Emerging Market Debt Market Commentary

August 2020

Emerging market (EM) Debt delivered mostly flat-to-modestly-positive returns (in USD terms) in August against the backdrop of mixed news flow and sentiment that led markets to trade sideways for most of the month. The easing of lockdown measures across EM aided a rebound in manufacturing activity and domestic consumption, with economic data generally surprising to the upside to beat low expectations. A weaker US dollar following dovish comments from Federal Reserve Chairman Jerome Powell, and the stabilization in oil prices on continued demand recovery were also positive factors. However, there has been a notable increase in COVID-19 cases in several countries, and the month witnessed some geopolitical risks as well. Upward inflationary pressures, although expected to be transient, have prompted a re-pricing of the rates curve outlook for most EMs. With almost $4.8bn of net inflows in August, according to Morgan Stanley, EMD funds have recorded eight consecutive weeks of inflows, the longest such streak since June 2019.

Figure 1 - Emerging Market Debt Index Returns – As of 31 August, 2020

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-0.33%	3.16%	0.27%	-4.39%	1.55%	0.74%	4.57%
EMBI GD (EM Hard Currency)	0.51%	7.91%	0.82%	1.37%	2.73%	4.14%	6.27%
CEMBI BD (EM Corporates)	0.90%	6.08%	1.53%	3.08%	6.02%	5.02%	6.14%
In EUR							
GBI-EM GD (EM Local Currency)	-1.45%	-4.05%	-7.90%	-10.26%	-6.49%	0.54%	3.22%
EMBI GD (EM Hard Currency)	-0.62%	0.37%	-7.40%	-4.86%	-5.40%	3.94%	4.89%
CEMBI BD (EM Corporates)	-0.24%	-1.33%	-6.75%	-3.25%	-2.37%	4.81%	4.77%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 August 2020. 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 and Macro levels as of 31 August 2020

Item	Δ 1 Month	Δ YTD	Current Level
GBI-EM GD Yield	+9 bps	-77 bps	4.45%
EMBI GD Yield	0 bps	+13 bps	5.06%
EMBI GD Spread	-17 bps	+132 bps	423 bps
CEMBI BD Yield	-9 bps	-53 bps	4.44%
CEMBI BD Spread	-25 bps	+73 bps	383 bps
CDX.EM 5y	-18 bps	-2 bps	172 bps
10y UST	+18 bps	-121 bps	0.70%
Dollar Index (DXY)	-1.29%	-4.40%	
DOW 30	+7.57%	-0.38%	28,430
Oil (WTI)	+5.81%	-30.22%	$ 42.61

Source: JP Morgan, Bloomberg as of 31 August 2020

Local Currency Market Highlights

Figure 3 - 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 $)	**-0.33%**	**3.16%**	**-4.39%**
FX Return (vs $)	-0.07%	2.04%	-9.23%
Price Return (Local currency)	-0.67%	-0.22%	1.66%
Interest Return (Local currency)	0.41%	1.32%	3.66%
In EUR			
Total Return (in €)	**-1.45%**	**-4.05%**	**-10.26%**
FX Return (vs €)	-1.19%	-5.15%	-15.58%
Price Return (Local currency)	-0.67%	-0.22%	1.66%
Interest Return (Local currency)	0.41%	1.32%	3.66%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 August 2020. 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.

EM Local Currency debt returned -0.33% in US dollar terms in August, as measured by the JP Morgan GBI-EM Global Diversified Index. Market focus has shifted to government fiscal measures, local budget discussions, and avoidance of a fiscal cliff in coming years, and away somewhat from monetary policy. With easing lockdowns leading to a rebound in domestic consumption and firming in inflationary pressure across EM, along with extended upward pressure on food prices, policy expectations for many EMs have re-priced; a majority are now pricing limited additional easing over the next year.

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

August 2020	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (BP)**
GBI-EM GD		**-0.33**	**-0.25**	**-0.08**		
Top 5 Performers	Uruguay	2.7	2.6	0.0	0.1%	0
	Philippines	2.2	0.9	1.4	0.2%	0
	Romania	2.2	1.1	1.0	3.0%	7
	Dominican Republic	1.7	1.3	0.4	0.1%	0
	Malaysia	1.7	-0.1	1.8	7.2%	12
Bottom 5 Performers	Peru	-0.8	-0.3	-0.5	3.2%	-3
	Chile	-2.6	-0.2	-2.4	2.8%	-7
	Hungary	-2.8	-1.0	-1.8	3.8%	-11
	Brazil	-6.3	-1.3	-5.0	8.8%	-56
	Turkey	-7.4	-2.3	-5.0	2.3%	-17

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

Turkey was the worst performer, returning -7.4%, and was the second largest detractor (-17 bps) from index returns as its central bank tightened liquidity conditions by reversing the loan stimulus measures introduced in previous months; it expects TRY17bn and $8.5bn of FX and gold liquidity to be withdrawn from the market. Turkey's central bank kept the policy rate stable in its August meeting at 8.25%, in line with expectations, but market participants have been cautious on the potential for further hawkish measures due to the increased upside risks to CPI forecasts and a material increase in money supply indicators.

Brazil was also a poor performer (-6.3%), giving back almost all its strong returns in July, and detracting -56bps from index returns. The Brazilian real weakened by 5.0% in August, and bonds sold off due to mounting pressure on the fiscal accounts; the senate overturned a presidential veto that prohibited wage increases to civil servants and the military for 18 months, an outcome seen as adverse for the markets. On the other hand, the minutes of the Brazilian central bank's policy meeting released in August seemed to show a more dovish tone than its released statement. Furthermore the country's leading indicators continued to improve at a gradual pace, reinforcing the rebound of economic activity.

Hungary lagged with a return of -2.8% and detracted -11bps from index returns. The recent upside surprise in CPI to 3.8% y/y and the less-dovish National Bank of Hungary (NBH) comments after its August policy meeting contributed to market participants expecting a stable policy rate for the rest of the year; the market had been pricing in a rate cut in Q4 2020.

Uruguay was the best performer, returning +2.7%, but with negligible impact on index returns due to its low weight. Uruguay stands out among LatAm countries as it has kept Covid-19 under control, despite a faster reopening, with a very effective testing and tracing regime. Activity and mobility indicators in recent weeks point to a strong economic rebound. Its fiscal data has seen a relatively small deterioration, with Covid fund expenditures so far only amounting to 0.3% of GDP, while revenues have been resilient, particularly from the energy segment.

Philippines was also among the best performers, returning +2.2%, again without any significant impact on overall index returns due to its low weight. Even as the Bangko Sentral ng Pilipinas (BSP) maintained its policy rate at 2.25% in August, it reiterated that the inflation environment remains benign and within target. The announcement of additional liquidity measures amounting to PHP1.2trn to boost loan growth is viewed as supportive for bonds, with the slower-than-expected economic recovery moving growth support back to being the policy priority.

Romania performed well, returning 2.2% and contributing +7 bps to index returns. Core inflation numbers had surprised slightly to the downside, contrary to developments in major CEE countries, while headline inflation continues to remain at the target level. The National Bank of Romania (NBR) cut its policy rate to 1.50% from 1.75% in August, with market sentiment also lifted as political risks related to a possible no-confidence vote on the ruling party came to an end.

Malaysia bonds returned +1.7% over the month, almost all from the FX component, and contributed +12 bps to index returns. Continued strong recovery in crude oil prices from their March/April lows this year, renewed demand for its currency as global investors sought yield through the local note, and improved consensus expectations for a rebound in Q4 GDP, all bolstered the currency's strength.

Hard Currency Market Highlights

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	**0.51%**	**7.91%**	**1.37%**
Spread Return	1.88%	8.25%	-7.80%
Treasury Return	-1.35%	-0.32%	9.95%
IG Sub-Index	-0.96%	5.08%	6.43%
HY Sub-Index	2.38%	11.56%	-4.58%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 August 2020. 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.

EM Hard Currency sovereign debt was up +0.51% in August, as measured by the JP Morgan EMBI Global Diversified Index. EM HC spreads tightened by 17bps, in line with other spread assets, on the back of positive risk appetite amid strong equity performance. Investors focused on better-than-expected earnings, steadily improving economic data, oil prices recovering to a five-month high, and improving prospects for a coronavirus vaccine. The treasury component dented spread returns, however, resulting in modest total return gains. US Treasury yields moved higher, especially at longer-dated maturities, driven mostly by term premia due to increasing market expectations for the Fed to move to average inflation targeting. EM Hard Currency saw strong inflows of around $3.2bn in August.

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

August 2020	Country	Total Return (%)	Spread Return (%)	TSY Return (%)	Index Weight	Index Impact (BP)**
EMBI Global Diversified		**0.51**	**1.88**	**-1.35**		
Top 5 Performers	Sri Lanka	11.6	11.9	-0.3	1.6%	19
	Venezuela	9.5	9.5	0.0	0.0%	0
	Suriname	8.6	8.8	-0.2	0.0%	0
	El Salvador	4.7	6.4	-1.6	1.0%	5
	Nigeria	4.6	5.9	-1.2	1.5%	7
Bottom 5 Performers	Saudi Arabia	-2.4	-0.4	-2.0	3.9%	-9
	Philippines	-2.4	-0.8	-1.6	3.1%	-8
	Belarus	-2.8	-2.3	-0.4	0.5%	-1
	Lebanon	-4.0	-4.0	0.0	0.3%	-1
	Zambia	-5.9	-5.8	-0.1	0.2%	-1

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

Sri Lanka was among the best performers, returning +11.6% and contributing +19 bps to index returns. The incumbent SLPP party recorded a massive victory in the August parliamentary elections. This was positive for bonds, as market participants expect Mahinda Rajapaksa government to work closely with the International Monetary Fund (IMF) to formalize an economic revival plan. IMF support is crucial for Sri Lanka to resolve its debt sustainability challenges as it will need to meet annual debt repayments of more than $4bn until 2025.

El Salvador returned 4.7%, contributing +5 bps to index returns. Bond spreads tightened during a risk-on month as virus cases in El Salvador remain relatively low and the external shock to its economy has been smaller than expected. While the country has managed to obtain sufficient external financing for 2020, debt sustainability concerns remain.

Suriname and **Nigeria** posted returns of +8.6% and +4.6% over the month, respectively. While contribution to overall index returns were negligible for Suriname, Nigeria contributed +7 bps. Spreads tightened, aided by the rally in gold (Suriname) and oil prices (Nigeria). Suriname spreads continue to benefit from the debt restructuring that it completed in July.

Zambia was the worst performer in August, delivering a negative return of -5.9%. Spreads widened after the shock dismissal of central bank governor Denny Kalyalya without any specified reason, at a critical time when the fiscal deficit was increasing. This raised concerns among investors who saw him as a credible governor trying to keep a spendthrift government in check.

Lebanon was the second worst performer, returning -4.0%. Lebanon spreads continue to suffer in the absence of key steps towards economic and fiscal policy reform. S&P downgraded more Lebanese government debt issues after it missed payments, citing the country's worsening economic crisis. It maintained the SD (selective default) rating for Lebanon's foreign debt after the country first defaulted in March, but ratings for three more bonds were cut to D from CC. The government's resignation seems to have pushed back the prospect of a deal to restructure the country's debt.

Belarus was also among the worst performers, returning -2.8%, amid investor concerns around the threat of international or EU sanctions in the wake of its disputed recent election results, which led to widespread protests amidst allegations of vote-rigging. However, uncertainty remains as sanctions could take weeks to materialize and EU sanctions require the agreement of all 27 members.

Hard Currency Corporate Bond Markets

Figure 7 - Key return drivers of EM hard currency corporate bond markets

CEMBI BD (EM Corporates)	Monthly Return	3 Month Return	YTD Return
Total Return	**0.90%**	**6.08%**	**3.08%**
Spread Return	1.57%	6.11%	-3.45%
Treasury Return	-0.66%	-0.03%	6.76%
IG Sub-Index	0.46%	4.94%	4.77%
HY Sub-Index	1.50%	7.69%	0.68%

Source: State Street Global Advisors, JP Morgan as at 31 August 2020. Past performance is not a guarantee of future results. Index returns reflect capital gains and losses, income, and the reinvestment of dividends

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