Commentary
Fixed Income

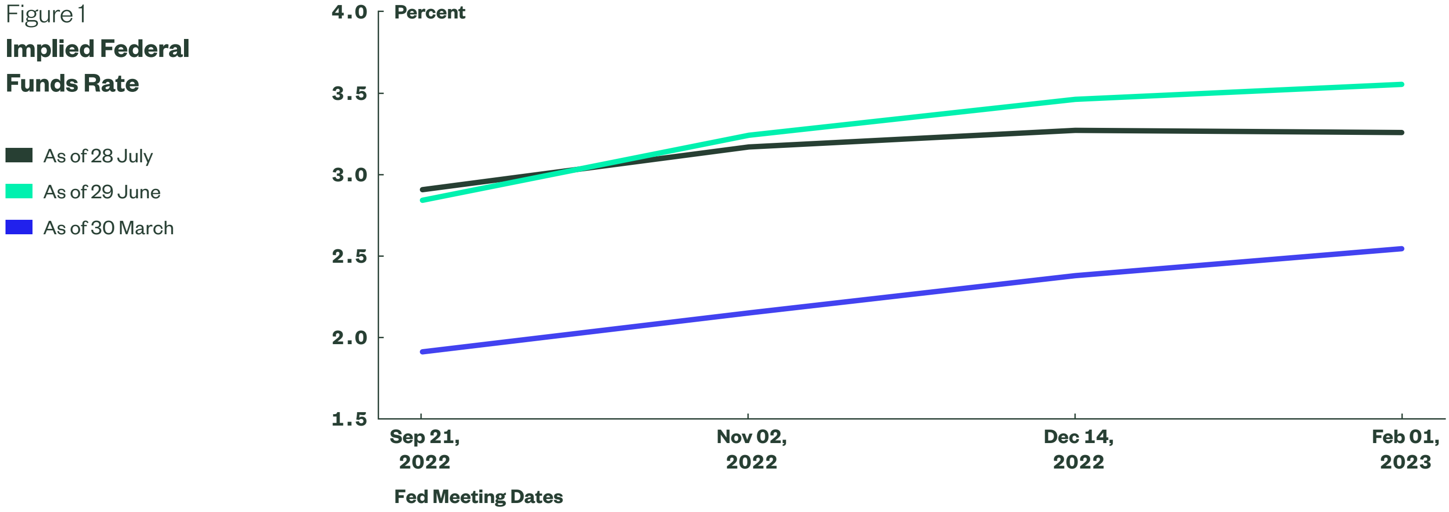
July 2022

Emerging Market Debt Market Commentary

Chart of the Month: Markets Reflect Shifting US Rate Expectations

Over the course of July, there was a slight reduction in the pace of implied future rate hikes by the US Federal Reserve.

Figure 1
Implied Federal Funds Rate



Source: Bloomberg Finance L.P., as of 28 July 2022. Past performance is not a reliable indicator of future performance.

EMD Commentary — July 2022

Emerging Market Debt (in USD terms) recorded modestly positive returns in July as concerns around weaker growth data from the United States and elsewhere, as well as indications that future US Federal Reserve moves were to be more data dependent, were interpreted by markets as dovish. This allowed for a slight easing in financial conditions and an improvement in risk sentiment globally. However, EM remains vulnerable to recession risk from the euro area, geopolitical concerns and sporadic rolling lockdowns in China.

During July 2022, hard currency outflows were -$3.1bn, while local currency outflows amounted to -$3.4bn.[1]

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Figure 2
Emerging Market Debt Index Returns — As of 29 July, 2022

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	0.29	-2.48	-14.28	-14.28	-18.70	-6.00	-2.65
EMBI GD (EM Hard Currency)	2.89	-3.48	-15.61	-18.01	-19.28	-4.70	-0.79
CEMBI BD (EM Corporates)	1.05	-2.62	-11.56	-13.04	-13.54	-1.07	1.30
In EUR							
GBI-EM GD (EM Local Currency)	2.83	0.89	-5.76	-4.40	-5.45	-3.20	0.22
EMBI GD (EM Hard Currency)	5.49	-0.13	-7.22	-8.55	-6.12	-1.87	2.13
CEMBI BD (EM Corporates)	3.61	0.75	-2.77	-3.01	0.55	1.87	4.28
In GBP							
GBI-EM GD (EM Local Currency)	0.09	0.61	-5.49	-4.59	-7.11	-5.80	-1.08
EMBI GD (EM Hard Currency)	2.68	-0.41	-6.95	-8.74	-7.77	-4.51	0.81
CEMBI BD (EM Corporates)	0.85	0.47	-2.49	-3.21	-1.22	-0.87	2.93

Source: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 July, 2022. 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 29 July, 2022

Item	∆ 1 Month	∆ 3 Months	∆ YTD	Current Level
GBI-EM GD Yield	-22 bps	7 bps	112 bps	6.84%
EMBI GD Yield	-37 bps	82 bps	290 bps	8.20%
EMBI GD Spread	-9 bps	94 bps	164 bps	533 bps
CEMBI BD Yield	-21 bps	67 bps	229 bps	6.88%
CEMBI BD Spread	10 bps	87 bps	102 bps	414 bps
CDX.EM 5y	-12 bps	42 bps	138 bps	327 bps
10y UST	-36 bps	-28 bps	114 bps	2.65%
Dollar Index (DXY)	1.16%	2.86%	10.70%	—
DOW 30	6.73%	-0.40%	-9.61%	32845
Oil (WTI)	-6.75%	-5.80%	31.13%	$98.62

Source: JP Morgan, Bloomberg, as of 29 July, 2022.

Local Currency Market Highlights

EM local currency debt returned +0.29% in US dollar terms in July 2022, as measured by the JP Morgan GBI-EM Global Diversified Index. This was mostly driven by negative foreign exchange (FX) returns (-1.35%), which is largely attributable to the continued strength of the dollar. The negative FX return was offset by positive price (+1.21%) and interest (+0.44%) returns. Growth risk had come to the forefront in EM economies during July as a result of the monetary tightening that had taken place already, resulting in a rally in their local currency bond markets on speculation that central banks could slow the pace rate hikes.

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 $)	**0.29**	**-2.48**	**-14.28**
FX Return (vs $)	-1.35	-3.78	-5.71
Price Return (Local Currency)	1.21	-0.05	-11.36
Interest Return (Local Currency)	0.44	1.34	2.79
In EUR			
Total Return (in €)	**2.83**	**0.89**	**-4.40**
FX Return (vs €)	1.18	-0.40	4.17
In GBP			
Total Return (in €)	**0.09**	**0.61**	**-4.59**
FX Return (vs €)	-1.56	-0.69	3.98

Source: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 July, 2022. 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 5
Best and Worst Performers Across EM Local Government Bond Markets in USD*

July 2022	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**0.29**	**1.65**	**-1.36**	—	—
Top 5 Performers	Chile	2.5	-1.4	3.9	2.1	5
	Poland	2.3	5.6	-3.2	6.9	16
	Czech Republic	2.0	4.0	-2.1	5.1	10
	Brazil	1.8	1.2	0.6	10.0	18
	Mexico	1.7	2.7	-0.9	10.0	17
Bottom 5 Performers	Egypt	-3.4	-2.8	-0.6	1.6	-5
	Peru	-5.0	-1.6	-3.4	2.3	-12
	Uruguay	-5.0	-1.0	-4.0	0.2	-1
	Colombia	-5.2	-2.0	-3.2	4.3	-22
	Hungary	-7.1	-3.1	-4.0	2.8	-20

Source: State Street Global Advisors, JP Morgan, Bloomberg, as at 29 July, 2022. 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 ending weight by total return.

Hungary was the worst performing country in July, returning -7.1% in USD terms and detracting 20 bps from the index return. The central bank raised the one-week deposit rate in early July by 200 bps to take it to 9.75%, which is by far the highest level in the European Union; however, the hike itself could not arrest the depreciation of the forint. Growing fears of recession, particularly in the EU, notably affected investor sentiment given Hungary's significant trade linkages within the region.

Chile was the best performing country in July, returning 2.5% in USD terms and contributing 5 bps to the index return. This was mostly driven by the surge in the Chilean peso which appreciated by over 16% against USD in the second half of July following the central bank's announcement of a $25bn foreign-exchange intervention program to buoy the battered currency. The relief rally came at a point when the peso's relative value has been hit by USD strength and declining copper prices, Chile's main export. CPI inflation surged again to touch 12.5% in June on a year-on-year basis.

Colombia underperformed in July, returning -5.2% in USD terms and detracting 22 bps from the index return. The central bank raised its benchmark rate by 1.5% for a second straight month to 9% following the slump in the Colombian peso, which fell to a record low on 12th July. The peso depreciated by over 3% against USD in July. Declining crude oil prices and uncertainty around the future economic policies of left-leaning Gustavo Petro, who became president on August 7, weighed on investor sentiment towards the country.

Brazil also outperformed in July, returning 1.8% in USD terms and contributing 18 bps to the index return, mostly driven by the positive reaction from investors to the government's push for additional fiscal spending. Brazil was one of the first LatAm central banks to begin monetary tightening in March 2021 and investors' hopes that it could contemplate rate cuts when a growth downturn materialises have diminished due to persistent inflation — the annual inflation rate hit 11.89% in June. Brazil's sovereign credit rating outlook was upgraded by Fitch to stable from negative, with the agency citing improvement in the nation's public finances through a turbulent period and the decisive monetary policy tightening of the central bank and commitment to combating inflation.

Poland also featured among the best performing countries in July, returning 2.3% in USD terms and contributing 16 bps to the index return. This was largely driven by bond returns (+5.6%) that were offset partially by FX returns (-3.2%). The central bank lifted the benchmark rate by half a percentage point to 6.5%, defying consensus predictions of a 75 bps increase. The central bank governor gave an indication that the central bank is close to ending its monetary tightening cycle amid a downturn in economic growth and as it expects inflation to reach a peak during the summer months. The threat of being cut off from Russian gas also eased a bit in July, boosting bond returns. The smaller-than-expected rate hike also led to weakness in the zloty, which fell by over 3% in the month.

Hard Currency Market Highlights

EM hard currency sovereign debt returned 2.89% in July 2022, as measured by the JP Morgan EMBI Global Diversified Index, driven by positive returns from both spread (0.73%) and treasury (2.15%) components. A relief rally was observed in US Treasuries due to a dovish interpretation of the latest meeting of the Federal Open Market Committee (FOMC). One-year forward rate expectations for the US have retreated more than 100bps from their peak in the space of a month, allowing for a slight easing in financial market conditions and underpinning a tightening in hard currency spreads.

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	**2.89**	**-3.48**	**-18.01**
Spread Return	0.73	-4.78	-10.80
Treasury Return	2.15	1.36	-8.08
IG Sub-Index	3.39	0.68	-16.97
HY Sub-Index	2.35	-7.63	-19.11

Source: State Street Global Advisors, Bloomberg, JP Morgan, as of 29 July, 2022. 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 7
Best and Worst Performers Across EM Hard Currency Government Bond Markets*

July 2022	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**2.89**	**0.73**	**2.15**	—	—
Top 5 Performers	Morocco	13.1	10.2	2.6	0.5	6
	El Salvador	11.2	9.8	1.3	0.4	4
	Paraguay	9.7	7.1	2.4	0.9	9
	Senegal	8.7	6.1	2.4	0.3	2
	Honduras	8.5	6.5	1.9	0.2	1
Bottom 5 Performers	Mozambique	-6.3	-8.1	2.0	0.1	-1
	Ecuador	-7.1	-9.3	2.4	1.3	-9
	Ethiopia	-8.9	-9.3	0.5	0.1	-1
	Ukraine	-18.0	-18.4	0.5	0.7	-12
	Pakistan	-20.7	-21.8	1.4	0.7	-15

Source: State Street Global Advisors, JP Morgan, Bloomberg, as at 29 July, 2022. 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 ending weight by total return.

Pakistan was the worst performer in July, returning -20.7% in USD terms and detracting 15 bps from index returns. Political uncertainty took centre stage as the party led by former prime minister Imran Khan won by-elections in the country's most populous state. This raised concern around the efforts to secure a crucial bailout from the International Monetary Fund (IMF).Market participants were also wary about Pakistan's external liquidity positions and financing conditions, as the central bank's liquid FX reserves slumped to $8.6bn as of 22 July. Fitch downgraded the outlook on the nation's credit rating to negative. The rupee also slid by over 14% in July, which further deteriorates financing conditions for Pakistan.

Ukraine also underperformed, returning -18% in USD terms and detracting 12 bps from the index return. The spread on dollar-denominated Ukrainian debt widened as the war situation worsened. The Ukrainian government declared that it is seeking a consent solicitation from bondholders to defer each bond principal and interest payments by two years. Bonds would continue to accrue interest to be paid during the deferment period, while also granting options to the cabinet of ministers to authorise payments during the deferment. A similar move made earlier in July by Naftogaz, wholly owned by the Ukrainian government, had built market expectations of a similar move by the government on its sovereign debt and led spreads on dollar bonds to widen.

El Salvador was another outperformer, returning 11.2% in USD terms and contributing 4 bps to the index return. President Nayib Bukele announced plans to buy back the country's USD-denominated bonds maturing in 2023 and 2025 at market prices, triggering a double-digit jump in securities across tenors.

Morocco was the best performer in the month, returning 13.1% in USD terms and contributing 6 bps to the index return. Spreads tightened on the dollar-denominated bonds amid an improving outlook and favourable terms of trade as several nations turned their attention towards the kingdom nation to source fertiliser exports; Morocco has significant phosphate mines, the main mineral from which fertilisers are produced.

Endnote

1 Source: JP Morgan.

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* Pensions & Investments Research Center, as of December 31, 2021.
† This figure is presented as June 30, 2022 and includes approximately $66.43 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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