Emerging Markets Debt Views: January 2026

Thriving fundamentals, from the bottom-up

BlackRock.
Emerging Markets Debt (EMD) Team

Quick read

The case for EM HC Sovereign Debt

Improving creditworthiness of EM sovereigns make a strong case for consistent income and capital appreciation.

Supportive backdrop for improving fundamentals

EM sovereigns are delivering growth, stable primary budgets alongside healthy current accounts.

Alpha opportunity in improving creditworthiness

Thorough research driven diverse ideas provide core ingredient for durable alpha in EM HC Sovereign debt.

"We are seeing stronger momentum in the lowest rated segment of EM credit, driven by stronger growth and reduced repayment risks"

EM Hard Currency (HC) Sovereign Debt: Making the case for Income and Outperformance

Emerging Markets HC Sovereign Debt has been a consistent source of income, diversification and excess return potential for global investors[1]. While historical returns have been volatile, income has consistently contributed to excess return over global bonds and return per unit of risk (Sharpe ratio) has been comparable.

Over last three years, EMD asset class has seen improving fundamentals resulting in net credit rating upgrades (number of upgrades vs downgrades) among sovereigns and resilient total returns, primarily driven by:

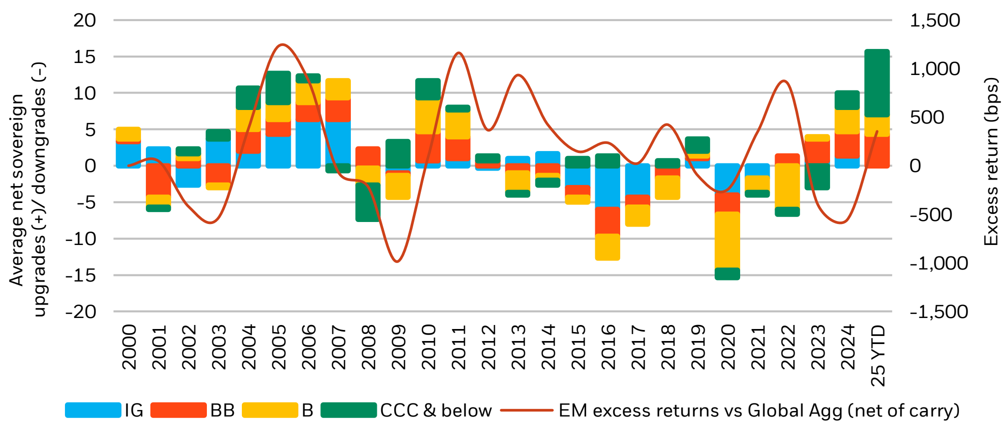
- **Stronger growth, moderating inflation & reduced repayment risks.**
- **Better policy making, healthier fiscal and external balances.**

Most EM sovereigns remain on improving trajectories (Exhibit 1) making a case for further upside potential. With advancing reforms, our internal analysis gives us conviction that the upward re-rating cycle may continue, particularly in high-yield rated names where reduced repayment risks still leave scope for spread compression and income potential.

In this outlook, we highlight that historically during an upgrade cycle, EMD has provided both income and capital appreciation relative to global bonds. EM HC Sovereign Debt is likely to continue benefiting from structural reforms, cyclical divergence and tactical opportunities (e.g. elections, geopolitics).

We review this opportunity set from the lens of fundamentals, creditworthiness, and ability (alongside willingness) of EM sovereigns to repay their debt obligations in the coming sections.

Exhibit 1: Net rating change in EM Sovereigns and EMD excess return over global bonds (net of carry)



Source: Moodys', S&P, Fitch, and Bloomberg data

[1]Performance measured for the JP Morgan EMBI Global Diversified Index (USD) over Bloomberg Global Aggregate Index since 2000. Diversification may not fully protect against market risk or investment loss.

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Resilient fundamentals, re-rated creditworthiness

Emerging market economies have been resilient to global shocks of 2025 and recorded a year of strong macro and market performance. This was complemented by strong EM ex-China (EMX) GDP growth of about 3.3%, and we expect a similar performance in 2026.

Notably, EMX contribution to global growth has been increasing and is expected to be at-par with that of developed markets and China combined, its main trading partners. This is a significant relative improvement from the pre-COVID period, when EM contributed about a third of global growth.

On the fiscal side, EM sovereigns have maintained a stable primary budget position. This contrasts with a sharp deterioration of fiscal positions in both developed markets and China. Sub-investment grade EM countries have shown the strongest fiscal effort (e.g. Argentina, Ecuador, Egypt, and some Central American and Sub-Saharan countries). While some sovereigns are still working on their fiscal readjustments (Eg. Brazil, Colombia, Romania), our conviction in relative outperformance of EM is supported by these broad improvements.

When analysing from the lens of external balances, EMX current account positions have improved when compared with pre-Covid period, reducing external borrowing needs. According to IMF data, foreign reserves adequacy has improved from 109% in 2017 to 114% projected in 2025.

In summary, **structural changes in policy frameworks[1] and strong reserves have contributed to broad improvement in EM fundamentals**. We believe these in turn have been a key driver of the current EM rating-upgrade cycle.

The broad improvement in fundamentals has also been recognised by the major rating agencies. EM sovereigns have delivered three consecutive years of net credit rating upgrades, in contrast to the prior long stretch of net downgrades driven by the end of Fed quantitative easing, weaker commodity prices and a stronger US dollar.

The last meaningful upgrade cycle took place before the Global Financial Crisis. A key difference this time is that **upgrades have been led by the high-yield segment of EM**. This reflects two distinct trends:

1. A number countries have made a deliberate effort to strengthen fundamentals (Paraguay, Costa Rica, Dominican Republic, Turkey, El Salvador, Nigeria, Egypt, South Africa to name a few).
2. Several sovereigns have completed post-Covid debt restructurings and are now progressing with reforms (Eg. Argentina, Ecuador, Ghana, Sri Lanka among others).

Our internal analysis gives us conviction that this net rating-upgrade cycle can extend into 2026. In our list of EM sovereigns, **roughly a quarter of names have a meaningful chance of an upgrade over the next twelve months, while only a handful appear at risk of a downgrade**. This positive momentum also helps to justify EM spread valuations relative to history.

Sustaining this momentum will ultimately depend on **EM sovereigns' ability (and willingness) to meet their debt obligations**. We cover this in more detail in the next section.

Exhibit 2: EM Fundamentals are on an improvement trajectory vs other markets

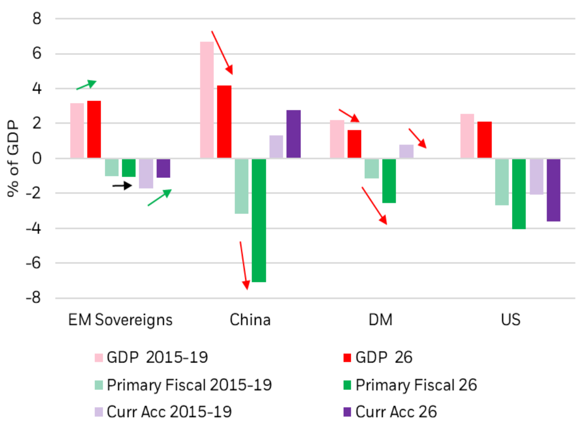
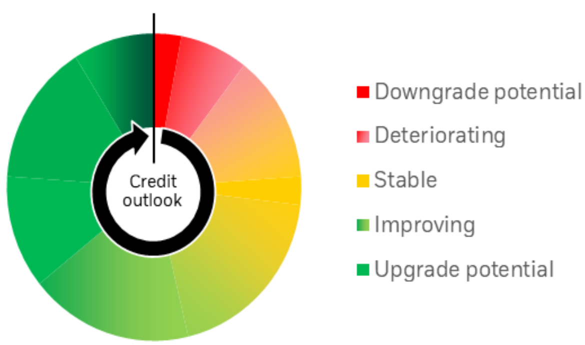


Exhibit 3: Our internal analysis points to a continuation trend of net rating upgrades



[1] Source: IMF World Economic Outlook, Chapter 2: Emerging Market Resilience: Good Luck or Good Policies? International Monetary Fund, October 2025

Assessing repayment ability (and willingness)

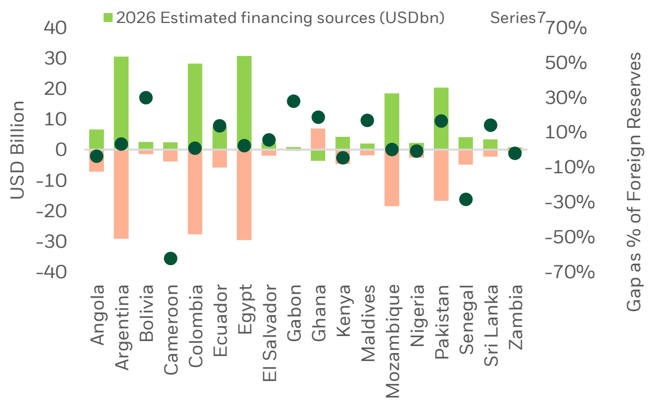
The improvement in credit ratings reflect EM sovereigns' ability to rebuild external buffers and ease their risks of repayment.

To illustrate this point further, we reviewed total gross reserves for a set of high yield & frontier sovereigns.

Exhibit 4: External reserve buffers have been rebuilt faster than expected since 2023

[1]Countries included are Pakistan, El Salvador, Angola, Nigeria, Bolivia, Tunisia, Kenya, Ecuador, Argentina, Mongolia and Mozambique. Source: JPMorgan Research, BLK Calculations. **Forecast may not come to pass.** 2025 levels correspond to July 2025 levels:

Exhibit 5: Gross financing need versus sources for a set of EM sovereigns



Source: JPMorgan Research. **Forecast may not come to pass.** FX reserves is an estimate for Gabon and Senegal as they are a member of the West African Economic and Monetary Union (WAEMU) and each member in the union has access to pooled reserves to meet their needs

Our analysis found that reserves outperformed by 34% in 2025 compared to the expected reserve accumulation path projected in 2023.

In our view, the better-than-expected reserves were driven by improving current account balances, higher Foreign Direct Investment flows, IMF programs and structural reforms. Looking forward, we review an expanded set of countries[2] that rank low on repayment capacity metrics[3] and assess their external financing needs versus estimated financing sources and buffers. Our analysis suggests that on aggregate, a net surplus is expected for these countries in 2026.

While some countries in our analysis present idiosyncratic risks, others have good fundamentals and prudent fiscal management which makes continuation of IMF support likely. Some names also require closer watch due to weaker reserves and heavier Euro denominated debt burdens.

Overall, we think repayment risks for EM are reducing on aggregate. While our analysis was done for a broad subset of sovereigns, individual country assessment and differentiation will be necessary to get the full picture. We believe a diversified, well researched active approach to EM HC Sovereign Debt can help select sovereign tilts and drive alpha opportunities.

Diverse opportunity set for alpha

EM HC Sovereign Debt presents a rich and diverse opportunity set for active investors. In our view, durable alpha comes from a set of diversified views across key alpha drivers and downside-protection measures, not large concentrated bets.

While strengthening fundamentals give investors confidence, they also make a strong case for higher strategic asset allocation to EM HC Sovereign Debt.

We believe in complementing this conviction with research driven approach across country selection, relative value, security selection, repricing stories and macro hedging to get a resilient, repeatable source of alpha & total return in global fixed income portfolios.

[2]Ranking based on debt to GDP, short term debt, amortization of debt due over the next 12 months, debt affordability metrics, reserve adequacy metrics, current account to GDP and fiscal deficit to GDP. Source: IMF, World Bank and JPMorgan.
[3]Angola, Argentina, Bolivia, Cameroon, Colombia, Ecuador, Egypt, El Salvador, Gabon, Ghana, Kenya, Maldives, Mozambique, Nigeria, Pakistan, Senegal, Sri Lanka and Zambia.

If you have any questions on the content or would like to discuss this further, please reach out to your relationship manager at BlackRock.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Note: EMD team views expressed as of January 2026. Subject to change.

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