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Invesco Fixed Income

Emerging Market Debt 2026 Investment Outlook

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Overview

- Emerging market (EM) central banks eased monetary policy in 2025, driven by disinflation and uneven growth. There is room for further rate cuts in 2026.
- We believe this interest rate backdrop, plus strong fundamentals and credible policy frameworks, positions EM debt as an attractive investment opportunity in 2026.
- Geopolitical and policy risks may introduce volatility, but long-term drivers—like favorable growth differentials and high nominal yields—remain intact.
- The Central and Eastern Europe, Middle East and Africa (CEEMEA) region offers potential high-yield opportunities in sovereign and corporate credit. Asia benefits from AI-driven trade cycles with selective local currency plays. And Latin America combines resilient domestic demand with easing cycles and attractive spreads—though valuations necessitate careful credit selection.

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Macro developments

EM central banks

In 2025, EM central banks faced a complex landscape of disinflation and uneven economic growth. Throughout the year, many EM central banks pursued monetary easing amid subdued inflation, a generally favorable global environment and concerns over domestic growth.

Figure 1: CEEMEA, Asia and Latin America central banks lowered interest rates, while others adopted a more cautious stance

	Monetary policy rate (%)					
	12/24	3/25	6/25	9/25	12/25	YTD change (ppt)
CEEMEA						
Turkey	47.50	42.50	46.00	40.50	38.00	-9.5
Egypt	27.25	27.25	24.00	22.00	21.00	-6.3
South Africa	7.75	7.50	7.25	7.00	6.75	-1.0
Poland	5.75	5.75	5.25	4.75	4.00	-1.8
Czech Republic	4.00	3.75	3.50	3.50	3.50	-0.5
Hungary	6.50	6.50	6.50	6.50	6.50	0.0
Asia						
Indonesia	6.00	5.75	5.50	4.75	4.75	-1.3
Thailand	2.25	2.00	1.75	1.50	1.50	-0.8
India	6.50	6.25	5.50	5.50	5.25	-1.3
Philippines	5.75	5.75	5.25	5.00	4.75	-1.0
Korea	3.00	2.75	2.50	2.50	2.50	-0.5
Malaysia	3.00	3.00	3.00	2.75	2.75	-0.3
Latin America						
Chile	5.00	5.00	5.00	4.75	4.50	-0.5
Colombia	9.50	9.50	9.25	9.25	9.25	-0.3
Mexico	10.00	9.00	8.00	7.50	7.00	-3.0
Peru	5.00	7.75	4.50	4.25	4.25	-0.8
Brazil	12.25	14.25	15.00	15.00	15.00	2.8

Source: Bloomberg Finance L.P. Data as of Dec. 18, 2025. CEEMEA is Central and Eastern Europe Middle East Africa.

EM central banks have increasingly taken the lead in shaping domestic policy cycles, prioritizing internal domestic economic conditions while remaining mindful of external factors. Since the late 1990s, EMs have made considerable progress in strengthening their monetary policy frameworks. This improvement was evident in response to the COVID-19 pandemic, when EM central banks promptly raised interest rates to curb inflation using conventional measures, like inflation targeting and flexible exchange rates. This proactive approach enabled most regions to transition from aggressive tightening to growth support earlier than many developed markets. Nevertheless, differences in the pace and scale of policy adjustments have continued.

In CEEMEA, Turkey led the way in 2025 with aggressive rate cuts, reducing its policy rate to below 40% after a series of measures designed to stabilize the economy, following a previous period of tightening. South Africa, Poland, and the Czech Republic eased throughout the year, trimming rates as inflation normalized. Hungary stood out by keeping its policy rate unchanged. Egypt made significant rate cuts early in the year before pausing to assess ongoing price pressures. It resumed easing in October, on the back of high real rates and constructive collaboration with the International Monetary Fund (IMF), as it transitions to an inflation-targeting framework.

In Asia, Malaysia and South Korea followed a similar pattern to Egypt, initiating preemptive rate cuts before adopting a cautious pause. Indonesia and Thailand eased more aggressively, while the Philippines and India opted for a more gradual approach to rate reductions. In Latin America, Mexico, Colombia and Peru eased cautiously throughout the year. Argentina and Chile largely kept rates steady as they navigated distinct economic and policy reforms. Brazil was an outlier, maintaining a hawkish stance by holding the Selic rate at 15% to anchor inflation expectations.

US market pulse

The US economy enters 2026 with a gradual buildup in momentum after a year of slower hiring and tariff-related headwinds. Policy uncertainty under the new administration, while still significant, has peaked, tail risks have been avoided, and companies are adapting to the new trade and regulatory environment. Fiscal stimulus is filtering through, the US Federal Reserve (Fed) has delivered risk-management cuts, bringing the policy rate closer to neutral, and financial conditions have eased, while AI-related investment continues to support growth. Although the much-hyped "AI productivity miracle" likely remains a longer-term story, capital deepening is underway, helping productivity stay above its 2010s trend. Overall, we expect real GDP growth to remain above 2%, with hiring improving in 2026.

Inflation remains sticky, hovering slightly above 3% as tariff pass-through continues. While this is not a reacceleration narrative, a "three-handle" on inflation is likely to keep the Fed cautious. With growth above trend, there is little macroeconomic justification for aggressive easing. However, new Fed leadership and potential changes in the Federal Open Market Committee point to a more accommodative stance, adding uncertainty to the Fed's policy reaction function. Our base case assumes two rate cuts in mid-2026 under new leadership, though dissenting votes and policy volatility are likely. The Fed's challenge will likely be balancing inflation discomfort against a backdrop of improving growth and tightening labor markets.

Our outlook for 2026 is one of gradual normalization rather than dramatic shifts. Growth should strengthen as policy clarity improves and investment flows continue, while inflation will likely be sticky in the first half. We expect inflation to ease in the second half but stay above target. For EM investors, the US backdrop suggests a supportive environment for risk assets, in our view, provided Fed easing is measured, and inflation expectations stay anchored.

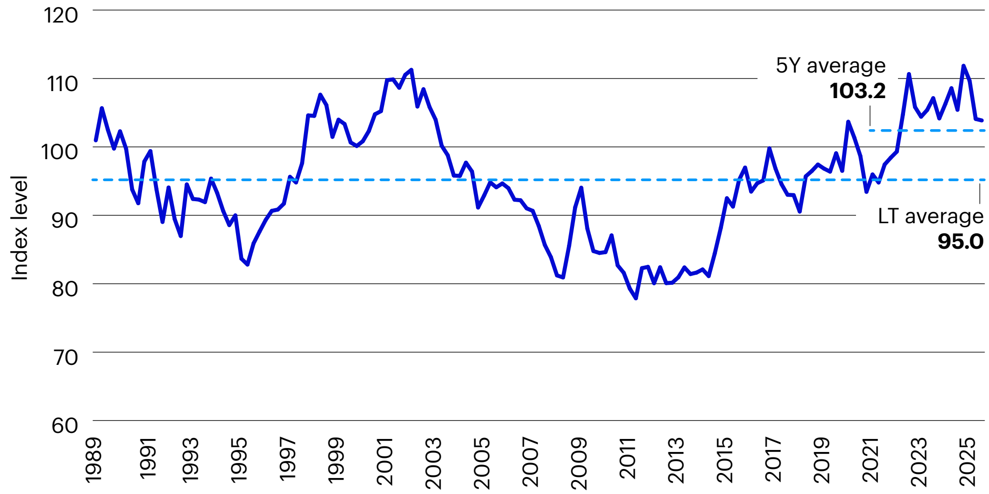
US dollar trajectory

The US dollar weakened almost nine percent in 2025 after years of strength, creating a favorable environment for EMs (Figure 2). Capital flows to the asset class, which have been negative for years, may be poised to return, as investors seek higher yields and improved diversification. Local currency EM debt returns and flows are highly correlated with US dollar movements. We believe this asset class stands to benefit from this trend, potentially offering attractive returns amid improving fundamentals.

The dollar's recent decline follows three years of dominance fueled by aggressive Fed rate hikes, resilient US growth, and massive portfolio inflows to the US. However, concerns over stretched US equity valuations, changing and unpredictable trade policy, and competitive pressures from global technology players have raised questions about "US exceptionalism". While we believe this shift marks a correction from extreme dollar strength rather than a structural collapse, it still opens the door for EM assets to outperform, in our view.

EM economies are entering this cycle from a position of strength, with record-high average credit ratings, credible monetary policies and robust growth differentials versus developed markets. Institutional improvements and orthodox responses to past inflation shocks have left EMs well-positioned to cut rates and stimulate growth. Combined with expanding market capacity and a historical sensitivity to dollar weakness, we believe these factors make EM a compelling opportunity for global investors in the year ahead.

Figure 2: US dollar at inflection point, with potential for further decline



Source: Citi Broad Real Effective Exchange Rate Index – USD. Data from March 31, 1989 to July 7, 2025.

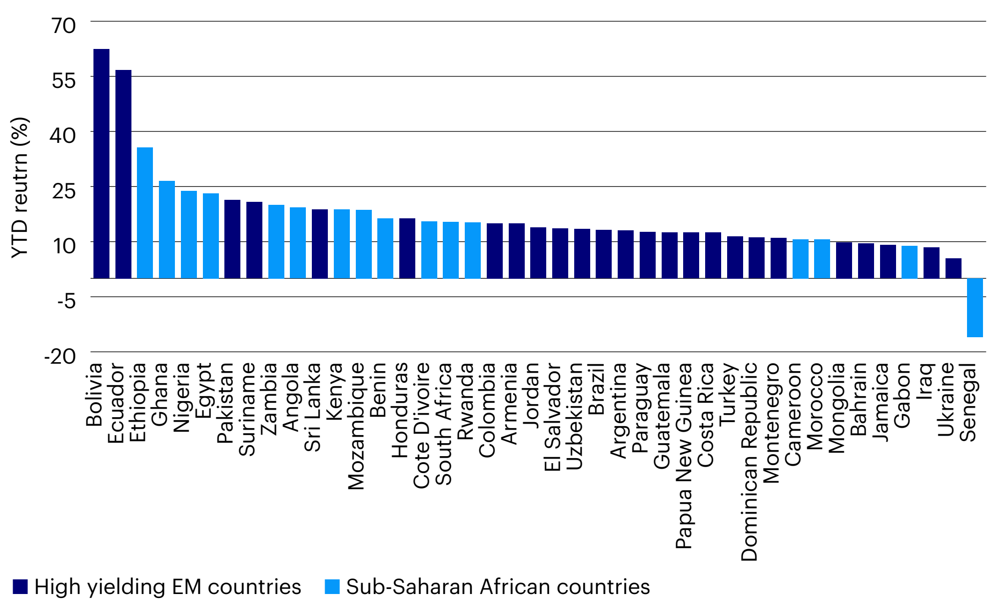
EM regional outlooks

CEEMEA

Hard currency sovereign and quasi-sovereign credit

After a strong showing in 2025 (Figure 3), Sub-Saharan African (SSA) countries continue to be one of the yieldier parts of the hard currency market – although they face diverse conditions. Ghana, Nigeria, Zambia and Gabon have emerged from serious crises (political or economic) in the last few years and remain committed to reform, whereas Senegal and Kenya took the more precarious path of grappling with political and fiscal issues on their own. Meanwhile South Africa, Egypt, Cote d'Ivoire and Morocco are large and more diversified economies that offer decent yield, in our view. In the Middle East and North Africa region, the ebbing of the war in Gaza and confrontation with Iran, coupled with the normalization of Syria, should be a broad regional positive and a catalyst for the restructuring of Lebanese external debt.

Figure 3: EM high yield external debt YTD total returns



Source: J.P. Morgan. Bloomberg L.P. Individual country high yield external debt YTD total returns. Data as of Nov. 17, 2025.

Corporate credit

CEEMEA corporate credit enjoyed a favorable environment in 2025, supported by a strong sovereign backdrop and a wave of credit upgrades. The region enjoyed a constructive macro outlook with stable or improving fundamentals in key markets such as Turkey, Ukraine, and Uzbekistan. Investors favored high yield risk over investment grade, with Ukrainian credits added to overweight lists, despite ongoing conflict-related challenges. The Middle East and Africa presented mixed opportunities, with limited value in the Gulf Cooperation Council states, due to tight spreads but selective opportunities in Israel and among certain African Multilateral Development Banks. Turkish corporates showed resilience. We maintained constructive views on the cement and electricity distribution sectors, though risks remain in export-oriented and highly leveraged names.

For 2026, we expect CEEMEA corporate credit to benefit from continued macro stability and selective credit improvements. The sovereign environment remains supportive, underpinning high yield corporates. We expect rate cuts in Turkey and Nigeria to support local currency credits, while political and fiscal risks require ongoing monitoring. The oil price outlook remains soft, suggesting caution in high beta energy credits. We prefer lower beta names with strong cash flow profiles. In Turkey, we favor domestically oriented credits with inflation-linked revenues and strong liquidity. African credits, particularly in utilities and infrastructure, offer carry opportunities, in our view, amid improving fundamentals. Overall, we believe the region's corporate credit market is positioned for stable to modestly positive performance, given careful credit selection and risk differentiation.

Local currency

South Africa

In 2025, South Africa emerged as one of the key local currency plays. A stable macroeconomic backdrop featuring steady annual headline and core inflation at 3.0%-4.0% and a gradual recovery toward 1.0%-1.5% growth has added to a more evident reform push. On the monetary policy front, the South African Reserve Bank (SARB) lowered its inflation target from 4.5% to 3.0%, a move confirmed by the National Treasury. Meanwhile, stronger-than expected fiscal revenues, combined with a continued commitment to fiscal discipline and smaller gross borrowing needs, enabled the Treasury to reduce bond issuance forecasts for the upcoming fiscal year. Together, these factors allowed South African government bonds to outperform other EM local currency yield curves in 2025, and we expect this supportive policy environment to persist.

Hungary

Hungarian local markets delivered strong returns in 2025, primarily driven by foreign exchange gains and carry. Looking ahead to 2026, we expect this performance to continue, as Hungary paused its easing cycle in 2025, but has the potential to resume it later in 2026. The central bank is expected to maintain high real yields through the first half of 2026, making unhedged positions attractive for generating strong carry returns, in our view, while helping to reduce the inflation risk premium. Additionally, opportunities in long-end rates may arise following the parliamentary elections, where the incumbent Fidesz party faces a credible challenge for the first time in a decade. Beyond politics, Hungary's macroeconomic backdrop remains supportive of resuming the easing cycle in 2026.

Czech Republic

Among the higher-grade local markets in the CEE4 (Czech Republic, Hungary, Poland, and Romania), the Czech Republic stands out as offering good value, in our view. The market has been pricing in late-cycle easing by anticipating rate hikes that are unlikely to materialize. We believe a rate cut is more probable, given low inflation outcomes and already elevated real rates. We expect the central bank to move cautiously, and the currency to continue its gradual appreciation.

Romania

We believe Romania presents a compelling case, combining ongoing fiscal reforms with the potential for the start of an easing cycle amid weak growth and economic rebalancing in 2026. While leadership transitions and further fiscal reform initiatives are unlikely to take center stage until

2027, next year will likely focus on delivering the two-and-a-half to three percentage points of fiscal tightening outlined in the new government's consolidation program. We expect the flow of European Union structural funds to support investment growth, offsetting the likely weakness in private consumption and helping the government to walk the thin line between fiscal consolidation and guiding the economy to a softer landing. Policy implementation is being driven by a strong and credible prime minister, whose party recently gained momentum following the PNL's (National Liberal Party) mayoral victory in Bucharest.

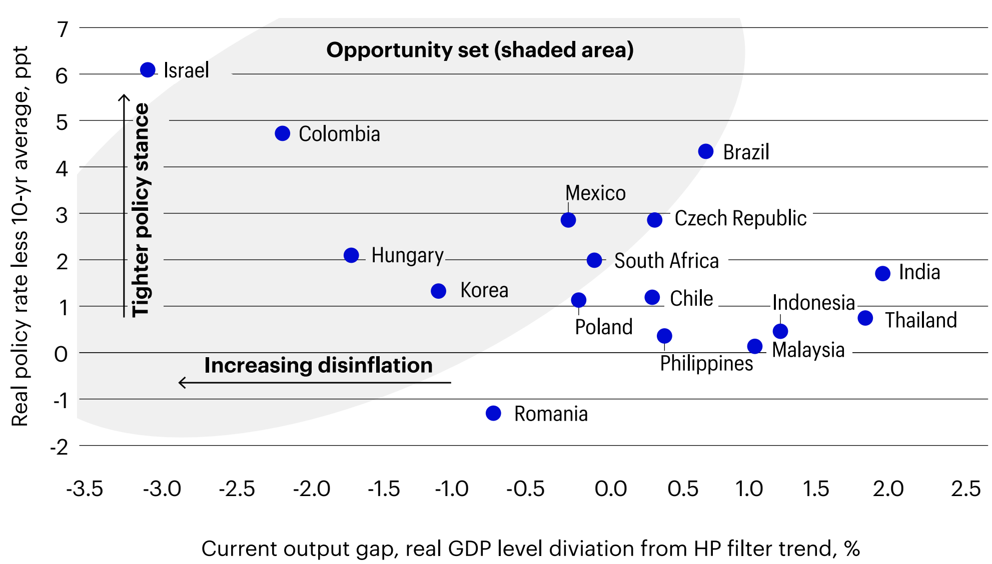
Frontier

Frontier high-yield currency carry has been, and we believe will continue to be, a significant contributor to EM performance in 2026, offering high yields with lower correlation to global macro trends. Turkey and Egypt were key market focuses in 2025, and we expect continued opportunities in these markets in early 2026. Turkey's disinflation program remains underway, while Egypt has benefited from sustainable macroeconomic rebalancing and a positive funding outlook.

Sub-Saharan Africa

Beyond Turkey and Egypt, Sub-Saharan African countries attracted increased attention in the latter half of 2025. Ghana, Nigeria, and Zambia all saw interest, as rate-cutting cycles began. We expect this trend to continue into 2026 for Nigeria, though less so for Zambia. Ghana, however, appears relatively expensive, in our view, given a slowing rate-cutting cycle and concerns over currency dynamics over the next six months. Additionally, pockets of carry opportunities are emerging in the Near East region of the former Soviet republics. Kazakhstan's authorities, for example, are working to strengthen the macroeconomic framework to combat rising inflation. The central bank has been hiking policy rates and may continue to do so, with the currency likely playing a more prominent role as an anchor in the disinflation program.

Figure 4: Local debt opportunity set based on policy stance and inflation path



Source: Invesco and Bloomberg L.P. Data as of Dec. 4, 2025. The HP (Hodrick-Prescott) filter trend shows the long-term movement in a time series (such as GDP) by separating it from short-term cyclical fluctuations. It works by minimizing the variation in the trend, controlled by a smoothing parameter to reveal underlying economic patterns.

Asia

Local currency

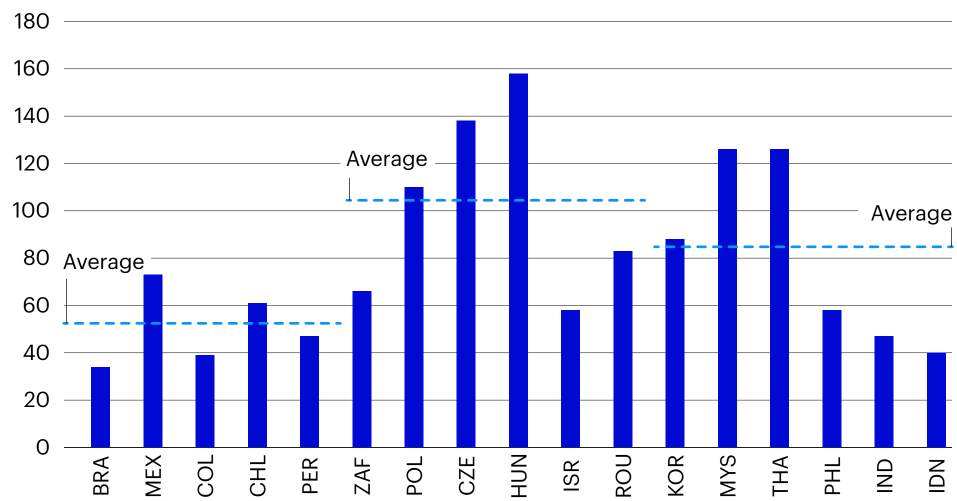
The Asia ex-China business and trade cycle is likely to continue expanding on the back of the AI investment boom, with Taiwan and Korea at its center. Given the connectivity of supply chains in the manufacturing of electronics components and equipment, we see a positive spillover to southeast Asia, as the global push for data center build-out continues. Among the region's high yielding markets, we see the most value in India's long-end bonds and exposure to the Indian rupee. We expect the current positive mix of strong growth momentum and low inflation to continue, despite ongoing tariff uncertainty. We expect the fiscal consolidation seen over the past several years to be preserved, while the broader reform agenda is being relaunched, aimed at liberalization, simplification and the overall improvement of the business environment.

We see fewer opportunities elsewhere in the region. We do not expect China to allow its currency to strengthen more than it has since April this year – roughly 4%.[1] Asian markets will likely maintain their low beta to the US dollar, with low yields on offer. Therefore, we prefer the Malaysian and Thai currencies since their central banks exercise limited interventions in their currency markets. In rates, we remain positive on Philippine duration, given the country's slowing business cycle, caused primarily by domestic political gridlock.

Latin America

Two important dynamics have anchored Latin America's fundamentals. First, the region has faced a limited impact from the shift in US tariff policy. Because most of Latin America - with the exception of Mexico - is not attached to a specific global supply chain like the Central and Eastern European countries are to Germany and the Southeast Asian countries are to China, it is more adaptable. Latin American countries also have a lower degree of trade openness when compared with other regions, containing risks in a world of rising trade uncertainty.

Figure 5: Trade openness indicator— Latin America's regional average stands below CEEMEA and Asian counterparts



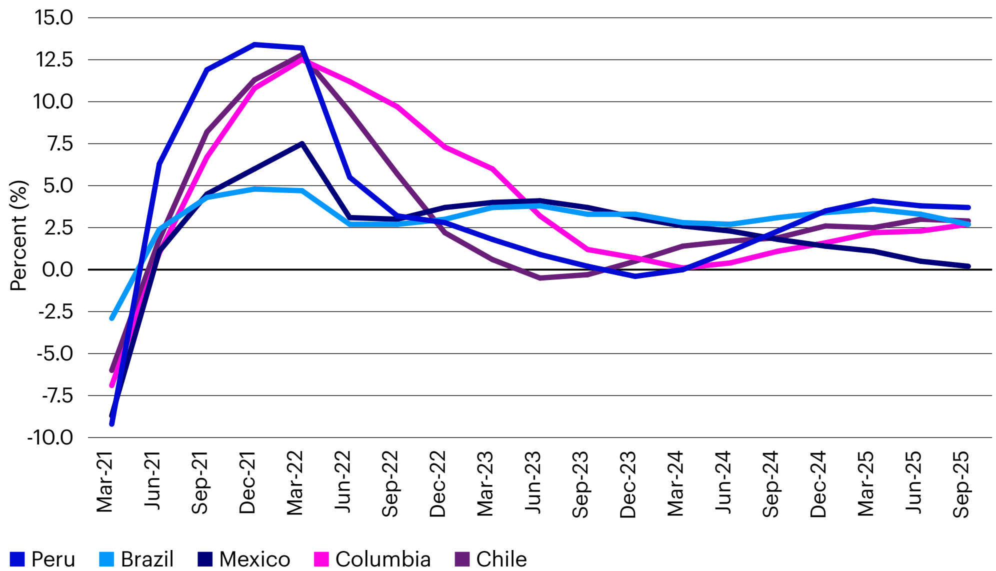
Source: UNCTAD. Data as of Dec. 31, 2024.

Second, with the exception of Mexico, domestic demand growth has been resilient, especially in Peru and Colombia. Brazil and Chile have shown signs of growth deceleration, but we do not expect significant deviation from potential growth - we expect small negative output gaps that would allow easing cycles to begin or be continued.

1. Source: Bloomberg L.P. April. 1, 2025 Dec. 1, 2025.

Figure 6: Except for Mexico, GDP growth has been strong across the region

Year-over-year growth



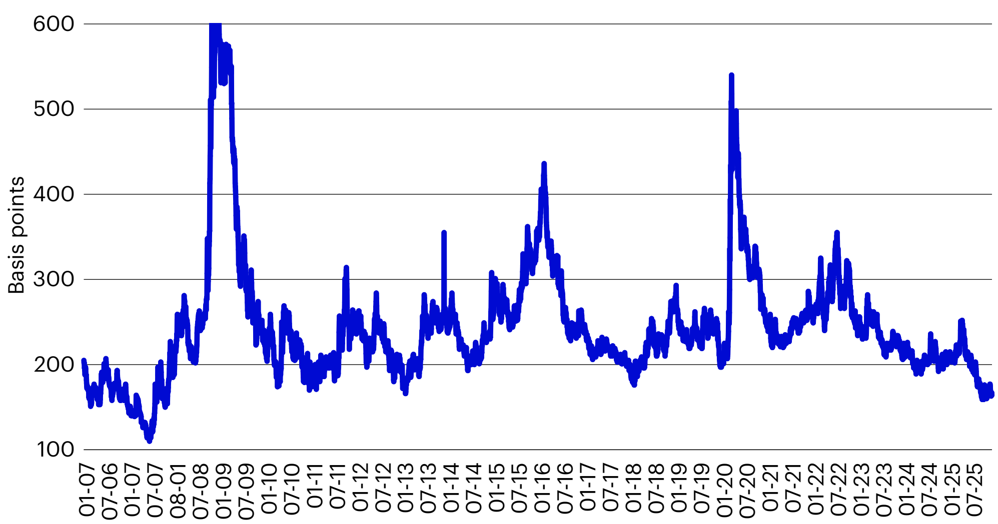
Source: Invesco, National Statistical offices (IBGE, INEI, INE, DANE, INEGI). Data as of Sept. 30, 2025.

Hard currency sovereign and quasi-sovereign credit

Latin American sovereign credit posted solid performance in 2025. By early December, the J.P. Morgan EMBIG diversified Latin America Index had tightened significantly, outperforming most other regions except Africa. Even accounting for idiosyncratic situations, including rallies in Venezuela, Argentina, and Bolivia and excluding lower rated credits, Latin America still showed more improvement compared to Asia, the Middle East and CEE.

Figure 7: Average sovereign credit spreads at historical lows

Simple-weighted average of Latin America sovereigns, excluding single Bs and CCCs



Source: Invesco and Bloomberg L.P. Data as of Dec. 11, 2025.

From a historical standpoint, current spreads are near the tightest levels seen in the past two decades. Subject to global credit stability, we believe Latin American sovereigns can continue to perform well in 2026. The region boasts more BB rated names than Asia and CEEMEA, which generally provide attractive spreads without excessive default risk. However, given current tighter valuations, we believe containing credit risk is essential.

Country views

Ecuador and Argentina continue to be among our most constructive sovereign views. Ecuador has exhibited strong GDP growth recovery and balance of payments improvement, with the export complex broadening beyond oil and gas. The Noboa administration has taken resolute steps in favor of IMF-proposed measures, which are intended to boost the policy mix, and Noboa maintains the political capital to push for such reforms. We expect Ecuador's market access to resume in 2026, which should act as a positive market catalyst.

In Argentina, investors are monitoring the sharp economic regime change, which is enabling structural reform and higher growth. The Milei administration's economic policy is supported by the international community, especially the IMF and the US Treasury. With the Milei administration's mandate confirmed at the November mid-term elections, the next steps will likely be to transition away from capital controls and accumulate foreign reserves, and to secure access to international markets and investment flows under the self-imposed fiscal anchor that has righted the inflation trajectory. We are constructive on the government's steps to advance its ambitious agenda, which has also paved the way for positive corporate developments, especially in the oil sector.

Panama remains in a precarious situation from a ratings standpoint, with a high likelihood of losing the second of three investment grade ratings, unless it makes considerable efforts toward fiscal reform in a worsening political environment. In the distressed space, there is hope that Venezuela - the region's large and long-running default story - could see a lasting resolution following the recent US military intervention and leadership change.

Corporate credit

Latin America's corporate credit market faced challenges in 2025, marked by several notable credit events, particularly in the high yield segment, and lagged other EM regions in performance. Key issuer defaults and distressed debt exchanges weighed on performance, especially in Brazil. Despite these headwinds, the region's overall credit fundamentals remained stable, supported by a constructive US macro backdrop, easing trade tensions, and supportive commodity prices, especially copper. The region's corporate issuance was robust, with a significant increase over 2024, driven by refinancing and some merger and acquisition activity, led by Brazil, Mexico, and Chile.

Looking ahead, we expect Latin American corporates to deliver more moderate but still positive performance in 2026, outperforming the broader EM universe. The outlook benefits from reduced macro uncertainties, including a likely renewal of the United States-Mexico-Canada Agreement, expected rate cuts in most countries and a busy but generally constructive election calendar in key countries, such as Colombia and Peru. We expect credit fundamentals to remain stable, with idiosyncratic opportunities in the oil and gas, utilities, technology, media and telecom, and mining sectors. Challenges remain in the chemicals, Brazilian steel, and sugar and ethanol sectors, but these are balanced by resilience in Brazilian proteins, cement, and select financials. Technicals remain supportive, as net financing is expected to be negative for the ninth consecutive year, and we expect improved inflows into EM.

Local currency

The Latin America local currency complex can be divided into two groups. The first includes countries whose central banks are advanced in their easing cycles, including Chile, Peru, Mexico and Uruguay. In many of these countries, we believe monetary policy terminal rates are priced above neutral estimates, and a benign inflation backdrop should allow convergence. In addition, currency performance should benefit from terms of trade gains and potentially positive political tailwinds, especially in Chile and Peru, allowing duration to perform well.

The second group includes the higher yielding countries, which are far behind in easing monetary policy, including Brazil and Colombia. The central bank of Brazil currently maintains a policy rate of 15%, which represents a 10.8% real rate on an ex-ante basis (i.e., after subtracting inflation expectations), suggesting substantial policy tightness when compared to an estimated neutral rate of around 5%. Recent inflation readings have shown a gradual decline in headline and core inflation, while growth has also decelerated. The start of an easing cycle would likely open an opportunity in the fixed income space.

In contrast, the central bank of Colombia has followed a cautious approach in the past few months, having paused its previous easing cycle, and recently changing its forward guidance, opening the possibility of hikes. Markets have reacted by pricing in a fair number of hikes. We expect the central bank to maintain a hawkish stance, but the exact path for monetary policy will likely depend on multiple factors, including the extent of deterioration in inflation expectations, the strength of the domestic economy and the influence of the incumbent government's income policy. As this process unfolds, we expect interest rate volatility to present positive return opportunities.

Figure 8: Latin America nominal and real ex-ante policy rates are still above neutral estimates

	Brazil	Mexico	Colombia	Chile	Peru
Nominal policy rate	15.0%	7.3%	9.3%	4.5%	4.3%
Conensus CPI 2026 (Bloomberg)	4.2%	3.7%	4.2%	3.2%	2.1%
Real ex-ante policy rate (Nominal policy rate - Consensus CPI 2026)	10.8%	3.6%	5.1%	1.3%	2.2%
Neutral rate estimate	5.0%	1.8-3.6%	2.75-3.0%	1.3%	2.0%

Source: Invesco and Bloomberg L.P. Data as of Dec. 17, 2025.

Conclusion

We expect the broad global easing cycle to continue into 2026, though with notable divergence across regions. Inflation has been effectively managed with orthodox monetary policy, reducing inflationary pressures and reflecting significant improvements in institutional credibility. This macro backdrop has created room for most EM central banks to lower interest rates from elevated levels, enhancing the appeal of local bonds. Meanwhile, prudent fiscal policies have encouraged investors to recognize the diversification benefits of EM, especially amid growing fiscal concerns and heavy bond issuance in developed markets. Additionally, we expect EM growth to outpace developed country growth, reinforcing a strong fundamental case for investment.

From a valuation perspective, EM yields remain attractive, in our view, with further potential for capital appreciation as central banks continue to ease monetary policy. Coupled with expectations of a weaker US dollar, inflows into the asset class have grown, creating a positive technical backdrop. Given the relatively modest global investor exposure to EM assets, especially local bonds, we expect these positive flows to continue.

While global uncertainties, such as evolving US trade policies, ongoing geopolitical tensions and regional conflicts, may introduce periods of volatility, we believe the medium to long-term drivers of positive EM performance remain intact. These include a softening US dollar, favorable growth differentials relative to developed markets and high nominal yields. We also expect idiosyncratic factors like fiscal policy decisions and election cycles to continue to shape performance across individual countries, serving as key sources of differentiation.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

Important information