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Investment themes for emerging market debt - Q2 2025

Growth leadership rotation to benefit fundamentally resilient EM, but multiple macro cross-currents at play.

EM local currency is supported by **attractive real rates.** We prefer idiosyncratic opportunities.

A **preference for front-end carry in quality high yield (HY)** names in EM hard currency sovereign and corporate credit.

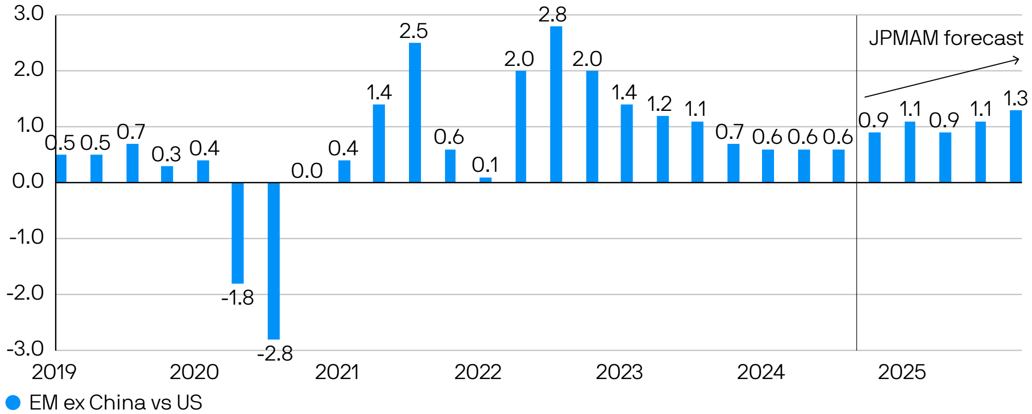
Turning more bullish EM foreign exchange (FX) but prefer EUR-based resurgence trades.

Risks: tariffs/trade uncertainty and other Trump policies (fiscal); changes to Federal Reserve (Fed) path, tightening US financial conditions; oil.

J.P.Morgan ASSET MANAGEMENT

1 – EM fundamentals remain resilient

Healthy EM growth differential vs DM
(EM ex China – US real GDP growth, %, 2 quarters moving average)



We expect emerging markets (EM) to grow by 4% in 2025 and **the difference between EM excluding China and the US to increase to a healthy 1.1-1.3% in the second half of 2025.**

US exceptionalism is fading as a slowing US economy and policy uncertainty brings back recession fears. However, **support can be found with significant EU stimulus,** which should support emerging European countries.

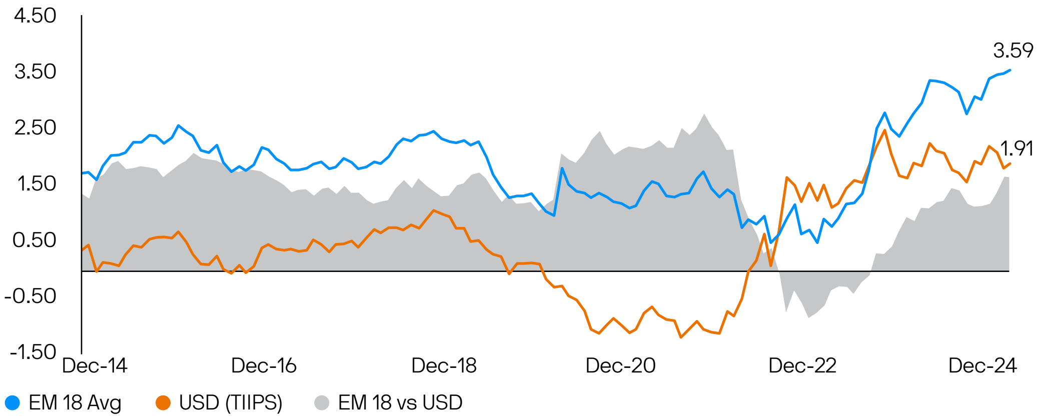
China is also slowing led by a decline in net exports. Yet **China is pivoting its economy** to offset tariff headwinds with fiscal policy support and domestic demand expansion.

EM country fundamentals remain resilient with fiscal consolidation and public debt at manageable levels. Credit rating agencies are taking note with significantly more upgrades than downgrades in 2024, a trend we expect to continue in 2025.

Source: J.P. Morgan Asset Management, International Monetary Fund (IMF). As of March 2025. Opinions, estimates, forecasts, projections and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. There can be no guarantee they will be met.

2 – Attractive real EM local rates

Local real yields at long-term highs
Real yields



Real yields in EM local are at decade high levels. These extreme levels are a combination of two factors. Firstly, **inflation has declined significantly** across regions after peaking in the Covid pandemic where EM central banks hiked quickly and aggressively. This allowed EM central banks better quality to cut rates sooner than DM central banks, though the pace of cuts slowed towards the end of 2024 with geopolitical uncertainties on the horizon.

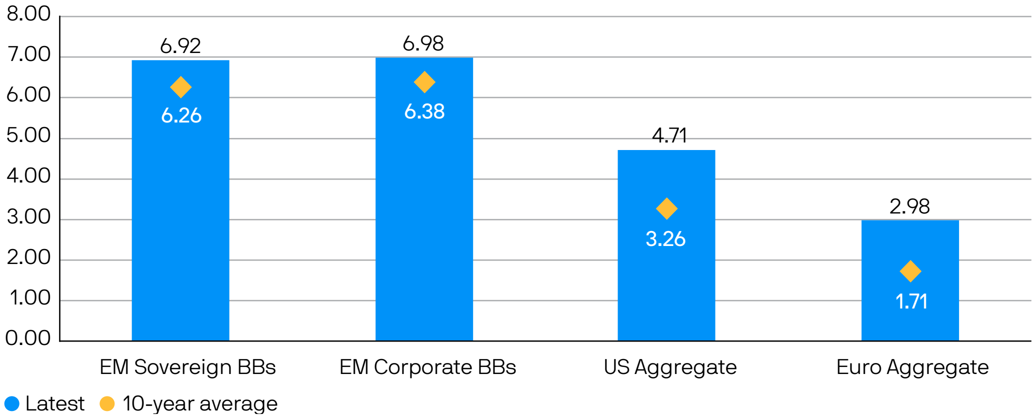
As such, restrictive policy rates remain in place today giving **EM central banks ample room to cut rates** when needed if economic difficulties arise. On the other hand, if the current soft-landing environment persists then investors are able to capture high real yields vs developed markets.

Source: Bloomberg, J.P. Morgan Asset Management. As of 21 March 2025. EM 18 = 10Y Bonds in (ZAR HUF PLN CZK RON ILS IDR INR THB MYR CNY KRW PHP BRL COP MXN CLP PEN). US Treasury 10 Year Inflation Indexed Bond.

3 – Preferring front-end carry in quality high yield

Balancing quality and attractive diversified carry in BB's

(yield to worst, %)



Source: J.P.Morgan Asset Management, as of 28 March 2025. EM Sovereign: JPM EMBI Global Diversified. EM Corporate: JPM CEMBI Broad Diversified. US Aggregate: Bloomberg US Aggregate. Euro Aggregate: Bloomberg Euro-Aggregate. Indices do not include fees or operating expenses.

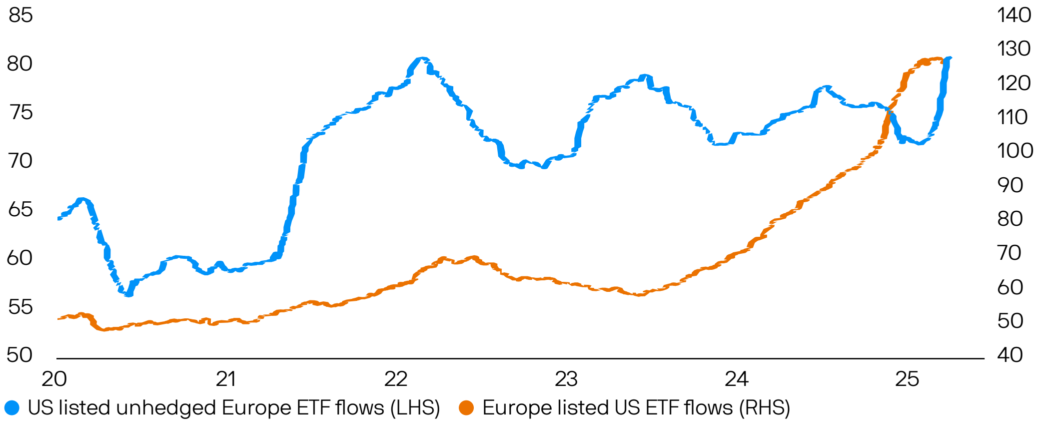
The insatiable search for yield remains top of mind for investors. Core rates remain high, supporting valuations while spreads are tight across fixed income market, leading to a difficult search for value.

We find **value in the shorter duration, upper high yield** part of the EM hard currency market. The securities we like are primarily rated BB by credit rating agencies and have the fundamental strength to transition to investment grade in the near future. Such countries include Paraguay, Oman and Guatemala.

Whether sovereigns or corporates, we find that these **BB issuers** provide a nice balance of yield pickup vs developed market bonds, while remaining shorter duration in these securities provides protection from short-term market volatility.

4 – Turning more bullish on EM FX

Equity investors are turning to non-USD assets



Source: Bloomberg, Goldman Sachs, EPFR as of March 2025.

Equity investors have been increasingly turning away from USD assets. **This, coupled with US dollar overvaluation, leads us to be biased to hold a long EM FX position.**

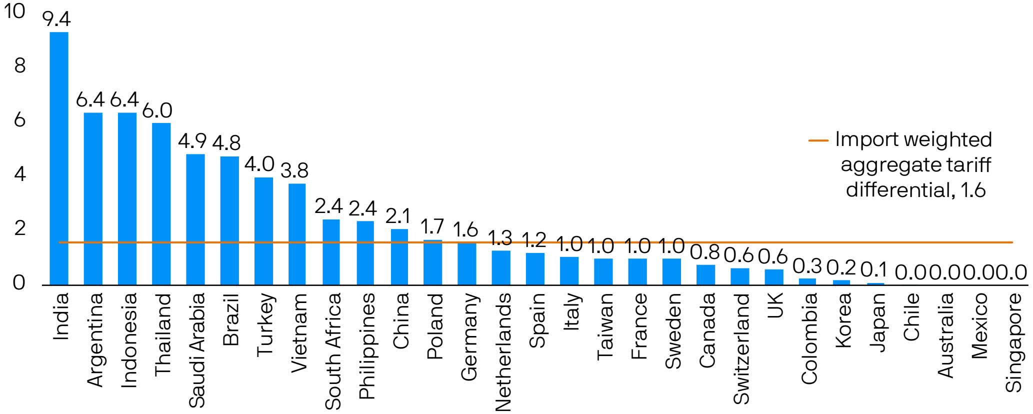
Specifically, we **like higher quality FX**, mainly from Asia and emerging Europe. Meanwhile, we are being more tactical with those currencies which exhibit more "high beta" returns.

Most EM countries have battled capital outflows throughout the years of US exceptionalism. The US has experienced years of foreign inflows into equity and bond markets which have the potential to reverse as the US economy slows and if US rates fall. We are **more selective on Latin America** due to the uncertainty around the commodity outlook affecting demand for the currencies of the region.

5 – Risks

Tariff differential by country: some larger EM economies at risk

Positive bilateral tariff differentials against US (pp)



Source: UBS, World Bank as of March 2025

Tariffs are the hot headline within geopolitics at the moment and some see them as the main risk to emerging markets. **We find the situation nuanced** where reciprocal tariffs are more of an issue for select countries rather than the global macro environment.

Some larger EM countries such as India, Argentina and Indonesia are at risk if further tariffs are introduced.

Many EM countries generally have higher tariff differentials than DM countries. **Yet the highest tariff countries are larger closed economies and so less impacted if these tariffs are introduced.**

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