Emerging Market Debt Market Commentary

May 2020

Global risk sentiment continued to improve over the last month as more economies began the slow process of restarting activity. However, a fundamental reappraisal of EM prospects remains underway given the ongoing uncertainties. The re-opening so far has not been followed by a spike in new COVID-19 cases, reassuring markets that the economic normalization process can continue unimpeded for now. In EM, certain regions like Asia (notably China and Korea) and Emerging Europe appear to have controlled the virus relatively well.

In contrast, much of Latin America, Africa and India are further behind and are continuing to try to control their outbreaks; recoveries and moves to reopen their economies are far more tentative. As policy support remains in place, with central banks ready to act if needed, major economies continue to increase their fiscal response. Although uncertainty regarding the pandemic remains elevated, there has been some early improvement in EM asset performance in May.

Figure 1 - Emerging Market Debt Performance – As of 29 May 2020[1]

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	5.18%	-2.80%	-3.49%	-7.33%	2.05%	1.13%	2.00%
EMBI GD (EM Hard Currency)	6.07%	-6.57%	-4.17%	-6.06%	0.38%	2.36%	4.24%
CEMBI BD (EM Corporates)	3.91%	-4.29%	-1.89%	-2.83%	3.19%	3.64%	4.37%
In EUR							
GBI-EM GD (EM Local Currency)	3.57%	-4.02%	-4.34%	-6.48%	2.24%	1.50%	1.70%
EMBI GD (EM Hard Currency)	4.44%	-7.74%	-5.01%	-5.21%	0.56%	2.74%	3.94%
CEMBI BD (EM Corporates)	2.32%	-5.49%	-2.75%	-1.95%	3.38%	4.02%	4.07%

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 related levels as of 29 May, 2020

Item	Δ 1 Month	Δ YTD	Current Level
GBI-EM GD Yield	-33 bps	-68 bps	4.54%
EMBI GD Yield	-88 bps	+100 bps	5.92%
EMBI GD Spread	-95 bps	+225 bps	515 bps
CEMBI BD Yield	-62 bps	+39 bps	5.35%
CEMBI BD Spread	-63 bps	+169 bps	479 bps
CDX.EM 5y	-45 bps	+114 bps	287 bps
10y UST	+1 bps	-126 bps	0.65%
Dollar Index (DXY)	-0.68%	+2.03%	
DOW 30	+4.26%	-11.06%	25,383
Oil (WTI)	+88.38%	-41.88%	$ 35.49

[1] Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 May 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 $)	**5.18%**	**-2.80%**	**-7.33%**
FX Return (vs $)	2.65%	-5.36%	-11.05%
Price Return (Local currency)	2.08%	1.34%	1.88%
Interest Return (Local currency)	0.41%	1.39%	2.30%
In EUR			
Total Return (in €)	**3.57%**	**-4.02%**	**-6.48%**
FX Return (vs €)	1.08%	-6.74%	-10.66%
Price Return (Local currency)	2.08%	1.34%	1.88%
Interest Return (Local currency)	0.41%	1.39%	2.30%

EM Local Currency debt was up by +5.2% in US dollar terms in May, as measured by the JP Morgan GBI-EM Global Diversified Index. Early central bank easing and improving sentiment have favored local currency bonds, but the rally is losing steam as EM central banks turn more cautious about additional rate cuts. The primary COVID-19 epicenter has moved from DM to EM. Chile and Peru are struggling to stabilize new case growth per capita, while the total number of new cases remains among the highest in Brazil and Russia. Latin America (LatAm) would appear to be the most vulnerable in terms of existing market positioning and dependence on external capital flows, lower FX reserves, and a higher dependence on commodity prices. Monetary policy has its limits and weaker balance sheets constrain fiscal support in the public and private sectors.

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

May 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	Colombia	11.8	5.9	5.6	5.9%	69
	South Africa	11.7	7.2	4.2	7.5%	87
	Mexico	10.5	2.7	7.6	10.0%	105
	Russia	8.0	3.2	4.7	8.7%	70
	Chile	7.6	3.6	3.8	2.5%	19
Bottom 5 Performers	Brazil	1.7	2.0	-0.3	9.6%	16
	Turkey	1.6	-0.8	2.5	3.0%	5
	Malaysia	-0.6	0.5	-1.1	6.9%	-4
	China	-2.9	-1.6	-1.3	3.0%	-9
	Dominican Rep	-4.0	0.4	-4.4	0.1%	-1

Source: State Street Global Advisors, JP Morgan as at 29 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.

Colombia was the month's best performer, returning +11.8%, with most of it coming through the bond channel. The sell-off in Q1 was partly reversed, helped by a stabilization and much welcomed rise in oil prices. Banco Central de Colombia cut interest rate by 50 bps to a record low of 2.75% to combat a slump that the finance ministry forecasts will be the deepest in the nation's history.

South Africa was the second-best performer in the index, delivering a strong return of +11.7%, and made the second highest contribution to index returns (+87 bps). The recovery in South Africa after the Q1 sell-off was due to the South African Reserve Bank cutting its policy rate by 50 bps to an all-time low of 3.75% in a bid to support an economy that has contracted by -16.1% this year due to the virus and restrictions on economic activity. The rand also rallied over 4% from recent lows.

Mexico returned +10.5% and was the biggest contributor to index returns (+105 bps). Banco de Mexico's liquidity provision in the bond market helped to offset pressures from continued liquidation of the country's Mbonos bonds by foreign investors. The central bank also cut interest rates by 50 bps to 5.5%. The currency rallied by over 7.5% as the 'risk on' sentiment continued.

Dominican Republic proved the worst performer (-4.0%) in May as the Fitch ratings agency downgraded its credit ratings outlook from stable to negative (BB-), citing falling economic activity as the pandemic exerted balance of payment pressure given the country's reliance on tourism and remittances. The fiscal and monetary response will exacerbate pre-existing public finance and monetary weaknesses and lead to a deterioration of the government's balance sheet.

China was the second worst performer (-2.9%) and a significant detractor from index returns (-9 bps), partly due to a further escalation in US/China tensions. The People's Bank of China (PBOC) conducted open market operations to inject CNY10bn of liquidity through seven-day repo for the first time in almost two months.

Brazil: Despite the difficult political situation and accelerating virus outbreaks, returns in Brazil were positive. The currency was stable while the bonds managed to rally further as the economic outlook deteriorated further.

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	**6.07%**	**-6.57%**	**-6.06%**
Spread Return	6.60%	-9.91%	-14.83%
Treasury Return	-0.50%	3.70%	10.30%
IG Sub-Index	4.68%	-1.53%	1.29%
HY Sub-Index	7.98%	-12.58%	-14.46%

EM Hard currency sovereign debt was up +6.1% in May, as measured by the JP Morgan EMBI Global Diversified Index. The COVID-19 shock has pushed the global economy into recession and triggered massive capital outflows from emerging markets, particularly by hard currency investors. The International Monetary Fund (IMF) has stepped in to provide assistance and so far made $100bn available through rapid-disbursing emergency financing facilities for low-income and emerging market countries. Emergency financing of $22.8bn has been approved (half of which is meant for African countries) to mitigate the impact of the pandemic. Nevertheless, the challenges for weaker hard currency borrowers remain severe.

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

May 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	40.7	41.1	-0.3	0.8%	33
	Zambia	38.5	38.4	0.1	0.2%	8
	Ecuador	31.7	31.7	0.0	1.0%	31
	Argentina	29.7	29.8	-0.1	1.1%	34
	Iraq	23.6	23.5	0.1	0.5%	13
Bottom 5 Performers	Papua New Guinea	-1.2	-1.3	0.1	0.1%	0
	Sri Lanka	-1.8	-2.0	0.1	1.3%	-2
	Suriname	-24.8	-25.0	0.2	0.0%	-1
	Venezuela	-29.8	-29.8	0.0	0.0%	0
	Belize	-39.9	-40.0	0.1	0.0%	c

Source: State Street Global Advisors, JP Morgan as at 29 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 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 month, returning +40.7% and contributing +33 bps to the index return as it continues to recover from significant underperformance in Q1. The rally is partly due to the country being eligible for a suspension of debt repayments as agreed between the G20 group and 73 emerging nations, although borrowing rates may remain elevated. As oil accounts for one-third of Angola's GDP and is used to pay off the debt, the recovery in oil prices and global demand is a boost to the country's economic growth prospects.

Zambia and **Ecuador** were among the best performers in the index, returning +38.5% and 31.7%, respectively. Zambia's central bank cut interest rates for the first time in more than two years, by 225 bps to 9.25% and provided a $550m credit line to lenders that may face liquidity challenges, in order to cushion the economy. The IMF approved

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

Ecuador's request for emergency financial assistance of c.$643m under its Rapid Financing Instruments facility, allowing it to meet urgent balance of payment needs stemming from the outbreak of COVID-19.

Argentina delivered strong returns of +29.7% over the month and contributed+34 bps to headline index returns. Argentina's bond and FX recovered strongly as its central bank provided liquidity support through monetary base expansion. The Central Bank of the Argentine Republic also set a floor for time deposit rates at 70% of the monetary policy rate.

Belize and **Venezuela** featured among the worst performers with returns of -39.9% and -29.8%, respectively. Belize's debt-to-GDP ratio skyrocketed to 120% amid the COVID-19 economic shock as the government borrowed $75m from the central bank to fund its Food Assistance Program ($10m) and Unemployment Relief Program ($65m). Venezuela's bond market has been rocked by default and sanctions, followed by political crisis in the country.

Suriname bonds continued to weaken, posting losses of -24.8% over the month. Spreads widened further on the back of Moody's downgrading Suriname's rating to B3 and changing its outlook to negative; S&P also downgraded the country's debt to CCC+ from B amidst uncertainty regarding upcoming elections.

Sri Lanka was among the worst performing countries, detracting by -2 bps from the index returns. Due to Sri Lanka's public and external debt sustainability challenges, S&P downgraded its rating by one notch from B to B-, citing a risk that COVID-19 could push the nation's economy into a recession and weaken its already-fragile fiscal position.

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	**3.91%**	**-4.29%**	**-2.83%**
Spread Return	4.07%	-6.78%	-9.01%
Treasury Return	-0.15%	2.67%	6.79%
IG Sub-Index	2.72%	-2.57%	-0.15%
HY Sub-Index	5.64%	-6.74%	-6.51%

[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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