Commentary
Fixed Income

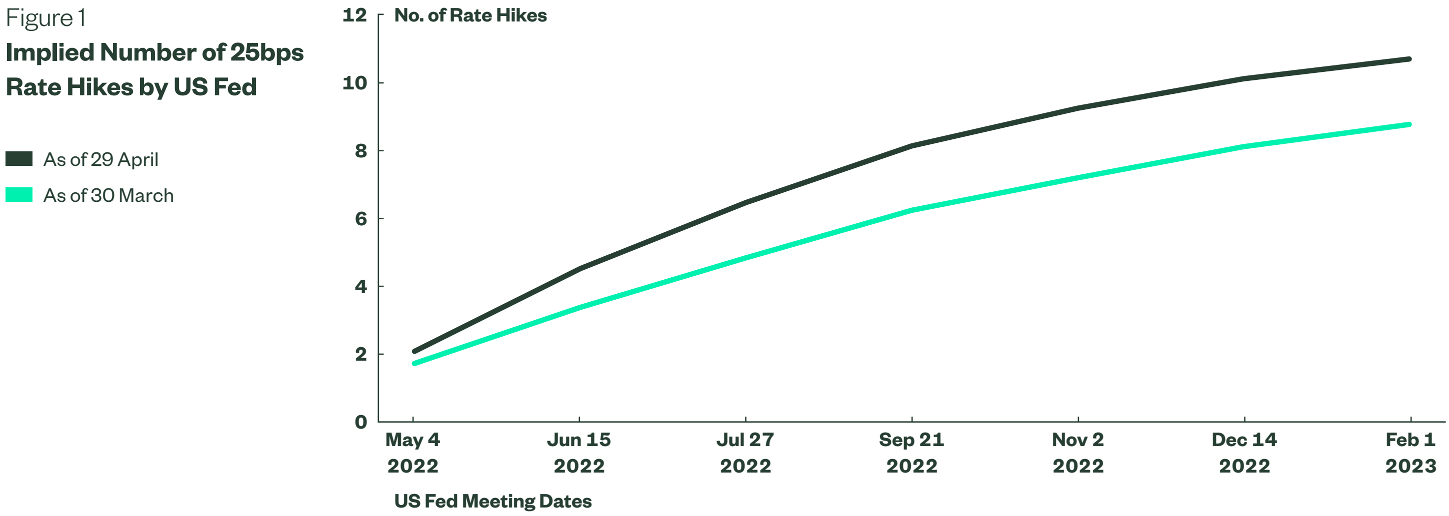
April 2022

Emerging Market Debt Market Commentary

Chart of the Month: US Fed Expected to Accelerate Rate Hikes

Over the course of April, market participants priced in a more aggressive interest rate hike approach by the US Federal Reserve.

Figure 1
Implied Number of 25bps Rate Hikes by US Fed



Source: Bloomberg Finance L.P., as of 30 April 2022. Past performance is not a reliable indicator of future performance.

EMD Commentary — April 2022

Emerging markets (EM) underwent a sharp correction in April 2022 as the macro backdrop for the EM asset complex became more challenging amid growth fears emanating from China and a significant pick-up in inflation globally. Inflation in EM Asia, which had been reasonably benign, moved higher as well amidst surging commodity prices which fed through to the consumer price index (CPI). This prompted most of the EM Asia central banks to adopt a measured removal of the accommodative stance maintained thus far. In contrast, the Latin American central banks are at the late stage of their tightening cycles, while central and eastern European (CEE) central banks are in the middle of their cycles.

US CPI inflation surged yet again as the March headline CPI rose by 8.6% year-on-year (y/y). The US Federal Reserve became more hawkish and has indicated its intention to front-load interest rate hikes and normalise their balance sheet at a faster pace than initially projected. The rate hike expectations became more aggressive and based on the implied rate hikes priced in Fed Fund Futures, the policy rate is now expected to reach 3.0% by the end of 2022 (as of 29 April, source: Bloomberg); at the end of March, the market was pricing in a rate of 2.5% by year-end (see Figure 1). Demand for 'safe haven' assets, along with the support provided by higher interest rates saw the US dollar outperform against most EM and developed market (DM) currencies since the start of the year. Similarly, EM hard currency spreads widened as concerns around the debt servicing capabilities of a few EM countries increased, especially those economies rattled by current macro headwinds and idiosyncratic geopolitical events. Over April 2022, hard currency outflows were -$0.9bn, while local currency outflows amounted to -$2.9bn. (source: JP Morgan).

Figure 2
Emerging Market Debt Index Returns — As of 29 April 2022

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	-6.03	-12.09	-13.17	-12.10	-15.95	-3.10	-1.28
EMBI GD (EM Hard Currency)	-5.59	-12.56	-15.45	-15.05	-14.51	-1.97	0.23
CEMBI BD (EM Corporates)	-2.06	-9.18	-10.83	-10.70	-9.70	1.00	2.17
In EUR							
GBI-EM GD (EM Local Currency)	-0.89	-6.59	-4.75	-5.24	-4.09	-1.13	-0.66
EMBI GD (EM Hard Currency)	-0.43	-7.09	-7.25	-8.43	-2.44	0.03	0.87
CEMBI BD (EM Corporates)	3.30	-3.49	-2.18	-3.73	3.04	3.06	2.82
In GBP							
GBI-EM GD (EM Local Currency)	-1.45	-6.06	-5.20	-5.17	-7.31	-1.88	-0.69
EMBI GD (EM Hard Currency)	-0.99	-6.57	-7.69	-8.36	-5.72	-0.73	0.83
CEMBI BD (EM Corporates)	2.71	-2.94	-2.64	-3.66	-0.42	2.27	2.78

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 April 2022. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualised.

Figure 3
Key EM and Macro Levels as of 29 April 2022

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	53 bps	82 bps	105 bps	6.77%
EMBI GD Yield	94 bps	165 bps	208 bps	7.38%
EMBI GD Spread	39 bps	55 bps	71 bps	439 bps
CEMBI BD Yield	52 bps	125 bps	162 bps	6.20%
CEMBI BD Spread	-4 bps	6 bps	15 bps	327 bps
CDX.EM 5y	57 bps	73 bps	96 bps	285 bps
10y UST	60 bps	116 bps	142 bps	2.93%
Dollar Index (DXY)	4.73%	6.65%	7.62%	—
DOW 30	-4.91%	-6.13%	-9.25%	32977
Oil (WTI)	4.40%	18.76%	39.20%	$ 104.69

Source: JP Morgan, Bloomberg Finance L.P., as of 29 April 2022.

Local Currency Market Highlights

EM local currency debt returned -6.03% in US dollar terms in April 2022, as measured by the JP Morgan GBI-EM Global Diversified Index. The overall weakness was largely driven by EM FX weakness (-4.02%) as the US Fed's indication of more aggressive rate hikes and 'safe haven' demand boosted USD. Consequently, there was significant retracement from the March EM FX gains of major commodity exporters in LatAm while the currencies of CEE countries sold off amidst worsening news flow around the Russia-Ukraine War, notably Russia cutting off natural gas exports to Poland and Bulgaria. The local bond returns also contributed negatively (-2.00%) as inflationary concerns exacerbated by the war in Ukraine prompted central banks to adopt a more aggressive approach to policy normalisation, resulting in local yields moving higher.

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 $)	**-6.03**	**-12.09**	**-12.10**
FX Return (vs $)	-4.02	-2.64	-2.21
Price Return (Local currency)	-2.46	-10.45	-11.32
Interest Return (Local currency)	0.46	1.00	1.43
In EUR			
Total Return (in €)	**-0.89**	**-6.59**	**-5.24**
FX Return (vs €)	1.12	2.86	4.65
In GBP			
Total Return (in €)	**-1.45**	**-6.06**	**-5.17**
FX Return (vs €)	0.56	3.39	4.72

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 April 2022. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualised.

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

April 2022	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Average Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**-6.03**	**-2.00**	**-4.02**	—	—
Top 5 Performers	Turkey	9.1	10.5	-1.4	1.1	10
	Dominican Republic	-0.5	-0.6	0.1	0.2	0
	Philippines	-1.1	-0.2	-0.9	0.1	0
	Indonesia	-2.0	-1.1	-0.9	10.0	-20
	Egypt	-2.2	-1.0	-1.1	1.6	-3
Bottom 5 Performers	South Africa	-9.1	-1.6	-7.5	9.8	-89
	Chile	-9.5	-1.9	-7.6	2.1	-20
	Poland	-9.9	-4.0	-5.8	6.8	-68
	Peru	-9.9	-6.9	-3.0	2.3	-22
	Hungary	-10.9	-3.2	-7.7	3.2	-34

Source: State Street Global Advisors, Bloomberg, JP Morgan, as at 29 April 2022. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends.
* Country and currency performance of JP Morgan GBI-EM Global Diversified Index.
**Index impact is calculated by multiplying the period average weight by total return.

Hungary was the worst performing country in April, returning -10.9% in USD terms and detracting 34 bps from the index return. Prime Minister Viktor Orban's Fidesz party won a fourth term on the back of a landslide electoral win. Still, investors were concerned about economic growth prospects and inflation, leading to weakness in the forint. Spiraling inflation and higher interest rates in key trading partner nations prompted the central bank to raise rates on April 28th, lifting the one-week deposit rate by 30 bps to 6.45%. Consumer prices grew 8.5% y/y in March, hitting a 15-year high, although it was below estimates of 8.8%. Sentiment turned negative amid fraying ties with the European Union as the EU triggered its 'rule-of-law' mechanism to deny more than €40bn of EU funds to Hungary.

Poland also underperformed in April (-9.9% in USD terms and detracting 68 bps from the index return), as a spike in Polish CPI drove the yields on government bonds higher. The CPI for April came in at 12.3% y/y, a 24-year high that exceeded the consensus forecast of 11.4%. On 6th April, the central bank delivered a surprise interest rate hike in raising the reference rate by 100 bps to 4.5% to tackle surging inflation. Coupled with the upside inflation surprise, this led to the yields on Polish government bonds spiking to 2008 levels, with the 10-year yield rising by more than 115 bps over April to 6.37%. Russia cut off natural gas deliveries to Poland and Bulgaria over its refusal to pay for supplies in roubles. Adding to the concerns of investors, Prime Minister Mateusz Morawiecki proposed to lift the public debt cap of 60%/GDP to increase military spending.

South Africa also performed poorly, returning -9.1% in USD terms and detracting 89 bps from the index return. The South African rand weakened and the benchmark bonds sold off as rolling power cuts, infrastructure damage caused by severe floods, and early signs of a COVID comeback added to concerns around the economic outlook. This also hampers the government's plans to reduce the budget deficit and curb government debt.

Turkey was an outlier, returning 9.1% in USD terms and contributing 10 bps to the index return. Most of the returns came from the rally in local currency government bonds as the Turkish 10-year yield declined by 3.68% over April to settle at 20.23%. Interest rates were kept unchanged despite surging inflation printing above 61% in March to put more pressure on the central bank's unconventional policies to support the lira.

Hard Currency Market Highlights

EM hard currency sovereign debt returned -5.59% in April 2022, as measured by the JP Morgan EMBI Global Diversified Index. The treasury and spread components were significantly negative, as US Treasury yields shot up on expectations of aggressive rate hikes amidst inflationary concerns. Spreads also widened due to the broader risk-off sentiment arising from the challenging macro backdrop for EM in the aftermath of the Russia-Ukraine crisis — EM growth forecasts were revised downward and inflationary concerns were rising. This stoked fears around the debt servicing capacity of some frontier EM countries, while idiosyncratic geopolitical events also weighed on returns.

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	**-5.59**	**-12.56**	**-15.05**
Spread Return	-1.89	-5.49	-6.33
Treasury Return	-3.77	-7.49	-9.31
IG Sub-Index	-5.87	-14.32	-17.53
HY Sub-Index	-5.31	-10.73	-12.42

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 April 2022. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualised.

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

April 2022	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Average Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**-5.59**	**-1.89**	**-3.77**	—	—
Top 5 Performers	Zambia	5.5	6.2	-0.7	0.3	2
	Pakistan	3.7	5.6	-1.8	1.2	4
	Tunisia	3.1	3.8	-0.7	0.1	0
	Maldives	1.6	2.8	-1.2	0.1	0
	Mozambique	1.5	4.3	-2.8	0.1	0
Bottom 5 Performers	Serbia	-10.6	-6.8	-4.1	0.1	-1
	Ghana	-10.9	-8.8	-2.3	1.3	-14
	El Salvador	-13.1	-11.6	-1.7	0.5	-7
	Sri Lanka	-14.5	-13.6	-1.1	0.8	-11
	Ukraine	-19.8	-18.8	-1.2	1.0	-19

Source: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 April 2022. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends.
* Country and currency performance of JPM EMBI Global Diversified Index.
**Index impact is calculated by multiplying the period average weight by total return.

Ukraine was the worst performer, returning -19.8% in USD terms and detracting 19 bps from the index return. The spread on dollar-denominated Ukrainian debt deteriorated amidst the worsening war situation. Ukraine has raised around $1.5 billion through war bond auctions since Russia's invasion on February 24 and the International Monetary Fund (IMF) also lent support and encouraged other nations to provide grants and donations to Ukraine to help it meet its financing needs as economic conditions deteriorate.

Among the poorer performers was **Sri Lanka,** returning -14.5% in April and detracting from index returns by 11 bps. Early in the month, the country warned of an unprecedented default and that it would halt payments on foreign currency denominated debts in order to preserve its dwindling dollar stockpile for food and fuel imports (FX reserves slumped 16% to $1.94bn in March). This triggered a series of credit rating downgrades: Moody's cut its rating for Sri Lanka to Ca from Caa2, following similar downgrades by S&P Global and Fitch. The government is expediting talks with the IMF in restructuring its debts and to prevent a hard default. Interest payments of $78 million were due on April 18 and failure to make these payments within a 30-day grace period would trigger the country's first default since independence in 1948.

Ghana also featured among the poorer performers, returning -10.9% and detracting from index returns by 14 bps. The annual inflation rate surged to 19.4% in March, a 12-year high driven largely by the impact from supply shocks related to the Russia-Ukraine War that has stoked increases in food, fuel and fertiliser prices. Concerns around growth increased as soaring inflation would reduce private consumption and investment.

Zambia was the best performer in the month, returning 5.5% in USD terms and contributing 2 bps to the index return. The rally was largely driven by a comment from IMF Managing Director Kristalina Georgieva that China has committed to join Zambia's creditor committee on its external debt restructuring process — Chinese state and commercial creditors account for about one-third of the country's $17.3bn external debt. The revamping of its external debt would also unlock $1.4bn in bailout funds from the IMF and further concessional financing.

Also among the outperformers was **Pakistan,** which returned 3.7% and contributed 4 bps to the index return. The Parliament elected Shehbaz Sharif as the country's new prime minister on 11th April, providing some political stability to the crisis-stricken economy. Market participants considered that the newly-installed coalition government could be well positioned to work out a deal with the IMF to secure the remaining $3bn tranche of loans from a $6bn bailout package that was agreed in 2019. It is critical (at least in the short term) that Pakistan receive this bailout tranche as it has external funding requirements of $14.1bn in January–June 2022 alone, more than the central bank's $11.3bn in FX reserves as of April 1.

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* Pensions & Investments Research Center, as of December 31, 2020.
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