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# Emerging markets debt: Past, present and future

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Over the last decade, emerging market (EM) hard-currency and local currency debt has grown significantly. We believe default rates have peaked for EM sovereigns and corporates and that should be a tailwind for performance. EM hard currency debt has outperformed similarly rated US corporate debt year-to-date in 2025, including during and after the tariff announcements.

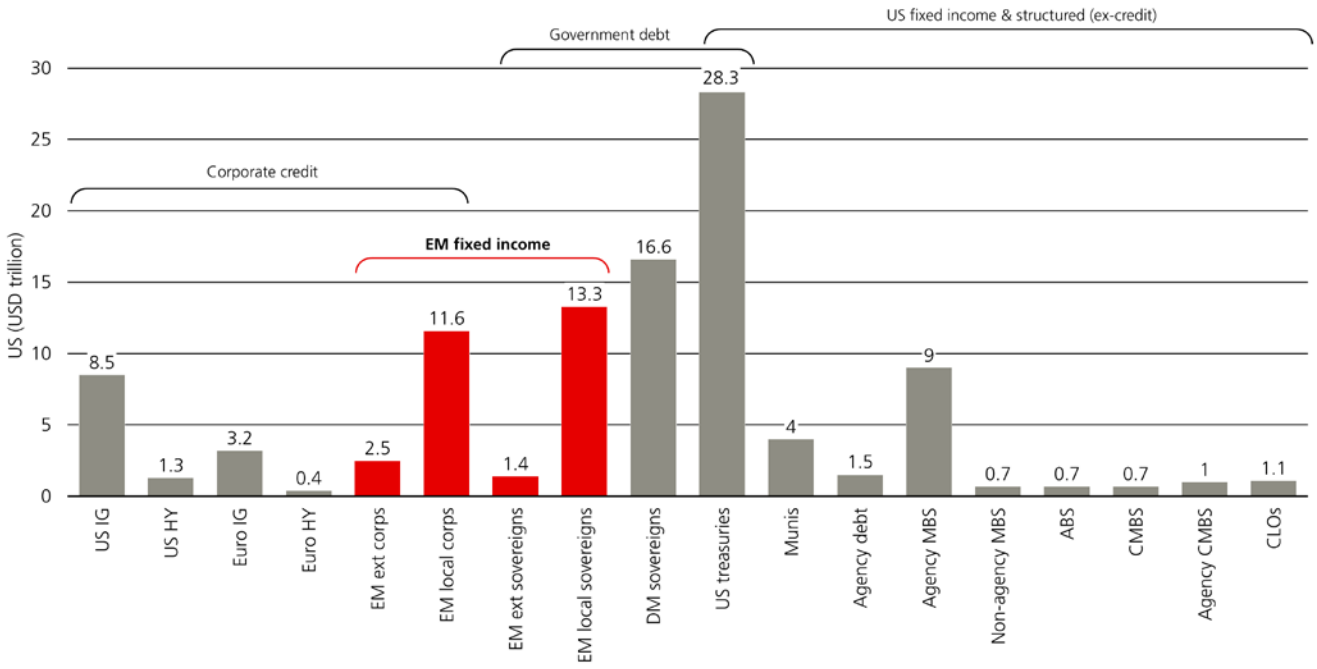
Relative valuations versus other fixed income sectors are attractive in EM high-grade and high-yield and that has driven strong crossover interest in the sector, which we expect to continue. Positive technical factors could provide additional tailwinds to returns.

**Past**

Over the last decade, emerging market (EM) sovereign hard-currency debt has approximately doubled in size from around USD 700 billion in the early 2010s to USD 1.4 trillion now according to data from JPMorgan. Emerging market corporate hard-currency debt has grown at an even higher rate and is now at USD 2.5 trillion. Just over half of this debt is rated investment grade.

Over the same time period, EM local currency debt for sovereigns and corporates has grown to become the dominant segment of EM debt as shown below. The JPMorgan GBI-EM Index (Local Currency Debt) has become more representative of the investment universe with China and India being added in 2020 and 2024 respectively.

**Figure 1: EM fixed income market**

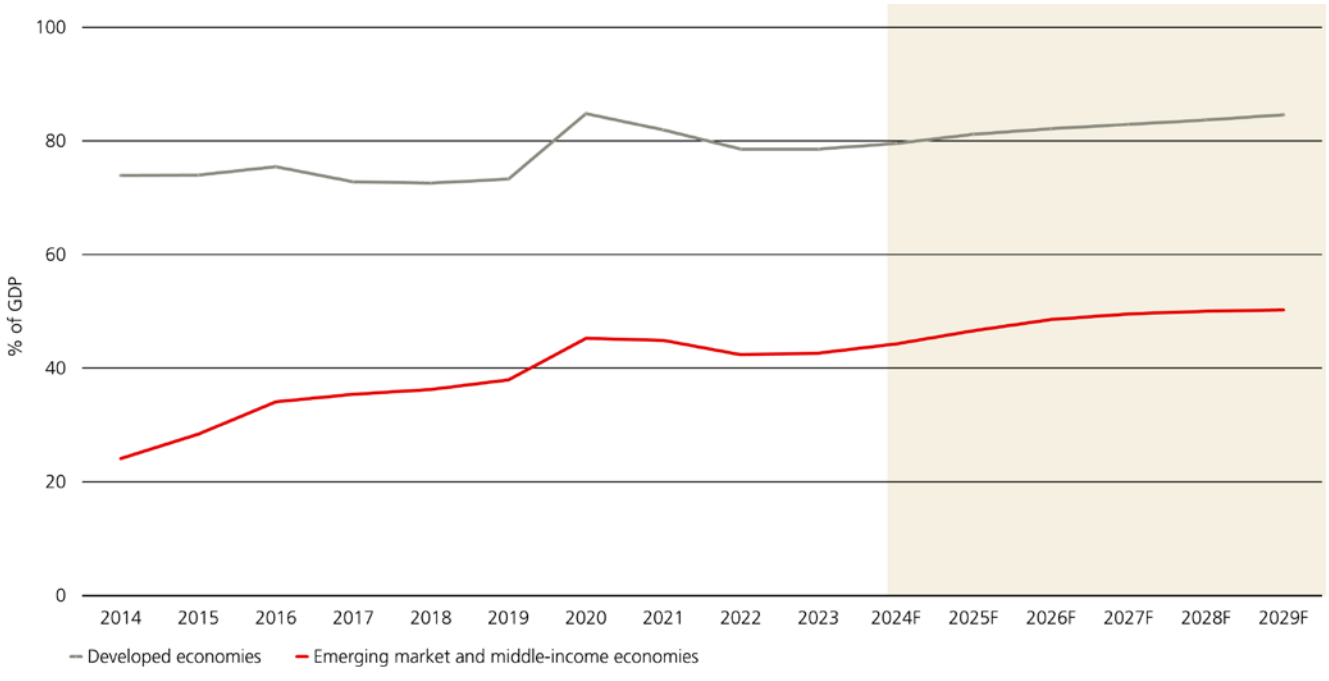



Source: JP Morgan, as of 31 December 2024

Through this period, emerging market economies, including frontier countries, have on average grown by more than 4% and companies domiciled in these countries have generally benefited as well. This growth has not been achieved solely through increased government spending.

As per IMF data, net government debt on average for advanced economies is above 80% while for emerging and middle-income economies it hovers close to 45% as shown in figure 2.

**Figure 2: Government net debt forecast**

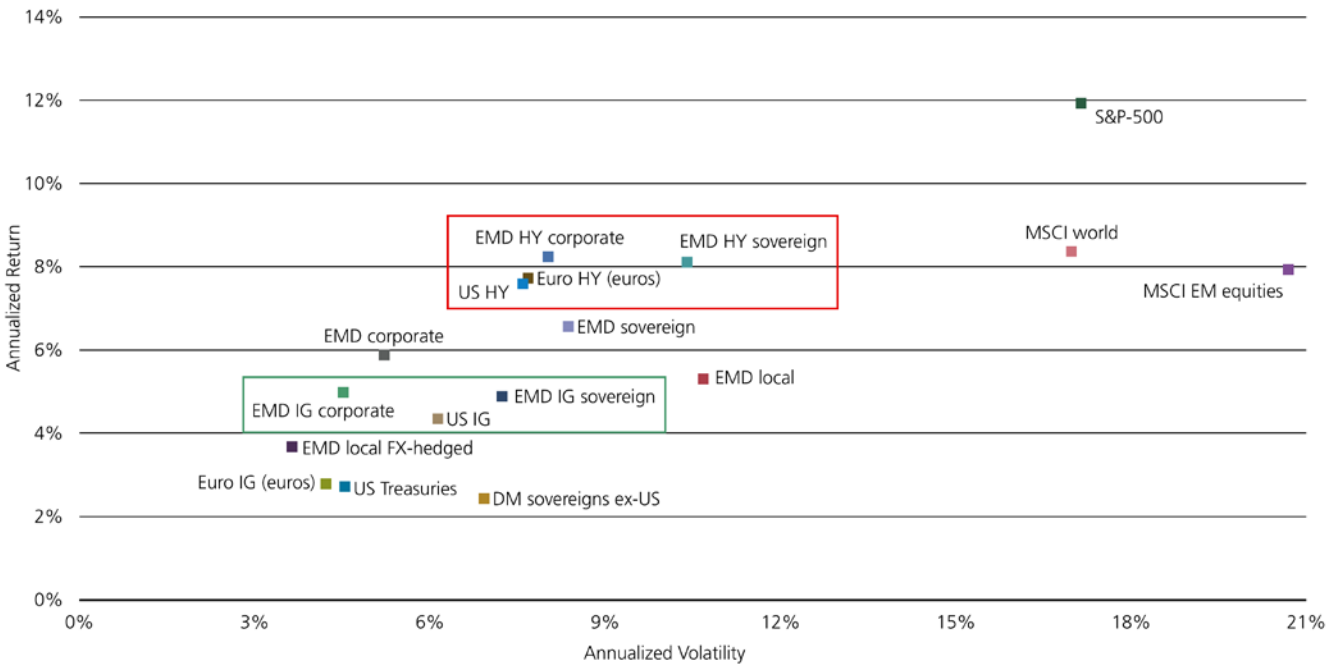



Source: IMF and Macrobond Data, as of 30 April 2025

**Return of and return on capital**

When looking at historical returns generated from underlying investments, it is perhaps helpful to look at the Sharpe ratio – an objective metric for risk-reward, which expresses how much excess return is received for the volatility of holding a riskier asset. Using data from 2003-2024, the return profile for hard currency emerging market debt within sovereigns and corporates is significantly above that of sovereign debt issued by the US, other developed market sovereigns and US investment grade companies, even during a period that includes US exceptionalism.

**Figure 3: Sharpe ratios**



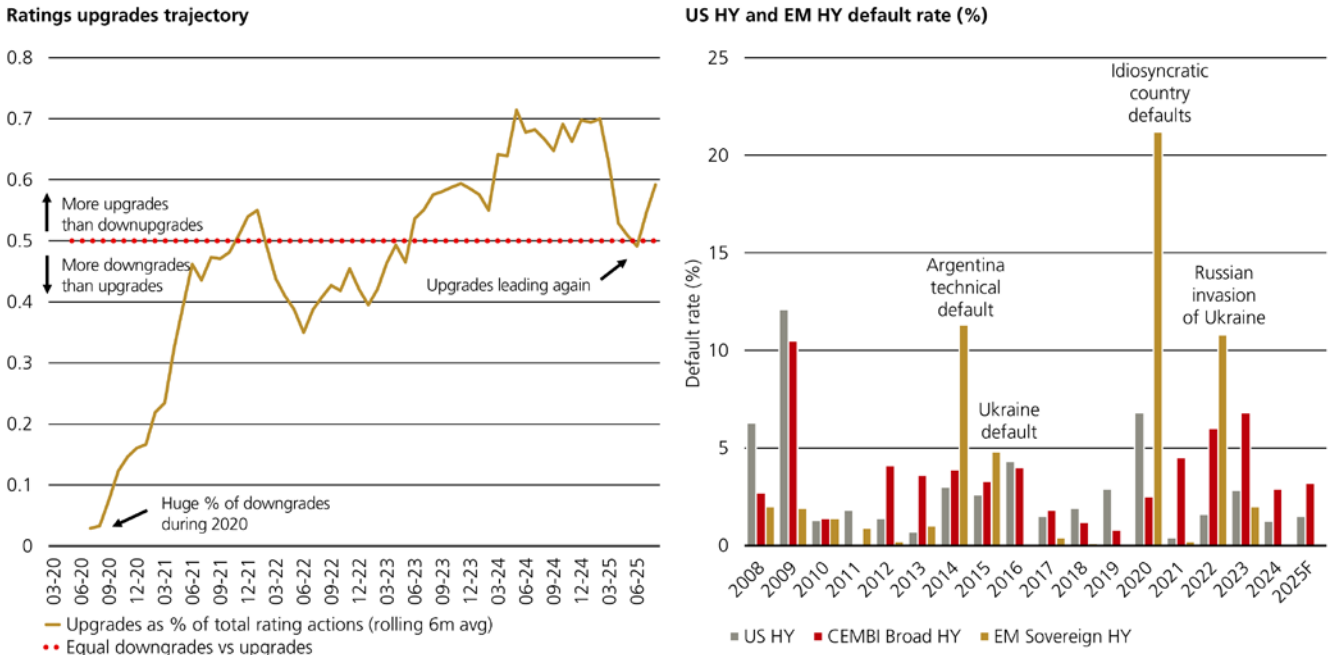

Source: Bloomberg data from 2003-2024. Index tickers – US IG: LUATTRUU Index, US HY: LF98TRUU Index, Euro IG: LP06TREU Index, Euro HY: LP01TREU Index, EMD Sovereign: JPEIDIVR Index, EMD Corporates: JBCDCOMP Index, EMD Local: JGENVUUG Index, US Treasuries: LUATTRUU Index, DM sovereigns ex-US: LGTRTRUU Index, All indices are in US dollars except for Euro IG and Euro HY

**Present**

We believe default rates have peaked for EM sovereigns which should be a tailwind for performance. The wave of defaults due to the pandemic and the Russian invasion of Ukraine is behind us: there have been no sovereign defaults since the end of 2023, and we do not currently anticipate any material sovereign defaults in 2025. Corporate defaults have also been decreasing over the last couple of years.

The outlook from credit rating agencies for emerging-market debt has become more positive than negative, with ratings upgrades on an improving trajectory as shown below, and we even have a few 'rising stars' in sovereign markets; these are credits that are expected to receive at least two out of three investment grade ratings with Oman and Azerbaijan being recent examples.

**Figure 4: Favorable credit ratings and fewer defaults**




Source: Bank of America and JPMorgan, as of 31 July 2025

EM hard currency debt has outperformed similarly rated US corporate debt year-to-date in 2025, including during and after the tariff announcements. EM currencies have held up well vs. the dollar, which may provide EM central banks with leeway to cut rates aggressively to manage potentially lower growth. Emerging markets outside Asia generally avoided high reciprocal tariffs even before the 90-day extension. We believe debt issued by Asian countries should be supported by their strong external position and lower oil prices, as most Asian countries import oil, and lower prices should help offset the impact of tariffs. We believe most of the Asian countries targeted with initial high reciprocal tariffs also have fiscal room to help mitigate any impact on growth.

EM sovereign and corporate debt indices, unlike equity indices, are constrained at the country level. As of end-June 2025, Saudi Arabia has the largest weight in the JPMorgan EMBI Global Diversified index at 5.17% followed by Mexico at 4.93%. Equivalent country exposures for the JPMorgan CEMBI Broad Diversified index stand at 6.38% for China and 5.08% for Brazil. This relatively low country concentration risk contrasts with global equity portfolios, which have massive exposure to US stocks, and global emerging markets equity portfolios tracking the MSCI Emerging Markets Index, which have over 80% exposure to stocks in China, Taiwan, India, South Korea and Brazil.

Further, frontier countries such as Argentina, Egypt, Nigeria, Ukraine, etc., are now part of the debt indices accounting for 26% in the JPMorgan EM sovereign debt index and almost 12% in the JPMorgan EM corporate debt index.

**Future**

We believe relative valuations vs. other fixed income sectors are attractive in EM IG and EM HY and that has driven strong crossover interest in the sector, which we expect to continue. Yields are in the top quartile of a fifteen-year trading range, so returns in the high single digits over the last couple of years and year-to-date 2025 for HC EM sovereign and corporates are attractive.

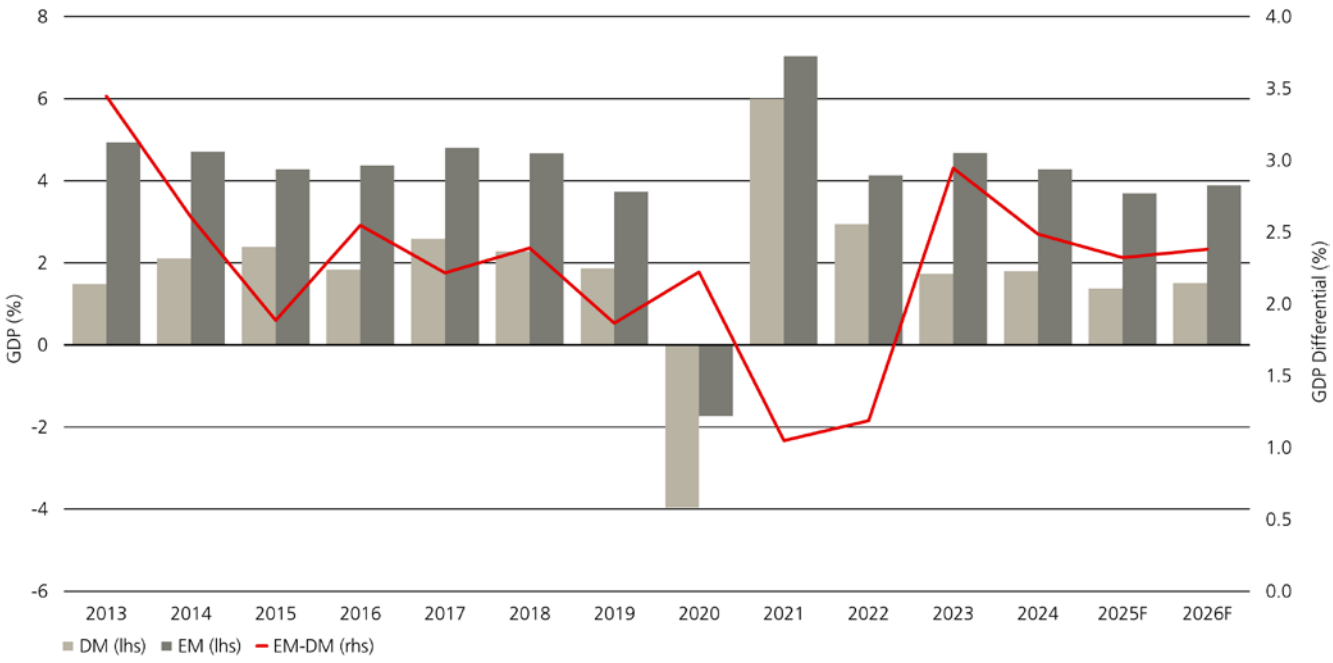
If the dollar stabilizes, or weakens, and if policy rates decline globally, as expected, it may provide EM debt with important tailwinds over the coming years. Such conditions have not existed over the last decade or so and could be an important driver of flows.

In addition positive tail risks may emerge over the coming year. Easing of tariffs, reduced geopolitical tensions or negotiation of ceasefires as well as continued stabilization of growth in China would be very positive for EM assets. In such an environment, we believe EM sovereign and corporate dollar denominated debt is likely to continue to perform well. Local currency debt may also perform well over the long term though there could potentially be periods of dollar strength that could generate volatility.

Despite the uncertainty of potential tariffs, we believe growth prospects for countries such as Mexico and Poland are likely to improve, led by a pickup in near-shoring and friend-shoring activities and in foreign direct investments as businesses adjust their global supply chain strategies. According to IMF forecasts, growth in emerging markets is still expected to be stable around the 4% mark as shown in the figure below, despite a projected slowdown in US growth.

Growth in China, at over 5% in first-half 2025, has been pretty strong despite the trade war, but even during last couple of years of slower growth in China commodity prices have been trading in a higher range and are likely to remain so over the coming years due to supply constraints and demand from decarbonization; this should benefit EM countries which are commodity exporters: more than 60% of the countries in the EM sovereign hard currency index are commodity exporters.

**Figure 5: EM-DM growth differential**

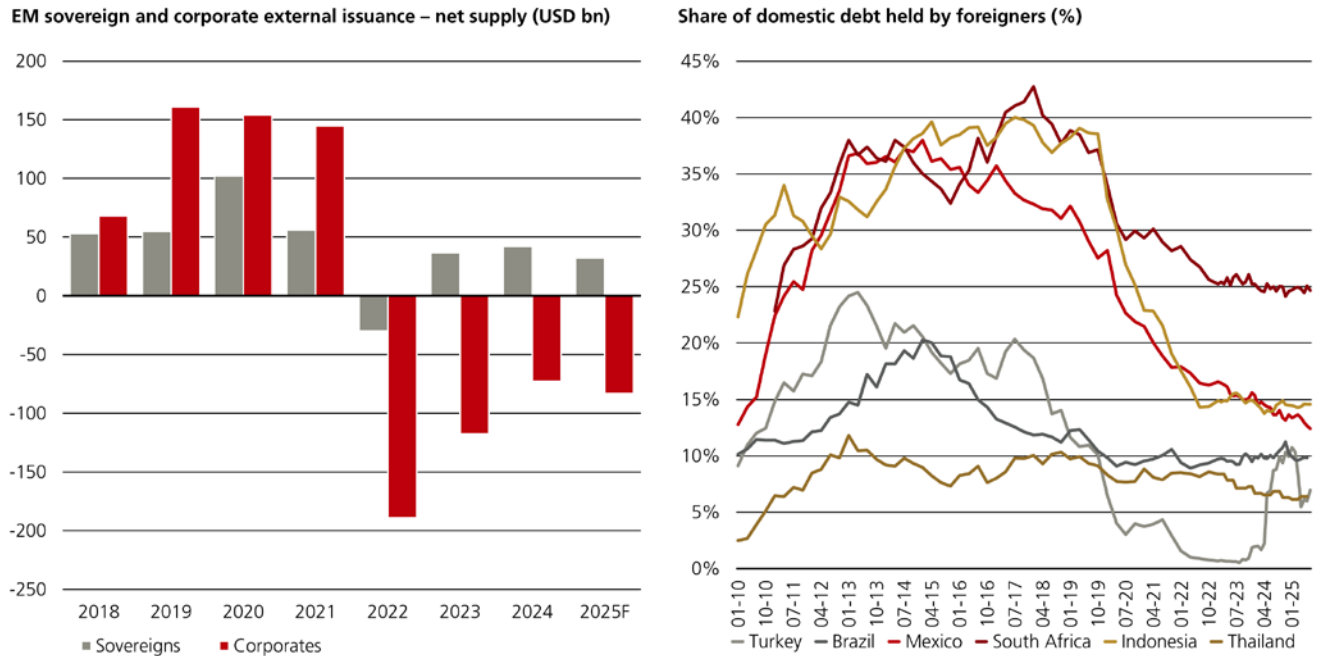



Source: IMF and Macrobond Data, as of 30 April 2025

Policy uncertainty in the US has led to an increase in flows into EM funds over the last several months which we think will be an important technical driving performance. EM external debt net issuance for sovereigns and corporates combined is expected to be negative, which could create additional upward pressure on existing bond prices.

Investors are still underweight the asset class and we are seeing renewed interest in the sector from institutional investors globally. These positive technical factors highlighted above could provide an additional tailwind to returns.

**Figure 6: Positive technical factors for emerging market debt**




Source: JP Morgan as of July 2025; Macrobond as of July 2025 for share of Domestic debt held by foreigners.

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