Emerging Market Debt Market Commentary

May 2021

Emerging market debt (in USD terms) generated positive returns in May, even as EM investors appear increasingly cautious about near-term sentiment and a relatively less supportive rates backdrop. Prospects appear to be brightening in Latin America (LatAm), where economic activity has been better than expected during May. There have been positive surprises in Brazil and Mexico despite the restrictions on mobility resulting from an acceleration of COVID cases. Developed market central banks continue to lean against normalization expectations by reiterating their view that the bar for policy normalization remains high amid slow progress towards maximum employment. Inflation challenges and policy credibility issues have mounted though and some EM central banks have started tightening. May saw overall positive flows of +$2.5bn and +$1.3bn into local currency and hard currency, respectively. (Source for flows data: J.P. Morgan).

Figure 1 - Emerging Market Debt Index Returns – As of 31 May, 2021

	1m	3m	6m	YTD	12m	3yrs	5yrs
In USD							
GBI-EM GD (EM Local Currency)	2.26%	-3.54%	4.17%	-4.57%	11.22%	0.96%	3.02%
EMBI GD (EM Hard Currency)	2.22%	-1.35%	3.26%	-2.42%	15.97%	5.32%	5.14%
CEMBI BD (EM Corporates)	0.60%	-0.14%	3.95%	-0.21%	14.33%	6.58%	5.90%
In EUR							
GBI-EM GD (EM Local Currency)	0.91%	0.86%	-0.98%	-2.12%	-1.39%	1.95%	2.74%
EMBI GD (EM Hard Currency)	-0.13%	1.94%	-1.33%	-0.95%	0.90%	4.53%	3.52%
CEMBI BD (EM Corporates)	-0.54%	0.24%	0.07%	0.88%	1.12%	5.55%	4.10%
In GBP							
GBI-EM GD (EM Local Currency)	-0.17%	-0.08%	-4.94%	-5.94%	-5.74%	1.28%	5.18%
EMBI GD (EM Hard Currency)	-1.31%	0.88%	-5.38%	-4.93%	-3.65%	3.81%	5.96%
CEMBI BD (EM Corporates)	-1.72%	-0.80%	-4.04%	-3.17%	-3.44%	4.82%	6.55%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 May, 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 31 May, 2021

Item	Δ 1 Month	Δ 3 Months	Δ YTD	Current Level
GBI-EM GD Yield	1 bps	24 bps	73 bps	4.95%
EMBI GD Yield	-9 bps	-15 bps	40 bps	4.96%
EMBI GD Spread	-7 bps	-26 bps	-19 bps	333 bps
CEMBI BD Yield	-3 bps	7 bps	31 bps	4.35%
CEMBI BD Spread	3 bps	2 bps	-18 bps	304 bps
CDX.EM 5y	-7 bps	-33 bps	8 bps	160 bps
10y UST	-3 bps	19 bps	68 bps	1.59%
Dollar Index (DXY)	-1.59%	-1.16%	-0.12%	
DOW 30	1.93%	11.63%	12.82%	34,529
Oil (WTI)	4.31%	7.84%	36.69%	$ 66.32

Source: JP Morgan, Bloomberg as of 31 May, 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 $)	**2.49%**	**1.59%**	**-2.19%**
FX Return (vs $)	1.90%	1.66%	-0.28%
Price Return (Local currency)	0.17%	-1.38%	-3.96%
Interest Return (Local currency)	0.40%	1.30%	2.07%
In EUR			
Total Return (in €)	**0.91%**	**0.86%**	**-2.12%**
FX Return (vs €)	0.34%	0.94%	-0.22%
In GBP			
Total Return (in €)	**-0.17%**	**-0.08%**	**-5.94%**
FX Return (vs €)	-0.75%	0.00%	-4.05%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 May, 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 2.49% in US dollar terms in May, as measured by the JP Morgan GBI-EM Global Diversified Index. Emerging market currencies posted positive monthly returns as they drew support from a weaker dollar and lower US Treasury yields. The asset class posted strong gains after a weak US jobs report revived risk appetite under the premise that the US Federal Reserve will keep easy monetary policy in place for a little longer, which led to low beta emerging EMEA countries and high beta LatAm countries contributing positively to the index performance. Within the EM space, EEMEA and LatAm central banks moved towards normalization, with central banks in Asia maintaining policy.

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

May 2021	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight	Index Impact (bps)**
GBI-EM GD		**2.49**	**0.57**	**1.90**		
Top 5 Performers	South Africa	9.7	3.8	5.7	8.2%	80
	Hungary	3.9	-1.4	5.3	4.0%	16
	Brazil	3.7	0.3	3.4	8.5%	32
	Czech Republic	3.2	0.0	3.3	4.3%	14
	Mexico	2.9	1.5	1.3	9.6%	28
Bottom 5 Performers	Colombia	0.0	-0.9	0.9	4.5%	0
	Malaysia	-0.6	0.1	-0.7	7.1%	-4
	Uruguay	-0.8	-0.9	0.1	0.1%	0
	Turkey	-1.8	0.5	-2.2	1.8%	-3
	Chile	-2.0	-0.9	-1.0	2.3%	-4

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

South Africa was the best performer (+9.7%) and the largest contributor to index returns (80 bps) in May. The South African Reserve Bank (SARB) maintained its policy rate at 3.5% while significantly revising growth forecasts upward. The South African rand rallied during the month (+5.7%) to its highest in more than two years on the back of higher commodity prices (which benefits the resource-rich country). The rand was bolstered by bond inflows after foreign investors bought 3.7bn rand worth of South Africa bonds.

Hungary generated positive returns (+3.9%), mainly attributable to FX (+5.3%). As part of its quantitative easing (QE) program, the Hungarian National Bank purchased 57.2bn forint of government debt on the secondary market. In addition, the currency appreciated amid speculation around the potential for two possible interest rate hikes (of 15 bps each) in June and Q3 2021.

Brazil continued to be a strong performer, returning 3.7% to be the second largest contributor (32 bps) to index returns. President Bolsonaro is negotiating an agreement to freeze up to 30bn reais ($5.3bn) in expenditure and change the 2021 fiscal target, thus providing some relief to the fiscal deficit. Brazil's central bank lifted its benchmark interest rate for the second straight month by 75 bps to 3.5%. The Brazilian real strengthened by 3.4% in May, striking a more optimistic tone on the nation's recovery despite rising coronavirus case numbers.

Czech Republic returned 3.2% over the month, aided by sharp currency gains (+3.3%) that were fueled by expectations of policy tightening. Although the central bank kept its interest rate at 0.25% in May, it strongly indicated the possibility of an interest rate hike this summer. The bank is gearing up to be the first in the European Union to lift borrowing costs as pandemic-related risks have eased and inflation quickened.

Mexico delivered positive returns (+2.9%) and was a large contributor (28 bps) to index returns. The Mexican economy did well during the month amid growing demand in the US for the country's exports (the trade surplus surged to $1.5bn in April). This is poised to boost its manufacturing and food industry going forward as economic activity seems likely to pick up in the next few quarters amid declining COVID-19 cases and related deaths.

Chile was the worst performer (-2.0%) and the largest detractor (-4 bps) from the index as the country is implementing emergency aid of $10.8bn to help families and small companies amid the ongoing coronavirus outbreak. The measures will be paid by windfalls from government sovereign funds, external debt and higher copper prices. Government bond yields continued to increase against the backdrop of uncertainty around this year's presidential elections.

Turkey was the second poorest performer (-1.8%) and detracted -3 bps from the index. As the country's central bank kept its benchmark interest rate unchanged at 19% (targeting a 5% inflation rate), Turkish President Erdogan's demand for an interest rate cut sent a minor shockwave through the currency market, with the lira weakening by -2.2% and touching an all-time low.

Malaysia returned -0.6% against the backdrop of contracting economic activity that weighed on markets and currency, and as the government instituted fresh controls to curb the pandemic amid new cases and a trailing vaccination drive. Following the Movement Control Order, the government announced a very limited fiscal stimulus with a MYR 40bn package for economic support – the government is to contribute MYR 5bn. The central bank kept the overnight policy rate unchanged at 1.75%.

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	**1.06%**	**2.30%**	**-1.39%**
Spread Return	0.73%	2.83%	2.92%
Treasury Return	0.33%	-0.51%	-4.19%
IG Sub-Index	0.68%	0.94%	-3.81%
HY Sub-Index	1.48%	3.86%	1.43%

Sources: State Street Global Advisors, Bloomberg, JP Morgan as of 31 May, 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 generated returns of 1.06% in May, as measured by the JP Morgan EMBI Global Diversified Index, with spreads tightening by 7 bps over the month. Idiosyncratic developments remain a source of intra-EM volatility, creating relative value opportunities.

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

May 2021	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight	Index Impact (bps)**
EMBI Global Diversified		**1.06**	**0.73**	**0.33**		
Top 5 Performers	Zambia	7.9	7.7	0.1	0.3%	2
	Sri Lanka	6.4	6.1	0.2	1.2%	8
	Tajikistan	6.3	6.0	0.3	0.1%	0
	Lebanon	4.9	4.9	0.0	0.3%	1
	Argentina	4.6	4.2	0.4	1.2%	5
Bottom 5 Performers	Colombia	-1.6	-2.1	0.5	2.7%	-4
	Ethiopia	-3.0	-3.2	0.2	0.1%	0
	Belarus	-3.3	-3.7	0.4	0.5%	-2
	El Salvador	-3.5	-4.0	0.5	1.0%	-3
	Papua New Guinea	-5.9	-6.3	0.5	0.1%	0

Source: State Street Global Advisors, JP Morgan as at 31 May 20201. 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.

Zambia was the best performer (+7.9%) in the month, contributing 2 bps to the index return. Zambia's dollar bond gained after a broad agreement for a secure lending program was reached with the International Monetary Fund (IMF); the program will assist the country's macroeconomic parameters, fiscal targets and policy objectives.

Sri Lankan bonds delivered a gain of 6.4% and was the biggest contributor to index returns (8 bps). Sri Lankan government debt is leading gains in the Asian dollar bond market as investors bet that the nation will avoid defaulting on its short-term notes, with the help of a Chinese funding facility ($500 million loan and $1.5bn currency swap line from China). Furthermore, the Central Bank of Sri Lanka called for further monetary and fiscal stimulus after holding the standard lending facility rate at 5.5%.

Lebanon bonds returned 4.9% in May on expectations of financial aid from Qatar when a government is formed. Lebanon is still in the midst of its worst economic crisis in decades amid political divisions, lack of a government, runaway inflation and failure to secure support from the IMF.

Argentina bonds generated a return of 4.6% and was the second largest contributor (5 bps) to index return. Its dollar bonds climbed after President Alberto Fernandez urged the IMF to renegotiate its record $45bn loan and asked the group of government creditors known as the Paris Club to delay a $2.4bn payment.

Tajikistan posted positive returns in the month; however, it did not have significant impact on the index.

El Salvador bonds returned -3.5% in May after President Nayib Bukele's ruling party criticized the US Biden administration, stoking a sell-off in bonds due in 2025. This left investors concerned that political tensions with the US might dim the prospects of a proposed deal with IMF.

Belarus bonds returned -3.3% after Fitch affirmed its Long-Term Foreign Currency Issuer Default Rating (IDR) at 'B' with a negative outlook. The negative outlook reflects vulnerabilities that have been elevated by a post-election political crisis that poses risks to the country's macroeconomic and financial stability. The country's external position remains strained after FX reserves dropped by $2.6bn (47%) last year, reflecting central bank sales in the face of deposit outflows and foreign currency repayments. In addition, the conflict between the government and opposition following last year's election remains unresolved.

Colombia's dollar-denominated bonds dropped after S&P cut the country's credit rating by 1 notch (BB+) to sub-investment grade amid a political crisis and mass unrest. This was after a government plan to raise taxes to curb the fiscal deficit (that widened to 8.6% of GDP this year) was blocked by congress amid recent mass street protests. Colombian assets weakened over the past month as investors priced in the increased likelihood of a downgrade.

Papua New Guinea and **Ethiopia** generated negative returns, but this did not have a significant impact on the index.

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