Commentary
Fixed Income

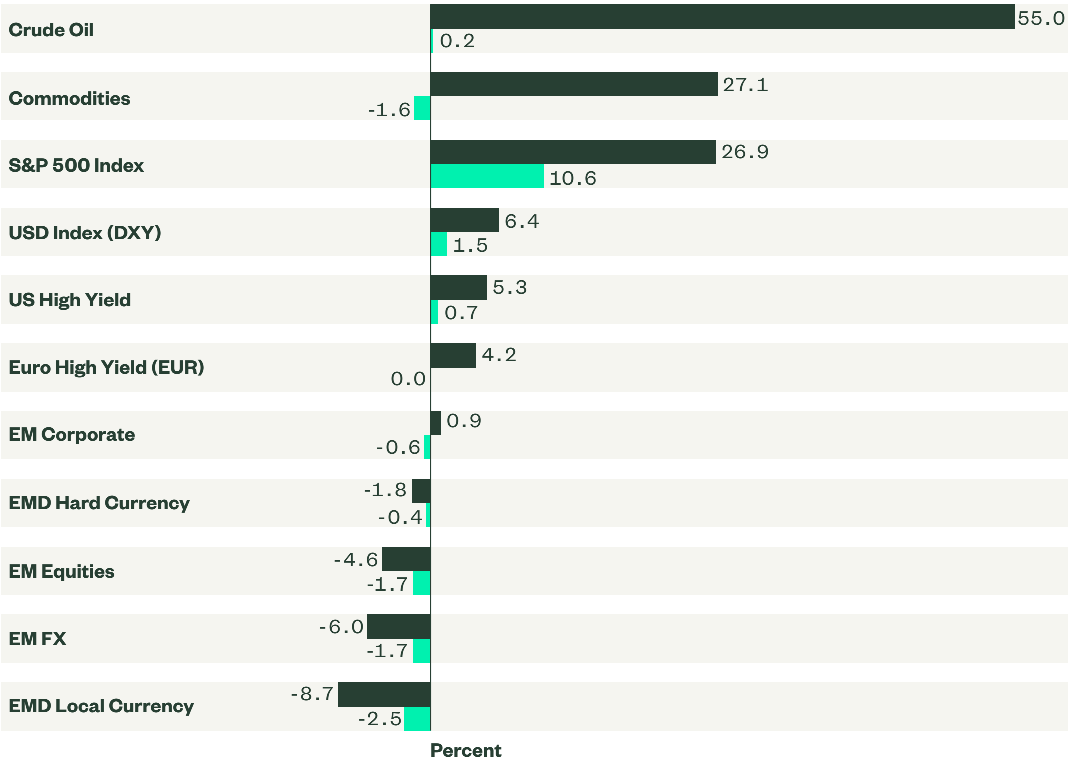
Quarter 4, 2021

Emerging Market Debt Market Commentary

Chart of the Quarter: EM Assets Underperform

In a quarter marked by new COVID concerns, hawkish central banks, a strengthening US dollar and a shift in risk appetite, the underperformance of emerging market assets in 2021 was extended.

Figure 1
Asset Class Returns[1]



Source: Bloomberg Finance LP., as of 31 December 2021. Past performance is not a reliable indicator of future performance. Returns are in USD unless otherwise stated. Index returns reflect capital gains and losses, income, and the reinvestment of dividends.

EMD Commentary — Q4 2021

Emerging market debt (in USD terms) recorded negative returns in Q4 in both hard currency and local currency, mostly on the back of negative news flow around the Omicron COVID-19 variant and inflation. The more hawkish-than-expected congressional testimony of US Federal Reserve Chair Jerome Powell in late November and subsequent scale-back in monthly asset purchases by $40bn and $20bn per month for Treasuries and Agency MBSs respectively in December meeting was also an important factor. EM Central banks (most of Latin America (LatAm) and Central and Eastern Europe (CEE)) accelerated the pace of monetary policy normalisation, staying ahead of the tightening curve compared to their developed market (DM) counterparts.

As concerns mounted that the spread of the Omicron variant could have an adverse effect on global supply chains, the recovery of travel and tourism dependent EM economies was delayed. Idiosyncratic policy risks and geopolitical risks — especially in LatAm and Turkey — contributed to weakness over the quarter. The sell-off (particularly in local currency debt) in October and November was partially offset by gains in December as sentiment recovered. Over the course of the fourth quarter, hard currency inflows were positive at $4.2bn, while local currency outflows amounted to -$3.9bn. Over 2021, flows into EM hard currency and local currency funds were $31.2bn and $21.4bn, respectively (source: JP Morgan).

Figure 2
Emerging Market Debt Index Returns — As of 31 December, 2021

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	1.56	-2.53	-5.56	-8.75	-8.75	2.07	2.82
EMBI GD (EM Hard Currency)	1.40	-0.44	-1.14	-1.80	-1.80	5.94	4.65
CEMBI BD (EM Corporates)	0.40	-0.61	-0.36	0.91	0.91	6.93	5.36
In EUR							
GBI-EM GD (EM Local Currency)	0.52	-0.67	-1.51	-1.82	-1.82	2.25	1.28
EMBI GD (EM Hard Currency)	0.37	1.46	3.10	5.66	5.66	6.13	3.09
CEMBI BD (EM Corporates)	-0.62	1.29	3.90	8.57	8.57	7.11	3.78
In GBP							
GBI-EM GD (EM Local Currency)	-0.80	-2.97	-3.68	-7.91	-7.91	0.00	0.95
EMBI GD (EM Hard Currency)	-0.95	-0.89	0.83	-0.89	-0.89	3.79	2.75
CEMBI BD (EM Corporates)	-1.93	-1.06	1.62	1.84	1.84	4.76	3.44

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 31 December, 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 annualised.

Figure 3
Key EM and Macro Levels as of 31 December, 2021

Item	Δ 1 Month	Δ 3 Months	ΔΔ YTD	Current Level
GBI-EM GD Yield	4 bps	42 bps	150 bps	5.72%
EMBI GD Yield	-13 bps	17 bps	74 bps	5.29%
EMBI GD Spread	-23 bps	12 bps	17 bps	369 bps
CEMBI BD Yield	-4 bps	18 bps	54 bps	4.58%
CEMBI BD Spread	-13 bps	6 bps	-10 bps	312 bps
CDX.EM 5y	-27 bps	5 bps	36 bps	187 bps
10y UST	7 bps	2 bps	60 bps	1.51%
Dollar Index (DXY)	-0.34%	1.53%	6.37%	—
DOW 30	5.38%	7.37%	18.73%	36338
Oil (WTI)	13.64%	0.24%	55.01%	$ 75.21

Source: JP Morgan, Bloomberg, as of 31 December, 2021.

EM local currency debt returned -2.53% in US dollar terms in Q4, as measured by the JP Morgan GBI-EM Global Diversified Index — this was largely due to underperformance from both EM FX weakness and the tightening policies of many EM central banks. Unfavourable performance has been driven by a range of factors including: political discord (particularly in LatAm); policy uncertainty and geopolitical risks in Turkey; persistently high inflation that is keeping EM central banks ahead of developed market (DM) counterparts in the monetary policy normalisation cycle; and expectations of continued global supply disruptions.

Figure 4
Best and Worst Performers Across EM Local Government Bond Markets in USD*

Q4 2021	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
GBI-EM GD	—	**-2.53**	**-0.88**	**-1.67**	—	—
Top 5 Performers	Peru	9.0	5.2	3.6	2.1	19
	China	2.5	1.1	1.4	10.0	25
	Indonesia	1.9	1.4	0.4	10.0	19
	Thailand	1.1	-0.3	1.4	9.1	10
	Mexico	0.9	0.5	0.4	9.5	8
Bottom 5 Performers	Dominican Republic	-6.9	-5.3	-1.7	0.1	-1
	Colombia	-8.0	-1.8	-6.3	4.1	-33
	Poland	-9.4	-8.1	-1.5	7.2	-68
	Hungary	-10.3	-6.2	-4.4	3.5	-36
	Turkey	-38.2	-7.7	-33.1	1.1	-43

Source: State Street Global Advisors, JP Morgan, as at 31 December, 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 was the worst performer in Q4 with the lira depreciating by over 33% amidst a series of unconventional policy decisions from the central bank. This included a 200 bps rate cut on 21 October and 100 bps rate cuts in both November and December even as inflation spiked to 36.1% (CPI, y-o-y %) in December — this is way above the bank's 5% target. The central bank also had to intervene twice in early December to help stabilise the lira. Investors believe that the resulting expansion in consumer credit — as expectations of Turkey's GDP growth have risen from 4% at the start of 2021 to 9% by December — would further pressure the country's external accounts and FX reserves.

Central and Eastern Europe (CEE) countries **Hungary and Poland** underperformed as markets continue to price in steeper tightening cycles as the reopening of economies leads to real GDP recovering to pre-pandemic levels and narrowing output gaps. The central banks of Poland and Hungary increased their policy rates by 165 bps and 75 bps, respectively, in three separate hikes during the quarter. Hungary and Poland also both face potential delays and suspensions in EU transfers amid recent tensions over the rule of law.

Colombia's economy has experienced a strong recovery, contributing to market consensus GDP growth forecasts for 2021 gradually moving higher to stand at 9.1%. High levels of consumer and business confidence, as well as the recent upward trend in oil prices, have led to markets to expect BanRep will accelerate its rates normalisation process in upcoming meetings — this has resulted in local rates selling off. Risk premia related to fiscal and political uncertainties have contributed to the COP underperforming on FX markets.

Peru was the best performing country in Q4 (+9.0%), buoyed by the resignation of Prime Minister Guido Bellido in October — a leftist who had called for the nationalisation of the nation's largest gas field — following a cabinet reshuffle. Investors seemed to be optimistic on what appears to be a shift to the political center for the recently-installed government and the removal of a radical section of Castillo's party.

China achieved a positive return of +2.5%, with positive contributions from both the local rates and FX return components. The People's Bank of China cut the Reserve Requirement Ratio (RRR) by 0.5 percentage points, effective from December 15, in a move to boost liquidity and growth. The country's manufacturing purchasing managers' index (PMI) bounced back to 50.3 in December after consecutive declines in October and November, aided by authorities' efforts to boost coal and power supply to ease power rationing. The consensus GDP growth forecast for 2021 is 8% y/y and 5.2% for 2022. However, much depends on the transmission of the Omicron variant as China's persistence with its zero-COVID policy might lead to services and consumption being significantly impacted from any new COVID outbreaks.

Hard Currency Market Highlights

EM hard currency sovereign debt returned -0.44% in Q4, as measured by the JP Morgan EMBI Global Diversified Index. The 10-year US Treasury yield was relatively flat over Q4 but spreads widened in a poor quarter for EM risk assets as commentary from the Fed became progressively more hawkish — in December, the Fed reduced the pace of monthly net asset purchases by $40bn and $20bn per month for Treasuries and Agency MBS (mortgage-backed securities) respectively. Late-November reports of the emergence of the Omicron COVID-19 variant, along with concerns around the debt repayment capability of frontier EM countries as debt servicing costs rise from extremely low levels, also contributed to weakness. Hard currency spreads tightened by 23 bps in December as concerns around Omicron eased slightly, but this was not enough to cover the losses in November.

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	**1.40**	**-0.44**	**-1.80**
Spread Return	2.10	-0.37	1.60
Treasury Return	-0.68	-0.07	-3.34
IG Sub-Index	0.95	1.05	-1.93
HY Sub-Index	1.88	-1.95	-1.45

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 31 December, 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 annualised.

Figure 6
Best and Worst Performers Across EM Hard Currency Government Bond Markets*

Q4 2021	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified	—	**-0.44**	**-0.37**	**-0.07**	—	—
Top 5 Performers	Suriname	12.6	13.4	-0.7	0.1%	1
	Uruguay	2.9	2.1	0.8	2.3%	7
	Oman	2.5	2.7	-0.3	2.8%	7
	Papua New Guinea	2.5	2.9	-0.5	0.1%	0
	Mexico	2.3	2.2	0.2	5.0%	12
Bottom 5 Performers	Sri Lanka	-14.0	-13.6	-0.5	0.8%	-11
	El Salvador	-16.7	-17.0	0.3	0.6%	-10
	Ethiopia	-20.0	-19.4	-0.7	0.1%	-2
	Venezuela	-38.3	-38.3	-0.1	0.0%	0
	Lebanon	-39.1	-39.0	-0.3	0.2%	-8

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

Lebanon bonds continued to sell off through Q4 as the country faces difficulties in emerging from what has been the worst social and economic crisis since its 1975–1990 civil war. Hyperinflation, shortages of essentials, and significant power blackouts continue to be features. The country has started initial technical discussions with the International Monetary Fund (IMF), the first step needed before negotiation of the actual terms on the monetary and economic policies that the country must undertake in order to benefit from IMF assistance.

Among the poorer performers in Q4 were frontier countries **Ethiopia** (whose bonds weakened after the US announced its intention to cut off Ethiopia from duty-free access in response to the Tigray conflict and as S&P downgraded its rating by one notch to CCC in November); and **El Salvador**, where investors are concerned that the announcement of a bitcoin bond issuance may lead to a break from traditional IMF funding, leaving it with a highly uncertain funding model. This contributed to a steep widening of spreads in USD-denominated El Salvador bonds.

Sri Lanka also underperformed, with Moody's downgrading its rating by one notch to Caa2 and Fitch following suit by reducing its Long-Term Foreign-Currency Issuer Default rating to CC from CCC. These decisions were driven by concerns about depleting FX reserves and the increasing net indebtedness of the central bank due to liquidity injections. Investors are also worried about its ability to meet upcoming debt payment obligations of around $26bn from 2022 through to 2026 as they seek bailouts from swap facilities with India and China.

Suriname spreads rallied after the government announced that it had implemented all necessary actions for a $688m three-year extended fund facility programme from the IMF to be approved. The approval from the IMF executive board was received in the final week of December, which unlocks $57.5m of funding immediately.

Endnote

1 Asset Class Returns, Chart of the Quarter.

Crude Oil = Generic 1st 'CL' Future (USD)

S&P 500 = S&P 500 Index (USD)

US High Yield = Bloomberg U.S. High Yield 2% Issr Cap R Index Value Unhedged (USD)

Euro High Yield = Bloomberg Pan-European High Yield Total Return Index Value Unhedged (EUR)

EMD Local Currency = J.P. Morgan GBI-EM Global Diversified Composite Unhedged (USD)

EMD Hard Currency = J.P. Morgan EMBI Global Diversified Composite (USD)

EM Corporates = J.P. Morgan Corporate EMBI Broad Diversified Composite (USD)

EM Equities = MSCI Emerging Markets Index (USD)

EM FX = J.P. Morgan GBI-EM Global Diversified FX return (USD)

Commodities = Bloomberg Commodities Index (USD)

US Dollar (DXY) = U.S. Dollar Index Spot (USD)

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* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of September 30, 2021 and includes approximately $59.84 billion 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.

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