Commentary
Fixed Income

October 2022

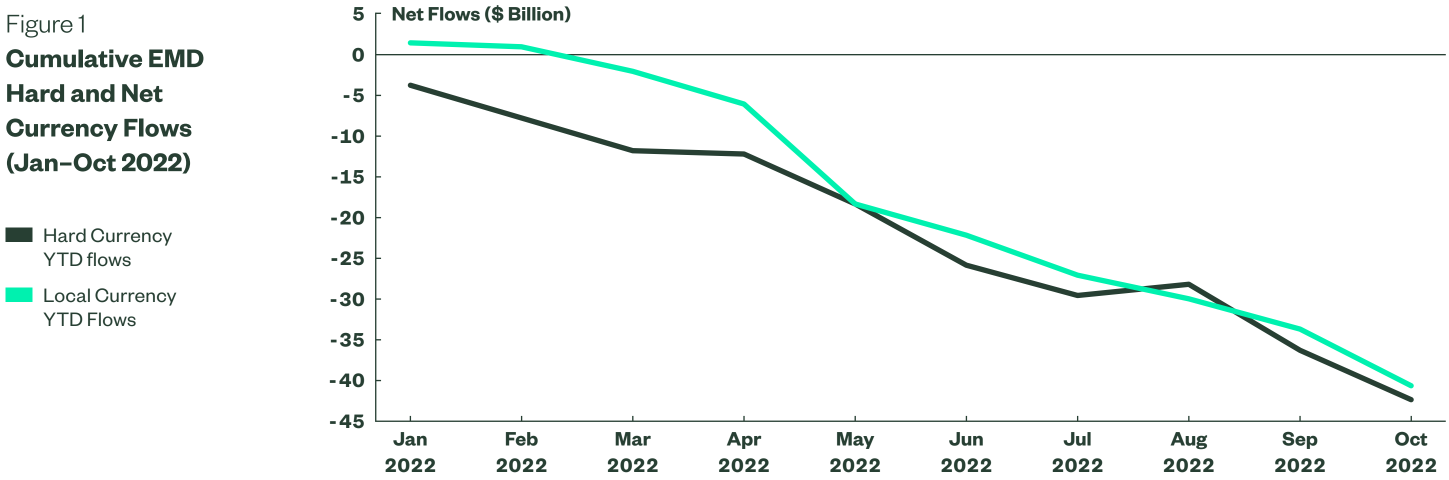
Emerging Market Debt

Market Commentary October 2022

Chart of the Month: EMD Net Flows Remain Negative Through October

On the back of rising interest rates and inflation, questions continue to be raised about the ability of EM economies to manage external debt. The cascading effect of this concern led to hard currency funds experiencing significant outflows as 2022 progressed, and this worsened in October with local currency funds also following suit.

Figure 1
Cumulative EMD Hard and Net Currency Flows (Jan–Oct 2022)



Source: Bloomberg Finance L.P., JP Morgan, as of 31 October 2022. Past performance is not a reliable indicator of future performance.

EMD Commentary — October 2022

Emerging market debt experienced pockets of respite towards the end of October, exhibiting some stability after the volatility and headwinds of the third quarter. Despite rigidity in EM fundamentals, the possibility that the US Federal Reserve might be more measured in its monetary tightening approach going forward provided some relief, as did a partial recovery of EM currencies against USD and retracements in bond yields. The particular inflation dynamics among various EM economies mandated EM central banks to act at different times and with varying magnitudes. This is especially the case in EMEA and Latin America (LatAm), where the tightening cycle is more advanced, and where inflation is expected to peak in Q4.

A key factor in early October was OPEC's (Organization of the Petroleum Exporting Countries) move to cut its crude oil production by 2 million barrels per day, starting in November. This should bolster prices and benefit the EM oil exporters. China has maintained its focus on policy continuity, with no immediate actions announced on potential reopening and growth stimulus. The meeting between the International Monetary Fund (IMF) and World Bank (WB) in mid-October did little to address investor concerns about the global macro outlook and downside risks were highlighted. Tunisia and Egypt indicated they were close to agreements with the IMF for funding.

In EM sovereign credit, year-to-date spreads have widened to their highest in a decade. This impacted investor sentiment, raising further concerns about the outlook for capital flows into EM bond funds.

During October 2022, hard currency outflows were -$4.4bn, while local currency outflows amounted to -$5.6bn.[1]

Figure 2
Emerging Market Debt Index Returns — As of 31 October 2022

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	-0.88	-5.84	-8.18	-19.29	-20.27	-8.21	-3.54
EMBI GD (EM Hard Currency)	0.15	-7.11	-10.34	-23.83	-24.19	-7.19	-2.66
CEMBI BD (EM Corporates)	-2.05	-5.63	-8.10	-17.93	-18.06	-3.48	-0.20
In EUR							
GBI-EM GD (EM Local Currency)	-1.75	-2.86	-1.99	-7.13	-6.65	-4.43	-0.32
EMBI GD (EM Hard Currency)	-0.73	-4.16	-4.29	-12.36	-11.23	-3.37	0.59
CEMBI BD (EM Corporates)	-2.92	-2.64	-1.91	-5.57	-4.05	0.50	3.14
In GBP							
GBI-EM GD (EM Local Currency)	-3.90	-0.48	0.13	-5.05	-5.08	-4.57	-0.75
EMBI GD (EM Hard Currency)	-2.90	-1.82	-2.23	-10.40	-9.74	-3.51	0.16
CEMBI BD (EM Corporates)	-5.03	-0.26	0.21	-3.46	-2.44	0.35	2.69

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 31 October, 2022. 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 31 October 2022

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	12 bps	59 bps	171 bps	7.43%
EMBI GD Yield	9 bps	146 bps	436 bps	9.66%
EMBI GD Spread	-17 bps	10 bps	174 bps	543 bps
CEMBI BD Yield	62 bps	169 bps	398 bps	8.56%
CEMBI BD Spread	35 bps	27 bps	129 bps	441 bps
CDX.EM 5y	-35 bps	-31 bps	108 bps	296 bps
10y UST	22 bps	140 bps	254 bps	4.05%
Dollar Index (DXY)	-0.53%	5.31%	16.57%	—
DOW 30	13.95%	-0.34%	-9.92%	32733
Oil (WTI)	8.86%	-12.26%	15.05%	$ 86.53

Source: JP Morgan, Bloomberg Finance L.P., as of 31 October 2022. 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 -0.88% in USD terms in October 2022, as measured by the JP Morgan GBI-EM Global Diversified Index. This was mostly driven by negative price returns (-0.69%), evident from the increase in 1-month yields by 12 bps, and the inflation dynamics across regions. The Russia invasion, the China zero-COVID tolerance policy, and the effect of the energy crisis in Europe continued to dampen performance in EMEA and APAC regions. However, some LatAm countries have shown positive excess returns in October, benefiting from net commodity exports, less vulnerability on energy dependence, and being less correlated to China. The FX returns were less negative (-0.64%) compared to September (-3.37%) due to central bank intervention in some EM regions (notably Czech Republic and Poland). The negative returns were marginally offset by positive interest returns (+0.44%).

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 $)	**-0.88**	**-5.84**	**-19.29**
FX Return (vs $)	-0.64	-4.59	-9.81
Price Return (Local currency)	-0.69	-2.63	-13.70
Interest Return (Local currency)	0.44	1.38	4.22
In EUR			
Total Return (in €)	**-1.75**	**-2.86**	**-7.13**
FX Return (vs €)	-1.51	-1.61	2.35
In GBP			
Total Return (in €)	**-3.90**	**-0.48**	**-5.05**
FX Return (vs €)	-3.66	0.77	4.43

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 31 October 2022. 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*

October 2022	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Average Index Weight (%)	Index Impact (bps)**
GBI-EM GD		**-0.88**	**-0.23**	**-0.64**	—	—
Top 5 Performers	Chile	4.7	3.1	1.5	2.0	9
	Uruguay	4.3	1.8	2.5	0.2	1
	Brazil	4.1	1.0	3.1	10.0	41
	Hungary	2.7	-1.3	4.0	2.9	8
	Peru	2.7	2.9	-0.2	2.4	7
Bottom 5 Performers	China	-2.1	0.7	-2.9	10.0	-21
	Dominican Republic	-2.5	-1.4	-1.1	0.1	0
	Indonesia	-3.0	-0.7	-2.4	10.0	-30
	Colombia	-9.2	-3.5	-5.7	3.9	-36
	Egypt	-19.1	0.0	-19.1	1.4	-26

Source: State Street Global Advisors, Bloomberg, JP Morgan, as at 31 October 2022. 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.

Egypt underperformed in October due to wide current account deficits and elevated inflationary pressures (reaching 15.3%). Egypt had to seek a bail-out from the IMF, resulting in a $3 billion loan agreement with a commitment to a "durably flexible exchange rate regime". Egypt is among the top five countries in the world at risk of defaulting on its foreign debt, according to Moody's. The Egyptian pound has depreciated by 45 percent since the start of the year, falling to 22.75 pounds against the dollar. The pound's decline has affected importers, resulting in bottlenecks to bring in goods. The National Bank Of Egypt raised interest rates by 200 basis points, aiming to manage inflation and adjust its monetary policy in line with the IMF's lending requirements.

Colombia underperformed as the Colombian peso fell to a record low. Other pressing concerns include inflation and weaker employment statistics. The currency has declined by around 20% against the dollar in 2022. The macroeconomic policies and the smaller-than-expected rate hike by the central bank failed to arrest the downward trend. The peso could face further weakness if the US Fed continues to raise its interest rates.

China underperformance was driven by sharp sell-offs in October and the events around the closely-monitored Party Congress that reinforced President Xi's authority. Also, there was no indication that an easing of the zero-COVID policy is on the horizon. China's exposure to foreign interests at the expense of its economic growth continue to have negative consequences. The real estate slump persisted in October, with prices in major cities dropping for the fourth straight month. The bleak backdrop is magnified by the ongoing decline of the Chinese yuan against the dollar that has continued to weigh on returns.

Chile was one of the best performers in October. The central bank's meeting on October 12 resulted in an increase in borrowing costs to 11.25%. The consensus belief is that this level of 11.25% places borrowing costs at the level required for inflation convergence, given the prevailing macroeconomic environment. The Chilean peso ended the month on a positive note on the dollar's slight reversal near the end of October.

Brazil witnessed the victory by the leftist Luiz Inácio Lula da Silva and his Workers' Party in October. The new government is expected to return Brazil to the state-led model for economic development. Brazil's Manufacturing PMI declined to 50.8 in October 2022, which still signals continued expansion. The monetary policy committee kept the Selic rate at 13.75% for the second straight month after an 18-month monetary tightening cycle. The impact of higher interest rates were evident on household credit and a moderate jump in delinquency rates. Market participants indicated a belief that the central bank will now leave rates stable over the medium term.

Hard Currency Market Highlights

EM hard currency (HC) sovereign debt delivered a return of 0.15% in October 2022, as measured by the JP Morgan EMBI Global Diversified Index. The reduction in spread (-17 bps) coupled with the headwinds of recessionary concerns in the US contributed to positive spread return (+1.54%). As mentioned previously, investor sentiment on EM markets' ability to manage external debt weighed heavily on HC returns, in addition to idiosyncratic geopolitical events, as reflected in negative treasury returns (-1.36%). Major underperformance by treasuries of distressed APAC countries also skewed the overall treasury returns towards the negative side.

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	**0.15**	**-7.11**	**-23.83**
Spread Return	1.54	1.18	-9.75
Treasury Return	-1.36	-8.19	-15.61
IG Sub-Index	-1.17	-9.20	-24.61
HY Sub-Index	1.57	-4.82	-23.01

Source: State Street Global Advisors, Bloomberg, JP Morgan, as of 31 October 2022. 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*

October 2022	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified		**0.15**	**1.54**	**-1.36**	—	—
Top 5 Performers	Ecuador	11.7	12.5	-0.8	1.2%	14
	Angola	9.6	10.6	-0.9	1.4%	13
	Argentina	9.1	9.6	-0.5	1.1%	10
	El Salvador	9.0	9.7	-0.6	0.4%	4
	Gabon	7.7	8.2	-0.5	0.4%	3
Bottom 5 Performers	Suriname	-11.0	-10.9	-0.1	0.1%	-1
	Ukraine	-15.0	-14.6	-0.4	0.6%	-8
	Pakistan	-15.4	-15.1	-0.4	0.5%	-8
	Ghana	-20.9	-20.5	-0.5	0.8%	-16
	Zambia	-21.9	-21.8	-0.2	0.2%	-4

Source: State Street Global Advisors, Bloomberg, JP Morgan, as of 31 October 2022. 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.

Zambia was the worst-performing country, most likely driven by investor perceptions around the debt relief targets put forward by the IMF. Bondholder sentiment is skewed towards the possibility of lower-than-expected recovery rates (49% vs investors' expectations of 45%). The prospects for the near future also appear less optimistic, considering that Zambia is renegotiating its $6 billion debt with China.

Ghana bonds continued to perform poorly in October after the long-term issuer default rating downgrade by Fitch to CC in September. Ghana is struggling with wide current account deficits and rising inflationary pressures. Further rating downgrades could ensue amid likely discussions on an IMF bailout. President Nana Akufo-Addo's administration has appealed for an IMF assistance package of $3 billion. The country's local currency, the cedi, has continued to depreciate against the US dollar (down around 40% year to date), reflecting the high debt burden.

Pakistan continues to record negative returns. The flood-hit country is struggling with inflation (approaching 27%) and has little to show in terms of recovery, despite the bailout from the IMF last quarter. The country's FX reserves have remained stagnant around $8 billion over the last four months and balance of payments issues seem likely. Supply-chain bottlenecks along with the geopolitical turbulence continue to weigh on performance. The chain of events along with the rating downgrades by Moody's and Fitch have contributed to a spike in credit default swap spreads recently.

Ukraine's underperformance persisted as the Eurobond market remains closed given bondholders' agreement to defer payment of interest and principal. Ukraine's foreign exchange reserves are nearing depletion, since the war-hit country is having to sell US dollar bonds. Significant external financing for humanitarian needs made the IMF approve disbursement of $1.3 billion under the food shock window of the Rapid Financing Instrument.

Ecuador was the best performing country in October, aided by the government's planned bond buyback announcement; the government believes that the bonds are currently trading at discounted levels. The buyback transactions are to be financed through the issuance of a guaranteed Blue Bond.

Endnote

1 Source: JP Morgan.

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* Pensions & Investments Research Center, as of December 31, 2021.
† This figure is presented as of September 30, 2022 and includes approximately $55.12 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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