

EMERGING MARKETS DEBT – MONTHLY MARKET MUSINGS

# Conflict in the Middle East

## – turning point or proof point?



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### Key takeaways

- As conflict broke out in the Middle East, March kicked off with a decisively different market backdrop for EM assets.
- EM assets have held up relatively well, but uncertainty persists, especially for EM local.
- The conflict's scope and duration will be key to determine whether this becomes a turning point for global risk sentiment or a proof point of EM resilience.

**March 2026** – As March begins, global markets are under pressure due to the hostilities in the Middle East (ME). This marks a sharp turn in sentiment after a very solid February, especially for emerging markets (EM). Last month, broader markets were tested by rising US/Israel–Iran tensions, dire projections on AI's impact on industries and jobs and the US Supreme Court's repeal of the International Emergency Economic Powers Act-based tariffs. But the US Dollar Index was largely unchanged, gold stabilised around USD 5,000 an ounce and EM performed solidly. The JP Morgan EMBIGD Index rose 1.4% and the JP Morgan GBI-EM GD Index 1.3%. As in 2025, frontier markets (FMs) again outperformed EM in both hard and local currency – and exceeded US high yield and US investment grade. Inflows into EM continued, with investor interest focused on local currency. Year-to-date inflows into EM local (USD 7.6bn) have outpaced hard currency (USD 4.7bn).

The Iran conflict could be a turning point for markets and EM. At the

moment uncertainty persists around its potential evolution. Different scenarios could play out – [note here](#) the most concerning of which is one where a wider – and protracted regional war sours global risk appetite and has a longer-lasting impact on oil prices, affecting global growth and inflation. The scope and duration of this conflict remain key, in our view. We focus on that in the second part of this note.

Markets have so far taken a milder early view of the conflict. While hostilities triggered some risk-off moves, EM hard currency has been resilient, whereas EM FX and EM local remain under pressure. This has come alongside a spike in oil and gas prices; a stronger US dollar and a sell off in US Treasury (UST) bonds. Investors have favoured gold over UST bonds as a safe haven, suggesting markets are more focused on the conflict's inflationary impact. Also notable is the performance dispersion across EM assets: ME countries such as Egypt, Saudi Arabia and Bahrain saw the sharpest dollar-bond declines, while many Asian and Eastern European

currencies weakened as these are energy-importing nations facing balance of payments strain. Energy makes up 3–14% of consumer price index (CPI) baskets across Asia, so higher oil prices have monetary policy implications. On the first trading day after bombing began, laggards included the Korean won, Hungarian forint, South African rand and Polish zloty – a mix of importers and heavily positioned markets – prompting central-bank interventions. Front-end rates in economies that are on a monetary policy easing cycle – including Hungary, Poland, Turkey and South Africa – have seen pressure and remain vulnerable to such rate cuts being priced out. On a regional basis, Latin America stands to be the relative winner as investors likely rotate into some of its oil exporters (eg, Mexico, Colombia, Ecuador). Finally, EM have performed relatively solidly in this sell-off, with Egypt being the hardest hit. Going forward, more caution appears warranted on the EM FX and local currency side as uncertainty persists and the dollar likely remains bid.

Importantly, we highlight the risk of the conflict turning broader and more protracted. The market appears to be discounting a more significant impact on global growth at the moment. But longer and more widespread regional hostilities could change that and in turn sour risk appetite for higher yielding asset classes like EM.

For now, the more contained reaction and asset repricing could also open opportunities on the hard-currency side for relative-value selection, currently favouring energy exporters. We continue to like “good quality carry” names. With EM having strengthened macro fundamentals, there are many strong options to choose from. But whether these events prove EM resilience or mark a shift to a different market backdrop will depend largely on the conflict’s scope and duration. Recent developments reinforce the view that most risks EM face this year are exogenous – from US foreign policy to the US Federal Reserve’s rate path, AI’s impact on equity markets, and concerns around private credit.

### **The ME conflict and its permutations**

While recent flashpoints in the ME have largely had limited market impact – eg, last year’s Israel–Iran twelve-day war – a sustained, broader conflict could change this. A protracted blockage of the Strait of

Hormuz, disrupting around 20% of the world’s daily oil and gas supply, would affect global trade, inflation and monetary policy. While regional oil production remains mostly unaffected, flows through the strait have been significantly hit. China, the largest buyer of Iranian oil, would likely bid for alternative sources. Liquefied natural gas production from Qatar has also been heavily affected. ME economies may face softer consumer activity, disrupted travel and weaker tourism, though their buffers remain relatively strong to absorb short-term revenue shocks. Gulf remittances into the broader region could also be impacted. Whether these disruptions prove short- or longer-term will be crucial.

Another issue to watch will be how Iran’s government setup evolves. While the country remains a small economy with limited trade links beyond oil, protracted instability could spill into neighbouring states. The experience of Iraq in the early 2000s comes to mind, as ethnic groups span borders. This is also relevant for Turkey – an energy importer with significant trade ties to Iran and already host to regional ethnic minorities and refugees – which has been favoured by EM investors, particularly in the long lira trade. However, Turkey’s central bank has been especially active in tightening liquidity and intervening with its over USD 200bn in FX reserves to contain volatility. Given the lira’s central role in the central bank’s disinflation strategy, the bank is likely to stand firmly behind the currency.

The ME represents 16% of the main JPM EM sovereign index. By including Egypt and Morocco, the weight rises to 19%. We have long preferred being underweight ME investment grade sovereigns (Saudi Arabia and UAE), partly due to market technicals, while favouring high yield credits such as Jordan and Egypt. On the local currency side, Egypt has attracted many investors over the past year, so positioning represents a vulnerability. On the corporate side, UAE real estate names suffered most on the first trading day after hostilities began. The sector has boomed thanks to the relocation of professionals to the region and Russian investment. It remains to be seen whether recent events will permanently affect its risk perception. Given the diversified nature of EM, there will be both winners and losers from this conflict, with its scope and duration key to determining whether this becomes a turning point for global risk sentiment or a proof point of EM resilience.

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**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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