Commentary
Fixed Income

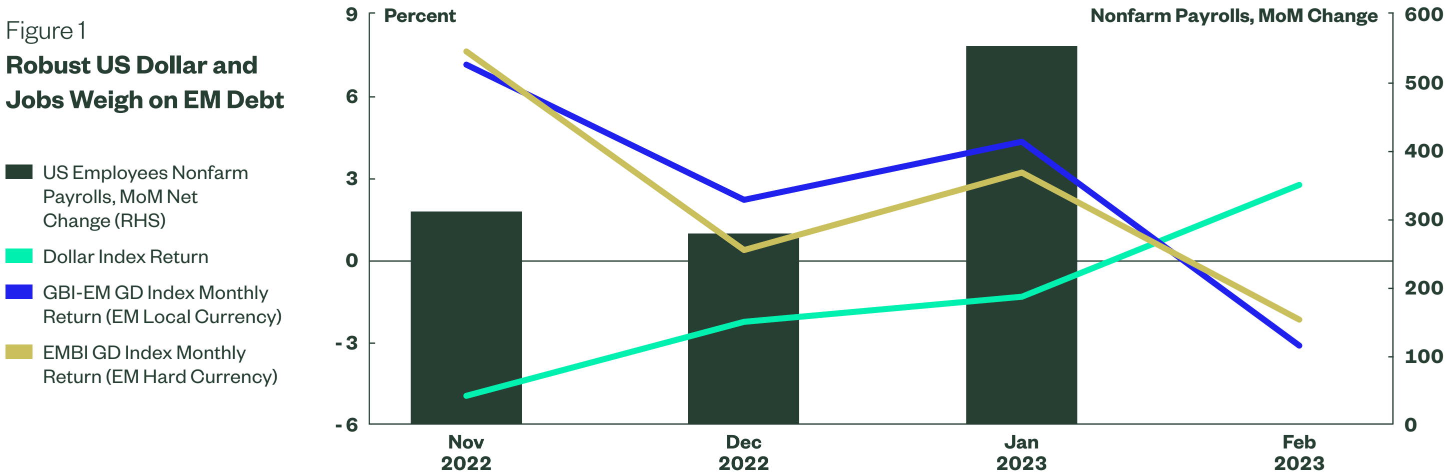
February 2023

Emerging Market Debt
Market Commentary: February 2023

Chart of the Month: EMD Returns Reverse Gains Achieved in January

The more robust than expected economic backdrop in developed markets, alongside tight employment markets, still-high inflation, and a rebounding US dollar weighed on EMD returns in February.

Figure 1
Robust US Dollar and Jobs Weigh on EM Debt



Bloomberg Finance LP, JP Morgan as of 28 February 2023. Past performance is not a reliable indicator of future performance. Index returns reflect capital gains and losses, income, and the reinvestment of dividends.

EMD Commentary — February 2023

Emerging market (EM) debt in February 2023 was weaker as strong global economic activity prompted markets to price in higher terminal rates. The shift in valuations also factored in a slowing disinflation pace and a renewal of US dollar strength. Inflation prints in the month were generally higher than initial expectations, especially in EM Asia. Most EM economies are now more exposed to extended tightening cycles, with a timeframe for rate cuts pushed further out. The momentum shift in terminal rate expectations, coupled with increased volatility in rates, dampened the year-to-date returns in EM markets.

Investor risk appetite was curtailed amid geopolitical tensions. Potential resolutions pertaining to Russia's invasion of Ukraine are still ambiguous as the conflict reached its first anniversary. US-China tensions escalated further following comments from US Secretary of State Antony Blinken on China's military aid to Russia. Some uncertainty around when Turkey's elections will take place has arisen following the tragic earthquake in the country. The US Non-Farm Payrolls (NFP) data remains a critical focus as a stronger-than-expected result for February could increase the likelihood of a 50 basis points (bps) hike by the Federal Reserve in March. New export orders observed in China helped address concerns around diminishing demand.

During February 2023, net flows into EM hard currency and local currency funds were $0.1bn and $-1.1bn respectively.[1]

Figure 2
Emerging Market Debt Index Returns — As of 28 February 2023

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	-3.16	3.17	4.20	0.99	-6.11	-4.29	-2.96
EMBI GD (EM Hard Currency)	-2.21	1.22	2.13	0.89	-8.64	-5.17	-0.73
CEMBI BD (EM Corporates)	-1.60	2.96	2.11	1.39	-4.92	-1.79	1.55
In EUR							
GBI-EM GD (EM Local Currency)	-0.83	0.17	-1.20	1.64	-0.56	-3.17	-0.21
EMBI GD (EM Hard Currency)	0.15	-1.72	-3.16	1.53	-3.24	-4.05	2.08
CEMBI BD (EM Corporates)	0.77	-0.04	-3.18	2.04	0.70	-0.63	4.43
In GBP							
GBI-EM GD (EM Local Currency)	-1.53	1.49	0.15	0.35	4.06	-2.57	-0.42
EMBI GD (EM Hard Currency)	-0.56	-0.43	-1.84	0.24	1.25	-3.46	1.87
CEMBI BD (EM Corporates)	0.06	1.28	-1.85	0.75	5.37	-0.02	4.21

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February, 2023. Past performance is not a reliable indicator of future performance. 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 3
Key EM and Macro Levels as of 28 February 2023

Item	∆ 1 Month	∆ 3 Months	∆ YTD	Current Level
GBI-EM GD Yield	19 bps	-6 bps	-5 bps	6.81%
EMBI GD Yield	47 bps	8 bps	3 bps	8.58%
EMBI GD Spread	3 bps	-21 bps	-5 bps	447 bps
CEMBI BD Yield	47 bps	-24 bps	-8 bps	7.31%
CEMBI BD Spread	-2 bps	-33 bps	-25 bps	351 bps
CDX.EM 5y	19 bps	15 bps	3 bps	241 bps
10y UST	41 bps	31 bps	5 bps	3.92%
Dollar Index (DXY)	2.72%	-1.02%	1.30%	—
DOW 30	-4.19%	-5.59%	-1.48%	32657
Oil (WTI)	-2.31%	-4.35%	-4.00%	$ 77.05

Source: JP Morgan, Bloomberg Finance L.P., as of 28 February 2023. Past performance is not a reliable indicator of future performance. Index returns reflect capital gains and losses, income, and the reinvestment of dividends.

Local Currency Market Highlights

EM local currency debt returned -3.16% in USD terms in February 2023, as measured by the JP Morgan GBI-EM Global Diversified Index. A major detraction from performance came from foreign exchange (FX) returns (-2.59%), driven by higher core rates and broader US dollar strength as a result of repricing in yields. Speculation of a possible delay in future policy rate easing and higher terminal rates exposed vulnerabilities in local bond markets, especially in the EM economies that are closely tied the Fed's rate cycle. Repricing in local bonds led by these factors contributed to negative returns in the month.

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 $)	**-3.16**	**3.17**	**0.99**
FX Return (vs $)	-2.59	1.36	-0.13
Price Return (Local currency)	-0.98	0.52	0.28
Interest Return (Local currency)	0.40	1.30	0.84
In EUR			
Total Return (in €)	**-0.83**	**0.17**	**1.64**
FX Return (vs €)	-0.26	-1.64	0.52
In GBP			
Total Return (in €)	**-1.53**	**1.49**	**0.35**
FX Return (vs €)	-0.95	-0.32	-0.77

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February 2023. Past performance is not a reliable indicator of future performance. 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 5
Best and Worst Performers Across EM Local Government Bond Markets in USD*

February 2023	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Average Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**-3.16**	**-0.58**	**-2.59**	—	—
Top 5 Performers	Dominican Republic	6.6	4.5	2.1	0.2	1
	Turkey	4.1	4.5	-0.4	1.4	6
	Peru	2.1	1.1	1.0	2.3	5
	Uruguay	0.2	0.7	-0.5	0.2	0
	Mexico	0.1	-2.5	2.5	10.0	1
Bottom 5 Performers	Malaysia	-5.1	-0.1	-4.9	10.0	-51
	Chile	-5.4	-1.5	-4.0	2.1	-11
	South Africa	-5.8	-0.8	-5.0	9.6	-56
	Colombia	-6.9	-2.9	-4.0	3.6	-25
	Thailand	-7.0	-0.3	-6.7	10.0	-70

Source: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February 2023. Past performance is not a reliable indicator of future performance. 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.

Thailand underperformed in February as strong returns in January were party reversed. The country's economy was weaker than market expectations in the final quarter of 2022, with quarter-on-quarter GDP shrinking -1.5%. Exports dropped as a result of a shortfall in demand. The Thai baht depreciated around 7% against the dollar and closed February at 35.35.

Colombia was also an underperformer. President Gustavo Petro's reforms to overhaul Colombia's conservative economic model continued to rattle financial markets. Rapid sell-offs were observed in Colombia's local bond market as investors contemplated the reforms. The Colombian peso declined 4% to close February at around 4,862.

South Africa underperformed in February, reflecting the economy's sensitivity to the Fed's monetary policy stance and US dollar strength. The South African rand weakened about 5% against the US dollar and closed the month at around 18.36. The local currency risk and a worsening energy crisis that has resulted in more power cuts are reflected in the steepness of the yield curve.

Dominican Republic was the best performer in February, backed by strong growth data, tourism revenue and improved debt ratios. The markets are expecting the central bank to commence cutting interest rates in Q3 2023 from the current 8.5% rate. S&P Global Ratings retained their 'BB' long-term ratings with stable outlook, reflecting the economy's resilience and growth.

Turkey local bonds performed well in February. The earthquake tragedy prompted the Central Bank of Turkey (CBT) to cut its main interest rate by 50 bps, taking it to 8.5% from 9%. The potential for more central bank easing to support the post-earthquake recovery resulted in risks being skewed to the downside.

Hard Currency Market Highlights

EM hard currency (HC) sovereign debt delivered a return of 8.11% in Q4 2022, as measured by the JP Morgan EMBI Global Diversified Index. The spread return (+7.56%) contributed significantly, with spreads tightening by 107 bps during the quarter, a trend predominantly observed in the LatAm regions. The expectations for slower-paced Fed rate hikes, coupled with China's relaxation of its zero COVID policy, added to the positive momentum, creating opportunities in the hard currency space.

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	**-2.21**	**1.22**	**0.89**
Spread Return	0.50	2.44	0.96
Treasury Return	-2.69	-1.19	-0.06
IG Sub-Index	-2.03	0.66	0.52
HY Sub-Index	-2.40	1.79	1.27

Source: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February 2023. Past performance is not a reliable indicator of future performance. 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 7
Best and Worst Performers Across EM Hard Currency Government Bond Markets*

February 2023	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**-2.21**	**0.50**	**-2.69**	—	—
Top 5 Performers	Venezuela	15.9	15.7	0.2	0.0	0
	Sri Lanka	7.8	8.7	-0.8	0.7	5
	Lebanon	7.7	7.6	0.1	0.2	1
	Tunisia	5.5	6.2	-0.7	0.1	1
	Nigeria	2.0	4.4	-2.3	2.0	4
Bottom 5 Performers	Egypt	-5.5	-3.5	-2.1	2.6	-14
	Argentina	-6.8	-4.7	-2.1	1.4	-9
	Zambia	-9.9	-9.7	-0.2	0.2	-2
	Ukraine	-12.7	-11.1	-1.8	0.6	-7
	Ecuador	-27.0	-25.1	-2.5	1.0	-27

Source: State Street Global Advisors, Bloomberg, JP Morgan as of 28 February 2023. Past performance is not a reliable indicator of future performance. 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.

Ecuador was the worst performer in February owing to political risks and volatility. The dollar bond market sold off after President Guillermo Lasso's proposed constitutional changes were rejected by the voters. The markets priced in a worst case scenario of Lasso being impeached as the opposition majority in the National Assembly signaled their intent to initiate impeachment hearings.

Ukraine was another underperformer. An expected escalation in Russian military operations continues to derail financial markets and impact yields. Persistent pressure on Ukraine's finances resulted in a ratings downgrade by Moody's Investor Services from Caa3 to Ca, with stable outlook.

Egypt also underperformed in February as inflation continues to weigh heavily on the economy. The annual core inflation rate touched 31.24% in January 2023 (a five-year high). The annual urban inflation rate increased for the seventh straight month to 25.8% in January 2023, ahead of market expectations of 23.8%.

Venezuela was the best performing country in February. Venezuela is under international economic sanctions and its bonds are trading at low levels. However, markets rallied in February as the country was on track to ship three million barrels of crude oil to the US as part of the license issued by the US Treasury Department after a three-year ban.

Sri Lanka performed well in February. The inflation rate slowed in February for the fifth consecutive month, aided by improvements in supply conditions. The country is optimistic of International Monetary Fund (IMF) approval for a $2.9 billion bailout. The country's currency was allowed to trade in wider bands in an effort to convince the IMF of its reform intentions.

Endnote

1 Source: JP Morgan.

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* Pensions & Investments Research Center, as of December 31, 2021.
† This figure is presented as of December 31, 2022 and includes approximately $58.60 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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