



# Emerging Market Debt 1Q 2026 outlook

From Emerging Market Debt

Emerging Markets enter 2026 on strong footing, supported by Fed easing, resilient commodity prices, and a softer U.S. dollar - factors that continue to underpin EM fixed income. With improving fundamentals and scope for further spread compression, the asset class offers compelling opportunities for selective, research-driven investors as credit quality strengthens, and economic resilience broadens across regions.

## The new paradigm of pricing emerging market risk

For decades, the pricing of Emerging Market (EM) bonds relied on a simple principle: compare the yield to the gold

standard of safety - U.S. Treasury bonds. This benchmark was considered to have a relatively risk-free rate, forming the foundation for global fixed-income valuation.

Market conditions have evolved, prompting a timely reconsideration: How should one define a 'risk-free rate' in current markets? Many investors are increasingly questioning whether U.S. Treasuries continue to serve as a suitable benchmark. Rising fiscal deficits, political polarization, and global macro uncertainty have introduced risks that were once unthinkable for the U.S. government debt market. China can currently borrow in U.S. dollars at rates about 59 basis points lower than the U.S. Treasury on 13-year bonds—even though the dollar is a currency China neither controls nor can print.

### Chinese bonds trading tighter than US



### EM yields remain attractive relative to history<sup>2</sup>



1. Data as of December 5, 2025. 2. Data as of December 12, 2025  
Source: Intercontinental Exchange (ICE), J.P. Morgan EMBI Global Diversified Blended Yield



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Although EM index credit spreads remain tight by historical standards, investors have increasingly shifted their focus to all-in yields when evaluating the attractiveness of EM debt, as yields remain compelling on a historical basis.

Furthermore, we see room for additional spread compression and continued outperformance, supported by a rising share of investment-grade issuers in the index and upward rating momentum among high-yield countries.

## Emerging market sovereign credit: opportunities ahead in 1Q 2026

EM hard currency sovereign debt has returned approximately 13.67% year-to-date as of December 4, 2025, as measured by the JP Morgan EMBIG Diversified Index. We emphasize main drivers for emerging market sovereign performance in 2026 as structural improvements, supportive political developments, enhanced market access, and potential rating upgrades.

Our outlook remains positive on Ecuador and Argentina, where strong reform momentum under International Monetary Fund (“IMF”) programs, are complemented by cooperative relations with the U.S. In Hungary, we see notable upside risk as markets seem to underestimate the chances of a favorable election outcome next year, which could potentially unlock EU funding and significantly boost Hungarian assets. Suriname also stands out, with recent liability management easing investor concerns and offering compelling returns for those backing its long-term reform strategy. On ratings, Morocco’s recent move to investment grade reflects solid fiscal progress, while the Bahamas has achieved an upgrade to BB- through substantial debt reduction. We anticipate further rating improvements in Ivory Coast, driven by robust growth, and in Nigeria, where fiscal reforms and stronger tax collection are encouraging. Lastly, while Romania faces downgrade risk, current valuations more than compensate for this uncertainty.

## A weaker U.S. dollar can create a virtuous cycle for emerging markets

A weaker US dollar is a powerful tailwind for emerging-market debt because it improves fundamentals and, crucially, creates room for central banks to ease policy. As EM currencies appreciate, imported inflation and FX pass-through pressures fade, helping anchor inflation expectations. That gives central banks the confidence to cut rates or shift to a more accommodative stance without risking a renewed inflation spike or currency stress. Lower policy rates feed directly into lower local bond yields and cheaper domestic credit. At the same time, the local-currency value of US-dollar debt falls, improving debt ratios

and reducing interest burdens, supporting capital inflows and cheaper external funding.

These dynamics set up a potential “virtuous circle” for EM fixed income. Stronger FX, lower inflation and rate cuts support domestic demand and investment, reinforcing the improvement in debt sustainability and credit quality. Investors respond to the combination of credible easing cycles and better macro data by reallocating capital into EM local and hard-currency bonds, compressing yields and spreads. In effect, a softer dollar not only reduces the burden of dollar liabilities, but it also unlocks and extends EM easing cycles, turning into a self-reinforcing support for EM debt.

## EM local currency debt: leading the charge

Local currency EM sovereign bonds have significantly outperformed hard currency peers, delivering 18.25% YTD as of December 4, 2025 (JP Morgan GBI-EM Global Diversified Index), with 7.73% of this return driven by FX appreciation. Amid this ongoing virtuous cycle, we see attractive opportunities across several EM local markets. We are constructive on Hungary, highlighting asymmetric upside should EU fund flows be restored following the April 2026 parliamentary elections. In South Africa, we continue to find value in both FX and rates markets, supported by improving medium-term budget projections and the recent adoption of a lower inflation target. We see value in high-yielding EM local markets that remain underappreciated due to their idiosyncratic nature. Continued progress in inflation-targeting frameworks and improving macro fundamentals reinforce the investment case, particularly given the attractive yields offered by countries such as Uzbekistan, Egypt, and Uruguay.

## U.S. dollar index: one of the sharpest slides in a decade



Data as of December 12, 2025  
Source: Macrobond 2025

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