Emerging Market Debt Market Commentary

January 2021

Emerging market debt (in USD terms) experienced a volatile start to the year, with the end result for the month being a modestly negative overall return. Concerns about the reintroduction of COVID lockdowns, slow vaccine rollouts and the impact on EM growth and fiscal outcomes, as well as political risks in some EM countries, resulted in some weakness. Despite the recent volatility, the medium-term prospects for EMD remain in place against the backdrop of an ongoing global recovery aided by policy support. Prospects are also bolstered by the US Federal Reserve maintaining its dovish monetary policy approach in the absence of notable inflation pressures, while positive news around additional vaccines in the pipeline also underpins sentiment. The month saw flows of +$5.6bn and +$6.3bn for hard currency and local currency, respectively, as investors continued to move money into higher yielding assets. (Source for flows: Morgan Stanley).

Figure 1 - Emerging Market Debt Index Returns – As of 29 January, 2021

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	-1.07%	7.99%	5.91%	-1.07%	2.92%	1.15%	6.42%
EMBI GD (EM Hard Currency)	-1.09%	4.68%	3.24%	-1.09%	2.55%	4.68%	6.89%
CEMBI BD (EM Corporates)	-0.07%	4.10%	4.80%	-0.07%	5.44%	5.97%	7.18%
In EUR							
GBI-EM GD (EM Local Currency)	-0.37%	3.54%	3.09%	-0.37%	-6.12%	2.00%	3.98%
EMBI GD (EM Hard Currency)	-0.38%	0.37%	0.49%	-0.38%	-6.45%	5.56%	4.44%
CEMBI BD (EM Corporates)	0.64%	-0.19%	2.00%	0.64%	-3.82%	6.86%	4.73%
In GBP							
GBI-EM GD (EM Local Currency)	-1.52%	1.68%	1.23%	-1.52%	-1.21%	2.33%	7.11%
EMBI GD (EM Hard Currency)	-1.54%	-1.43%	-1.32%	-1.54%	-1.55%	5.91%	7.58%
CEMBI BD (EM Corporates)	-0.52%	-1.98%	0.17%	-0.52%	1.22%	7.21%	7.88%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 January 2021. 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 29 January 2021

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	5 bps	-19 bps	5 bps	4.27%
EMBI GD Yield	17 bps	-48 bps	17 bps	4.72%
EMBI GD Spread	0 bps	-69 bps	0 bps	352 bps
CEMBI BD Yield	11 bps	-46 bps	11 bps	4.15%
CEMBI BD Spread	-5 bps	-66 bps	-5 bps	317 bps
CDX.EM 5y	22 bps	-44 bps	22 bps	173 bps
10y UST	15 bps	19 bps	15 bps	1.07%
Dollar Index (DXY)	0.72%	-3.67%	0.72%	
DOW 30	-2.04%	13.14%	-2.04%	29,983
Oil (WTI)	7.58%	45.85%	7.58%	$ 52.2

Source: JP Morgan, Bloomberg as of 29 January 2021

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 $)	**-1.07%**	**7.99%**	**-1.07%**
FX Return (vs $)	-0.97%	5.56%	-0.97%
Price Return (Local currency)	-0.49%	1.07%	-0.49%
Interest Return (Local currency)	0.38%	1.23%	0.38%
In EUR			
Total Return (in €)	**-0.37%**	**3.54%**	**-0.37%**
FX Return (vs €)	-0.26%	1.23%	-0.26%
In GBP			
Total Return (in €)	**-1.52%**	**1.68%**	**-1.52%**
FX Return (vs €)	-1.42%	-0.63%	-1.42%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 January 2021. 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 -1.07% in US dollar terms in January, as measured by the JP Morgan GBI-EM Global Diversified Index. Countries most affected by the month's EM FX sell-off included those that are positioned downstream in supply chains and more at risk of de-globalization, have relatively weak national healthcare, and have limited fiscal and/or monetary policy options. Even though the majority of EM central banks continued to stay on hold, markets seemed to price in the relative lack of vaccination progress in emerging markets versus developed markets thus far, adding to some uncertainty over the recovery path from the pandemic.

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

January 2021	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (bps)**
GBI-EM GD		**-1.07**	**-0.10**	**-0.97**		
Top 5 Performers	Turkey	2.3	0.5	1.8	1.9%	4
	China	1.2	0.0	1.2	10.0%	12
	Romania	1.1	2.0	-0.9	3.3%	4
	Uruguay	1.0	0.6	0.4	0.1%	0
	Hungary	0.6	-0.3	0.9	4.0%	3
Bottom 5 Performers	South Africa	-1.7	0.7	-2.4	7.6%	-13
	Chile	-2.8	0.2	-3.0	2.6%	-7
	Russia	-2.8	-0.9	-2.0	7.0%	-20
	Colombia	-3.7	0.2	-3.9	5.3%	-20
	Brazil	-6.3	-1.5	-4.8	8.2%	-52

Source: State Street Global Advisors, JP Morgan as at 29 January 2021. 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.

Brazil was the worst performer (-6.3%) in January and was a significant detractor (-52 bps) from index returns. A rebound in COVID-19 cases increased risks of more stringent lockdowns and there is ongoing political pressure for an extension of emergency aid that could cost 0.3-1.3% of GDP. Moreover, uncertainty around keeping spending under the budget cap, and whether congress can provide the authorization needed to finance a new round of fiscal support to households without formally breaching the spending cap, has led to increased fiscal sustainability concerns from market participants.

Colombia was the second worst performer (-3.7%) and was a significant detractor (-20 bps) from index returns. Increasing COVID-19 case numbers has resulted in major cities, including Bogotá, reintroducing restrictions. Uncertainty about the timing of its tax reform, which is crucial for the country to preserve its investment grade (IG) status, also contributed to weak performance, primarily through the FX.

Russia underperformed the index, returning -2.8%. The RUB saw a modest sell-off on the back of geopolitical risks related to the arrest of Kremlin critic Alexei Navalny, an event that drew the ire of several US allies and raised the possibility of a political clash with the West, placing additional pressure on Russian assets. The RUB has been underperforming peers since mid-2020 amid foreign policy uncertainty and inflation risks putting pressure on the capital account. Higher-than-expected headline inflation and elevated expectations led to a modest sell-off in local currency rates as well, as market participants appeared to price in the diminishing prospect of the central bank extending its easing cycle.

China was the most significant positive contributor in the month, returning 1.2%. The CNY strengthened further in January on the back of sustained export-driven improvement in manufacturing sectors, and the growth in industrial production, driven by IT-related sectors. The Lunar New Year disruption to production and exports is expected to be smaller than usual, given that the authorities and companies urged people not to travel back to their hometown over the holiday period. Markets are closely watching the recent COVID-19 resurgence in China’s northern provinces, as well as the gradual withdrawal of liquidity by the central bank.

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	**-1.09 %**	**4.68%**	**-1.09%**
Spread Return	0.20%	6.27%	0.20%
Treasury Return	-1.28%	-1.50%	-1.28%
IG Sub-Index	-1.24%	1.59%	-1.24%
HY Sub-Index	-0.91%	8.53%	-0.91%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 29 January 2021. 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 achieved returns of -1.09% in January, as measured by the JP Morgan EMBI Global Diversified Index. Even as EMBI GD spreads were flat overall for the month, there was a sharp sell-off of US Treasury rates earlier in the month amid expectations of additional fiscal stimulus under a unified US government. Higher net supply was also a factor, before a recovery ensued partly due to mixed US economic data and the Fed's emphasis on maintaining accommodative policy.

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

January 2021	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight	Index Impact (bps)**
EMBI Global Diversified		**-1.09**	**0.20**	**1.28**		
Top 5 Performers	Costa Rica	6.2	7.8	-1.5	0.8%	5
	Sri Lanka	5.8	6.1	-0.3	1.1%	6
	Angola	4.8	6.0	-1.1	1.1%	5
	El Salvador	4.3	5.6	-1.2	1.0%	4
	Venezuela	4.1	4.1	0.0	0.0%	0
Bottom 5 Performers	Lebanon	-4.3	-4.3	0.0	0.2%	-1
	Belize	-5.2	-4.3	-1.0	0.0%	0
	Argentina	-5.4	-4.4	-1.0	1.2%	-6
	Ethiopia	-7.2	-7.1	-0.1	0.1%	-1
	Ecuador	-15.4	-14.5	-1.0	1.0%	-16

Source: State Street Global Advisors, JP Morgan as at 29 January 2021. 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.

Ecuadorean bonds were the worst performers, posting a negative return of -15.4% and detracting -16 bps from headline index returns. Investors were concerned by comments from front-runner presidential candidate Andres Arauz that, if elected, he will not comply with the conditions of a financing package negotiated with the IMF in 2020. Ecuador completed a $17.4 billion debt restructuring that was accepted by creditors, but Arauz has described the deal as overly favorable to creditors. Bonds have been trading lower for months as the already-weak economy struggles through the pandemic, and the upcoming election in February has created a binary risk event as well.

Argentina was among the worst performers, returning -5.4% and detracted -6 bps from index returns. Markets are concerned about the risks of a delay in the expected timeline for an IMF program from April to the second half of 2021. This is exacerbated by a rise in COVID-19 cases, which requires increased spending, and large monetary financing that has the potential to exert pressure on macroeconomic stability.

Costa Rica was the best performer, returning 6.2%. Late in the month, the IMF and Costa Rica announced an agreement for a three-year Extended Fund Facility (EFF) program of $1.75bn. This places it in a better position than regional peers to access multilateral financing, and markets consider the terms of the program to be a significant step in the fiscal consolidation process.

Sri Lanka bonds saw a slight rebound over the month, returning 5.8%, after dropping almost -30% in 2020. Sri Lanka remains vulnerable with loss of revenues from tourism, high debt/GDP, an unsustainable interest payment/revenue ratio, and low FX reserves versus external financing needs.

Angola bonds returned 4.8% over the month. Angola’s fiscal metrics have improved as it has taken decisive action to reduce non-essential outlays, while allocating much-needed resources to health and related infrastructure to mitigate the impact of the COVID-19 pandemic. The recent rebound in oil prices and, by extension, demand for Angola’s oil exports have aided performance as well.

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