

# Five themes for EM debt in 2026: a year of greater divergence



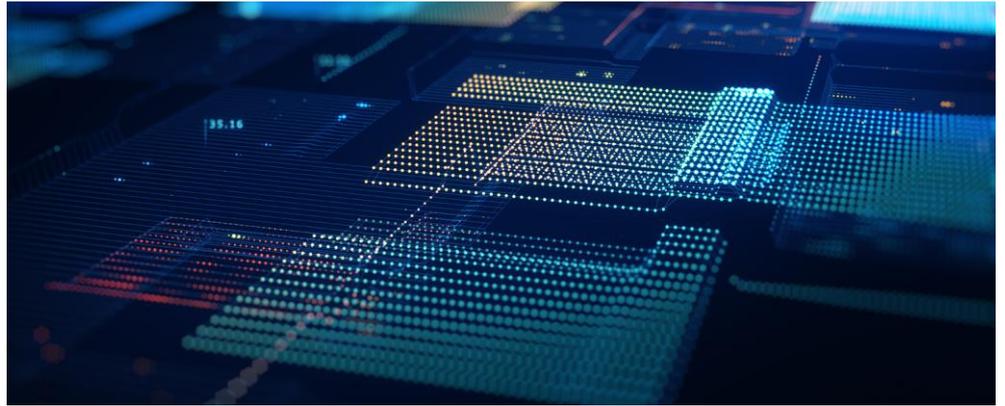
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## Five themes driving our outlook for emerging market debt (EM) in 2026

1. Macro tailwinds and AI momentum – uneven gains
2. EM fundamentals – resilience on trial
3. Local currency carry and technicals – a powerful but selective tailwind
4. Dollar softness unlocks upside for some EM currencies
5. Hard currency debt – idiosyncratic and reform-driven opportunities



## Theme 1: Macro tailwinds and AI momentum – uneven gains



Global growth in 2026 is expected to moderate but remain positive, creating a more stable macro backdrop – but the benefits for EM will be uneven. The acceleration of investment in artificial intelligence (AI) continues to broaden the global growth impulse. Korea, Taiwan, Malaysia and China stand to gain most from AI-driven demand for semiconductors and data-centre infrastructure, while India and the Philippines, with less exposure to hardware, may see limited upside and India may also face labour-market pressures from generative AI adoption.

Commodity exporters in Latin America (such as Chile for copper, Brazil for iron ore) and parts of Africa could benefit from higher demand for critical minerals, but this tailwind is contingent on sustained global capex and stable Chinese growth. Meanwhile, oil exporters may experience softer terms of trade as crude prices trend lower.

Developed market conditions should broadly support EM. US growth may cool under tariff-related inflation and political uncertainty, yet fiscal support and tech investment should sustain momentum. Europe’s outlook is improving on the back of German fiscal expansion, and Japan’s reflation adds stability, while China shows tentative signs of bottoming out.

Still, the benefits for EM will diverge: Asia’s exporters are most exposed to shifts in US tech performance, while LatAm faces election-driven policy risks, and Central & Eastern Europe, Middle East and Africa (CEEMEA) remains vulnerable to lingering inflation and geopolitical shocks. The US Federal Reserve (Fed’s) gradual, data-dependent approach and a likely US soft landing should help anchor global risk sentiment and keep US yields in a range manageable for EM assets, reducing the risk of abrupt outflows. However, tail risks – such as a dollar rebound, renewed inflation forcing Fed hikes, or geopolitical flare-ups – could disproportionately impact weaker credits and frontier markets.

## Theme 2: EM fundamentals – resilience on trial

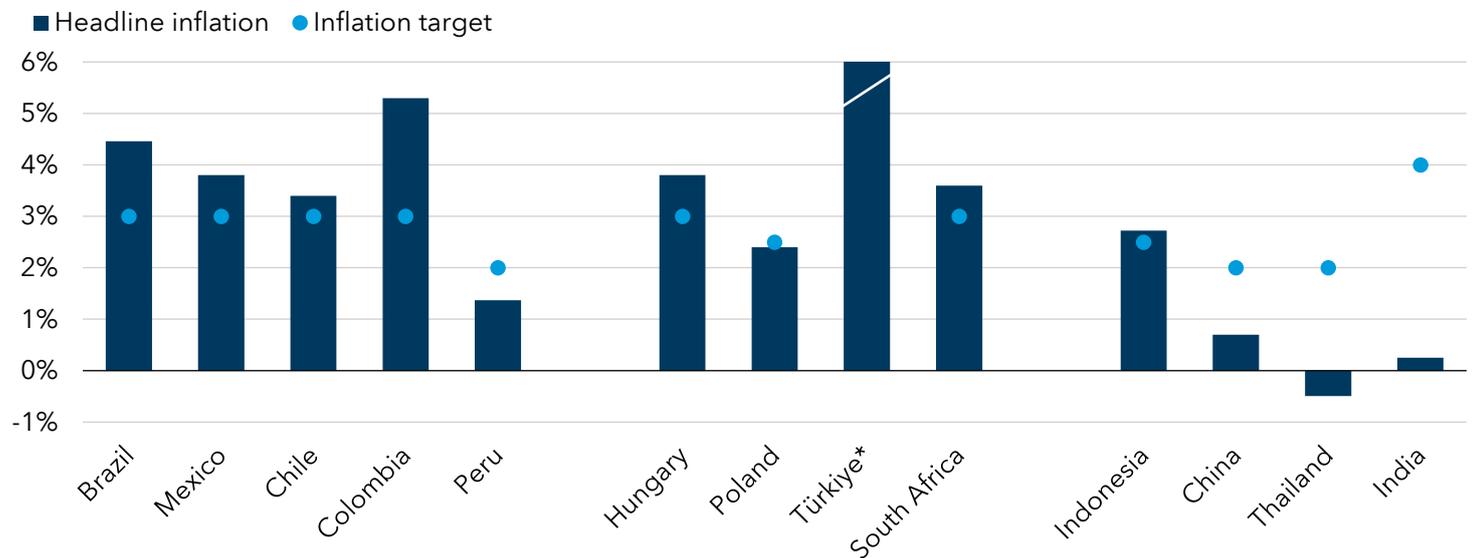


Emerging markets have shown remarkable resilience through recent global shocks, from the pandemic to geopolitical tensions. However, 2026 is likely to test that resilience more than 2025, and the ability to withstand headwinds will vary across countries. While credible policy frameworks and stronger buffers position EMs better than in past cycles, differentiation within the asset class is becoming more pronounced.

EMs are benefitting from prior monetary tightening and a broad disinflation trend, giving central banks some room to manoeuvre. However, this cushion varies by country, shaped by differences in monetary frameworks, fiscal positions, and external conditions.

Inflation remains more persistent in Latin America and Central and Eastern Europe, particularly in services, driven by tight labour markets and elevated government spending. In contrast, Asia shows a more moderate trend, supported by China’s disinflationary influence and stronger external balances. A spike in commodity prices or renewed global inflation could force policymakers to reverse easing – a scenario that would challenge EM resilience.

### Headline inflation and central bank targets



Inflation rates are reported for November 2025, except for India and South Africa, where the latest available data is for October 2025. \* Türkiye’s headline inflation rate is 31.07%, with an interim target of 16% set for the end of 2026. Official inflation reports and targets sourced from respective central bank websites.

Many EMs now enjoy stronger external positions than in the past, supported by tourism recovery, diversified service exports, and, in some cases, commodity windfalls. Over the past decade, most have also reinforced their defences by lengthening debt maturities, building reserves, and maintaining flexible exchange rates – buffers that help absorb moderate shocks.

Still, resilience varies: Asia benefits from wide current account surpluses and tech-driven exports, while Latin America’s gains are tempered by commodity dependence. CEEMEA presents a mixed picture, with Gulf oil exporters retaining robust cushions but Central Europe facing weaker trade flows and higher financing needs.

Frontier markets remain most at risk, with thin reserves and heavy reliance on external funding. If global growth slows or US tariffs rise, export-heavy Asia and commodity-dependent LatAm and Africa could see trade balances deteriorate, although commodity exporters have been somewhat less affected by higher tariffs than manufacturing exporters.

Fiscal resilience varies significantly across EM regions, with Asia generally showing stronger fiscal positions than Latin America and Africa. Many Asian EMs ran relatively prudent budgets and built fiscal space, which bolsters their resilience to growth headwinds. In contrast, parts of Latin America and Sub-Saharan Africa still carry heavy public debt loads and higher borrowing costs – a legacy of the pandemic and earlier shocks.

While most Latin American governments have improved fiscal discipline recently, populist political pressures could complicate consolidation ahead of upcoming elections.

2026 brings a crowded EM political calendar, with LatAm at the centre – Brazil, Colombia and Peru are among key contests – shaping policy and market sentiment. Voter priorities are shifting from economic agendas to security and governance, driving a tilt toward right-leaning candidates and raising risks of polarisation in some jurisdictions. The results of these elections will extend far beyond voting day, shaping economic policy and influencing investor sentiment across global markets.

### EM Elections in 2026

Country	Month	Main election(s)	Key risks
Colombia	Mar-Jun	President, Parliament	Governability, fiscal
Thailand	Mar	Parliament	Govt formation delays
Peru	Apr-May	President, Legislature	Constitutional changes, reform delays
Hungary	Apr	Parliament	Fiscal slippage, EU funds
Israel	By Oct	Parliament	Security
Brazil	Oct	President, Legislature	Fiscal slippage, reform uncertainty
South Africa	Nov	Local govt	Coalition uncertainty, leadership succession

Source: Capital Group

Corporate fundamentals in EMs are broadly solid, especially compared to developed market peers, but not without vulnerabilities. Default rates in EM have remained low and have been concentrated in a few trouble spots rather than broad-based weakness.

For example, the spike in defaults over 2023–2024 was largely due to the Chinese property sector’s well-documented crisis, not a widespread deterioration in EM corporate health. Excluding China’s property developers, EM corporate default rates have been near cycle lows.

### Theme 3: EM local currency carry and technicals – a powerful but selective tailwind

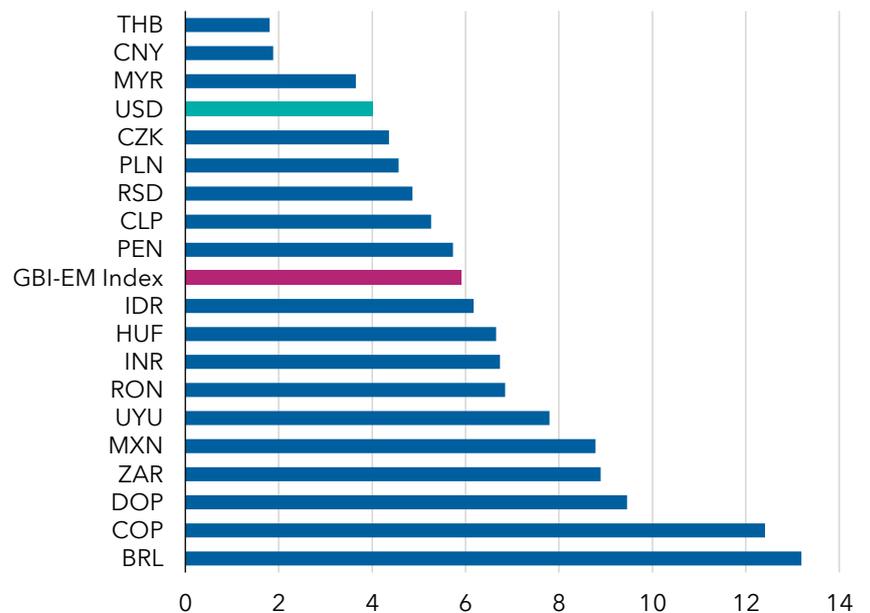


Local currency debt is supported by a combination of attractive yields in many parts of the EM universe, favourable technical factors and the ongoing monetary easing cycles in select markets.

In recent years, many EM central banks moved early to curb inflation, often tightening ahead of developed markets. This proactive stance has left real yields at historically high levels – particularly in Latin America and South Africa – creating attractive income opportunities.

Elevated carry not only provides steady returns but also cushions against volatility. However, this advantage is uneven: while Latin America and parts of CEEMEA offer double-digit nominal yields and positive real rates, several Asian economies – where inflation is lower and policy cycles are more advanced – deliver less carry but greater stability.

#### EM local currency bond yields (%)



#### Past returns are not a guarantee of future returns

As at November 2025. Yield for USD based on the 10-year US Treasury yield. Source: JPMorgan

On the technical side, investor exposure to EM local currency debt has been steadily rebuilding after years of outflows, supported by improving fundamentals and attractive real yields. However, allocations generally remain well below pre-pandemic levels – both as a share of global investible liquidity and relative to EMs’ growing weight in the global economy and market capitalisation. This underweight positioning offers a technical tailwind, but the magnitude of potential inflows will vary:

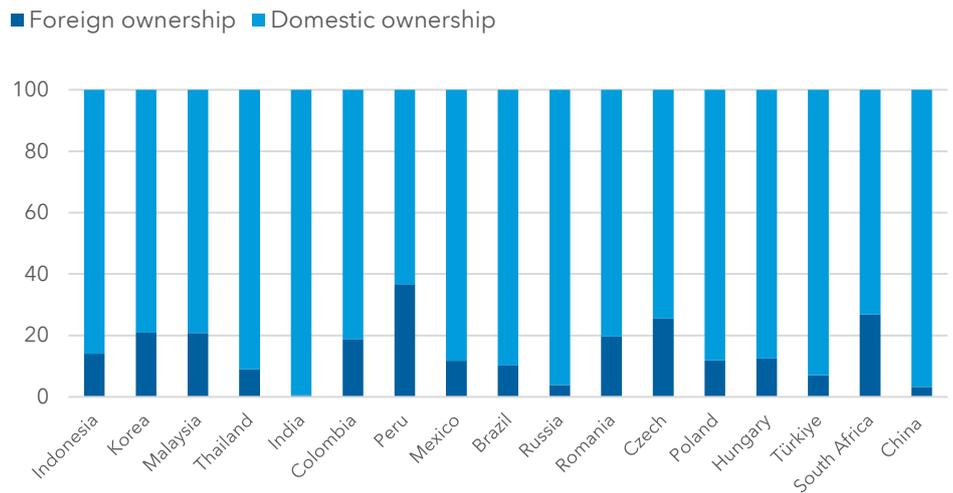
- Latin America has seen the strongest re-engagement, driven by high carry and credible monetary frameworks, yet positioning is still light compared to historical norms.
- Asia remains under-owned despite improving fundamentals, partly due to lower nominal yields and lingering concerns about China’s growth outlook.
- CEEMEA shows mixed dynamics: some markets (South Africa) attract flows on yield, while others remain sidelined due to geopolitical and inflation risks.
- Frontier markets are the most underweight, reflecting liquidity constraints and reform uncertainty, but any incremental allocation here could have outsized price impact.

Even modest rebalancing toward benchmark weights could translate into significant inflows, but selectivity will dominate – favouring regions with credible policy anchors and structural tailwinds over those with persistent vulnerabilities.

#### Foreign ownership of local currency government debt



Data as at September 2025. Source: IIF. Countries include Indonesia, Korea, Malaysia, Thailand, India, Colombia, Peru, Mexico, Brazil, Russia, Romania, Czech Rep, Poland, Hungary, Türkiye, South Africa and China. Calculated as simple average.



Data as at September 2025. Source: IIF

While the pace and extent of EM rate reductions are projected to slow in 2026, the easing cycle is not over – and the scope for cuts will vary significantly across regions. A handful of central banks still have room to lower rates, notably Mexico, Brazil, and South Africa, where real yields remain high and inflation trends are favourable.

Policy easing is under way in Mexico, with rates down from double digits earlier in 2025 and further cuts likely as growth slows and fiscal discipline holds, though election uncertainty and peso stability will keep the pace gradual. In Brazil, falling inflation expectations and credible policy support additional rate reductions to bolster activity amid softer growth, but the central bank will remain cautious given global volatility and domestic political risks.

South Africa also has scope to ease thanks to high real rates and disinflation, though structural challenges – such as fiscal fragility and energy-sector risks – mean cuts will be measured and closely tied to inflation trends.

#### Theme 4: Dollar softness unlocks upside for some EM currencies



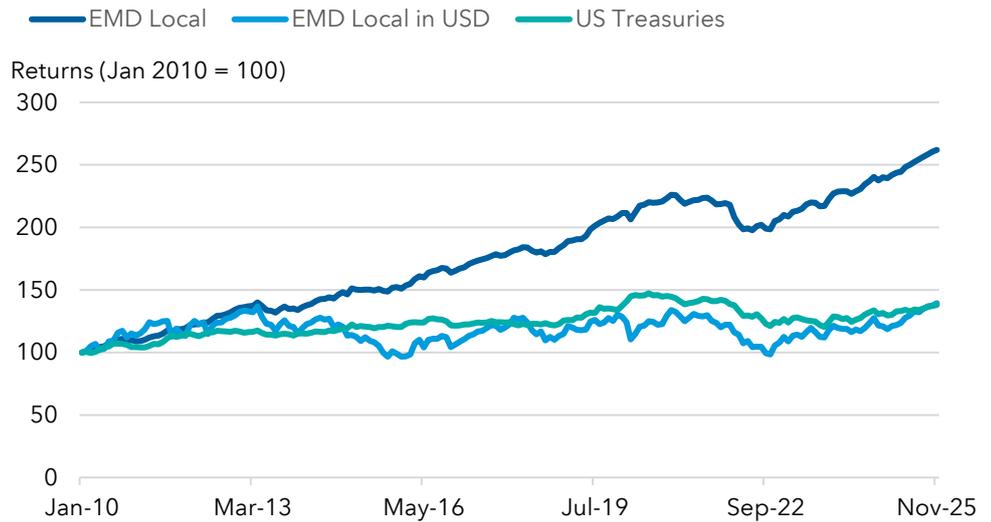
After years of exceptional strength – a major headwind for EM local currency returns – the US dollar began facing structural challenges in 2025. Dollar valuations are still stretched, positioning in US assets remains heavy, and the drivers behind outsized American growth have been losing steam. Meanwhile, the dollar’s yield advantage is eroding as global rate differentials narrow.

These dynamics could open the door for EMFX to deliver even further gains in 2026, but results will be increasingly differentiated across regions and currencies. High carry currencies supported by strong external balances and

credible policy frameworks are best placed to benefit. Latin America stands out, with the Brazilian real and Mexican peso supported by disciplined central banks, robust trade flows, and a favourable carry environment.

In Asia, select markets such as India, Indonesia, and the Philippines continue to offer high real yields and policy flexibility, while commodity exporters like South Africa and Chile are well placed to benefit from global investment in energy transition and AI-related infrastructure.

**USD strength was headwind for EM local returns**  
**EM local returns might benefit if recent USD weakness persists**



**Past results are not a guarantee of future results.**

Data as at 28 November 2025 in USD terms. EMD local: JP Morgan GBI-EM Global Diversified Composite Index. Sources: Bloomberg, JP Morgan

Even if the dollar regains some strength on AI-driven investment, we expect this to represent a normalisation rather than the dominant headwind it once was. EM economies have demonstrated resilience to global shocks, and many are now entering a phase where local drivers – such as credible monetary policy, fiscal consolidation, and reform momentum – will matter more for currencies.

That said, risks are not uniform: trade policy uncertainty around the 2026 United States-Mexico-Canada Agreement (USMCA) review and potential tariff escalations could weigh disproportionately on North American currencies, while a slowdown in China’s credit cycle and global growth concerns could pressure Asia’s export-heavy markets more than others.

**Theme 5: Hard currency debt – idiosyncratic and reform-driven opportunities**



With valuations tightening, hard currency debt demands a highly selective strategy focused on alpha rather than beta. Opportunities are concentrated in markets undergoing structural reforms, post-crisis recoveries, or leadership transitions that reshape credit profiles. External anchors – such as IMF programs, international support, and improved geopolitical ties – further strengthen the case for targeted exposure.

Mexico remains a high-conviction view across sovereign and corporate debt. Sovereign bonds benefit from disciplined fiscal management and strong external buffers that reinforce debt sustainability.

On the corporate side, leading financial institutions maintain solid profitability and asset quality, while telecom and energy issuers offer defensive characteristics and incremental yield, supported by government backing. In Brazil, select corporates look attractive after recent spread widening – driven by idiosyncratic factors – relative to the still-solid credit fundamentals and growth outlook.

Beyond Latin America, we see value in Asian corporates and frontier sovereigns. In Asia, companies in China and India are well positioned, supported by favourable policy, ample liquidity, and sector-specific tailwinds in technology and infrastructure. Macao gaming stands out as a strong conviction, with rising visitor numbers and mass-market demand driving profitability. Operators maintain healthy cash flow and balance sheet strength, while regulatory changes are largely priced in.

On the Frontier side, select credits offer high carry and diversification benefits, underpinned by improving fiscal anchors and strong investor appetite for scarce hard-currency paper. Egypt is a notable example: Gulf inflows and IMF support have strengthened reserves and reduced near-term funding risk, while dollar bonds continue to offer attractive spreads relative to peers, backed by fiscal stability and regional support.

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