Emerging Market Debt Market Commentary

First Quarter, 2021

Emerging market debt (in USD terms) experienced a weak first quarter as markets reacted to a number of developments that included investor concerns about rising US Treasury yields leading to a pick-up in market volatility across asset classes; a modest increase in COVID-19 cases in some regions slowing down the recovery in travel and tourism sectors; political developments in some Latin American countries; and idiosyncratic events in Turkey. Markets are also starting to price in the scope of EM central banks responding to rising external inflation pressures. Even though EM fund flows saw a deteriorating trend in the last four weeks of the quarter, overall year-to-date flows were positive with flows of +$5.2bn and +$9.3bn into hard currency and local currency assets, respectively (source for flows: Morgan Stanley).

Figure 1 - Emerging Market Debt Index Returns – As of 31 March, 2021

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-3.07%	-6.68%	2.30%	-6.68%	13.03%	-0.79%	3.08%
EMBI GD (EM Hard Currency)	-0.96%	-4.54%	1.00%	-4.54%	16.00%	4.04%	5.05%
CEMBI BD (EM Corporates)	-0.64%	-0.80%	3.60%	-0.80%	18.31%	6.13%	6.14%
In EUR							
GBI-EM GD (EM Local Currency)	0.11%	-2.85%	2.07%	-2.85%	5.52%	0.72%	2.44%
EMBI GD (EM Hard Currency)	2.28%	-0.62%	0.77%	-0.62%	8.30%	5.63%	4.41%
CEMBI BD (EM Corporates)	2.62%	3.27%	3.37%	3.27%	10.45%	7.75%	5.48%
In GBP							
GBI-EM GD (EM Local Currency)	-1.78%	-7.54%	-4.14%	-7.54%	1.58%	-0.24%	3.93%
EMBI GD (EM Hard Currency)	0.36%	-5.42%	-5.37%	-5.42%	4.25%	4.62%	5.92%
CEMBI BD (EM Corporates)	0.69%	-1.72%	-2.93%	-1.72%	6.32%	6.72%	7.01%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 March, 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 31 March, 2021

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	29 bps	78 bps	78 bps	4.99%
EMBI GD Yield	18 bps	73 bps	73 bps	5.28%
EMBI GD Spread	-4 bps	3 bps	3 bps	354 bps
CEMBI BD Yield	20 bps	44 bps	44 bps	4.48%
CEMBI BD Spread	-1 bps	-22 bps	-22 bps	300 bps
CDX.EM 5y	-7 bps	34 bps	34 bps	186 bps
10y UST	34 bps	83 bps	83 bps	1.74%
Dollar Index (DXY)	2.59%	3.66%	3.66%	
DOW 30	6.62%	7.76%	7.76%	32,982
Oil (WTI)	-3.80%	21.93%	21.93%	$ 59.16

Source: JP Morgan, Bloomberg as of 31 March, 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 $)	**-3.07%**	**-6.68%**	**-6.68%**
FX Return (vs $)	-1.68%	-3.49%	-3.49%
Price Return (Local currency)	-1.86%	-4.43%	-4.43%
Interest Return (Local currency)	0.47%	1.23%	1.23%
In EUR			
Total Return (in €)	**0.11%**	**-2.85%**	**-2.85%**
FX Return (vs €)	1.50%	0.35%	0.35%
In GBP			
Total Return (in €)	**-1.78%**	**-7.54%**	**-7.54%**
FX Return (vs €)	-0.38%	-4.34%	-4.34%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 March, 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 -6.68% in US dollar terms in Q1, as measured by the JP Morgan GBI-EM Global Diversified Index. Both bond and currency (FX) returns were almost equally impacted as markets adjusted for domestic fiscal and policy credibility issues in LatAm countries, some idiosyncratic country risks (especially Turkey), and higher US rates volatility through a repricing of local rates premia and FX.

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

Q1 2021	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (bps)**
GBI-EM GD		**-6.68**	**-3.19**	**-3.49**		
Top 5 Performers	Dominican Republic	5.2	2.6	2.6	0.2%	1
	China	0.3	0.5	-0.2	10.0%	3
	Philippines	-1.8	-0.8	-1.1	0.2%	0
	South Africa	-2.3	-1.8	-0.5	7.7%	-18
	Uruguay	-2.9	1.3	-4.2	0.1%	0
Bottom 5 Performers	Thailand	-8.4	-4.6	-3.7	8.8%	-73
	Peru	-11.4	-7.9	-3.5	2.5%	-28
	Colombia	-12.4	-5.9	-6.5	4.9%	-61
	Brazil	-12.9	-5.4	-7.5	8.3%	-107
	Turkey	-20.0	-10.9	-9.1	1.8%	-37

Source: State Street Global Advisors, JP Morgan as at 31 March, 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.

Turkey's return of -20.0% made it the worst performer in Q1 and a significant detractor (-37 bps) from index returns. The surprise removal of the central bank governor Naci Agbal by President Erdogan near the end of the quarter hurt policy credibility, particularly given the suggestion that the decision might be related to the bank's 200bp rate hike on 18 March. This drove a major spike in volatility in Turkish assets as investors were wary of a return of unorthodox/interventionist policies, which may result in a reversal of portfolio flows and/or domestic dollarization, along with elevated FX volatility.

Brazil underperformed the index, returning -12.9%, and was the most significant detractor from index returns (-107 bps). Multiple factors contributed to this underperformance including a shortage in vaccines and new lockdown measures amid the spread of more lethal strains, along with negative revisions to economic data. Furthermore, risks of fiscal slippage increased even as attempts to change the spending cap in structurally compromising ways were averted. Political risks also picked up as former President Lula was cleared to run in the October 2022 election, raising the potential for polarization and risks of populism on both sides of the political spectrum. The monetary policy committee increased the selic rate by 75bp to 2.75% in its March meeting in a unanimous decision, highlighting the rise in current and expected inflation due to the rise in commodity prices.

Colombia performed poorly, returning -12.4% and detracting -61 bps from the index. Markets have priced in a meaningful probability that the country could lose its investment grade status due to its deteriorating fiscal situation – the government expects a fiscal deficit of about 8.9% of GDP in 2021. Much depends on the speed and quantum of rebound in oil prices, which is likely to provide support to both the fiscal and external accounts, as well as approval of proposed tax reforms, which are focused on the elimination of exemptions from VAT and income tax – this could deliver additional revenues amounting to 1.5-2.0% of GDP.

Peru returned -11.4% over the quarter, detracting -28 bps from the index return. Even though commodity prices have rebounded and should benefit exporters such as Peru, significant political risk weighed on Peruvian assets. Yonhy Lescano seems to be consolidating as the leading candidate in the presidential elections polls, and markets are concerned that Lescano could derail the market-friendly orientation of Peru's economic policies if he wins. The race for second place in a likely run-off election remains open, and the candidates and parties with the highest level of support have a populist bias. Strengthening of fiscal buffers and implementation of reforms to reclaim lost fiscal space remains challenging in this context. On the monetary policy side, the central bank has maintained its accommodative monetary policy stance, keeping the policy rate at the lower bound of 0.25%.

Thailand generated returns of -8.4% in the quarter and was the second-worst detractor (-73 bps) from index returns. The country's vaccination drive has been delayed, which could further postpone schemes to reopen borders for international visitors. Inbound visitor numbers remain low and this lack of travel exports led to a sharp fall in GDP growth (tourism contributed to approximately 20% of GDP in 2019, according to government projections). A pickup in COVID-19 infections led to restrictions in early 2021 and is likely to impact GDP growth in Q1. With the policy rate at, or very close to, the effective lower bound, the Bank of Thailand held its policy rates at 0.50% in its February meeting, and market participants expect it to continue to do so in the medium term.

Dominican Republic delivered positive returns of +5.2%, with an equal contribution from local currency bonds and FX, but had no meaningful impact on index returns. Markets seemed to have reacted positively to President Abinader's administration's awareness of the need for fiscal reform and advancement on other issues such as a pact with public electric companies to ensure self-sustainability. The recent increase in international reserves, which reached $12bn, helped contain the risks on the fiscal and external fronts to some extent.

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	**-0.96%**	**-4.54%**	**-4.54%**
Spread Return	0.63%	0.73%	0.73%
Treasury Return	-1.59%	-5.23%	-5.23%
IG Sub-Index	-0.62%	-5.30%	-5.30%
HY Sub-Index	-1.35%	-3.66%	-3.66%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 March, 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 delivered a negative return of -4.54% in Q1, as measured by the JP Morgan EMBI Global Diversified Index. Even as EMBI GD spreads were resilient over the quarter in widening by a mere 3 bps, a large bear steepening move in US Treasuries that saw 5-year and 10-year yields rise 58 and 83 bps respectively weighed on total returns. The move higher in rates has been largely due to vaccine distribution and optimism, improving global growth trends, rising commodity prices and higher inflation expectations – this is not a bad backdrop for EM HC per se, particularly given broad monetary conditions that are still highly accommodative. However, investors finding higher real yields in the US may be less tempted to allocate capital into EM.

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

Q1 2021	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight	Index Impact (bps)**
EMBI Global Diversified		**-4.54**	**0.73**	**-5.23**		
Top 5 Performers	Venezuela	16.5	16.5	0.0	0.0%	0
	Sri Lanka	10.1	11.9	-1.6	1.1%	11
	Zambia	8.9	9.6	-0.6	0.2%	2
	Costa Rica	6.9	13.4	-5.7	0.8%	6
	El Salvador	6.3	11.9	-5.0	1.0%	6
Bottom 5 Performers	Panama	-8.8	-0.6	-8.3	2.8%	-25
	Peru	-9.4	-1.5	-8.0	2.8%	-26
	Ecuador	-13.1	-8.2	-5.4	1.1%	-14
	Belize	-14.0	-10.2	-4.2	0.0%	0
	Argentina	-15.1	-11.1	-4.5	1.1%	-17

Source: State Street Global Advisors, JP Morgan as at 31 March, 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.

Argentina bonds were the worst performers in Q1, returning -15.1% and detracting -17 bps from headline index returns. The country's fiscal outlook has deteriorated, and markets are pricing in potential risk that an IMF program is delayed until late in Q2, after mid-term elections. Also Argentine bonds' absence of carry in a rising core yield environment has impacted valuations. Inflation has also risen to levels seen during past devaluation episodes.

Belize performed poorly, returning -14.0%, but it didn't have an impact on index returns due to its low weight. Belize's government announced its intention near the end of March to restructure its dollar-denominated bonds due to mature in 2034, as part of a broader economic plan to restore fiscal sustainability.

Ecuador was among the worst performers, generating a negative return of -13.1% and detracting significantly from index returns (-14 bps). Even though international reserve levels are relatively high, and oil prices have increased, Ecuador continues to face structural, institutional and economic problems. Political risks have also recently increased as pro-market candidate Lasso, who is seen as more likely to reach a new agreement with the IMF that would reinforce the country's short-term capacity to pay back debt, now faces a difficult race to defeat Arauz in the runoff election.

Peru returned -9.4% over the quarter, detracting -26 bps from the index. Even though commodity prices have rebounded and should benefit exporters such as Peru, significant political risk has led spreads to widen, as highlighted in the previous section.

Panama performed poorly, returning -8.8% and detracting -25 bps from index returns, although most of the negative performance was from the underlying rates. Spreads remains sensitive to the vaccine rollout, given that the virus remains widespread. Furthermore, limited policy space makes it hard to enact further countercyclical measures. Following Fitch's downgrade of Panama' foreign currency rating to BBB- from BBB in February, Moody's downgraded its rating to Baa2 from Baa1 on March, with both agencies highlighting weakening public finances relative to rating peers.

Sri Lanka bonds returned +10.1, and was the highest positive contributor to index returns (+11 bps). Bonds rallied near the end of the quarter as investors gained more confidence that its upcoming July 2021 and January 2022 bond payments would be made on the back of news that China has approved a 10 billion yuan ($1.54 billion) currency swap line with Sri Lanka.

Zambia (strong rally in copper, hope for agreement for a $1.3 billion loan from IMF), **Costa Rica** (agreement for a three-year IMF Extended Fund Facility program for $1.75bn in January) and **El Salvador** (President Nayib Bukele's major victory in legislative elections in March giving power to approve budgets with external debt, including signing on to an IMF program) each delivered positive returns over the quarter, albeit with relatively modest impact on index returns.

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