Emerging Market Debt Market Commentary

Second Quarter 2021

Emerging market debt (in USD terms) delivered positive returns in the second quarter as the recovery in global economic growth continued to aid EM countries. Even as concerns about China growth and COVID-19 infections in Asia intensified during the quarter, higher growth in EM countries, a weaker dollar (dollar Index at -0.85% in Q2 2021) and lower US Treasury yields (10-year US Treasury at -27 bps lower in Q2 2021) underpinned the good performance. EM fund flows continued to increase with Q2 flows at +$7.1bn and +$4.3bn into hard currency and local currency, respectively (Source for flows: Morgan Stanley).

Figure 1 - Emerging Market Debt Index Returns – As of 30 June, 2021

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-1.21%	3.54%	-3.38%	-3.38%	6.57%	4.12%	3.25%
EMBI GD (EM Hard Currency)	0.73%	4.06%	-0.67%	-0.67%	7.53%	6.71%	4.86%
CEMBI BD (EM Corporates)	0.84%	2.10%	1.28%	1.28%	8.67%	7.51%	5.79%
In EUR							
GBI-EM GD (EM Local Currency)	1.85%	2.61%	-0.31%	-0.31%	0.93%	3.58%	1.91%
EMBI GD (EM Hard Currency)	3.47%	3.13%	2.49%	2.49%	1.84%	6.16%	3.50%
CEMBI BD (EM Corporates)	3.58%	1.18%	4.49%	4.49%	2.92%	6.95%	4.42%
In GBP							
GBI-EM GD (EM Local Currency)	1.65%	3.41%	-4.39%	-4.39%	-4.68%	2.56%	2.57%
EMBI GD (EM Hard Currency)	3.39%	3.93%	-1.71%	-1.71%	-3.83%	5.11%	4.17%
CEMBI BD (EM Corporates)	3.49%	1.97%	0.21%	0.21%	-2.80%	5.89%	5.10%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 30 June, 2021. 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 annualized.

Figure 2: Key EM and Macro levels as of 30 June, 2021

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	4 bps	-1 bps	77 bps	4.98%
EMBI GD Yield	-5 bps	-37 bps	35 bps	4.91%
EMBI GD Spread	7 bps	-14 bps	-12 bps	340 bps
CEMBI BD Yield	-8 bps	-22 bps	22 bps	4.26%
CEMBI BD Spread	-1 bps	3 bps	-19 bps	303 bps
CDX.EM 5y	-4 bps	-30 bps	4 bps	156 bps
10y UST	-13 bps	-27 bps	55 bps	1.47%
Dollar Index (DXY)	2.90%	-0.85%	2.78%	
DOW 30	-0.08%	4.61%	12.73%	34,503
Oil (WTI)	10.78%	24.19%	51.42%	$73.47

Source: JP Morgan, Bloomberg as of 30 June, 2021

Local Currency Market Highlights

Figure 3 - 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 $)	**-1.21%**	**3.54%**	**-3.38%**
FX Return (vs $)	-1.30%	2.11%	-1.58%
Price Return (Local currency)	-0.33%	0.16%	-4.28%
Interest Return (Local currency)	0.42%	1.25%	2.49%
In EUR			
Total Return (in €)	**1.85%**	**2.61%**	**-0.31%**
FX Return (vs €)	-1.30%	2.11%	-1.58%
In GBP			
Total Return (in €)	**1.65%**	**3.41%**	**-4.39%**
FX Return (vs €)	1.56%	2.00%	-2.61%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 30 June, 2021. 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 annualized.

EM local currency debt returned 3.54% in US dollar terms in Q2, as measured by the JP Morgan GBI-EM Global Diversified Index. A stronger-than-expected growth recovery in most parts of the world, higher commodity prices, mostly accommodative global monetary policy and liquidity conditions, delivered a powerful mix to drive positive EM returns, with both bond and foreign exchange (FX) providing good returns in the three months. There was also a monetary policy shift in some LatAm countries, with Mexico, Chile and Brazil experiencing FX appreciation after hawkish signals from their respective central banks. In CEEMEA (Central and Eastern Europe Middle East and Africa), Hungary's central bank raised its benchmark interest rate for the first time in a decade.

Figure 4 - Best and worst performers across EM local government bond markets in USD*

Q2 2021	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (bps)**
GBI-EM GD		**3.54**	**1.40**	**2.10**		
Top 5 Performers	Brazil	14.3	1.7	12.5	8.4%	120
	South Africa	10.7	7.1	3.4	8.0%	86
	Dominican Republic	5.0	5.6	-0.5	0.1%	1
	Uruguay	4.4	2.5	1.9	0.1%	1
	Russia	4.1	0.7	3.4	7.5%	30
Bottom 5 Performers	Thailand	-1.0	1.7	-2.6	8.6%	-8
	Colombia	-1.2	0.4	-1.6	4.6%	-6
	Philippines	-2.6	-2.1	-0.6	0.1%	0
	Peru	-3.7	-1.9	-1.8	2.3%	-8
	Chile	-6.9	-5.7	-1.3	2.2%	-15

Source: State Street Global Advisors, JP Morgan as at 30 June, 2021. 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 end weight by total return.

Brazil was the best performer, returning 14.3%, and was also the most significant contributor to index returns (120 bps). The strong performance was mainly due to appreciation of the Brazilian real (12.5%), after Brazil's central bank hiked its SELIC rate by 75 bps in June and planned further normalization. The currency rebounded from Q1's political turbulence and COVID-related lockdown. Reduced near-term fiscal concerns also supported performance.

South Africa was the second-best performer, returning 10.7%, and was the second largest contributor (86 bps). Performance was aided by the country's central bank governor stating that the country is in a strong position to deal with global monetary policy tightening and a gradual pullback by policymakers from stimulus measures enacted during the pandemic. South Africa's current account surplus and budget balance recovered faster than expected as import demand was suppressed by the economy's contraction. The surplus placed the country in a better position to deal with any repricing of financial assets and realignment of exchange rates.

Dominican Republic delivered a return of 5.0% in Q2 as tourism continued to revive in the Caribbean, with the island welcoming 390,000 tourists (42% of pre-pandemic level) in May. In addition, the Central Bank of the Dominican Republic (CBDR) announced RD$7-RD$8bn of available capital for sectors in need of loans.

Uruguay generated a return of 4.4%. Uruguay's central bank is currently engaging in expansive monetary policy, but it is likely to pivot when inflation expectations converge to its target range of 3-7%. The country's consumer price index reading of 6.76% year-on-year in April fell within the policy target levels for the first time in three years, and the central bank expects further slowing of inflation by 2022.

Russia returned 4.1% in the quarter, contributing 30 bps to the index return after the ruble strengthened on the back of a hawkish stance by the Central Bank of Russia (CBR). The CBR hiked interest rates by 50 bps to 5.5% during Q2. In addition, the CBR signaled plans to increase rates by a further 50 bps in July and keep the rates at 6% until the end of 2022. The CBR noted that consumer activity mostly reached pre-pandemic level during the latest quarter and said that it expects higher inflation to mainly come from strong domestic demand.

Chile and **Peru** were the worst performers in returning -6.9% and -3.7%, respectively, and were also the largest detractors (-15 bps and -8 bps, respectively) from index returns. There is a lot of rate hike pressure in LatAm countries, but central banks in Chile and Peru kept interest rates unchanged amid political turbulence during the quarter. The Central Bank of Chile (BCCh) said it plans to lift borrowing costs by 25 bps in July. In addition, political risks weighed on sentiment as Chile embarked on constitutional reform.
The Central Reserve Bank of Peru kept the interest rate unchanged at 0.25% for a 14th consecutive month. The political uncertainty after Pedro Castillo's win in the election rattled the country's market and sent Peru's bonds and currency lower amid fears that he might upend Peru's economic model.

Colombia underperformed in Q2, returning -1.2% and detracting -6 bps from the index amid violent protests over tax increases which were followed by the resignation of the finance minister and his deputy, triggering a sell-off in Colombian assets. Colombia's central bank kept interest rates unchanged at 1.75% and insisted that monetary policy cannot alone help in economic support and employment growth without fiscal adjustment. However, the central bank governor offered reassurance that inflation expectations are stable and in line with the target.

Thailand returned -1.0% and detracted -8 bps from index returns in Q2 amid street protests demanding the government's resignation as parliament plans to amend country's constitution and change its electoral system. Thailand's economic recovery was sluggish in the period amid a rise in COVID-19 cases and a slow pace of vaccination. The backdrop of political unrest and pandemic issues further delayed the plan to reopen the country for the crucial tourism sector.

Philippines generated a negative return of -2.6% but had no significant impact on the index return. A fresh surge of COVID cases drove the unemployment rate higher to 7.7% and inflation to 4.5% during the quarter.

Hard Currency Market Highlights

Figure 5 - 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	**0.73%**	**4.06%**	**-0.67%**
Spread Return	-0.37%	1.80%	2.55%
Treasury Return	1.10%	2.22%	-3.13%
IG Sub-Index	1.41%	3.01%	-2.45%
HY Sub-Index	-0.02%	5.27%	1.42%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 30 June, 2021. 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 annualized.

EM hard currency sovereign debt generated a return of 4.06% in Q2, as measured by the JP Morgan EMBI Global Diversified Index. EMBI GD spreads tightened by 14 bps and US 10-year Treasury yields fell by 27 bps amid a combination of global growth, anchored inflation risk premia and central banks stabilizing longer-term rates and monetary policy normalization. Furthermore, fiscal policies supported stronger growth and commodities-related revenues provided opportunity for additional spending during the quarter.

Figure 6 - Best and worst performers across EM hard currency government bond markets*

Q2 2021	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight	Index Impact (bps)**
EMBI Global Diversified		**4.06**	**1.80**	**2.22**		
Top 5 Performers	Ecuador	46.8	43.8	2.1	1.5%	70
	Zambia	11.5	11.4	0.1	0.2%	3
	Tajikistan	11.3	10.7	0.5	0.1%	1
	Angola	10.5	8.8	1.6	1.1%	11
	Cameroon	10.4	10.3	0.1	0.1%	1
Bottom 5 Performers	Papua New Guinea	-1.0	-2.3	1.4	0.1%	0
	Venezuela	-2.6	-2.7	0.0	0.0%	0
	Belarus	-3.3	-4.3	1.0	0.5%	-2
	El Salvador	-5.0	-7.3	2.5	0.9%	-4
	Suriname	-8.0	-8.5	0.6	0.0%	0

Source: State Street Global Advisors, JP Morgan as at 30 June, 2021. 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 end weight by total return.

Ecuador bonds were the best performers, returning 46.8% and were a significant contributor to index returns (70 bps). Ecuador's $550mn finance for its vaccination campaign, its talks with the International Monetary Fund (IMF) to negotiate a $6.5bn financial agreement, its common goal with the IMF in targeting debt sustainability and the election of millionaire banker Guillermo Lasso as president (perceived as a positive outcome among investors), helped underpin sentiment towards the economy.

Zambia returned 11.5% over the quarter after Fitch upgraded its Long-Term Local Currency (LTLC) Issuer Default Rating (IDR) to CCC from CC. In addition, Zambia was close to reaching a deal with the IMF that is crucial in restoring economic stability and to help create a fiscal space to fight the coronavirus pandemic. Also, an increase in copper prices supported the current account surplus in Q1 2021.

Tajikistan performed well, returning 11.3% after Moody's upgraded the outlook of B3 long-term foreign issuer ratings to stable from negative. This was driven by the country's stabilizing external payments position with an increase in foreign currency reserves, which Moody's expects to remain around the current level. Thus, the significant pressure on Tajikistan's credit profile from mounting external and liquidity risks diminished during the quarter.

Angola delivered a strong return (10.5%) and was the second largest contributor to index returns (+11 bps) following IMF approval for a $772mn disbursement under the Extended Fund Facility Program, bringing the total disbursement to date to about $3.9bn. The IMF stated that Angola's economic recovery is supported by sound policy as authorities continue to strengthen public finances and debt dynamics.

Cameroon returned 10.4% in Q2. Bonds rallied near the end of the quarter after Cameroon's government announced a Eurobond refinancing operation of XAF450bn ($820mn) worth of bonds at a 5.95% interest rate. By refinancing the Eurobond, the country has extended the amortization deadline and thus reduced the pressures on foreign exchange reserves as debt servicing costs reduced.

Suriname bonds were the worst performers, returning -8.0% as its Long-term Foreign Currency Issuer Default Rating (IDR) was downgraded to Restricted Default (RD) from 'C' by Fitch, reflecting the non-payment of $49.8mn of rescheduled external debt service on Suriname's 2023 and 2026 notes due last quarter (March).

El Salvador and Belarus generated negative returns in the quarter, albeit with only a modest impact on index returns. In El Salvador, policy decisions undermined a potential agreement with the IMF amid eroding credibility due to fiscal challenges, geopolitical tensions, anti-corruption accord, etc. In **Belarus**, bonds tumbled amid talk of new EU sanctions in an attempt to put more pressure on President Alexander Lukashenko.

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