

EMERGING MARKETS DEBT – MONTHLY MARKET MUSINGS

“Shop local” as inflows return to the asset class



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Key takeaways

- Another month, another outstanding performance for emerging market debt, particularly local currency. Has it got more to run? We think so.
- EM local currency bonds have evolved into a diversified asset class with a broad investor base. With investors shelving the “US exceptionalism” narrative, opportunities to diversify portfolios with EM local currency debt have become more appealing, bringing flows back into the asset class.
- Solid economic fundamentals, comfortable “real yield” cushions and proactive central bankers are likely to sustain the performance of EM local currency bonds.

June 2025 – As tensions flare up again in the Middle East, with Israel and Iran in conflict, we take stock of another impressive month of performance for emerging market (EM) debt, which has defied tariff, fiscal and geopolitical concerns. The reference hard currency sovereign debt index (JP Morgan’s EMBIGD) has returned over 4% year to date, the local currency equivalent (JP Morgan’s GBI-EM GD) has touched 10% and the corporate debt index (JP Morgan CEMBI BD) has delivered over 3%. These are far above US Treasuries, at around 2.5%, and most other fixed income asset classes.

How did EM pull it off once again? The size and diversity of the asset class allows active investors to take positions in those credits that are largely spared the brunt of new US tariffs – for example, in Latin America – or that remain relatively unscathed by turmoil in the Middle East. Despite some remaining concerns – including lingering uncertainty on what will happen after the 90-day pause in US

tariffs, the upcoming US tax and budget bills, and broader geopolitical risks – EM has shown tremendous resilience in the face of dramatic turns in global politics and policy this year.

In [last month’s edition](#), we highlighted a set of relative value opportunities in EM hard currency sovereign bonds – particularly some sovereign “reform stories” that have stayed the course against a rapidly changing market backdrop. This month, we focus on EM local currency debt.

Rather unexpectedly, EM local currency has been the outperformer this year. Roughly two-thirds of these impressive returns can be explained by foreign exchange moves. The other third can be explained by interest rates, as expectations that the US economy will underperform other major markets in 2025, and concerns about US policy credibility, have kept the US dollar under pressure. That has prompted investors to look for opportunities further afield.

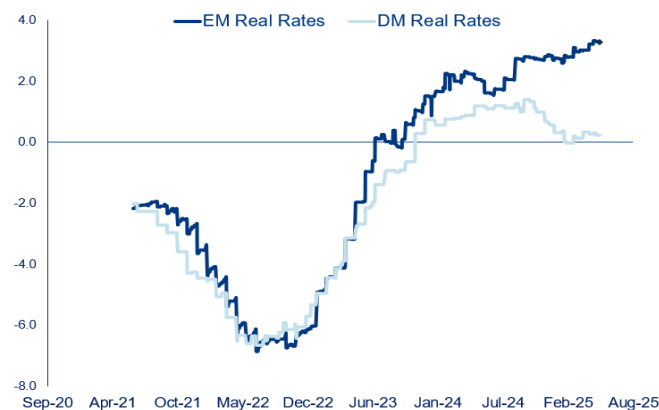
EM countries offer higher nominal yields than developed markets (DMs), particularly “high yielders”, such as Brazil (14%), Colombia (12%), South Africa (10.5%) and Mexico (9%). But “low yielders” also pack a punch, with the average yield to maturity of the JP Morgan GBI-EM GD Index at 6.1% on 16 June (fig. 1). Importantly, EM central banks can count on comfortable “real yield” cushions, reflecting prudent and proactive work on monetary policy in recent years. This is in sharp contrast to their DM counterparts (fig.2).

For the EM high yielders, the average real yield is in the 6-8% band. In addition, a combination of US dollar weakness, local inflation dynamics and the prospect of slower global growth has provided many EM central banks with room to ease policy rates – for example, Philippines, India, South Africa and Brazil. Solid economic fundamentals and successful “reform stories” have also helped make EM local opportunities attractive this year.

Fig. 1: JP Morgan GBI-EM DG Index average yield (%)



Fig. 2: Real rates differential between EMs and DMs (%)



The landscape of EM local currency opportunities has also evolved over the last 30 years, with the number of countries in the index growing from 11 in the early 2000s to 19. This has taken place alongside a redistribution in weights away from the high yielders to lower-yielding, lower-beta markets such as China and India.

Moreover, as we have discussed in previous editions, local institutional investors such as banks, pension funds and insurance companies have become large and sophisticated investors in their own markets, often anchoring their markets at times of global turbulence – when offshore investors have closed their positions. This has raised the importance of tracking local macro developments, thereby turning EM local currency debt into a more diversified source of alpha.

Attracted by such solid returns, and the about-turn in the “US exceptionalism” narrative that began the year, investors have reconsidered EM local currency opportunities, helping to drive a turnaround in net flows. Since mid-April (post-“Liberation Day”), EM local currency debt funds have seen a steady stream of inflows, totalling USD 1.3 billion (or around 2% of AUM). This has offset all outflows seen in the earlier part of the year (source: Standard Chartered).

There are still risks that could mar this picture. War between Israel and Iran and the potential for escalation, while not our base case, could cause some investors to take a pause. However, if earlier episodes of conflict between the two countries are any guidance, the market may be looking to fade risks from this war, barring a much more significant escalation. In addition, concerns around the medium to long-term fiscal stance in the US may encourage investors to further diversify their portfolios into the array of opportunities offered by EMs.

While EM local returns have been compelling across both foreign exchange (FX) and local currency bonds, we still believe there is more to be gained by exposure to some of the best stories – such as Brazil and South Africa on the local bond side or FX opportunities such as the Egyptian pound or the Turkish lira. Frontier market local opportunities, such as Nigeria, are also coming back onto investors’ radar after the de-risking witnessed around April’s “Liberation Day” tariff announcement.

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