Emerging Markets Debt Declines on Rising Rates, Ukraine Conflict and China Property

By: Emerging Markets Debt | April 11, 2022

Boston - Emerging markets debt indexes fell across the board during the first quarter, as investors took stock of the Russian invasion of Ukraine, further stress in the China property market and the rate-hike plans of an increasingly hawkish U.S. Federal Reserve.

However, EM investors clearly differentiated within the sector. Russian, Belarussian and Ukrainian assets were generally the hardest hit, with Russian sovereign bonds being removed from the indexes as of the end of the quarter. Geopolitical concerns also depressed Eastern European markets.

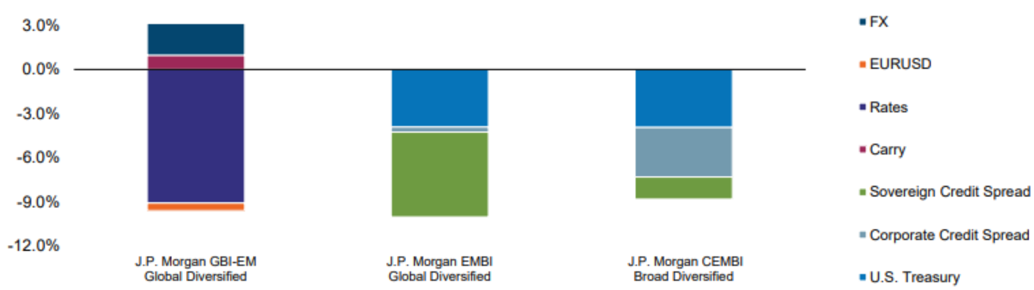
At the other end of the spectrum, assets in Latin America and South Africa were generally stronger. Investors tended to perceive countries physically distant from the conflict —with notable commodity exports and limited trade with Russia — as being attractive. Asian markets were more mixed but generally sold off, influenced by ongoing contagion across the Chinese property sector.

- EM local-currency debt lost 6.46%. Foreign currencies, led by Latin America and South Africa, gained against the U.S. dollar during the quarter, but that was overwhelmed by losses from rising interest rates.
- Dollar-denominated, hard-currency debt lost more than 10%, hurt by exposure to U.S. rates and sovereign spread widening, which was sparked by the Russia/Ukraine conflict and China property concerns.
- Corporate EM debt lost 8.82%, hurt by U.S. rate increases. Wider corporate and sovereign spreads also had a negative impact on performance.

War and rising rates were a double whammy for EM debt

Index performance recap

Q1 2022



Index	FX	EURUSD Exchange Rate Move	Rates	Carry	Sovereign Credit Spread	Corporate Credit Spread	U.S. Treasury	Total Return
J.P. Morgan GBI-EM Global Diversified	2.15%	-0.50%	-9.08%	0.97%	-	-	-	**-6.46%**
J.P. Morgan EMBI Global Diversified	-	-	-	-	-3.92%	-0.34%	-5.76%	**-10.02%**
J.P. Morgan CEMBI Broad Diversified	-	-	-	-	-1.51%	-3.37%	-3.94%	**-8.82%**

Sources: JP Morgan, Eaton Vance as of March 31, 2022. The vertical axis reflects the amount contributed by each factor to total return — adding the bars above 0% and below 0% (negative numbers) results in the total return in the headline. **FX** is the gain or loss in the GBI-EM from currency changes relative to the U.S. dollar. **EURUSD** reflects the portion of currency movement in the GBI-EM that is explained by the change of the euro (EUR) versus the U.S. dollar (USD). **Rates** refers to the contribution of change in local-currency interest rates in the GBI-EM. **Carry** refers to the risk-free returns in each GBI-EM country that cannot be attributed to FX, EURUSD or rates. **Sovereign Credit Spread** refers to the spread above U.S. Treasurys in the EMBI paid by a country. **Corporate Credit Spread** is the spread above the sovereign spread paid by an EM corporate issuer. **U.S. Treasury** refers to the contribution to return in the EMBI and CEMBI (both dollar-denominated indexes) due to interest-rate changes on the U.S. Treasury.

Looking ahead

Looking forward to the remainder of 2022, we are optimistic on EM debt, as valuations appear to be well-compensating investors for the risk.

The Russia/Ukraine war is a humanitarian tragedy that carries implications for the world order well beyond the scope of this blog, and it will continue to drive headlines — potentially for quite some time.

Fundamentals are mixed: generally speaking, commodity exporters are in better shape while importers are more challenged. Fed tightening is a concern, but markets appear to be pricing that in somewhat aggressively. COVID appears to broadly be less of a concern albeit with notable exceptions — for example, China.

While inflationary pressures remain elevated, many EM central banks have continued to respond with orthodox monetary policy, which is a positive. The growth and inflation dynamic remains critical.

China also remains a critical factor. Decreased consumer confidence in the property sector has created broad concerns. That said, targeted policy easing has begun in an effort to stabilize the market.

Bottom line: In our view, the volatility of the past several quarters has created opportunities in the EM sector. We believe that focusing on country-level macroeconomic and political research — along with standalone analysis of specific risk factors such as currency, credit spreads and interest rates — represents the best approach for capitalizing on today's uncertainty.

J.P. Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified is an emerging market debt benchmark that tracks local currency bonds issued by emerging market governments.

J.P. Morgan Emerging Markets Bond Index (EMBI) Global Diversified is an unmanaged index of USD-denominated bonds with maturities of more than one year issued by emerging markets governments.

J.P. Morgan Corporate Emerging Market Bond Index (CEMBI) Broad Diversified is an unmanaged index of USD-denominated emerging market corporate bonds.

Emerging Markets Debt
Eaton Vance Management

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