Emerging Market Debt Market Commentary

Second Quarter 2020

The unprecedentedly rapid and large monetary and fiscal stimulus put in place by the major global economies fuelled a sharp rebound in emerging bond markets over the quarter. As a result, Q2 Emerging Market Debt (EMD) returns were able to offset to a great extent the losses witnessed in the first quarter.

With developed market (DM) central banks signalling that their accommodative policies will not be reversed anytime soon, the appetite for risk assets and the hunt for higher yield gained traction. As a result, towards the end of Q2 we witnessed the return of flows into EM bond funds, with investors marginally favouring hard currency over local currency EM debt.

Figure 1 - Emerging Market Debt Index Returns – As of 30 June, 2020[1]

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	0.47%	9.82%	-6.89%	-6.89%	-2.82%	1.14%	2.34%
EMBI GD (EM Hard Currency)	3.51%	12.26%	-2.76%	-2.76%	0.49%	3.60%	5.30%
CEMBI BD (EM Corporates)	2.75%	11.15%	-0.16%	-0.16%	3.74%	4.52%	5.13%
In EUR							
GBI-EM GD (EM Local Currency)	-0.50%	7.28%	-6.94%	-6.94%	-1.47%	1.66%	2.18%
EMBI GD (EM Hard Currency)	2.52%	9.67%	-2.82%	-2.82%	1.89%	4.13%	5.13%
CEMBI BD (EM Corporates)	1.76%	8.58%	-0.22%	-0.22%	5.19%	5.05%	4.96%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 30 June 2020. 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 2020

Item	Δ 1 Month	Δ 3 Month	Δ YTD	Current Level
GBI-EM GD Yield	-3 bps	-85 bps	-71 bps	4.51%
EMBI GD Yield	-41 bps	-148 bps	+59 bps	5.52%
EMBI GD Spread	-41 bps	-152 bps	+184 bps	474 bps
CEMBI BD Yield	-42 bps	-165 bps	-3 bps	4.94%
CEMBI BD Spread	-39 bps	-154 bps	+130 bps	440 bps
CDX.EM 5y	-92 bps	-157 bps	+21 bps	195 bps
10y UST	0 bps	-1 bps	-126 bps	0.66%
Dollar Index (DXY)	-0.97%	-1.67%	+1.04%	
DOW 30	+1.69%	+17.77%	-9.5%	25,813
Oil (WTI)	+10.65%	+91.75%	-35.69%	$ 39.27

Source: JP Morgan, Bloomberg as of 30 June 2020

[1] Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 30 June 2020.

Local Currency Market Highlights[2]

Figure 3 - Key return drivers of EM local government bond markets[1]

GBI-EM GD (EM Local Currency)	Monthly Return	3 Month Return	YTD Return
In USD			
Total Return (in $)	**0.47%**	**9.82%**	**-6.89%**
FX Return (vs $)	0.11%	3.92%	-10.95%
Price Return (Local currency)	-0.08%	4.34%	1.80%
Interest Return (Local currency)	0.43%	1.35%	2.75%
In EUR			
Total Return (in €)	**-0.50%**	**7.28%**	**-6.94%**
FX Return (vs €)	-0.85%	1.60%	-11.49%
Price Return (Local currency)	-0.08%	4.34%	1.80%
Interest Return (Local currency)	0.43%	1.35%	2.75%

EM Local Currency debt was up by +9.8% in US dollar terms in Q2, as measured by the JP Morgan GBI-EM Global Diversified Index (the GBI-EM GD) . The strong rally witnessed was a reflection of improving global liquidity conditions as well as easing by domestic central banks, via rate cuts, quantitative easing (QE) as well as other non-conventional policies aimed at supporting domestic bond markets. EM FX also rallied, supporting further Local Currency returns over the quarter.

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

Q2 2020	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (BP)**
GBI-EM GD		5.18	2.45	2.65		
Top 5 Performers	Indonesia	21.5	6.4	14.2	9.66%	207
	Colombia	18.0	8.9	8.6	5.75%	103
	Russia	17.2	6.8	9.7	8.76%	150
	Uruguay	16.0	13.9	1.9	0.10%	2
	Chile	15.5	11.2	3.9	2.30%	36
Bottom 5 Performers	Malaysia	4.2	3.4	0.8	6.89%	29
	Peru	3.7	6.6	-2.7	3.44%	13
	China	-0.4	-0.7	0.3	4.00%	-2
	Brazil	-1.1	4.7	-5.5	9.01%	-10
	Dominican Republic	-4.8	2.8	-7.4	0.14%	-1

Source: State Street Global Advisors, JP Morgan as at 30 June May 2020. 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.

[2] The returns stated in this section are based on the local currency returns according to JP Morgan GBI-EM Global Diversified. Returns calculated in USD.

Indonesia was the best performer in the GBI-EM GD Index this quarter with a return of +21.5%, and with the highest contribution to total index returns (+207 bps). Performance was driven by the FX component of return as the rupiah rallied on the back of measures taken by the Central Bank of Indonesia to shore up the currency, and more broadly its financial markets, and to restore investor confidence. The rebound in Indonesian assets came after months of outflows from the country's bond and equity markets, driven by international investors. Sentiment towards the country's local currency markets was also boosted by expectations that Indonesia will benefit from supply chain diversification as companies seek to reduce their reliance on China following supply-chain disruptions during the Covid-19 crisis. Finally, local currency bonds were also supported by the decision of Bank of Indonesia to cut rates by 25bps to 4.25% in June. The Bank of Indonesia has also been purchasing bonds from the government at primary market auctions since April.

Colombia was the second-best performer in the index returning +18.0% over the quarter. The country's local currency markets were supported by the sharp rebound in oil prices during this period (+92%) with WTI oil reaching nearly $40 per barrel at the end of June. This along with the Central Bank of Colombia cutting rates by 125 bps to 2.5% over the course of the quarter were amongst the chief reasons for the outperformance of the country's local currency bond markets.

Russia also benefitted from the rebound in oil prices, delivering a return of +17.1% over the quarter and the second highest contribution to index total returns (+150 bps). The local currency markets of the country were further supported by the Central Bank of Russia cutting rates by 100bps to 4.5% in Q2. On the fiscal front, Russia announced a plan that envisions a total spending of 8.7 trillion rubles, or $123 billion, over the next two years and added measures including tax cuts and loans. However, the plan was considered muted as the government maintained a conservative fiscal policy amid an economic slump driven by a lockdown and a drop in budget revenues.

Dominican Republic was the worst performer in the GBI-EM GD Index, delivering a return of -4.8%. The underperformance of the country's local currency debt was driven by the FX component of return; the Dominican peso suffered due to election uncertainty and expected fiscal deterioration in an election campaign period. In addition to that, the country's reliance on tourism meant that Dominican peso also suffered from the impact of the Covid-19 crisis on the tourism industry.

Brazil was the second worst performer in the index, delivering -1.1% over the quarter and as the country continued to face a challenging outlook. Protracted disruptions to economic activity have led to larger fiscal deterioration that jeopardizes the much-needed reform agenda to address the country's low potential growth rate and fiscal imbalances. Meanwhile, measures by cities and states to contain the coronavirus outbreak have been undermined by President Bolsonaro who continued to oppose lockdown and social distancing measures.

Hard Currency Market Highlights[3]

Figure 5 - Key return drivers of EM hard currency government bond markets in USD[1]

EMBI GD (EM Hard Currency)	Monthly Return	3 Month Return	YTD Return
Total Return	**3.51%**	**12.26%**	**-2.76%**
Spread Return	3.48%	12.37%	-11.87%
Treasury Return	0.03%	-0.10%	10.34%
IG Sub-Index	1.81%	9.06%	3.13%
HY Sub-Index	5.69%	16.57%	-9.59%

EM Hard currency sovereign debt was up +12.3% in Q2, as measured by the JP Morgan EMBI Global Diversified Index. While sentiment towards emerging markets had deteriorated significantly during the COVID-19-induced turbulence in March—effectively stalling all new debt issuance—the initial shock eventually gave way to a period of stabilization and an improvement in sentiment during the second quarter. This was anchored by new bond issuance by EM sovereigns, especially in the Middle East and North Africa (MENA) region, followed by Latin America. Rating agencies have taken note, with the rating trend in EM turning decisively negative. Spreads on EM dollar sovereign bonds narrowed quickly from their COVID-19 crisis peaks partly due to large liquidity injections by mature market central banks and the International Monetary Fund (IMF) providing emergency support. As of 10 June, the IMF has disbursed c.$25bn of emergency financing to EM countries.

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

Q2 2020	Country	Total Return (%)	Spread Return (%)	TSY Return (%)	Index Weight	Index Impact (BP)**
EMBI Global Diversified		**6.07**	**6.60**	**-0.50**		
Top 5 Performers	Angola	119.4	120.5	-0.5	1.02%	122
	Gabon	45.8	45.3	0.3	0.34%	16
	Zambia	40.5	40.0	0.3	0.25%	10
	Tajikistan	40.3	39.6	0.5	0.06%	3
	Ecuador	40.1	39.8	0.2	1.07%	43
Bottom 5 Performers	Lebanon	-4.9	-5.1	0.2	0.40%	-2
	Barbados	-5.9	-6.4	0.6	0.07%	0
	Belize	-21.7	-22.2	0.6	0.03%	-1
	Suriname	-32.2	-32.5	0.5	0.04%	-1
	Venezuela	-39.6	-39.7	0.1	0.00%	0

Source: State Street Global Advisors, JP Morgan as at 30 June 2020. 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.

Angola was among the best performers in the quarter, delivering a staggering return of +119.4% and contributing +122 bps to index returns for an index weight of just over 1%. The nation saw its hard currency debt rally strongly as China who owns approximately 45% of Angola's debt agreed to a three-year moratorium. Angola is Sub-Saharan Africa's second biggest oil producer and its hard currency debt received a further boost by the rally in oil prices witnessed over the quarter.

[3] The returns stated in this section are based on the hard currency returns according to JP Morgan EMBIG Diversified. Returns calculated in USD.

Gabon and **Zambia** were among the best performers in the index, returning +45.8% and 40.5% respectively. Gabon's success in containing the COVID-19 pandemic and its fast recovery has helped enhance the competitiveness of its oil sector in particular and its entire economy at large. Zambia has received nearly $190mn from the World Bank, AfDB as well as the United States, Germany, Sweden, and the UK to support its response to COVID-19. Furthermore, it may benefit from the debt service suspension initiative put forth by the G20.

Ecuador gave out strong returns over the quarter, +40.1% and contributed the second most by +43 bps to headline index return. This is a rebound from the Q1 performance as IMF prepared a new credit line of ~$250mn under Rapid Financial Instruments to meet sell-off in crude oil.

Venezuela was the worst performer delivering a return of -39.6% as the US tightened sanctions further. Furthermore crude oil production by the country tumbled by ~32% in June and the government has not being able to re-establish the oil production lost.

Suriname and **Belize** hard currency debt continued to underperform delivering -32.2% and -21.7% respectively over the quarter. Moody's, Fitch and S&P have all downgraded Suriname's sovereign debt rating to either default or near default. Belize saw its rating downgraded from CCC to CC reflecting the risk of default over the next three months as the country struggles with high debt, weak economy and limited international reserves.

Hard Currency Corporate Bond Markets[4]

Figure 7 - Key return drivers of EM hard currency corporate bond markets[1]

CEMBI BD (EM Corporates)	Monthly Return	3 Month Return	YTD Return
Total Return	**2.75%**	**11.15%**	**-0.16%**
Spread Return	2.69%	11.06%	-6.56%
Treasury Return	0.06%	0.07%	6.85%
IG Sub-Index	2.09%	8.50%	1.93%
HY Sub-Index	3.68%	15.06%	-3.07%

[4] The returns stated in this section are based on the hard currency returns according to JP Morgan CEMBIB Diversified. Returns calculated in USD

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Expiry date 31 July 2021