



JANUARY 2026

# Carry on – another strong year for emerging market debt?

Surging interest in emerging market debt, several ratings upgrades and a weak dollar all suggest a possible repeat of last year's strong returns. We reveal our outlook for 2026 along with our top country picks.

A quiet shift has taken place in recent years. Many emerging market (EM) countries enjoy strengthening policymaking frameworks and generally stable politics, leading to



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improved macro fundamentals and sovereign credit rating upgrades. Contrast this with policy uncertainty and tensions in developed countries – notably the US – and it is no wonder why so many investors are exploring emerging market bonds.

As we predicted in a previous [outlook piece](#), emerging market debt performed well in 2025 with the main indices that track the asset class delivering “equity-like” mid-double-digit returns.\* This year, the factors driving returns might be somewhat different, but we still see several reasons at the macro, fundamental and technical level to predict another strong year of performance.

## Key takeaways

- Many emerging markets benefit from sound policy-making, solid economics and the return of international investment flows.
- Continued easing by the US Federal Reserve and a potentially weaker dollar provide a supportive backdrop, especially for local currency bonds.
- We see opportunities in bonds issued by Brazil, South Africa and Turkey as well as by Egypt and Pakistan, among others.

\* Both the JP Morgan Emerging Markets Bond Index (EMBI) Global Diversified index, which tracks hard currency debt, and the JP Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified index, which tracks local currency bonds, achieved mid-double-digit returns in 2025.

## A supportive global macro environment

One reason for optimism is the supportive global macro environment. While the US labour market continues to show signs of weakness, this vulnerability is offset by growth due to AI-related productivity improvements and infrastructure investment, which help to boost global risk appetite. With the US economy slowing down gradually, rather than rolling over, markets are pricing continued easing from the Federal Reserve. We think liquidity conditions should remain positive in early 2026.

In parallel with these developments, the perceived end of US exceptionalism – the belief that the US has a unique ability to outperform other markets – is contributing to a weaker US dollar. EM assets typically benefit in this scenario because a weaker dollar softens imported inflation and allows EM central bankers more room to ease monetary policy, which tends to benefit local currency bonds in particular. This was the case in 2025, when EM local currency markets were among the strongest performers in an overall strong year for the asset class. We think the US dollar could continue to weaken in 2026, providing the basis for stronger inflows into all EM asset classes, including equities, as investors respond to improved return prospects.

## Ratings upgrades testify to EM improvements

Setting aside the macro factors, emerging market economies have made significant improvements in policymaking in recent years. These

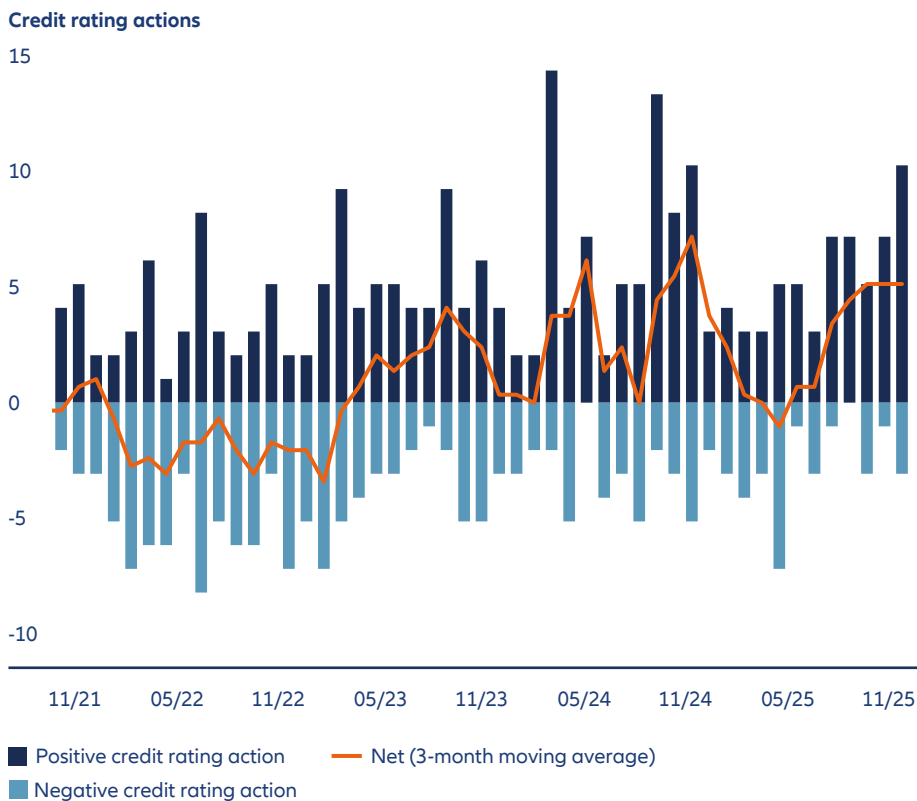
fundamental developments have been recognised by ratings agencies with a series of sovereign credit ratings upgrades (Exhibit 1).

Some EM countries achieved investment-grade status – for example, Oman and Azerbaijan – while others such as Ecuador and Pakistan graduated out of the low-ranked CCC-category by means of reforms to correct macro imbalances. Rating upgrades also occurred due to debt restructuring – for example, Ghana and Sri Lanka. While we expect a slowing of the rating upgrade trend this year, we do not expect it to reverse.

Of the 80 emerging markets in our investment universe, only two – Bolivia and Senegal – are at risk of default. Even if these countries were to default on their debts, which may yet be avoided, the impact on the overall asset class would be negligible – their weights in the JP Morgan EMBI Sovereign Index are just 0.22% and 0.23% respectively. Across the EM asset class, there were no defaults in either of the past two years (Exhibit 2).

Exhibit 1:

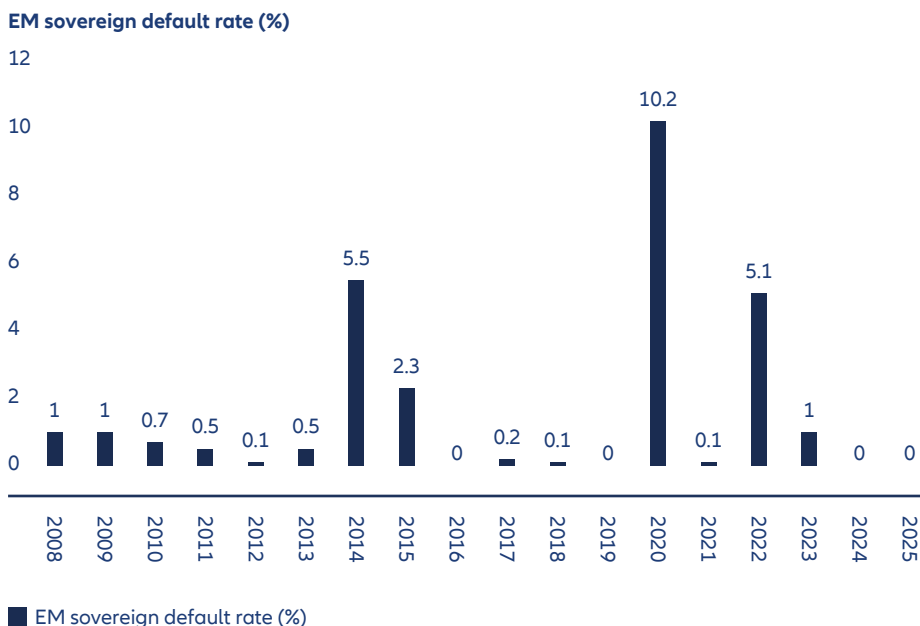
### Ratings agency upgrades and downgrades for EMs in past three years



Source: Allianz Global Investors, JP Morgan, as at 25 November 2025

Exhibit 2:

## EM sovereign default rate since 2008



Source: Allianz Global Investors, JP Morgan, as of 25 November 2025

## Capital allocation to EMs remains low by historical standards

A range of technical factors also point to a positive picture for the asset class. Despite strong 2025 performance across EM hard currency and local currency products, capital allocation to EM remains low by historic standards. The improved EM narrative has led to inflows into the asset class, but these flows have not yet matched outflows that occurred in the previous few years. From 2022 to 2024, about USD 150 billion was withdrawn from emerging market debt mutual funds. In 2025, these funds attracted some USD 31 billion. We expect more inflows this year.

Another supportive factor is a predicted fall in sovereign issuance.

Many sovereigns took advantage of strong market demand last year to pre-fund 2026 financing needs, with investment-grade sovereigns dominating issuance. We expect overall sovereign issuance to fall this year – with the exception of oil exporters, particularly in the Middle East, which may issue bonds to compensate for lower oil revenue. A combination of increased inflows and lower supply in 2026 is likely to support lower and more stable spreads.

## There are risks ahead, but they seem manageable

Of course, there are risks ahead that could derail the positive EM story, however it is notable that these are mainly exogenous – originating from outside the asset class. They include:

- Although not our base case, a strong US dollar would present challenges for EM assets, especially local currency bonds. The dollar might strengthen if the US economy were to accelerate unexpectedly.
- AI-related equity valuations are leading to concerns about a bubble reminiscent of the dot-com boom and bust. Although we don't believe the sector is in bubble territory just yet, a global equity sell-off – were it to occur – would harm EM assets regardless of their relatively strong fundamental underpinnings.
- In May 2026, Jerome Powell will be replaced as chair of the US Federal Reserve. Mr Powell's nomination for the role, in 2018, led to interest rate volatility and underperformance of most risk assets. A repeat scenario could occur should markets question the independence of his successor.

From an endogenous perspective we see two key risks:

- A continued fall in the oil price. Recent developments in Venezuela imply increased oil supply in the future, as would a possible peace deal between Russia and Ukraine. However, because the EM asset class includes both oil exporting and importing countries, EM investors have the opportunity to cushion themselves against the effect of low oil prices by shifting allocations from one to the other.
- Elections always have the potential to introduce instability in emerging markets. There are relatively few EM elections in 2026 and only a handful are likely to be consequential. Colombia has senate and presidential elections in May and June; markets expect a pivot to the right which could lead

to asset price outperformance. In October, Brazil will elect a new president and much of the senate and house. Whoever wins will need to address Brazil’s growing debt/GDP ratio. Hungary also has elections scheduled for April which might see the end of 16 years of rule by Viktor Orbán and his right-wing Fidesz party.

Just like 2025, volatility is to be expected given the risks highlighted above. However, we consider price movements an opportunity for active asset managers to deliver outperformance. Despite the risks, we believe the balance is tilted towards strong performance for emerging market debt this year.

Exhibit 3:

**Yield on the JP Morgan EMBI GD index**



Source: Allianz Global Investors / Bloomberg, as of 2 January 2026

**Outlook for emerging market debt in 2026**

Given that overall spreads are lower than this time last year, we do not anticipate large capital gains from spread compression in 2026. However, following repricing of global fixed income markets over the past few years, overall yields for EM sovereign bonds are closer to multi-year highs than lows, which is positive for the asset class. Exhibit 3 shows current yields for the JP Morgan EMBI GD index, which tracks hard currency sovereign bonds.

Using this same index, we can analyse a range of possibilities for the year ahead (Exhibit 4). These scenarios are based on potential changes in EM sovereign spread and US 10-year Treasury yields – we believe they indicate a positive picture for hard currency bonds. With US Treasuries

likely to remain in a tight range with slightly lower yields, we would expect carry rather than spread compression to be key in 2026.

What about local currency bonds? Based on our expectation of a weaker dollar, we believe these could again outperform hard currency markets, as they did in 2025. These assets may also benefit from rate cuts in some emerging markets. The following grid shows a range of possibilities for the JP Morgan Government Bond Index-Emerging Markets (GBI-EM) Global Diversified index, which tracks local currency bonds. These scenarios are based on potential changes in foreign exchange and local rates (Exhibit 5). Again, we believe they indicate a promising outlook.

This analysis is calculated at the index level and would not include

any investment outperformance – or alpha – that active investment management can deliver. Investment teams can generate index-beating returns by, for instance, investing in underpriced assets or avoiding sovereigns that subsequently default. What are our key country views for the year?

**Top emerging market picks for 2026**

In Brazil, domestic developments suggest the central bank needs to cut interest rates significantly from the current 15% – by much more than the market currently prices. This trend could offer benefits to investors in Brazilian real-denominated debt.

South Africa is among the strongest fiscal improvement stories, boasting

Exhibit 4:

**Analysis of JP Morgan EMBI GD index based on changes in spread and Treasury yield**

Spread change (bp) UST-10Y Change (BP)	-75	-50	-25	0	25	50	75
	-50	13.4	11.9	10.3	8.8	7.3	5.8
-25	11.9	10.3	8.8	7.3	5.8	4.3	2.8
0	10.3	8.8	7.3	5.8	4.3	2.8	1.3
25	8.8	7.3	5.8	4.3	2.8	1.3	-0.2
50	7.3	5.8	4.3	2.8	1.3	-0.2	-1.7

Source: Allianz Global Investors / Bloomberg, as of 2 January 2026. Past performance does not predict future returns. This does not constitute a recommendation or solicitation to buy or sell any particular security or strategy. The statements contained herein may include statements of future expectations and other forward-looking statements that are based on management’s current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. We assume no obligation to update any forward-looking statement.

Exhibit 5:

**Analysis of JP Morgan GBI-EM GD index based on changes in FX and local rates**

EM FX appreciation/depreciation (%) Change in JP GBI-EM yield (bp)	6.0%	4.0%	2.0%	0%	-2.0%	-4.0%	-6.0%
	-100	16.8	14.8	12.8	10.8	8.8	6.8
-50	14.3	12.3	10.3	8.3	6.3	4.3	2.3
0	11.9	9.9	7.9	5.9	3.9	1.9	-0.1
50	9.4	7.4	5.4	3.4	1.4	-0.6	-2.6
100	6.9	4.9	2.9	0.9	-1.1	-3.1	-5.1

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## CARRY ON – ANOTHER STRONG YEAR FOR EMERGING MARKET DEBT?

a credible central bank with a 3% inflation target. We believe there is a good chance yields will continue to fall. In Turkey, the disinflation story continues to suggest a central bank that has more cuts ahead.

Within high-yield sovereign credit markets, Egypt and Pakistan stand out as having the strongest macro improvement stories. Each is supported by a wealthy ally – Abu Dhabi and Saudi Arabia respectively – plus an IMF support programme.

Argentina under President Javier Milei also has great potential. His stronger-than-expected performance

in mid-term elections should lead to a positive reform agenda including much-needed FX reserve accumulation and an eventual return to hard currency primary markets.

Given our oil price concerns, we are more cautious on Angola and Bahrain – these sovereign credits are highly correlated to the oil price and each has weak macro fundamentals. Saudi Arabia is expected to issue a significant amount of US dollar debt as fiscal revenues are depleted by lower oil prices, while Colombia is also exposed to low oil prices and election uncertainty.

## Another year of strong emerging market debt returns?

Despite inevitable volatility, we think emerging markets are poised for a compelling year ahead, supported by solid fundamentals. Inflows are returning after years of scarcity, falling bond issuance is expected to benefit bond investors, and continued Fed easing alongside a weaker US dollar provide a tailwind. If investors can exercise skill in country selection, we believe another year of strong returns is within sight.

**Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors might not get back the full amount invested.**

**Past performance does not predict future returns. If the currency in which the past performance is displayed differs from the currency of the country in which the investor resides, then the investor should be aware that due to the exchange rate fluctuations the performance shown may be higher or lower if converted into the investor's local currency.**

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