

# Timely insights from portfolio managers and industry experts on key financial, economic and political issues.

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[Emerging Markets Debt | Global Investing](#)

## Greater Optimism Warranted for EM Debt in 2022 After Losses in 2021

**Boston** - Emerging markets (EM) debt (EMD) closed out 2021 with a number of macro tail winds, including stable fundamentals supported by continuing global economic trade expansion, higher commodity prices, a solid new-issue market and multilateral institutional support (e.g., the IMF).

But last year was nevertheless a rough one for the asset class overall, in contrast to the strong performance of most other risk markets. Only EM corporate debt eked out a gain in 2021 of 0.91%. EM sovereign debt lost 1.80%, and local-currency debt fell 8.75%.\*

Expectations for a more hawkish U.S. Federal Reserve appeared to be the strongest factor weighing on EM debt in the fourth quarter, but concerns over the property sector in China, along with the ongoing challenges posed by COVID-19 and its most recent variant strain, certainly contributed to the negative sentiment.

As was the case around much of the world, inflationary pressures remain elevated in most EM countries, and many EM central banks have continued reacting with orthodox monetary policy (Turkey having been a notable exception). Yield curves have flattened in many spots, and the implications will vary as we head into the new year along with growth and inflation dynamics.

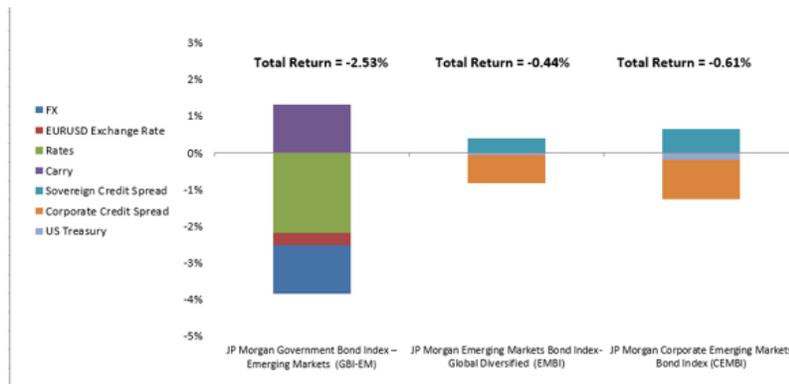
- EM local-currency debt\* lost 2.53%, mostly driven by the prospect of rising U.S. interest rates, the latest COVID wave and regulatory tightening in China.
- Dollar-denominated, hard-currency debt\* dropped a modest 0.44%, as sovereign credit spreads somewhat widened.
- Corporate EM debt\* also had a modest loss of 0.61%, hindered by marginally wider corporate credit spreads.

### Local-Currency Debt Loses Ground Due to Rising Rates and FX



**Emerging Markets Team**  
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"EM fundamentals have a number of macro tail winds, as the global economy continues to expand. Primary risks stem from Fed tightening, COVID-19 and regulatory tightening in China. We feel that markets are pricing these risks appropriately, and valuations generally appear fair and set to deliver sound risk-adjusted returns."



Sources: JP Morgan, Eaton Vance as of 12/31/21. 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 versus the U.S. dollar. **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. Treasuries 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.

## A Look Ahead

As we head into 2022, greater optimism is warranted for EMD, given the balance of fundamentals and valuations.

- Fundamentals appear stable, with global growth and trade continuing their rebounds, albeit at a slower rate. Fed tightening is a concern, but markets appear to be pricing that in somewhat aggressively. COVID also continues to be a challenge, with potential policy responses likely to be the most impactful aspect for economies.
- Inflationary pressures remain, and many EM central banks have responded with orthodox monetary policy. In some spots, there are signs that inflation may have peaked. The growth and inflation dynamic remains critical and one we continue to watch closely.
- China will continue to be a critical factor. A loss of consumer confidence in the property sector would be extremely challenging for the world's second-largest economy. There appears to be targeted policy easing in an effort to avoid further, notable price declines, and we expect these efforts will be maintained as we look to the Party Congress in the fall.

**Bottom line:** Markets increasingly differentiate among countries and their ability to manage the challenges of the COVID-19 pandemic and inflation. We believe the case for active management of EM debt portfolios will be especially important to identify the opportunities - and avoid the pitfalls - that are likely to arise in the 2022 environment.

\* EM corporate bonds are represented by the JP Morgan Corporate Emerging Markets Bond Index (CEMBI); EM sovereign bonds by the JP Morgan Emerging Markets Bond Index - Global Diversified (EMBI); local-currency bonds by the JP Morgan Government Bond Index-Emerging Markets (GBI-EM).

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