Commentary
Fixed Income

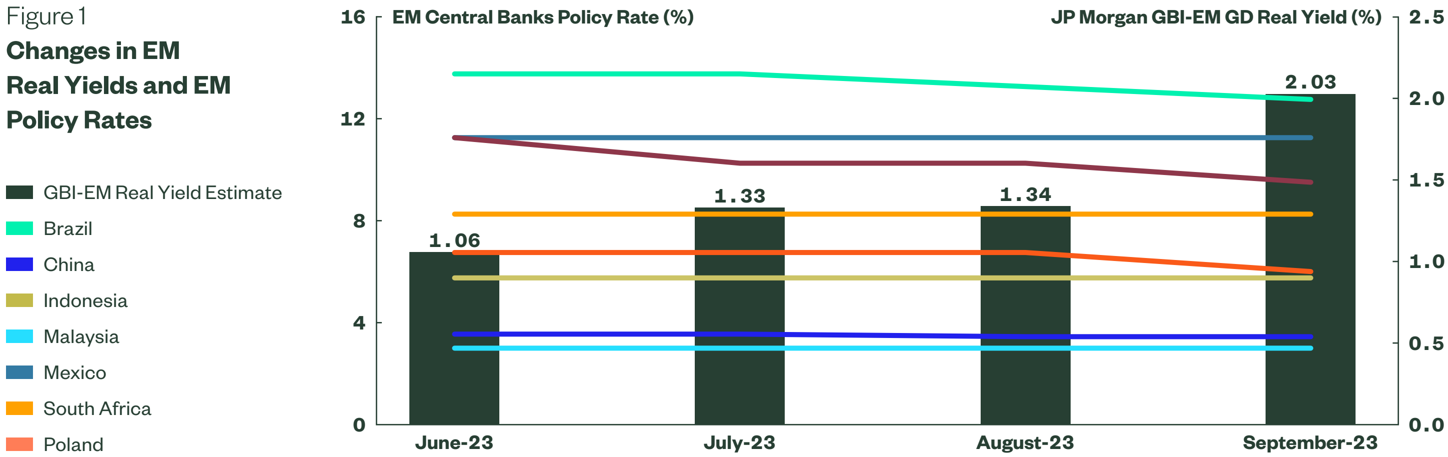
Q3 2023

Emerging Market Debt
Market Commentary: Q3 2023

Chart of the Quarter: EM Real Yields Improve, EM Central Banks Commence Easing

Some of the major emerging markets (EM) central banks began to loosen monetary policy during the latest quarter. Chile and Brazil led the way with more aggressive rate cuts than expected. In central Europe, Poland announced its first rate cut (of 75bps) in September, taking the policy rate to 6%. Others, including Indonesia, Malaysia, Mexico, and South Africa, have kept rates unchanged through recent meetings against the backdrop of positive real yields.

Figure 1
Changes in EM Real Yields and EM Policy Rates



Source: Bloomberg Finance L.P., JP Morgan as of 29 September 2023. Past performance is not a reliable indicator of future performance. GBI-EM GD Real Yields = GBI-EM GD country weighted average of (nominal yields minus inflation).

EMD Commentary — Q3 2023

The quarter began on a positive note for emerging market (EM) debt amid global disinflation and tightening credit spreads. Real yields in most EM economies remained on an upward trajectory through the period. Rising demand for duration earlier in the period within EM local markets was reflective of investor expectations that a hawkish Federal Reserve (Fed) has comparatively less of an impact on emerging markets. However, EM assets were subject to weaker risk sentiment in August, despite softening inflation prints across the board, as US Treasury yields surged and negative growth headlines emerged from China. EM inflationary pressures were back in focus with the supply-driven rally in oil prices driving prices up by 28.52% in the quarter (as shown in Figure 4). In September, repricing in core US rates, increased term premiums, and the rally in oil prices ensured that EMD performance in the quarter was negative.

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 an effort to bolster the shaky economy, the People's Bank of China (PBoC) lowered its one-year loan prime rate (LPR) by 10bps to 3.45% in August, which is a record low. The lending rates were maintained in September, as PBoC assessed the impact of the earlier rate cut. Economic momentum in China improved in August and September from a lower base observed early in Q3. Liquidity conditions in China improved further in September, with the PBoC announcing a 25bps cut in the Reserve Requirement Ratio (RRR).

A strong US dollar, the markets' reassessment of the Fed's policy approach, and the cascading effects from China's uncertain growth prospects weighed on the flows towards EM assets. Net flows during the quarter for hard currency and local currency funds amounted to-$10.6bn and -$4.5bn, respectively.[1]

Figure 2
Emerging Market Debt Index Returns — As of 29 September, 2023

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	-3.37	-3.26	-0.83	4.28	13.10	-2.70	0.00
EMBI GD (EM Hard Currency)	-2.60	-2.23	-0.10	1.76	10.01	-4.56	-0.35
CEMBI BD (EM Corporates)	-0.78	-0.26	1.12	3.38	8.25	-1.49	2.08
In EUR							
GBI-EM GD (EM Local Currency)	-0.94	-0.31	1.76	5.12	4.65	0.67	1.87
EMBI GD (EM Hard Currency)	-0.15	0.75	2.52	2.58	1.80	-1.26	1.51
CEMBI BD (EM Corporates)	1.71	2.78	3.76	4.21	0.16	1.92	3.99
In GBP							
GBI-EM GD (EM Local Currency)	0.32	0.77	0.46	2.77	3.44	-0.81	1.33
EMBI GD (EM Hard Currency)	1.12	1.84	1.21	0.29	0.62	-2.71	0.97
CEMBI BD (EM Corporates)	3.01	3.90	2.43	1.88	-0.99	0.41	3.44

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 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
ESG Emerging Market Debt Index Returns — As of 29 September, 2023

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
JESG GBI-EM (ESG EM Local Currency)	-3.55	-3.54	-0.58	5.01	14.94	-2.80	-0.03
JESG EMBI (ESG EM Hard Currency)	-2.94	-2.67	-0.79	1.14	9.06	-5.56	-0.54

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 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 4
Key EM and Macro levels as of 29 September, 2023

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	37 bps	44 bps	-10 bps	6.76%
EMBI GD Yield	53 bps	67 bps	48 bps	9.04%
EMBI GD Spread	9 bps	-2 bps	-22 bps	431 bps
CEMBI BD Yield	35 bps	53 bps	50 bps	7.89%
CEMBI BD Spread	-5 bps	-5 bps	-18 bps	358 bps
CDX.EM 5y	25 bps	13 bps	-12 bps	226 bps
10y UST	46 bps	73 bps	70 bps	4.57%
Dollar Index (DXY)	2.47%	3.17%	2.56%	—
DOW 30	-3.50%	-2.62%	1.09%	33508
Oil (WTI)	8.56%	28.52%	13.12%	$ 90.79

Source: JP Morgan, Bloomberg as of 29 September 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.

Local Currency Market Highlights

EM local currency debt returned -3.26% (in USD terms) in Q3 2023, as measured by the JP Morgan GBI-EM Global Diversified Index. A major detraction came from foreign exchange (FX) returns (-2.58%), with 17 out of the 20 countries in the index exhibiting negative FX returns for the quarter. Robust growth data from the US and market assessment that the Fed's interest rates will likely be held at high levels for longer added to the prevailing US dollar strength. Local bond yields rallied (+44bps) during the latest quarter alongside a shift in investor risk appetite caused by broader global economic concerns. Additionally, repricing in terminal rates for certain EM economies and renewed inflationary pressures through higher oil prices were among the headwinds against EM local market performance.

Figure 5
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 $)	**-3.37**	**-3.26**	**4.28**
FX Return (vs $)	-2.03	-2.58	-0.73
Price Return (Local currency)	-1.78	-2.03	0.97
Interest Return (Local currency)	0.44	1.35	4.04
In EUR			
Total Return (in €)	**-0.94**	**-0.31**	**5.12**
FX Return (vs €)	0.40	0.37	0.11
In GBP			
Total Return (in €)	**0.32**	**0.77**	**2.77**
FX Return (vs €)	1.66	1.45	-2.24

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 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 6
Best and Worst Performers Across EM Local Government Bond Markets in USD*

Q3 2023	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**-3.26**	**-0.68**	**-2.58**		
Top 5 Performers	Egypt	5.2	5.2	0.0	1.1%	6
	Colombia	1.4	-1.8	3.2	4.6%	6
	China	0.0	0.5	-0.6	10.0%	0
	South Africa	-0.2	-0.4	0.3	8.3%	-1
	Malaysia	-0.5	0.1	-0.6	10.0%	-5
Bottom 5 Performers	Peru	-5.2	-0.8	-4.4	2.4%	-12
	Czech Republic	-5.8	-0.5	-5.3	6.4%	-37
	Thailand	-5.8	-2.7	-3.2	9.8%	-57
	Chile	-13.7	-3.9	-9.8	2.0%	-27
	Turkey	-24.1	-20.2	-3.9	0.6%	-15

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 29 September 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.

Turkey was the worst performer in Q3. The annual inflation rate in Turkey increased to 61.5% in September 2023 from 58.9% in August, recording the highest level since December 2022. The Central Bank of Turkey raised its benchmark one-week repo rate by 500 bps to 30% in September, the fourth successive hike as the bank sought to combat soaring inflation. The Turkish lira depreciated against the US dollar by 5.41% in Q3 and closed at 27.42.

Chile was another underperformer in Q3. The Chilean peso continued to depreciate, exacerbated by poor economic data and inflation that slowed less than expected. Even so, Chile's annual inflation rate dropped to 5.1% in September, the lowest since August 2021. The Central Bank of Chile reduced its benchmark rate by 75bps in September, building on a 100bps cut in July. The Chilean peso depreciated against the US dollar by 11.13% in Q3 and closed at 891.53.

Thailand local bonds also performed poorly in Q3. Contrary to market expectations, Thailand's central bank raised its key interest rate by 25bps to 2.50% in its September meeting. This was the eighth consecutive hike, pushing borrowing costs to the highest level since 2013. Broader US dollar appreciation and the surge in commodity prices weighed on the local currency. The Thai baht, which depreciated against the US dollar by 2.70% in Q3, closed at 36.41.

Egypt was the best performer in Q3. The Central Bank of Egypt retained its key overnight deposit rate at 19.25% in its September meeting, having unexpectedly raised rates by 100bps in August. However, the September rate decision was in line with market expectations given no surprises in the latest inflation prints. The Egyptian pound depreciated by 0.17% against the US dollar in Q3 and closed at 30.85.

Colombian local bonds delivered positive returns in Q3. For the third consecutive meeting, Colombia's central bank left its benchmark interest rate unchanged at 13.25% in September. Despite the inflationary dynamics, overall the country's current account benefited from higher oil prices. The Colombian peso appreciated against the US dollar by 2.49% in Q3 and closed at 4,067.88.

Performance Comparison of JPM Local Currency Benchmark vs ESG Local Currency Benchmark

The JP Morgan ESG GBI-EM Index returned -3.54% (in USD terms) in Q3 2023, thereby underperforming the JP Morgan GBI-EM Global Diversified Index by -0.28%. This negative excess return was mainly driven by relative index overweights in Czech Republic (+1.83%), Poland (+2.06%), Chile (0.56%) and Hungary (0.89%), which detracted -0.11%, -0.09%, -0.08% and -0.04% from excess returns, respectively. A relative underweight in Turkey (-0.23%) contributed positively by 0.05%, as Turkey performed poorly during the period.

Figure 7
Key Return Drivers of ESG EM Local Government Bond Markets

JESG GBI-EM (ESG EM Local Currency)	Monthly Return (%)	3-Month Return (%)	YTD Return (%)
In USD			
Total Return (in $)	**-3.55**	**-3.54**	**5.01**
FX Return (vs $)	-2.25	-2.96	-0.43
Price Return (Local currency)	-1.73	-1.88	1.52
Interest Return (Local currency)	0.43	1.31	3.92

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 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 8
Relative Over/Underweights (JESG GBI-EM vs GBI-EM GD)

September 2023	Country	JESG GBI-EM (%)	GBI-EM GD (%)	Relative Weight (%)
Top 5 Overweights	Poland	9.26	7.20	2.06
	Czech Republic	8.19	6.36	1.83
	Romania	4.82	3.75	1.07
	Hungary	4.01	3.12	0.89
	Chile	2.52	1.96	0.56
Top 5 Underweights	Indonesia	9.65	10.00	-0.35
	Malaysia	9.65	10.00	-0.35
	Mexico	9.65	10.00	-0.35
	Egypt	0.70	1.09	-0.39
	China	6.43	10.00	-3.57

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 2023. Past performance is not a reliable indicator of future performance. Country exposures are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

Hard Currency Market Highlights

EM hard currency sovereign debt returned -2.23% (in USD terms) in Q3 2023, as measured by the JP Morgan EMBI Global Diversified Index. This performance was largely driven by negative Treasury returns (-3.54%). Broader risk-off sentiment, in addition to the possibility of another 25bps rate hike from the Fed later this year or in Q1 2024, weighed on the hard currency bond returns. The JPM EMBI GD yield widened by 67bps during the third quarter. Spread returns were, however, positive for the three months (+1.36%) amid market expectations of further spread tightening as the US economy looked set to avoid a recession — in the medium term, at least.

Figure 9

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	**-2.60**	**-2.23**	**1.76**
Spread Return	-0.05	1.36	3.97
Treasury Return	-2.55	-3.54	-2.12
IG Sub-Index	-3.43	-4.34	-1.05
HY Sub-Index	-1.74	-0.03	4.76

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 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 10

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

Q3 2023	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Average Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**-2.23**	**1.36**	**-3.54**		
Top 5 Performers	Venezuela	29.6	27.9	1.3	0.0%	0
	Lebanon	24.9	23.3	1.3	0.2%	5
	El Salvador	23.0	27.1	-3.2	0.7%	16
	Ukraine	21.1	21.4	-0.3	0.9%	19
	Suriname	13.5	13.2	0.3	0.1%	1
Bottom 5 Performers	Panama	-6.1	-0.1	-6.0	2.8%	-17
	Uruguay	-6.2	0.5	-6.6	2.2%	-14
	Chile	-6.5	0.3	-6.8	3.2%	-21
	Bolivia	-10.1	-9.6	-0.6	0.2%	-2
	Argentina	-14.3	-12.9	-1.6	1.2%	-17

Source: State Street Global Advisors, JP Morgan, Bloomberg as of 29 September 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.

Argentina was the worst performer in Q3. The country's dollar bonds plummeted immediately after Javier Milei, a right-wing outsider, won the most votes in a primary vote ahead of general elections in October. Earlier in the quarter, Argentina and the International Monetary Fund (IMF) agreed a deal to unlock $7.5 billion from the loan program, which offered some support for the economy. Argentina's annual inflation rate climbed to 124.40% in August from 113.40% in July.

Chilean dollar bonds underperformed in Q3. Markets were impacted as voters rejected a possible rewrite of the free-market constitution that has been in place since the military dictatorship of Augusto Pinochet in 1980. The country's government reduced its GDP forecast for 2023 to 0%, with key economic indicators signaling an increased likelihood of a recession. The economy is forecast to grow by around 2% in 2024.

Uruguay was another underperformer in Q3. Uruguay's latest budget forecast a bigger fiscal deficit for 2023, which could deteriorate further going into the elections in October 2024. The country's government increased its bond funding requirement for 2023 to $4.68 billion, an increase from a previous forecast of $4.27 billion. The yield on Uruguay's USD Government International Bond closed September at 5.65%, up from 4.90% at the end of the previous quarter.

El Salvador outperformed in Q3, having gained traction among institutional investors. El Salvador's dollar bonds rallied in August after Google's announcement of plans to establish an office in the country. President Nayib Bukele's commitment to debt repayment through buybacks contributed to improving investor optimism, as reflected in spread returns for the quarter.

Ukraine also outperformed in the quarter. Ukraine's government bonds recorded positive returns, bolstered by investor optimism on debt restructuring. The country's reserves decreased by 5% from $41.74 billion in July to $39.71 billion at the end of September, although overall reserves were moderately higher over the full quarter. The yield on Ukraine's 10-year USD-denominated government bond closed September at 31.44%, marking a decline from 32.78% at the end of June.

Performance Comparison of JPM Hard Currency Benchmark vs ESG Hard Currency Benchmark

The JP Morgan ESG EMBI hard currency index returned -2.67% (in USD terms) for Q3 2023, underperforming the JP Morgan EMBI Global Diversified Index by -0.44%. The market narrative around a US soft landing and the probability of recession impacted spreads, which narrowed over the course of the three months. The IG/HY spread compression enabled high yield (HY) hard currency bonds to outperform their investment grade (IG) counterparts in Q3. Broader risk-off dynamics weighed on the Treasury component, which had a bigger impact on the total return of the ESG index than the standard index.

Figure 11
Key Return Drivers of ESG EM Hard Currency Government Bond Markets in USD

JESG EMBI (ESG EM Hard Currency)	Monthly Return	3 Month Return	YTD Return
Total Return	**-2.94**	**-2.67**	**1.14**
Spread Return	-0.18	1.32	3.67
Treasury Return	-2.77	-3.94	-2.44
IG Sub-Index	-3.69	-4.60	-1.29
HY Sub-Index	-2.03	-0.22	4.25

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 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 12
Relative Over/Underweights (JESG EMBIG vs EMBI GD)

September 2023	Country	JESG EMBI (%)	EMBI GD (%)	Relative Weight (%)
Top 5 Overweights	Hungary	3.97	2.49	1.48
	Uruguay	3.52	2.24	1.28
	Romania	3.27	2.08	1.19
	Poland	2.87	1.83	1.04
	Saudi Arabia	5.62	4.77	0.85
Top 5 Underweights	Pakistan	0.06	0.61	-0.56
	Turkey	3.60	4.58	-0.98
	Malaysia	1.11	2.67	-1.56
	Mexico	3.28	5.06	-1.78
	China	0.90	4.61	-3.71

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 September 2023. Past performance is not a reliable indicator of future performance.
Country Exposures are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

Endnote

1 Source: JP Morgan.

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