

EMERGING MARKETS DEBT – MONTHLY MARKET MUSINGS

It takes two (actually, three) to tango in the Gulf



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Key takeaways

- The Middle East conflict has triggered a broad-based selloff. Emerging market (EM) debt has seen meaningful risk rotation into oil exporters in hard currency and a sharper repricing in EM foreign exchange and local currency bonds, where inflation fears mixed with concerns over heavy positioning.
- In March, markets priced in inflation fears. Price action at the turn of the month points to rising concerns about global growth. The future depends on the length and scope of the conflict.
- Any escalation or stalemate, with energy flows still blocked, would likely cause prices to fall further – but this time EM starts from more solid fundamentals.

April 2026 – As April begins, markets are reviewing those early assessments of the Middle East conflict that judged it would last “a couple of weeks”. Now in the fifth week of hostilities, the JP Morgan EMBIGD Index for emerging market (EM) hard currency debt has returned -3.3% in March and -1.3% year-to-date (YTD). The JP Morgan GBI-EM GD Index, which tracks local currency debt, was down -5.6% in March and -2.3% YTD, while JP Morgan’s CEMBI BD Index, which tracks corporate bonds, held up better – down -1.8% in March and -0.2% YTD. With statements from the fighting parties providing conflicting views for the time being and new actors entering the fray (eg, Houthis, Iraqi Shia militias), many investors are reassessing their initial views on the conflict’s scope and length – and the repercussions for the global economy.

EM debt – resilient but not immune

So far, EM fixed income has been relatively resilient, albeit not immune from the global selloff. Most of the repricing in EM fixed income has been in foreign exchange (FX) and local

currency bonds. This has been driven by rising energy, agricultural and industrial input prices triggered by the blocking of traffic through the Strait of Hormuz. Concerns about an inflation spike and sizeable investors’ positions in EM local currency opportunities (FX and bonds) led to a sharper selloff in that part of the asset class. It should be noted that EM local currency assets had become the most favoured portion of the asset class, receiving significant inflows since the US tariff announcement, “Liberation Day”, on 2 April last year.

EM hard currency bonds showed some resilience, selling off a modest 30 basis points in March and showing some dispersion. The Middle East EMBIGD regional sub-index sold off the most at 70 basis points, followed by the Europe and Africa sub-indexes at around 50 basis points, with Latin America the top performer during the month. The last week of March also saw some high yield credits open a new issuance window, including Angola, telecoms business Helios Towers and South Africa’s Sasol.

Risk rotations versus risk reductions

With inflation fears dominating the market in March, investors' reaction has been twofold so far. In hard currency, there was a rotation away from oil importers and into oil exporters (the EM asset class is split about equally between the two). Latin America has been preferred to Asia, for example, and within regions, Colombia, Ecuador, Angola and Nigeria have benefited. In EM local currency bonds, however, the focus has been on risk reduction. EM currencies suffered as "safe haven" flows pushed up the value of the US dollar, and local currency bonds saw a pricing out of earlier monetary policy easing expectations. Currencies that tend to perform well when market sentiment is positive – such as the South African rand – but also those of Asian commodity importers such as Thailand, Philippines and India – have come under pressure. In EM local bonds, South Africa was a case in point, with a selloff of over 100 basis points in March, exacerbated by its status as a "consensus long".

But EM policymakers have shown maturity

EM policymakers have by and large reacted in a textbook fashion to the turmoil. Some have paused monetary policy easing – for example, Chile, Hungary, South Africa and Indonesia. In general, countries have allowed their currencies to depreciate while facilitating foreign investors' exits and intervening largely to avoid disorderly currency moves. In other words, policy reactions have been measured and orthodox, including in some of the frontier markets (FMs) that had yet to be tested after becoming investor favourites in recent months, eg, Egypt and Nigeria. This confirms that the EM debt asset class and its policy responses have matured over the years, as we have said [in previous publications](#). Overall, while the selloff in some EM local currency debt has been sharp, investors' heavy positioning going into the crisis is likely to have played a part.

The future depends on length and scope of the conflict

With fast-moving headlines and limited insight in the decision-making process of involved parties, it is challenging to draw up an exhaustive set of scenarios for the conflict. There are multiple actors involved in the fighting, which complicates efforts to end the hostilities. Broadly speaking, any escalation or stalemate in which

global energy or agriculture input flows remain severely curtailed would see inflation fears turn into serious concerns about global growth and demand destruction. Price action at the turn of the month suggests such concerns are becoming more widespread. In many EMs, the heavy reliance on energy imports is likely to translate into both wider current account deficits, due to higher costs, and a dampening of economic activity due to lack of supply, especially in some FMs. This is in addition to a significant inflationary impact owing to the high weights that energy, transport and food have in consumer price index (CPI) baskets. Fuel typically has a weight of between 2-12% and food a weight of around 35% in FM baskets (and around 20% in the baskets of larger EMs). If the conflict persists, a further repricing of EM debt would likely ensue, including of the EM hard currency component that has been more resilient so far.

The latter had entered the conflict at near all-time tight spreads. With elevated core rates and the potential for further spread widening, some lower-rated sovereigns could lose market access, although we are not necessarily concerned about a return to the post-Covid EM default period, even if a couple of fiscally challenged FMs, such as Senegal and Mozambique, were to come under more sustained pressure. Indeed, it is important to highlight that many EM economies entered this crisis with solid fundamentals and larger reserve buffers – albeit also with higher debt burdens. In other words, the economic fundamentals are stronger today than during the last major test to the asset class in 2022. Nevertheless, a conflict escalation could still signal a turning point in appetite for the asset class, at least in the near term.

A de-escalation would likely generate a positive market reaction instead, with the recent selloff – especially in EM local currency bonds – likely perceived as an opportunity to add to positions. The need to repair damaged energy infrastructure in the region implies that energy and agriculture input prices would take some time to normalise. However, healthy buffers and sensible policymaking should allow the EM debt asset class to return to a more constructive cycle. That would allow EM debt to continue to benefit from the demand for portfolio diversification that remains a goal of investors, as multiple industry surveys have highlighted in the last year.

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