Emerging Market Debt Market Commentary

October 2020

Emerging market (EM) debt ended the month flat overall in US dollar terms. A pick-up in volatility was evident towards the end of the month as a new COVID-19 infection wave was seen in parts of Europe and the US, and a series of new and more stringent lockdown measures were introduced. This led to investor concerns about a potential pause in the underlying economic recovery, leading to a correction in risk assets. There was also a notable fall in oil prices. Financial markets seemed to be pricinrequig in a Biden victory in the US presidential election, and the key differences between the policies of Trump and Biden imply differing outcomes for EM markets. Most market participants believe that a Biden victory is likely to introduce a more multilateral approach/less confrontational stance to US policy, result in stronger US stimulus, and be supportive of EM assets. Inflows into EM assets remained healthy and broad-based in October, even as many investors stayed on the sidelines, awaiting the results of the US elections.

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

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	0.43%	-1.92%	6.77%	-5.92%	-3.81%	1.27%	3.94%
EMBI GD (EM Hard Currency)	-0.03%	-1.38%	12.30%	-0.54%	0.98%	3.35%	5.57%
CEMBI BD (EM Corporates)	0.26%	0.67%	9.99%	2.84%	4.24%	4.70%	5.88%
In EUR							
GBI-EM GD (EM Local Currency)	1.10%	-0.44%	0.40%	-9.34%	-7.88%	1.28%	2.84%
EMBI GD (EM Hard Currency)	0.64%	0.12%	5.60%	-4.15%	-3.28%	3.36%	4.45%
CEMBI BD (EM Corporates)	0.93%	2.20%	3.42%	-0.89%	-0.17%	4.71%	4.76%

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

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	-2 bps	11 bps	-76 bps	4.46%
EMBI GD Yield	5 bps	14 bps	27 bps	5.20%
EMBI GD Spread	-12 bps	-19 bps	130 bps	421 bps
CEMBI BD Yield	2 bps	8 bps	-36 bps	4.61%
CEMBI BD Spread	-12 bps	-24 bps	74 bps	384 bps
CDX.EM 5y	-13 bps	28 bps	44 bps	218 bps
10y UST	19 bps	35 bps	-104 bps	0.87%
Dollar Index (DXY)	0.16%	0.74%	-2.44%	
DOW 30	-4.61%	0.28%	-7.14%	26,502
Oil (WTI)	-11.01%	-11.12%	-41.39%	$ 35.79

Source: JP Morgan, Bloomberg as of 31 October 2020. Past performance is not a reliable indicator of future performance.

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 $)	**0.43%**	**-1.92%**	**-5.92%**
FX Return (vs $)	0.07%	-2.12%	-11.10%
Price Return (Local currency)	-0.09%	-1.08%	1.24%
Interest Return (Local currency)	0.44%	1.29%	4.56%
In EUR			
Total Return (in €)	**1.10%**	**-0.44%**	**-9.34%**
FX Return (vs €)	0.75%	-0.65%	-15.15%
Price Return (Local currency)	-0.09%	-1.08%	1.24%
Interest Return (Local currency)	0.44%	1.29%	4.56%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 October 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 (LC) debt returned +0.43% in US dollar terms in October, as measured by the JP Morgan GBI-EM Global Diversified Index. EM Local/FX markets have been reactive to US pre-vote news and COVID-related news flow over the past few weeks – with diverging performance among different countries in the index as a result. Some broader factors were also in play, including poor domestic central bank credibility (Turkey), low levels of domestic real rates (CEE, Brazil), policy benefit from an expected Biden victory (Mexico), sell-off in oil (Russia) etc. In spite of the uncertain backdrop, EM local currency debt saw +$2.8bn of inflows in October, but is yet to recover from the COVID-related outflows earlier in the year (YTD flows in EM LC: -$19.4 bn)[1].

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

October 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	Indonesia	3.9	2.1	1.8	9.6%	37
	Mexico	3.5	-0.2	3.7	9.6%	34
	South Africa	3.4	0.8	2.7	7.3%	25
	Chile	2.3	0.5	1.8	2.7%	6
	China	1.7	0.0	1.6	8.0%	13
Bottom 5 Performers	Russia	-1.7	0.7	-2.4	8.1%	-13
	Poland	-1.7	0.7	-2.5	8.2%	-14
	Czech Republic	-2.2	-0.8	-1.4	4.0%	-9
	Brazil	-2.9	-0.6	-2.2	8.5%	-24
	Turkey	-10.7	-2.8	-7.9	1.9%	-21

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

[1] Source for flows: Morgan Stanley

Indonesia performed well, returning 3.9% to be the largest contributor (+37 bps) to index returns. Even as Bank Indonesia left its policy rate unchanged at 4.00% at its October meeting, citing the need to maintain external stability, it continued to strike a relatively dovish tone. With inflation expected to remain below the central banks' target range, market participants believe that the central bank will eventually cut rates as realized GDP growth falls short of its projections.

Mexico delivered returns of +3.5%, mostly through its FX channel, and was the second largest contributor to index returns (+34 bps). The MXN has been reactive to the widening of the Biden-Trump win probability spread – and has continued to recover from its sharp sell-off earlier in the year. Local rates moved little over the month and Banxico has suggested limited room for further easing. Although supply shocks are vanishing in the goods price component, there are some price pressures in services inflation, and annual inflation is likely to remain above 4.0% for the foreseeable future.

South Africa returned 3.4% and contributed +25 bps to index returns. Its Medium-Term Budget Policy announced near the end of the month was broadly in line with expectations. Even though the country's growth outlook is weak, with tax revenue shortfalls and high execution risks to expenditure cuts, high beta South African local rates performed well in October, as did the currency. This suggests that markets have not been disappointed with the budget, and sees a high bar for further risks to its growth outlook and ratings downgrades.

Turkey was the worst performer, returning -10.7% in October, and was the second largest detractor (-21 bps) from index returns. While keeping the one-week and overnight repo rates stable at 10.25% and 11.75%, respectively, the Central Bank of Turkey increased the Late Liquidity Window Rate by 150bp to 14.75%, in contrast with Bloomberg consensus expectations. Market reaction was negative, as market participants were concerned about back-door tightening and a reversal from previous simplification efforts to the monetary policy transmission mechanism that began in 2018.

Brazil was the second-worst performer (-2.9%) and was a significant detractor (-24 bps) from index returns. The Central Bank of Brazil kept the Selic rate unchanged at 2.0% in line with expectations, but the market has mostly ignored its forward guidance, and rates kept responding to fiscal policy headlines and inflationary surprises. Fiscal concerns remain as Congress debates the 2021 budget and the possible creation of a new welfare program. Meanwhile, a significant jump in wholesale prices, combined with increased evidence of some pass-through to consumer prices, have kept short-term inflation under pressure.

CEE countries **Czech Republic** and **Poland** recorded returns of -2.2% and -1.7%, respectively, which detracted -9bps and -14bps from index returns. The resurgence of COVID-19 cases in October induced a sell-off in their currencies, as markets worried about the impact on economic activity this might bring as authorities implement measures to flatten the infection curve.

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	**-0.03%**	**-1.38%**	**-0.54%**
Spread Return	1.23%	1.14%	-8.48%
Treasury Return	-1.24%	-2.48%	8.68%
IG Sub-Index	0.09%	-1.47%	5.88%
HY Sub-Index	-0.18%	-1.26%	-7.97%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 October 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 (HC) sovereign debt was flat at -0.03% in October, as measured by the JP Morgan EMBI Global Diversified Index. Even as EM HC spreads tightened by 12 bps over the month overall, as they priced in reduced uncertainty around the outcome of US Presidential elections, underlying UST returns were negative as rates sold off on increased expectations of a more aggressive fiscal policy in the event of Biden victory. EM hard currency debt recorded strong inflows of +$4.7bn in October and YTD flows stand at +$6.1bn.[2]

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

October 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	Venezuela	15.7	15.7	0.0	0.0%	0
	Cote D'Ivoire	6.6	7.6	-1.0	0.5%	3
	Kenya	5.9	6.9	-0.9	0.9%	5
	Ghana	4.0	5.0	-1.0	1.4%	5
	South Africa	4.0	5.3	-1.2	2.5%	10
Bottom 5 Performers	Lebanon	-9.9	-10.0	0.0	0.3%	-3
	Zambia	-10.7	-10.6	-0.1	0.2%	-2
	Suriname	-11.1	-10.8	-0.4	0.0%	0
	Argentina	-12.7	-11.8	-1.1	1.2%	-15
	Sri Lanka	-20.1	-19.8	-0.3	1.1%	-21

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

Venezuela was the best performer, returning 15.7%, but it had no contribution to index returns because of its almost zero weight.

African countries **Cote D'Ivoire**, **Kenya** and **Ghana** performed well, returning 6.6%, 5.9% and 4.0% on expectations of a faster regional recovery in economic performance than initially expected.

[2] Source for flows: Morgan Stanley

South Africa returned +4.0% and contributed +10 bps to index returns. Even though the country faces weak growth, tax revenue shortfalls as well as high execution risks to expenditure cuts, market participants believe that South Africa could negotiate a World Bank loan on less stringent conditions and meet its budgeted funding needs without the need for a significant Eurobond issuance.**

Sri Lanka was the worst performer, returning -20.1% and was the largest detractor (-21 bps) from index returns. Markets are pricing in a potential scenario that the country may require some form of debt reprofiling, and recovery estimates for Sri Lanka depend on whether an IMF funding program is agreed. The timing and size of such a program are also factors.

Argentina was the second worst performer, returning -12.7% and detracting -15 bps from index returns. Argentina bonds have sold off despite the nation completing a $65bn restructuring in September. Markets are concerned about the lack of a credible plan to fix the economy and return to growth at a point when international reserves are at a four-year low and the country is running its highest deficit in almost three decades.

Suriname was among the worst performers, recording a negative return of -11.1%, after Fitch downgraded its long-term foreign currency Issuer Debt Rating to C from CC. The government announced that it intended to invoke a 30-day grace period on the interest payment for its $550m 2026 notes due on October 26. Failure to deliver the 2026 interest payment during the grace period would put the sovereign into restricted default and the bond into default.

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