Emerging Market Debt Market Commentary

July 2020

Emerging market (EM) debt saw strong returns in July (in USD terms) as it continued to recover from the sell-off earlier in the year. A weaker US dollar, broadly improving business confidence and purchasing managers' indices (PMI) across Asia and Latin America, and further progress on COVID-19 vaccine trials underpinned gains. A steady rise in the oil price on improving demand, continued fiscal support, accommodative monetary policy from global central banks also provided support over the month.

Figure 1 - Emerging Market Debt Index Returns – As of 31 July, 2020[1]

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	3.02%	8.86%	-2.83%	-4.08%	-0.81%	1.45%	3.49%
EMBI GD (EM Hard Currency)	3.71%	13.87%	-0.66%	0.85%	2.97%	4.57%	5.96%
CEMBI BD (EM Corporates)	2.32%	9.25%	0.61%	2.16%	5.21%	5.04%	5.62%
In EUR							
GBI-EM GD (EM Local Currency)	-2.15%	0.84%	-8.93%	-8.95%	-6.60%	1.35%	2.09%
EMBI GD (EM Hard Currency)	-1.49%	5.47%	-6.91%	-4.27%	-3.04%	4.47%	4.53%
CEMBI BD (EM Corporates)	-2.81%	1.20%	-5.71%	-3.02%	-0.94%	4.94%	4.20%

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

Item	Δ 1 Month	Δ YTD	Current Level
GBI-EM GD Yield	-16 bps	-87 bps	4.35%
EMBI GD Yield	-46 bps	+13 bps	5.06%
EMBI GD Spread	-34 bps	+149 bps	440 bps
CEMBI BD Yield	-41 bps	-44 bps	4.53%
CEMBI BD Spread	-33 bps	+98 bps	407 bps
CDX.EM 5y	-5 bps	+16 bps	190 bps
10y UST	-13 bps	-139 bps	0.53%
Dollar Index (DXY)	-4.15%	-3.15%	
DOW 30	+2.38%	-7.39%	26,428
Oil (WTI)	+2.55%	-34.05%	$ 40.27

Source: JP Morgan, Bloomberg as of 31 July 2020

[1] Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 July 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 $)	**3.02%**	**8.86%**	**-4.08%**
FX Return (vs $)	1.99%	4.81%	-9.17%
Price Return (Local currency)	0.54%	2.54%	2.34%
Interest Return (Local currency)	0.47%	1.33%	3.23%
In EUR			
Total Return (in €)	**-2.15%**	**0.84%**	**-8.95%**
FX Return (vs €)	-3.16%	-3.03%	-14.52%
Price Return (Local currency)	0.54%	2.54%	2.34%
Interest Return (Local currency)	0.47%	1.33%	3.23%

EM Local Currency debt was up by +3.0% in US dollar terms in July, as measured by the JP Morgan GBI-EM Global Diversified Index. USD weakness was a main contributor to return, although bond returns had a positive contribution as well as local currency yields rallied amid continued policy support, along with low inflation. Markets have pared back expectations of monetary policy stimulus in countries which continue to show consistent improvement in its economic activity, most notably in China. Local currency flows remain fragile as investors wait on the sidelines as big EM countries such as Brazil, Mexico and South Africa struggle to gain control of COVID-19. Despite the recent rally in EMFX, valuations versus the USD remain attractive.

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

July 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	Chile	9.1	0.6	8.4	2.8%	26
	Dominican Republic	9.1	9.4	-0.2	0.1%	1
	Hungary	8.7	0.4	8.3	3.8%	33
	Brazil	7.1	1.6	5.5	9.1%	65
	Poland	6.5	0.5	6.0	8.4%	54
Bottom 5 Performers	China	0.8	-0.5	1.4	5.0%	4
	Indonesia	0.7	3.0	-2.2	9.5%	7
	Thailand	-0.9	0.2	-1.1	8.9%	-8
	Russia	-3.4	0.6	-4.0	8.3%	-28
	Turkey	-5.2	-3.6	-1.8	2.8%	-14

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

Chile was the best performer over the month, returning +9.1% – almost all of which came from the currency channel. The Chilean peso strengthened by 8.4%, aided by improving signs of demand for copper, the country's biggest export; copper prices rose 5.7% over the month on the back of demand from strong factory activity in China. The Bank of Chile's monetary policy board unanimously decided to maintain the policy rate at 0.50%, as was broadly expected. The Board decided to keep the size of the current US$8bn asset purchases program unchanged, reiterating that the policy rate will remain at its technical minimum (0.50%) during the forecast horizon, and any additional support will be provided through unconventional policy if/when needed.

Dominican Republic was the second-best performer, also returning +9.1% in July, but without any significant impact on overall index returns (+1 bps) due to its low index weight. The market-friendly outcome of its general election near the start of the month has boosted market expectations for expansionary macro policies, supporting asset prices. The recovery of external demand, and favorable terms of trade – boosted by high prices for gold, the country's biggest export – aided the bond rally as well.

Hungary and Poland were among the best performers, delivering returns of +8.7% and +6.5%, and contributing +33 and +54 bps to index returns, respectively, almost all from the currency channel. Their currencies strengthened in tandem with the strengthening of EUR/USD, as European Union leaders struck a deal on the €750 billion coronavirus recovery fund aimed at helping hard-hit bloc members recover from the economic fallout of the pandemic. The eurozone is Central Europe's main trading partner. Hungary's central bank cut its base rate by 15 bps to 0.6% in its July meeting as expected, its second cut to shore up the economy after the impact of COVID-19, while Poland's central bank maintained its benchmark rate of 0.1%, as expected, and indicated that monetary policy will be shaped primarily through non-standard measures.

Brazil was among the top performers (+7.1%), with the highest contribution to index returns (+65 bps), mostly through the FX channel. The Brazilian real strengthened 5.5% in July as the government's proposals to congressional leaders to combine two federal consumption taxes into a single value added tax were well received by investors. The push by Brazil provided a welcome sign that the government's reform agenda is progressing despite the political infighting caused by the handling of the coronavirus crisis. Brazilian industrial confidence rose sharply in July, extending the rebound started in May, with the outlook for the coming months across sectors continuing to brighten.

Turkey was the worst performer, returning -5.2%, and was the second largest detractor (-14 bps) from index returns. Turkey's local currency bond returns were negative over July as market participants reduced expectations of further cuts for the rest of the year. Even though Turkey's central bank kept the policy rate in its July meeting at 8.25%, in line with expectations, it delivered a more hawkish message by highlighting upside risks to its year-end CPI inflation forecast amid loan growth at unprecedented levels and a material increase in money supply indicators.

Russia was the second worst performer, returning -3.4%, and was the largest detractor (-28 bps) from index returns; currency accounted for much of that. The currency's weakness seems to be down to a combination of several factors, such as pricing in the probability of a clear Joe Biden win in the US elections – which might lead to a greater push for renewed sanctions against Russia – a pick-up in the country's companies' dividend payments to foreign shareholders, and the slowing rebound in oil prices.

Thailand was among the worst performers as it saw returns of -0.9%, and detracted -8 bps from index returns. Negative returns were primarily driven by THB weakness. Thailand's economy, with a significant dependence on tourism, remains vulnerable as it saw no visitor arrivals for the third consecutive month due to continued inbound travel restrictions, and there was also a decline in its exports, driven by agricultural goods (mainly rice). Market participants expect the central bank to cut its policy rate by another 25bps in August to 0.25%.

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	**3.71%**	**13.87%**	**0.85%**
Spread Return	2.68%	13.26%	-9.51%
Treasury Return	1.01%	0.54%	11.45%
IG Sub-Index	4.21%	11.06%	7.47%
HY Sub-Index	3.10%	17.66%	-6.79%

EM Hard Currency sovereign debt was up +3.7% in July, as measured by the JP Morgan EMBI Global Diversified Index. EM HC spreads tightened by 34 bps, in sync with other spread assets, on the back of incoming activity indicators in EMs that are broadly supportive of the growth rebound. Also providing support was expectations of renewed fiscal support, improved access to financing either through capital markets or the IMF emergency lending facilitates – alleviating near-term liquidity pressures – and further progress on COVID-19 vaccine trials. EM Hard currency debt saw inflows of about $3.3bn in July, recovering almost half of its outflows since March. Performance of new issuances across both investment grade and high yield segments in EM HC have been positive in recent months, when looking at spreads/prices one month after issuance.

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

July 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	Suriname	17.7	17.3	0.3	0.0%	1
	Ecuador	16.7	16.5	0.2	1.2%	20
	Sri Lanka	14.7	14.3	0.3	1.5%	21
	Argentina	7.8	7.4	0.4	1.2%	9
	Dominican Republic	7.4	6.2	1.1	2.4%	17
Bottom 5 Performers	Cote D'Ivoire	-0.9	-1.7	0.8	0.5%	0
	Ghana	-1.0	-1.9	1.0	1.2%	-1
	Senegal	-1.6	-3.0	1.4	0.4%	-1
	Lebanon	-2.6	-2.7	0.1	0.4%	-1
	Turkey	-2.8	-3.6	0.9	3.1%	-9

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

Suriname was the month's best performer, returning +17.7%, but this had just a 1bp impact on overall index returns. Suriname spreads tightened after it completed a restructuring of debt, and it was upgraded to CCC and C by S&P and Fitch, respectively, in mid-July from a D rating.

[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 was the second-best performer, returning +16.7% and contributing +20 bps to index returns. Bond prices were up on the month as the market priced in the government's proposed restructuring offer to amend old bonds and a tender offer to receive new bonds.

Sri Lanka was among the best performers, returning +14.7% and contributing +21 bps to index returns. Bond prices bounced off their lows in line with broader risk sentiment over the month. However, with only about $6.7bn in foreign reserves, IMF support is crucial for Sri Lanka to resolve its debt sustainability challenges as it will need to meet its annual debt repayments of more than $4bn until 2025.

Turkey was the worst performer with a return of -2.8% in July, detracting -9 bps from overall index returns. Turkey's external debt to GDP ratio at 57% remains high versus EM peers' average of 30%. Weaker financial flows, combined with a growing current account deficit in the first half of 2020, has put pressure on the central bank's FX reserves.

Lebanon was among the worst performers, returning -2.6%. Moody's cut its rating to the lowest grade (C from Ca), as its economy minister announced that an IMF Bailout may only be for half of the $10bn sought when talks began. The absence of key steps toward plausible economic and fiscal policy reform in the face of the country's worst financial crisis since its independence, as well as the collapse of its currency in the black market, have all contributed to a highly unstable environment.

African countries such as **Ghana, Senegal and Cote D'Ivore** saw small negative returns with an insignificant impact on index returns, on broad concerns around debt sustainability as they continue to use available lines of credit to secure resources to fight the COVID-19 pandemic.

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	**2.32%**	**9.25%**	**2.16%**
Spread Return	1.73%	8.73%	-4.95%
Treasury Return	0.58%	0.48%	7.48%
IG Sub-Index	2.31%	7.30%	4.29%
HY Sub-Index	2.33%	12.08%	-0.81%

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

[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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