL.INST 0923  
Exp. Date: 09/30/2024