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## **Macroeconomic conditions create favourable outlook for Emerging Market Debt**

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**LONDON, 21 July 2025**

### **Six market conditions for an attractive entry point**

***By Wim Vandenhoeck Co-Head of Emerging Markets Debt at Invesco  
Invesco Fixed Income Emerging Debt Platform***

Over the last decade, the US economy's strength and resilience has drawn investors away from emerging markets (EM), resulting in sustained outflows from the asset class. However, this trend has led to more attractive valuations within the EM asset class.

A notable shift in 2025 has been the changing global perception of the US dollar. For over a decade, foreign investors have benefited from holding US assets either unhedged or partially hedged. However, as these investors begin to scale back allocations or repatriate capital, demand for US assets and by extension, the US dollar may decline. While trade policy remains a source of short-term volatility, the greater long-term risk to EMs lies in a potential resurgence of US exceptionalism, though we view this as unlikely in the near term. With growth differentials now favouring EM economies and inflation remaining contained, the backdrop for EM debt appears increasingly favourable for the remainder of the year.

We believe there are six current market conditions that create an attractive entry point for EM debt investments and should lead to a positive backdrop for EM debt in the coming months.

#### **1. EMs leading global growth**

The US economy is showing signs of cooling, at the same time as many EMs are experiencing improving growth, narrowing the US growth differential. In response to ongoing trade and policy uncertainty, countries abroad are also adopting more pro-growth agendas, for example by introducing structural reforms and increasing domestic spending, which is helping to drive domestic growth abroad.

#### **2. Stable to weakening US dollar**

Heightened trade and geopolitical uncertainties coupled with slowing US economic growth have challenged the narrative of US exceptionalism, and the US dollar has weakened. Invesco believes the US dollar will weaken further as the Federal Reserve (Fed) eases interest rates and various countries enact domestic policies to strengthen their local economies.

### **3. Sound policymaking and disinflation**

EM central banks were orthodox in hiking interest rates early to control inflation, and rates have generally remained elevated, offering investors attractive yields compared to those in developed markets. While EM central banks are expected to proceed cautiously, the current trend has shifted toward more aggressive monetary easing as the focus has shifted from inflation concerns to growth.

### **4. Attractive valuations and income levels**

Nominal and real interest rates remain elevated across EMs, offering attractive income potential, in our view. Additionally, we believe current interest rate differentials between developed markets and EM also present potential opportunities for investors.

### **5. More predictable path for US financial conditions**

With US inflation slowly stabilising and growth slowing, the US bond market has priced in multiple Fed rate cuts for the remainder of 2025 and into 2026. Rate cuts typically exert downward pressure on the US dollar and upward pressure on international local currencies. Additionally, this dynamic has tended to support EM external balances and led to capital appreciation of external debt.

### **6. Potential rebalancing of capital away from the US**

EM assets have been largely ignored over the last decade, as US equities and the US dollar have outperformed, leading to cheap EM valuations, in our view. The global shift in the “American exceptionalism” narrative and the high share of US assets in global portfolios, could prompt a rebalancing of capital away from the US.

### **Conclusion**

Policy uncertainty and slowing US economic growth have challenged the narrative of US exceptionalism, contributing to a softening US dollar and creating a more favourable backdrop for EM debt in our view. Additionally, ongoing trade and geopolitical uncertainties have prompted countries outside the US to take more proactive steps toward reviving their domestic economies. As a result, we expect non-US growth abroad to exceed US growth, with a wider differential toward the end of the year. With growth differentials narrowing between the US and EMs, a weakening US dollar, and attractive valuations, we believe EM debt assets present a compelling opportunity that we believe investors have under-allocated to for the last decade.

### **Credit market insights**

**By Hemant Bajjal, Co-Head of Emerging Markets Debt & Head of Macro Alpha  
*Invesco Fixed Income Emerging Debt Platform***

We are positive on EM local currency debt. A potential decline in the US dollar and capital outflows from the US should support the EM local debt asset class going forward. We have already seen upward pressure on some EM currencies, especially in Asia, and expect continued gains in EM currencies against the US dollar this year.

We expect global yield curves to keep steepening. Risks are building in long maturity bonds due to easy fiscal policy. The risk of larger US budget deficits going forward and worries about financing the deficit come at a time when global long-maturity government bonds have been performing poorly. This upward momentum in US and global long-maturity yields may be exacerbated by fiscal concerns and increased issuance needs in the US. We expect the US dollar to decline, driven by historically high valuations and

US policy. A weaker dollar would be consistent with the US administration's stated goal of addressing trade deficits. From a valuation perspective, the dollar is rich in a historical sense. Many global investors are likely overweight US assets and any rebalancing could contribute to dollar weakness. A weaker dollar could ease financial conditions in many countries outside the US and support non-US fixed income and currency markets, including emerging market local currency markets.

We have moved to neutral from underweight on emerging market (EM) credit. EM valuations are tight, in our view, but technicals have been supportive, including demand from institutional investors.

## **Ends**

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