# Emerging Market Debt Update

Aberdeen

## Summary


- Emerging market debt assets were weaker in May as concerns over contagion risk from the European sovereign debt crisis weighed on markets
- The JP Morgan EMBI Global Diversified index fell 1.50% and the GBI-EM Global Diversified index also fell by 4.35%
- Venezuela was the worst performer in the EMBI GD index over the month as worsening macro news and a deteriorating regulatory environment took effect


## Overview

Emerging market assets were considerably weaker in May, as concerns about contagion risk from the European sovereign debt crisis weighed on global markets. An unwelcome policy surprise from Germany, and rising interbank funding costs also hurt risk appetite, although the selloff on emerging market debt reflected more of an unwinding of some positions rather than a reappraisal of the asset class. A sense of calm appeared to be returning to the market by the end of the month, with emerging market debt rebounding over the last few trading sessions in May. Hard currency debt outperformed local currency debt, with the latter suffering due to sharp gains on the US dollar at the expense of the euro and other currencies. Overall, the JP Morgan EMBI Global Diversified index fell 1.50% while the benchmark spread widened 70 basis points to +338 over US Treasuries. Meanwhile, the GBI-EM Global Diversified index fell 4.35%, with Poland and Hungary the hardest hit countries, falling 11.30% and 11.79% respectively.

Venezuela was the worst performer in the EMBIG during May, sliding 15.33% on the back of worsening macro news and a deteriorating regulatory environment, with the government introducing new FX trading rules and intervening on local brokerage houses to stem the continued depreciation of the parallel exchange rate. Argentine debt also slumped by 9.08% during the month after Economy Minister Boudou reported that participation in the first segment of the debt exchange, comprising of institutional investors, resulted in roughly a 45% participation rate (US$8.5 billion), which was below official and market expectations.

The macro news in emerging markets was generally positive in May. Brazil's economy continued to show signs of strong growth, with the latest employment and retail sales figures suggesting that consumption would maintain a solid pace of expansion in the coming months. Inflation expectations for 2010 continued to increase, rising to 5.67% from 5.54% during the previous weekly survey, while remaining unchanged for 2011 at 4.8%. Mexico's April trade data supported a broadening recovery, although unemployment figures were disappointing. The robust growth story remained on track in Asia, with the Philippines and Thailand printing stronger than expected first quarter numbers, following impressive growth figures from China, Malaysia and Singapore. In the EEMEA region, South Africa's April retail sales surprised on the upside, while Russia posted healthy industrial production growth.

Going back to the epicenter of risk, there was some good news from Europe. Policy makers introduced various facilities in May to safeguard the financial stability of the Euro area. The shock and awe package of €750 billion, which included IMF support, provided a brief respite for the market. The move by the ECB to purchase European sovereign bonds was even more effective in reducing concerns of an imminent sovereign default. Spain and Italy took a step in the right direction by announcing fiscal tightening measures. Germany's unilateral decision to ban short sales, however, proved to be yet another blow for the market, raising concerns about the lack of policy cohesion. The market also remained fixated on the impact from rising interbank rates, evoking fears of what happened following the Lehman collapse.

## Outlook

For now, the focus appears to have shifted from sovereign default risk to the macroeconomic consequences of the fiscal measures to be taken in order to forestall such a crisis. In this context, we think emerging market debt will rebound, as the fundamental backdrop in the developing world remains sound. Improved market technicals should also be supportive for emerging market debt as we head into the second half of the year.

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## Performance of Emerging Market Debt (to 31 May 2010)

| | 31/05/10 | 28/02/10 | 31/12/09 | 31/05/09 | 31/05/07 | 31/05/05 |
|---|---|---|---|---|---|---|
| JPM EMBIGD (USD), spread over US Treasuries (bp) | 338 | 307 | 288 | 478 | 166 | 389 |

| | 1mth | 3mth | YTD | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|---|
| JPM EMBIGD (USD) Total Return (%) | -1.50 | 1.78 | 3.55 | 17.85 | 22.09 | 47.77 |

Source: JP Morgan, Bloomberg, as of 31 May 2010.
Past performance is not a guide to future performance.

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## For more information

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