Emerging Market Debt Market Commentary

February 2021

Emerging market debt (in USD terms) experienced a difficult February as markets reacted to a sharp sell-off of US Treasury bonds that sent yields higher. Improving economic prospects, driven by positive vaccination developments, rising commodity prices indicating better demand, along with a reassessment of the size of the fiscal stimulus in the US, all contributed to real yields becoming the key driver of higher rates. There has also been a pick-up in cross market volatility despite improving US and global growth prospects that would ordinarily be expected to be supportive of risk assets. Moreover, higher commodity prices and vaccine-supported re-openings should benefit emerging markets (EM) – February saw overall positive flows of +$3.5bn and +$3.1bn into hard currency and local currency EM debt, respectively, even as market volatility may have unsettled investors about allocating capital into EM (source for flows: Morgan Stanley).

Figure 1 - Emerging Market Debt Index Returns – As of 26 February, 2021

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-2.68%	-0.37%	3.41%	-3.72%	3.70%	0.59%	5.54%
EMBI GD (EM Hard Currency)	-2.55%	-1.78%	0.09%	-3.61%	0.91%	4.48%	5.94%
CEMBI BD (EM Corporates)	-0.10%	1.30%	3.76%	-0.17%	5.35%	6.29%	6.94%
In EUR							
GBI-EM GD (EM Local Currency)	-2.59%	-1.82%	1.89%	-2.95%	-6.16%	0.75%	3.23%
EMBI GD (EM Hard Currency)	-2.46%	-3.20%	-1.38%	-2.84%	-8.68%	4.65%	3.61%
CEMBI BD (EM Corporates)	-0.01%	-0.17%	2.24%	0.64%	-4.66%	6.46%	4.60%
In GBP							
GBI-EM GD (EM Local Currency)	-4.41%	-4.87%	-0.96%	-5.87%	-5.26%	0.10%	5.47%
EMBI GD (EM Hard Currency)	-4.29%	-6.21%	-4.14%	-5.76%	-7.81%	3.98%	5.87%
CEMBI BD (EM Corporates)	-1.88%	-3.27%	-0.63%	-2.39%	-3.75%	5.78%	6.88%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 26 February, 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 26 February, 2021

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	43 bps	35 bps	49 bps	4.71%
EMBI GD Yield	38 bps	34 bps	55 bps	5.10%
EMBI GD Spread	6 bps	-21 bps	7 bps	359 bps
CEMBI BD Yield	14 bps	9 bps	24 bps	4.28%
CEMBI BD Spread	-16 bps	-42 bps	-20 bps	302 bps
CDX.EM 5y	20 bps	28 bps	41 bps	192 bps
10y UST	34 bps	57 bps	49 bps	1.40%
Dollar Index (DXY)	0.33%	-1.08%	1.05%	
DOW 30	3.17%	4.37%	1.06%	30,932
Oil (WTI)	17.82%	35.64%	26.75%	$ 61.5

Source: JP Morgan, Bloomberg as of 26 February, 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 $)	**-2.68%**	**-0.37%**	**-3.72%**
FX Return (vs $)	-0.94%	0.25%	-1.91%
Price Return (Local currency)	-2.14%	-1.83%	-2.62%
Interest Return (Local currency)	0.38%	1.21%	0.76%
In EUR			
Total Return (in €)	**-2.59%**	**-1.82%**	**-2.95%**
FX Return (vs €)	-0.83%	-1.20%	-1.09%
In GBP			
Total Return (in €)	**-4.41%**	**-4.87%**	**-5.87%**
FX Return (vs €)	-2.65%	-4.25%	-4.01%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 January 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(LC) debt returned -2.68% in US dollar terms in February, as measured by the JP Morgan GBI-EM Global Diversified Index. Both bond and foreign exchange (FX) returns were negative as markets adjusted for the swing higher in US real rates through changes in local rates premia and currency – this was especially the case for some low-yielding EM countries. Political developments, particularly in Brazil and other Latin American countries, have added some idiosyncratic sources of volatility for EM LC as well.

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

February 2021	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (bps)**
GBI-EM GD		**-1.07**	**-0.10**	**-0.97**		
Top 5 Performers	Dominican Republic	2.1	1.5	0.6	0.1%	0.3
	Philippines	0.3	1.2	-0.9	0.2%	0.0
	China	0.0	0.0	0.0	10.0%	0.2
	South Africa	-0.7	-0.1	-0.6	7.6%	-5.5
	Russia	-0.7	-1.9	1.2	7.1%	-5.1
Bottom 5 Performers	Peru	-3.7	-3.4	-0.3	2.6%	-9.7
	Hungary	-3.8	-2.2	-1.6	4.0%	-15.0
	Brazil	-4.3	-2.3	-2.0	8.2%	-34.9
	Thailand	-5.2	-3.3	-1.9	8.6%	-44.4
	Mexico	-5.5	-2.2	-3.2	9.4%	-51.3

Source: State Street Global Advisors, JP Morgan as at 26 February, 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.

Mexico was the worst performer (-5.5%) and a significant detractor (-51 bps) from index returns. Both FX and local rates sold off over the month, after Banxico's unanimous policy rate cut at its February meeting raised uncertainty around where the rate-floor might be in this easing cycle. There was also increased uncertainty around government attempts at controlling the electricity market, which could potentially affect competition in the sector and eventually translate to higher costs for manufacturing firms.

Thailand was the second worst performer (-5.2%) and another significant detractor (-44 bps) from index returns. Most economic indicators illustrated contracting activity in January, reflecting the effect of new restrictions to contain the resurgence in COVID-19 cases. The country's vaccination drive has also faced delays, which would further postpone plans to allow international visitors. The Bank of Thailand held its policy rate unchanged at 0.50% in its February meeting, and market participants expect it to continue to do so in the medium term.

Brazil underperformed the index, returning -4.3% in February. Policy uncertainty mounted as proposed fuel price increases and threats of a truckers' strike prompted President Bolsonaro to replace the CEO of Petrobras, a state-run energy company, and to flag potential changes in other sectors. Disagreement on health and education spending resulted in the postponement of a critical vote on an emergency bill to secure debt sustainability, leading to additional market turbulence.

Hungary performed poorly, returning -3.8%. Even though the National Bank of Hungary (NBH) kept the base rate unchanged at 0.6% in February, with no changes to the interest rate corridor range – Hungary's high CPI (consumer price index) path, together with the NBH's sizeable liquidity injections, marks it out amongst its peers. With expectations of headline inflation to stay elevated, markets began pricing near-term rate hikes, leading to rates selling off.

Peru delivered returns of -3.7% in the month. Peruvian assets underperformed amid apprehension about the rise of Yonhy Lescano in the presidential elections polls – markets are concerned that Lescano could derail the market-friendly orientation Peru's economic policies if he wins. On the monetary policy side, the central bank continues with its accommodative monetary policy stance - maintaining the policy rate at the lower bound of 0.25%.

There were no significant positive contributors to index performance over the month.

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	**-2.55%**	**-1.78%**	**-3.61%**
Spread Return	-0.11%	2.49%	0.09%
Treasury Return	-2.45%	-4.17%	-3.70%
IG Sub-Index	-3.51%	-3.97%	-4.71%
HY Sub-Index	-1.44%	0.83%	-2.34%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 26 February, 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 (HC) sovereign debt recorded a return of -2.55% in February, as measured by the JP Morgan EMBI Global Diversified Index. Although EMBI GD spreads were resilient over a turbulent month in widening only 6 bps, a significant steepening in the US Treasury yield curve – with 5-year and 10-year yields rising 31 and 34 basis points (bps), respectively – weighed on total returns. While rising rates that reflect optimism about economic growth isn't bad for EM HC per se – particularly with broad monetary conditions still highly accommodative – higher real yields in the US may reduce the temptation for investors to allocate capital to emerging markets.

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

February 2021	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight	Index Impact (bps)**
EMBI Global Diversified		**-1.09**	**0.20**	**1.28**		
Top 5 Performers	Costa Rica	12.6	12.6	0.0	0.3%	3.4
	Sri Lanka	9.5	10.0	-0.4	0.2%	2.2
	Angola	5.5	5.5	0.0	0.0%	0.0
	El Salvador	2.2	3.3	-1.1	0.0%	0.1
	Venezuela	1.8	4.6	-2.7	1.1%	1.9
Bottom 5 Performers	Lebanon	-5.4	-3.3	-2.2	1.1%	-6.2
	Belize	-5.5	-1.7	-3.9	2.3%	-12.7
	Argentina	-5.7	-2.3	-3.5	0.8%	-4.8
	Ethiopia	-5.9	-2.4	-3.6	2.8%	-16.9
	Ecuador	-6.3	-2.9	-3.5	2.8%	-17.5

Source: State Street Global Advisors, JP Morgan as at 26 February, 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.

Peru bonds were the worst performers, returning -6.3% and detracting -18 bps from headline index returns. Spreads widened as the country faced a second wave of COVID-19 infections, which prompted the government to mandate stay-at-home orders in the main urban centers amid concerns that a third COVID-19 wave associated with delays in securing vaccine supplies could follow. Part of the risk-off move was also associated with the aforementioned election uncertainty.

Panama was among the worst performers, returning -5.9% and detracting -17 bps from index returns. Spreads remain sensitive to the pace of vaccine rollout, given that the virus remains widespread, and limited policy space makes it hard to enact further countercyclical measures. Fitch downgraded Panama foreign currency ratings to BBB- from BBB in February and set the outlook to negative, highlighting the country's weakening public finances.

Uruguay performed poorly, returning -5.5% and detracting -13 bps from index returns. Even though Uruguay navigated the pandemic in better shape than many of its peers, it is among the few countries in LatAm yet to begin vaccinating the population – an expected slow vaccination rollout poses some risks ahead of the winter. A downgrade to expected GDP growth in 2021 amid the impact of tightened restrictions to control the first COVID wave in 1Q led to some underperformance as well.

Lebanon bonds recovered somewhat from their extreme lows on expectations of financial aid from Qatar once a government is formed. Lebanon remains in the middle of its worst economic crisis in decades against the backdrop of political divisions, lack of a government, runaway inflation and a failure to secure support from the International Monetary Fund (IMF).

Zambia bonds performed well, as the strong rally in copper prices in recent months (+15% in February alone) provides Balance of Payment support, and the Zambian government has indicated a willingness to agree a support programme with the IMF. Progress towards a deal will depend on it reaching a restructuring agreement with its main lenders to help put the country's debt trajectory back on a sustainable course.

Ecuador bonds came off its January lows as conservative presidential candidate Guillermo Lasso overtook a rival to face left-wing economist Andres Arauz in the second round of election voting on April 11. Austerity policies are considered less likely should Arauz be elected and may lead to a selloff in bonds, further threatening the nation's debt sustainability. A victory by Lasso, who aims to strengthen investor confidence through orthodox economic reforms, is considered a more benign outcome from a market perspective.

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