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Emerging Markets | Emerging Markets

EM debt hit by equity selloff, but much less so

Emerging Markets Debt Team
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Boston - The global equity market selloff has begun to weigh on emerging markets debt, but losses in the sector so far have been significantly smaller. Obviously, the risk to EM debt will likely grow if the severity of the pandemic increases, and more uncertainty is priced into the market.

From the S&P 500 Index peak on February 19 through the market close on February 27, EM local currency debt, as represented by the J.P. Morgan Government Bond Index - Emerging Markets Global Diversified (GBI-EM), has retreated 2.14%. Sovereign dollar-denominated debt, as represented by the J.P. Morgan Emerging Market Bond Global Diversified Index (EMBI GD), has fallen 1.09%. Corporate EM debt, represented by the J.P. Morgan Corporate Emerging Market Bond Broad Diversified Index (CEMBI BD), has fallen 0.33%.

Over the same timeframe in the equity markets, the S&P 500 has fallen 12.03%, and the MSCI World Index has lost 10.02%.

In terms of what we know about the spread of the coronavirus, the latest news has been mixed. In China, sentiment has changed, and reactions have been more geared towards restarting the economy to try and avoid mass unemployment. China reported zero new cases outside of Hubei province on Sunday and a number of provinces lowered their emergency response measures. There is the possibility that officials are understating cases and lifting measures prematurely to get the economy back on track.

Cases on are the rise in South Korea, Iran and Italy, many of which have no known connection to China. Italian authorities have shut down schools, universities, museums and many other public areas in the northern region of the country in response.

The longer-term impact on EM countries will likely depend on their economic ties to China. For example, in Southeast Asia, countries that are part of the Chinese manufacturing supply chain could face a slowdown. Additionally, many Asian countries will be affected as tourism from China likely declines. More broadly, commodities exporters globally will be hit as commodity prices fall due to reduced demand from China. Likely examples include exporters such as Chile, Saudi Arabia and Brazil.

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On the other hand, countries that have fewer direct economic ties to China and import commodities may do better, as falling import prices are a boost to their economies, like the Dominican Republic and Mexico.

Our overall view is that the virus is more widespread than being reported, meaning there is still a vast amount of uncertainty. Stocks are falling in response, and oil continues to take a hit as demand falls. We believe global supply chains will be disrupted more than originally anticipated, especially given the surge to new cases outside of China.

Bottom line: Until the world gets a better handle on the specifics of the coronavirus, uncertainty and caution will drive the impact on emerging markets and the rest of the global economy. The emerging markets debt team will be monitoring the situation closely and sharing our views with you as they take shape.

J.P. Morgan Government Bond Index - Emerging Markets Global Diversified (GBI-EM) is an unmanaged index of local-currency bonds with maturities of more than one year issued by emerging markets governments.

J.P. Morgan Emerging Market Bond Global Diversified Index (EMBI GD) 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 Broad Diversified Index (CEMBI BD) is an unmanaged index of USD-denominated emerging markets corporate bonds.

S&P 500 Index is an unmanaged index of large-cap stocks commonly used as a measure of US stock market performance.

MSCI World Index is an unmanaged index of equity securities in the developed markets.