

EMERGING MARKETS DEBT – MONTHLY MARKET MUSINGS

“I get by with a little help from my friends” – EM & the US dollar



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Key takeaways

- Emerging markets (EMs) have continued to perform strongly despite a backdrop of large primary issuance and renewed geopolitical risks. We affirm our conviction in EM local currency.
- We look at the role of the US dollar in EM debt. Despite a recent pullback, we expect further weakening in the dollar, which would support EM local currency investments.
- Data from central banks' reserve allocations points to a long-term diversification away from US assets. But for the moment there is no sign that the policy changes introduced by the Trump administration have accelerated this trend.

October 2025 – Emerging market (EM) fixed income has performed strongly over the past month. Year to date, the hard currency sovereign debt index has returned 11.7%. Recent weeks have also seen a surge in EM sovereign issuance – USD 43.5 billion in September, more than any other month this year and nearly triple what was issued in the same month in 2024. EM sovereigns have issued around USD 200 billion in total this year.

Investment-grade issuers such as Indonesia and Mexico account for about 80% of issuance. Frontier markets such as Angola and Kenya have re-entered the market too. Issuers have focused on the belly and front end of the curve to avoid locking in high borrowing costs at the very long end, amid rising developed market (DM) yields.

After witnessing its biggest fall since 1973 – down nearly 10% against a basket of major currencies in the first nine months of the year – the US dollar has regained some strength. This led to some mixed EM foreign exchange (FX) performance. Risk

sentiment has been tempered by the US government shutdown, renewed US-China trade tensions, and challenges among US regional banks, alongside bankruptcies such as First Brands and Tricolor. Yet these longer-term, DM-centred macro risks may also support debasement trades and investment flow diversification into digital assets and international markets. That could favour EM assets, especially as financial conditions remain easy. In this environment, we believe the EM local currency investment thesis holds – and note that the EM local currency index has returned 16.1% year to date.

The outlook strengthens our conviction to stay neutral on spread exposure given tight valuations. Our strongest conviction remains in EM rates. We still believe prospects for EM FX remain more appealing than for their DM counterparts and we still expect a weaker US dollar in the long term due to fiscal issues, lower rates and policy dynamics. This month, we look at the US dollar as a reminder of its importance to EM investing.

From MAGA to MEGA

One consequence of President Donald Trump's bid to "Make America Great Again" was this year's rally in EM assets, which helped to "Make EM Great Again" after a few lacklustre years. It also prompted many investors to consider diversifying portfolios beyond US assets. While the latter have since recovered from the broad-based sell-off that followed "Liberation Day" on 2 April, the US dollar has remained on the back foot, especially versus EM currencies; few depreciated against it this year. Stronger EM currencies support EM policymakers in their inflation fight by providing them with the chance to ease policy with fewer financial stability concerns. This in turn contributed to strong EM equity market performance.

Diversification and debasement

Debates over diversifying investment flows away from the US, on dollar hedging and on debasement trades, have multiplied since "Liberation Day". EM fund flows have picked up a turnaround in appetite for EM opportunities. Gold prices are at all-time highs and investment in cryptocurrencies has soared. In this environment, it feels significant that central banks appear to be diversifying their holdings away from the US dollar. Between the first and second quarters, the dollar's share in central bank reserves sank to 56.3% – a 1.5-point fall – according to IMF data. But has reallocation really occurred?

The IMF's Currency Composition of Official Foreign Exchange Reserves (COFER) data, tracking 149 central banks' currency reserves, show this drop is nearly fully explained (92%) by exchange rate movements.¹ Since reserves are reported in US dollars, exchange rate shifts can affect reported shares even without actual changes to central bank holdings. The numbers can be misleading. For example, the apparent decline of the dollar mirrors a 1.13-point rise in the euro's share, yet in this case, valuation effects explain 1.17 points of the adjustment – more than the move itself. If the exchange rate were held constant, the euro's share in portfolios would have gone down. Similar effects are seen in other major currencies.

These findings dispel the notion of a sudden acceleration of dedollarisation by central banks. However, the trend for these actors to diversify their holdings away from the US is

occurring, albeit gradually, as COFER data for the last two decades confirms. Central banks have been shifting slowly away from the US dollar and into "non-traditional reserve currencies", including the Australian dollar, Canadian dollar, Chinese renminbi, etc. Roughly one quarter of the US dollar decline has favoured the Chinese renminbi, although this trend has slowed since 2022.

Gold is another large recipient of reallocation flows amid rising policy uncertainty and geopolitical risk – a centrepiece of the debasement trade. The Official Monetary and Financial Institutions Forum says that one third of the 75 central banks it surveyed will increase gold holdings in the next one to two years.

Extending some (USD) help to Argentina

One of few EM currencies to depreciate against the US dollar this year is the Argentine peso. All Argentine assets have seen significant volatility, particularly since elections in the province of Buenos Aires in September called into question President Javier Milei's economic plan. With a friendly administration in the White House, US dollars came to the rescue. US Treasury Secretary Scott Bessent extended a USD 20 billion US Treasury swap line and allowed direct peso purchases in "blue chip" swap and spot markets – an unprecedented show of support for a sovereign with a history of debt defaults like Argentina.

Volatility in Argentine assets persisted after President Trump stated that US aid to the country may be conditional on Mr Milei's party winning midterm elections, which will take place on 26 October. As markets monitor the strength of US commitment, and the upcoming elections, Argentines will decide whether to continue supporting Mr Milei's reform agenda. His policies have led to sharp fiscal cuts, reducing the deficit and lowering inflation, but this has brought hardship for many.

We have [previously discussed](#) how EMs have made strides in recent years by strengthening their policy frameworks, improving economic fundamentals, deepening their local debt markets and enhancing communication with investors. It cannot be denied, however, that this year's US dollar moves have been a key factor in strengthening the case for the asset class and are likely to continue to do so.

¹"Dollar's Share of Reserves Held Steady in Second Quarter When Adjusted for FX Moves", October 2025, by Kwende, Nephew, Sanchez-Munoz, IMF

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