

EMERGING MARKETS DEBT – MONTHLY MARKET MUSINGS

“Tax me if you can” – EMs dig deep



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Key takeaways

- Emerging markets (EMs) have continued to perform strongly, although EM foreign exchange had a wobble in July.
- Tariffs and taxes have dominated headlines in the US. This month, we focus on taxes, as these help EMs finance development in the context of budgetary pressures, aid cuts and ambitious goals.
- Lower income countries raise just under 13% of GDP in taxes versus over 35% on average in OECD economies. Some are making efforts to improve that. We look at recent attempts in Dominican Republic, Nigeria and Romania.

August 2025 – July’s headlines were dominated by tariffs and taxes. Much ink was spilled on the White House pushing back, to 1 August, a deadline for nations to reach a trade deal with the US. The debate in Congress of the “Big Beautiful Bill” also took up a lot of column space. The impact of the latter on the long-term fiscal path of the US – with tax cuts expected to enlarge the deficit – is a driver behind one of our core views: that the US Treasury curve will steepen. We maintain this view despite some curve flattening seen in late July.

A few emerging market (EM) local currency markets also had a wobble in July with volatility picking up in EM foreign exchange for the first time since April. But that seems to have given way to some position resizing rather than a reassessment of the EM local market investment thesis. The local currency index (JP Morgan’s GBI-EM GD) has returned over 11% in the year to end-July. EM hard currency returns have also risen further (JP Morgan’s EMBIGD index returned 6.5% in the same period).

So, with EM back on some asset allocators’ radar screens, and with EM local currency performing well, we are watching closely new trade developments following the announcements at the start of this month. While the US has made progress in reaching deals with larger trading partners, risks linger for some EMs, including for some of this year’s “favourite trades” eg, South Africa. More generally, any significant fallout on global trade, and on economic growth, could dent sentiment towards EM. Yet that would likely come hand in hand with US monetary policy easing and a weaker US dollar, which supports EM local currency assets at a time when EM central banks also have room for more rate cuts.

Meanwhile, we thought we would talk about the “other T” this month, taxes. They have been a hot topic around the world this summer – from the “Big Beautiful Bill” in the US to Brazil’s government sparring with its Congress, and from the UK Chancellor Rachel Reeve’s debacle in parliament to Nigeria’s tax reform.

Taxes are a tricky subject. In developed markets (DMs) and some more established EMs, the conversation tends to emphasise the concern that taxes may stifle investment and economic growth. It is less often mentioned that they alleviate budgetary pressures. However, in low and lower-middle-income (from here, “lower income”) countries, the debate is more mixed. And in frontier markets (FMs), the focus is on raising governments’ tax intake.

Facing an array of challenges, FMs have to dig deep – fiscal pressures persist, aid budgets are cut, and Sustainable Development Goals need financing. A figure often quoted is that lower income countries need USD 3 trillion of investment a year by 2030 (or 7% of their combined GDP). With interest rates staying “high for longer” across the world, debt servicing costs have risen, accounting for a growing portion of government spending. In this context, domestic revenue mobilisation is a critical tool for economic resilience. Yet on average, these countries raise just under 13% of GDP in taxes versus over 35% on average in OECD economies.¹

Recent research by the World Bank suggests there is a tax threshold of around 15% of GDP at which a country’s future inclusive growth significantly improves.² It suggests that lower income countries graduate to middle-income status at around the same threshold. But increasing tax revenues can be difficult and it is hard to estimate a country’s tax capacity. A 2023 study by the IMF claimed lower income countries could raise their tax-to-GDP ratio by 9 percentage points (pp).³ However, trends in tax-to-GDP ratios in the last two decades suggest this target may be optimistic. Beyond its fiscal function, tax capacity is associated with accelerated growth and better institutions. But improving tax capacity is challenging, especially in many FMs where the social contract between citizens and the state is under strain. Tax reforms can be socially sensitive and legal capacity may be wanting.

In the broader EM space, tax is likely to remain a topic of interest to governments and investors. UN data for the period 2010-2021 shows that progress in increasing tax-to-GDP ratios has been modest in Africa and Central and Eastern Europe and even lower in Latin America and Asia.

Among the improvers, Mozambique (+8.6pp), Uganda

(+5.1pp), Suriname (+4.2pp), Mexico (+3.8pp), and South Africa (+3.7pp) stood out. More recently, Dominican Republic, Nigeria and Romania are in focus.

Recent attempts at tax reform in EM

The **Dominican Republic’s** improvement in tax-to-GDP ratio in 2010-2021 was +2.1pp, leading to a ratio of 14.4% in 2021. Since then, it has had two false starts at tax reform. When President Luis Abinader won a second term in 2024, he made it a priority to gain an investment-grade credit rating and had a second go at tax reform (after trying once in his first term). He tried to increase public sector revenues to raise capital expenditures and broaden social security. While this proved unfruitful, the recent appointment of a new finance minister signals a commitment to a fiscal sustainability.

Nigeria’s tax-to-GDP ratio dropped 5.1pp between 2010 and 2021, although that was partly explained by a GDP rebase exercise. The recent review of the economy’s size, published in July, made the ratio look even worse (11% of GDP). The country has just approved important tax reforms, however. This includes a set of four laws aiming to improve collection methods, broaden the tax base and increase coordination across government entities. Tax collection will be centralised under the new Nigeria Revenue Service, which is empowered to help states with their intake. While estimates of their impact vary, they could add +2% of GDP in one to three years. Another case of political will pulling difficult change.

Romania is also an example – though the focus was more on raising taxes to be in line with peers. After President Nicușor Dan won elections in May, the country announced several fiscal packages aiming to reduce the deficit by 1.23% of GDP in 2025 and 3.75% GDP in 2026. Measures were wide-ranging, including increasing the standard rate of VAT to 21% (while harmonising reduced rates at 11%) and increasing excise taxes on alcohol, fuel, tobacco and sugary drinks to 10%. The country also raised dividend tax to 16% and increased bank turnover tax from 2% to 4%. These changes triggered a rally in Romanian assets.

We have long maintained that economic policymaking in EM countries is improving. As active investors we strive to find and invest in those that show demonstrable progress.

¹ ‘Getting Targets Right: How Much Revenue can Lower-Income Countries Raise?’, 2024, by M. Gallien, A. Lees & G. Mascagni, G., ICTD Policy Brief 6.

² ‘Taxing for Growth : Revisiting the 15 Percent Threshold’, 2024, by R. Choudhary, F. Ruch, & E. Skrok, World Bank Group.

³ ‘Building Tax Capacity in Developing Countries’, 2023, by JC. Benitez, M Monsour, & C. Vellutini, IMF.

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