

# Emerging market debt: Enduring strength outlook holds



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The first half of 2026 has reinforced a key theme: developed markets remain constrained by sticky inflation, wider fiscal deficits, and higher long-dated bond yields. Many emerging markets, on the other hand, move into the second half of 2026 with a more supportive mix of orthodox policy settings, healthier real yields, and comparatively better inflation dynamics. In our view, this leaves the case for emerging market debt largely intact and especially strengthens the appeal of EM local currency debt on a relative-value basis.

Our latest outlook builds upon our [view](#) that EM countries are relatively more resilient and offer more value than their DM counterparts; signs of policy divergence should put local currency debt in good stead for the rest of 2026, although a strong US dollar could impact returns. In hard currency, we continue to believe that high yield (HY) debt can deliver positive outcomes, while the fortunes of investment grade (IG) bonds could be hurt in a scenario where rates remain higher for longer.

## EMD navigates inflation, geopolitics, and oil shocks

The first months of 2026 have proven to be more complex than many investors had anticipated at the turn of the calendar year. In developed markets, a sharp shift in the geopolitical landscape—particularly in the Middle East—added to energy price pressures and renewed the threat of inflation staying above central banks’ target levels. At the same time, markets also grappled with fiscal deterioration in the US and other developed economies, keeping investors focused on higher term premia and heavy issuance. This weighed on core government bonds and challenged the argument for broad developed market duration as a defensive anchor.

Through early May, emerging market debt had held up comparatively well for the year to date, although the Iran conflict added uncertainty and contributed to wide-ranging performance outcomes within the EMD universe, and notably between oil importers and exporters. Hard currency debt returns were resilient albeit with differences between the IG and HY portions, amid changing US rate expectations and swings in global risk sentiment. Meanwhile, local currency debt was impacted by a stronger USD despite the relatively higher carry, credible policy frameworks, and in some cases, undervalued currencies. So while outcomes were mixed, the overall picture stayed constructive.

## YTD 2026 performance highlights<sup>1</sup>

- **Hard currency EMD:** Mixed returns as spreads and Treasury yields moved with risk sentiment and shifting expectations around Fed policy.
- **Investment grade sovereigns:** Income supported returns, but elevated developed market government bond yields constrained overall gains.
- **High yield:** Robust performance bolstered by supportive country-specific stories.
- **Local currency EMD:** Renewed US dollar strength dampened progress, notwithstanding positive real yields, selective policy easing, and a relative valuation cushion.

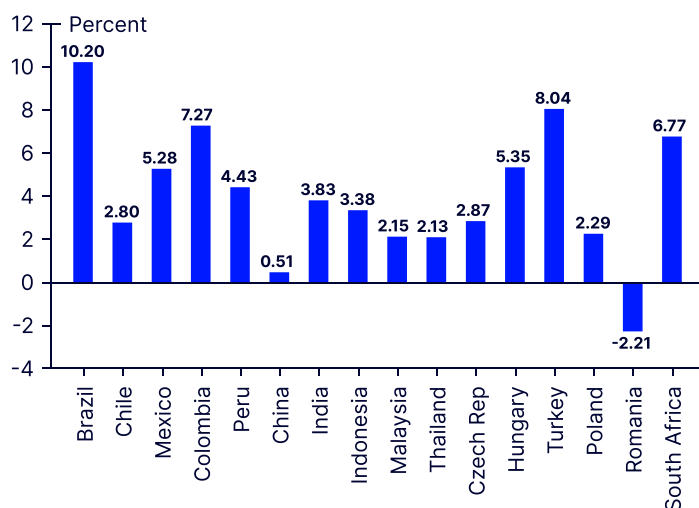
## Key Themes for H2 2026: resilience, relative value, and policy divergence

For the second half of 2026, the global fixed income backdrop looks less like one shaped for a broad duration rally and more like a market driven by relative-value considerations. Even if the US Federal Reserve (Fed) was to ease modestly, inflation and fiscal concerns in developed markets limit the case for relying on core sovereign duration alone. In our view, this reinforces the argument for emerging markets exposure, given the positive real yields and strong policy credibility of many EM countries. The differentiated outcomes across the global fixed income landscape that have ensued from this environment has made the goldilocks scenario previously posited less convincing.

For **local currency EM debt**, we see a constructive environment. A number of EM central banks have shown a willingness to tackle renewed inflation concerns by tightening more aggressively than expected, cementing policy credibility and offering a counterpoint to the stronger USD. In return, investors are being paid higher real yields (versus developed market sovereign debt). The currencies of a number of EM countries also appear undervalued versus the US dollar, creating the potential for a currency tailwind if the dollar's 2026 advance was to falter.<sup>2</sup>

In our view, the relative value case is now central. Compared with many developed market sovereigns, EM local curves offer higher carry and better inflation-adjusted income; and in selected local markets, there is more scope for rate cuts without the same fiscal concerns seen elsewhere. Volatility may still feature, particularly in FX, but we believe local currency debt currently offers more pathways to return than broad developed market duration.

Figure 1: EM real yields remain positive



Source: State Street Investment Management, Bloomberg Finance L.P., JP Morgan, as of March 31, 2026. **The performance data quoted represents past performance. Past performance does not guarantee future results.**

On the **hard currency EMD** front, yields also retain appeal in an environment where capital gains may be difficult to achieve. Meanwhile, the relative-value case is less straightforward than in local markets—this is because hard currency returns remain more tightly linked to US rates and spread conditions. Simply put, hard currency debt presents attractive carry and select opportunities, but the range of drivers is narrower than in local markets at this time.

## Key risks to monitor

Although prospects for EMD remain constructive, the second half of 2026 seems likely to experience intermittent bouts of volatility.

- **Geopolitics:** Heightened tensions, especially in the Middle East, could push already elevated oil prices to new highs. The knock-on impact on inflation would add to policy uncertainty, further weighing on sentiment.
- **US growth:** Outside of AI-related activity, a weaker US growth backdrop could slow global demand, support the US dollar, and pressure EM growth and currencies. As noted, this concern is tempered by the strong carry cushions that local markets offer relative to developed markets.
- **Sticky inflation, widening deficits:** Deteriorating developed market fundamentals could sustain high term premia, limit bond rallies, and support the US dollar. The near-term impact could pressure EM FX, but it also reinforces the relative-value case for select EM local markets.
- **Elections:** Event risk stemming from elections in 2026 should not be discounted, with major votes taking place in Brazil, Colombia, and Peru—the US midterms are also key for emerging markets. The election campaigns and outcomes could influence fiscal policy, reform momentum, trade, and foreign policy, potentially introducing renewed volatility—especially for local markets and currencies.

## EMD prospects remain robust: Local currency debt the highlight

Emerging markets still compare favorably with developed peers on policy execution, inflation management, and relative value. While uncertainty around US policy, geopolitics, and growth remains, EM debt continues to offer attractive opportunities through the remainder of 2026. Within the asset class, **local currency debt** remains our preferred exposure given its broader set of potential return drivers.

Because the EMD universe spans diverse countries and policy regimes, outcomes will invariably vary. An indexed approach is an effective way to capture the broad opportunity without relying too heavily on any single macro outcome.

This paper is part of a broader **Income, Engineered for Outcomes** series.

- Visit the [Fixed Income Hub](#) to continue the series

## Endnotes

- 1 Source: State Street Investment Management, JP Morgan as of April 30 2026.
- 2 Source: State Street Investment Management, as of April 30, 2026.

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\* This figure is presented as of March 31, 2026 and includes ETF AUM of \$1,940.32 billion USD of which approximately \$184.18 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Investment Management are affiliated. Please note all AUM is unaudited.

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