Commentary
Fixed Income

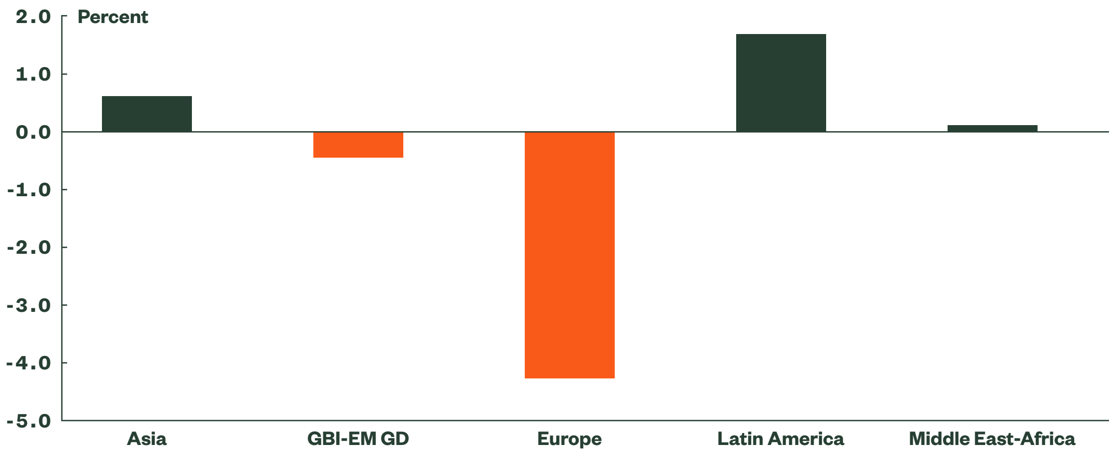
February 2022

Emerging Market Debt Market Commentary

Chart of the Month: Impact of Ukraine War on EM Currencies

There was a sharp sell-off in the currencies of Russia and Central Eastern European countries in February in the wake of Russia's invasion of Ukraine. The related surge in commodity prices bolstered the performance of a number of EM currencies, particularly in Latin America.

Figure 1
FX Return By Region



Source: Bloomberg Finance L.P., as of 28 February 2022. Past performance is not a reliable indicator of future performance.

Monthly Commentary — February 2022

Emerging market debt (in USD terms) experienced a turbulent month, with Russia launching a full scale invasion of Ukraine towards the end of February. The sudden escalation took markets by surprise and led to broad risk-off moves across all major risk assets. Significant retaliatory sanctions were imposed on Russia including: cutting off the Central Bank of Russia's (CBR) access to its offshore reserve assets, the removal of major Russian banks from the SWIFT messaging system, and the stifling of access to global capital markets. Against this backdrop, there was a massive sell-off of Russian, Ukrainian and Belarusian local and hard currency bonds, with ripple effects felt across CEE (Central Eastern European) markets and Turkey.

Commodities markets have been heavily impacted as large companies withdraw from Russia, lenders pull back from financing deals, and the threat of new sanctions deters buyers. This further intensifies the supply concerns around energy, metals and agricultural commodities, of which Russia and Ukraine are significant exporters. This has driven a strong price rally with Brent crude oil up about 10% in February to touch $96 per barrel as of 28 February. The currencies of some EM commodity producers rallied, especially in Latin America. Despite the imposition of far-reaching sanctions, energy-related trades are so far still allowed, which limits to some extent the concerns for European Union countries that rely heavily on Russian energy imports.

US Federal Reserve officials signaled that they are still on track to initiate a rate hike cycle at the upcoming March 15–16 meeting, despite the advent of war in Ukraine; US inflation continued to heat up, with the January CPI rate rising to 7.5% year-on-year, the highest print in almost 40 years. During February, hard currency outflows amounted to -$3.7bn, while local currency outflows were -$0.6bn. (source: JP Morgan).

Figure 2
Emerging Market Debt Index Returns — As of 28 February, 2022

	1m (%)	3m (%)	6m (%)	YTD (%)	12m (%)	3yrs (%)	5yrs (%)
In USD							
GBI-EM GD (EM Local Currency)	-5.00	-3.53	-10.59	-5.01	-9.96	-1.06	0.95
EMBI GD (EM Hard Currency)	-6.55	-7.93	-11.48	-9.21	-7.50	0.79	1.95
CEMBI BD (EM Corporates)	-4.84	-6.06	-7.63	-6.43	-5.43	3.28	3.42
In EUR							
GBI-EM GD (EM Local Currency)	-5.19	-3.32	-6.03	-3.82	-2.70	-0.61	-0.16
EMBI GD (EM Hard Currency)	-6.73	-7.74	-6.97	-8.07	-0.03	1.25	0.83
CEMBI BD (EM Corporates)	-5.03	-5.86	-2.92	-5.27	2.20	3.76	2.28
In GBP							
GBI-EM GD (EM Local Currency)	-5.01	-4.88	-8.29	-4.11	-6.18	-1.35	-0.56
EMBI GD (EM Hard Currency)	-6.55	-9.22	-9.20	-8.35	-3.61	0.50	0.43
CEMBI BD (EM Corporates)	-4.85	-7.37	-5.25	-5.55	-1.45	2.98	1.88

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 28 February, 2022. Past performance is not a reliable indicator of future performance. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualised.

Figure 3
Key EM and Macro Levels as of 28 February, 2022

Item	∆ 1 Month	∆ 3 Months	∆∆ YTD	Current Level
GBI-EM GD Yield	34 bps	61 bps	57 bps	6.29%
EMBI GD Yield	92 bps	122 bps	135 bps	6.64%
EMBI GD Spread	85 bps	78 bps	101 bps	470 bps
CEMBI BD Yield	78 bps	111 bps	114 bps	5.73%
CEMBI BD Spread	69 bps	65 bps	77 bps	390 bps
CDX.EM 5y	75 bps	73 bps	100 bps	287 bps
10y UST	5 bps	38 bps	31 bps	1.83%
Dollar Index (DXY)	0.17%	0.74%	1.08%	—
DOW 30	-3.53%	-1.71%	-6.73%	33,893
Oil (WTI)	8.59%	44.64%	27.27%	$ 95.72

Source: JP Morgan, Bloomberg Finance L.P., as of 28 February, 2022. Past performance is not a reliable indicator of future performance.

Local Currency Market Highlights

EM local currency debt returned -5.00% in US dollar terms in February, as measured by the JP Morgan GBI-EM Global Diversified Index. The overall weakness of the index originated with events in Ukraine, with Russian local currency bonds detracting -4.93% from index returns. The RUB fell sharply and the sell-off in the local currency bonds saw the 10-year yield touch 16% as of 25th February, at which point trading was halted in local markets. The effects were also felt in CEE countries where FX returns were negative. However, the strong rally in commodity prices amid supply concerns boosted the FX returns of some commodity currencies, particularly in Latin America.

Figure 4
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 $)	**-5.00**	**-3.53**	**-5.01**
FX Return (vs $)	-0.38	1.20	0.12
Price Return (Local currency)	-5.03	-6.03	-5.96
Interest Return (Local currency)	0.40	1.30	0.83
In EUR			
Total Return (in €)	**-5.19**	**-3.32**	**-3.82**
FX Return (vs €)	-0.56	1.41	1.30
In GBP			
Total Return (in €)	**-5.01**	**-4.88**	**-4.11**
FX Return (vs €)	-0.38	-0.14	1.02

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 28 February, 2022. Past performance is not a reliable indicator of future performance. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualised.

Figure 5
Best and Worst Performers Across EM Local Government Bond Markets in USD*

February 2022	Country	Total Return USD (%)	Bond Return (%)	FX Return (%)	Index Weight (%)	Index Impact (bps)**
GBI-EM GD	—	**-5.00**	**-4.55**	**-0.45**	—	—
Top 5 Performers	Uruguay	8.2	4.3	3.9	0.1	1
	Dominican Republic	5.5	1.1	4.5	0.1	1
	Brazil	3.6	0.5	3.1	8.4	30
	Thailand	1.8	0.0	1.8	9.2	17
	Egypt	1.0	1.0	0.0	1.2	1
Bottom 5 Performers	Czech Republic	-1.9	1.5	-3.4	4.6	-9
	Poland	-2.4	-0.3	-2.1	7.0	-17
	Turkey	-4.3	-1.1	-3.2	1.0	-4
	Hungary	-5.8	-2.1	-3.7	3.5	-20
	Russia	-74.7	-65.0	-9.7	6.6	-493

Source: State Street Global Advisors, JP Morgan, as at 28 February, 2022. Past performance is not a reliable indicator of future performance. 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.

Russia was the worst performer in February, returning -74.7% in USD terms and detracting 493 bps from the index return. The escalation of the situation along Russia-Ukraine border worsened as Putin recognised the independence of two breakaway Ukraine regions — Donetsk and Luhansk — on 21 February, with a full-scale invasion following three days later. The retaliatory sanctions imposed on Russia, most notably cutting off CBR's access to its offshore reserve assets, cutting off major Russian banks from SWIFT, and stifling access to global capital markets, made the Russian local bond market almost inaccessible for foreign investors — trading activities were suspended in local markets. RUB fell sharply, forcing the government to intervene through FX selling and imposing capital controls. The CBR raised its key interest rate from 9.5% to 20% and ordered export-focused companies to sell foreign currency in an emergency move to contain the depreciation of the ruble as well as addressing inflationary concerns — January CPI inflation increased by 8.7% year-on-year (y/y). The situation remains extremely fluid and much depends on how soon a de-escalation can be achieved as talks take place between Russia and Ukraine.

Hungary was also particularly weak, depreciating -5.8% in USD terms and detracting 20 bps from the index return. Consumer prices grew 7.9% y/y in January, ahead of estimates of 7.4% and fueling expectations of more aggressive central bank rate hikes. Although the central bank raised the 1-week deposit rate by 30 bps to 4.6% on 24 February in line with expectations, the Russia-Ukraine escalation prompted a 75 bps hike in early March to 5.35%. The initial currency gains for the HUF after the rate hike were wiped out by the impact of the Russia-Ukraine escalation and the Forint reached an all-time low of 330.93 per USD as of 28 February, making it one of the worst-hit currencies.

Turkey underperformed with a return of -4.3% in USD terms, detracting 4 bps from the index return. The lira weakened amid surging inflation (the February CPI increased to a 20-year high of 54.4% y/y) and the repercussions from the Russia-Ukraine war. As global risk appetite fell, Turkey was one of the most affected currencies due to abnormally high inflation and its dependence on Russia and Ukraine for energy and grain imports. The country's debt rating was downgraded by Fitch to B+ from BB-, taking it further into sub-investment grade territory.

Uruguay was the best performer in February, returning 8.2% in USD terms. The outperformance was driven by both FX gains and local yield compression. The FX rally was mostly driven by buoyancy in commodity prices.

Brazil was among the best performing countries, returning 3.6% in USD terms and contributing 30 bps to the index return. The central bank maintained its aggressive approach to monetary policy tightening, increasing interest rates by 150bps to 10.75% in February, up from 2% about a year ago. The relatively attractive carry, cheap local stocks and buoyant oil prices are attracting foreign inflows, while the central bank has signaled a likely slowdown in the pace of future rate increases.

Hard Currency Market Highlights

EM hard currency sovereign debt returned -6.55% in February, as measured by the JP Morgan EMBI Global Diversified Index. Underperformance of the overall index was almost entirely driven by the widening of spreads (notably in Russian, Ukrainian and Belarusian bonds) due to broader risk-off sentiment stemming from the build-up to and outbreak of the Russia-Ukraine war.

Figure 6
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	**-6.55**	**-7.93**	**-9.21**
Spread Return	-6.18	-5.07	-7.02
Treasury Return	-0.39	-3.02	-2.35
IG Sub-Index	-6.52	-9.17	-10.02
HY Sub-Index	-6.58	-6.63	-8.35

Sources: State Street Global Advisors, Bloomberg, JP Morgan, as of 28 February, 2022. Past performance is not a reliable indicator of future performance. Index returns reflect capital gains and losses, income, and the reinvestment of dividends. Performance returns for periods of less than one year are not annualised.

Figure 7
Best and Worst Performers Across EM Hard Currency Government Bond Markets*

February 2022	Country	Total Return (%)	Spread Return (%)	Treasury Return (%)	Index Weight (%)	Index Impact (bps)**
EMBI Global Diversified	—	**-6.55**	**-6.18**	**-0.39**	—	—
Top 5 Performers	Lebanon	12.8	12.9	-0.1	0.2	3
	Costa Rica	2.3	2.8	-0.5	0.8	2
	Tajikistan	1.3	1.7	-0.4	0.1	0
	Ecuador	1.2	1.6	-0.4	1.6	2
	Mozambique	0.7	1.0	-0.3	0.1	0
Bottom 5 Performers	Senegal	-8.2	-7.9	-0.4	0.3	-2
	Ghana	-11.4	-11.2	-0.3	1.4	-16
	Ukraine	-60.5	-60.4	-0.1	2.1	-127
	Russia	-71.8	-72.2	1.6	3.0	-215
	Belarus	-80.6	-80.6	0.1	0.4	-32

Source: State Street Global Advisors, JP Morgan, as at 28 February, 2022. Past performance is not a reliable indicator of future performance. 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.

Russia was the worst performer in February, returning -71.8% in USD terms and detracting 215 bps from the index return. Since hard currency bonds are traded offshore, the closure of Russian exchanges to non-local participants had less of an impact and there was also no issue of RUB convertibility. However, many of these bonds were under the cloud of retaliatory sanctions, leading to them trading at steep discounts. It remains to be seen whether the upcoming debt obligations on Russian sovereigns will be fulfilled — the next coupon payment date is 16 March. Notably, Fitch and Moody's have slashed Russia's sovereign rating status below investment grade.

As one might expect, **Ukraine** was also one of the underperformers, returning -71.8% in USD terms and detracting 127 bps from the index return. As Russian forces advanced on Ukraine's major cities, economic activities came to a standstill and people began to flee the country. The UN Refugee Agency has said that more than 1.5 million people have fled into neighboring countries. The yield on the September 2032 bond shot up to 25.71% as of 28 February.

Among the poorer performers in February was **Ghana**, returning -11.4% in USD terms and detracting from the index return by 16 bps. Moody's lowered Ghana's long-term debt rating by a notch to Caa1 from B3 on 4 February, although an African Union-backed panel has requested a review of the downgrade. Despite annual inflation increasing to 13.9% in January, its highest level in almost six years, from 12.6% in December, the central bank decided to keep the policy rate unchanged. Investors remain concerned about the debt servicing capability of the West African country amid surging inflation, while the proposed 20% expenditure cuts by the government failed to contain the sell-off in dollar-denominated debt in February.

Lebanon was the best performer in February, returning 12.8% in USD terms and contributing 3 bps to the index return. The rally was largely driven by Prime Minister Najib Mikati's statement that the government will begin talks with debt holders as it is currently discussing an economic recovery plan with the International Monetary Fund.

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* Pensions & Investments Research Center, as of December 31, 2020.
† This figure is presented as of December 31, 2021 and includes approximately $61.43 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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