



Geopolitics on the Tightrope

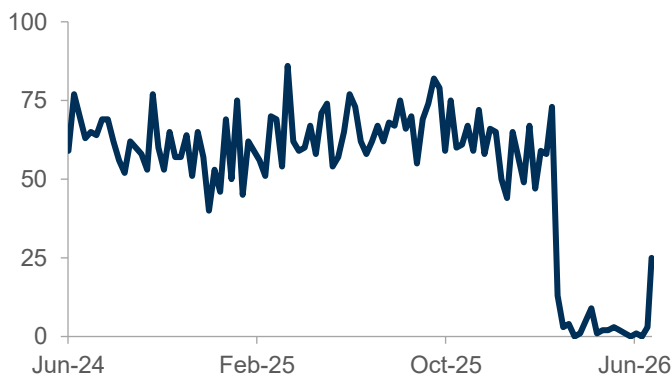
From Emerging Market Debt

The United States and Iran have reached a Memorandum of Understanding, marking a constructive step toward de-escalation, although the contours of a final agreement are still being negotiated and material geopolitical and implementation risks remain.

Markets have reacted positively to the initial progress: energy prices have fallen as the immediate risk premium has faded, helped by reports of an increase in the number of vessels allowed to transit the Strait of Hormuz, a critical chokepoint for global oil flows. This has largely reversed

the earlier spike in crude prices and eased concerns that tensions could trigger a broader supply shock. Importantly, despite disruptions to oil flows since early March, global supply chains have proven more resilient than initially expected, with alternative routing, inventory buffers, and flexible sourcing helping to absorb the impact. While the MoU has improved sentiment and reduced near-term pressure on energy markets, investors are likely to remain cautious until a binding final deal is reached, compliance mechanisms are clarified, and the risk of renewed disruption in the Gulf meaningfully recedes..

Daily Strait of Hormuz tanker vessel crossings



Data as of June 26, 2026
Source: Bloomberg

Brent crude price | Price per barrel



Growth in Emerging Markets has been resilient to external shocks

The global economy entered the energy shock from a position of solid momentum, supported by resilient demand, improving labour-market conditions, and targeted fiscal measures designed to soften the impact of higher energy costs. Growth is still expected to run close to potential, albeit with moderate downward revisions concentrated among energy-importing economies, while developed markets have shown a healthier pickup than previously expected, including a renewed improvement in US job creation after a softer patch. Regional performance, however, has become divergent: Asia has absorbed the Strait of Hormuz disruption better than feared through alternative energy sourcing, reserve drawdowns, fuel substitution, and resilient tech demand, while Europe's growth projections have been revised lower as higher energy prices weigh on real incomes, confidence, and consumption without an offsetting tech-led investment impulse. Central and Eastern Europe is receiving some support from EU funding flows, with Hungary benefiting from improved political and EU-relations expectations, and Latin America remains comparatively firm on commodity gains, led by Brazil, although Mexico continues to lag and tighter financial conditions may weigh on regional growth later in the year.

Central banks turn cautious

While some central banks remain on hold or continue easing in isolated cases, the broader policy stance has shifted towards tightening, with an increasing number of central banks signaling or preparing for rate hikes,

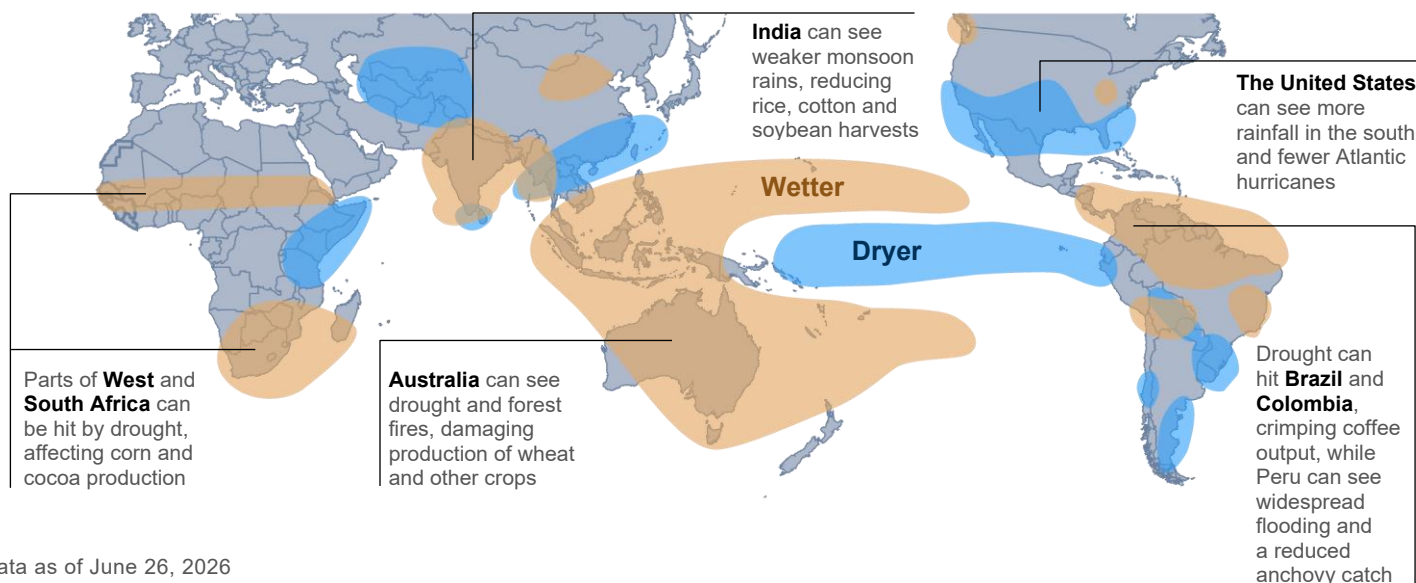
particularly in Asia and lower-yielding parts of Latin America. Policy inertia has been notable, with several central banks scaling back expectations for rate cuts and maintaining a cautious, hawkish posture in response to still-resilient inflation risks.

The decline in oil prices is providing some relief to inflation across emerging markets, although the impact differs depending on how fully previous energy price increases were passed through to consumers. Economies that allowed a more complete pass-through, such as Thailand, the Philippines, and Chile, we believe are likely to see a more tangible easing in price pressures, while those that relied on subsidies, including Mexico and India, will experience a more limited effect. More notably, inflation had already been surprising on the downside prior to the fall in oil, largely due to subdued food price dynamics despite elevated input costs—an important factor given that food carries a significant weight in EM inflation baskets. Although food price momentum has picked up slightly in recent months, it remains close to seasonal norms in most cases, with only a few countries such as Brazil and the Philippines showing clearer upside risks.

El Nino adds to inflationary risks

A potential Super El Niño developing into 2026 represents a significant macroeconomic shock, primarily through its impact on food prices and, by extension, inflation, especially in emerging markets. By disrupting global weather patterns, it increases the likelihood of droughts in some regions and flooding in others, ultimately reducing agricultural yields and driving up global food prices.

El Niño's global reach | How cyclical Pacific Ocean warming can affect weather around the world



Data as of June 26, 2026

Source: International Research Institute for Climate and Society, US National Oceanic and Atmospheric Administration

This effect is magnified in emerging economies, where food typically accounts for 30 to 50% of CPI baskets, compared to a much smaller share in developed markets, making inflation outcomes far more sensitive to agricultural shocks. The impact is particularly acute in South and Southeast Asia, where agriculture plays a larger economic role and adverse weather conditions can quickly translate into rising food inflation, eroding real incomes and increasing the risk of a more hawkish central bank response. Staple crops such as rice, wheat, and maize, which are highly sensitive to temperature and rainfall during key growth stages, are especially vulnerable, with countries like the Philippines facing outsized exposure due to their reliance on a narrow set of food staples. Similarly, El Niño induced dryness tends to drive up prices of key commodities such as palm oil, heavily concentrated in Indonesia and Malaysia, adding to global inflationary pressures. Beyond crops, secondary effects can emerge through livestock disruptions, water scarcity, and higher energy demand for cooling, as well as reduced hydroelectric output in vulnerable regions. Taken together, while El Niño is often framed as a localized climate phenomenon, its transmission through food systems, commodity markets, and supply chains makes it a globally relevant inflation shock, with disproportionately severe consequences for emerging markets and important implications for monetary policy.

Outlook

Against a backdrop of uneven disinflation and increasingly hawkish central bank postures across emerging markets, alpha opportunities in sovereign debt are becoming more selective and tied to idiosyncratic reform stories and inflation resilience. While lower oil prices have provided

some relief, persistent food-related pressures, potential El Niño risks, and sticky domestic inflation dynamics continue to constrain policy easing and reinforce the importance of credible macro frameworks. In this environment, we believe countries such as Ecuador and Argentina stand out, where strong political commitment to IMF-backed reforms and supportive external relationships help anchor expectations at a time when inflation risks remain elevated and policy credibility is paramount. Their exposure to commodities also provides a partial hedge against inflation shocks, supporting external balances. Similarly, Hungary presents an asymmetric opportunity, as markets appear to underappreciate the potential for political change that could lead to Euro adoption, particularly relevant given the broader challenges of managing inflation in the region. In smaller frontier markets like Suriname, progress on debt restructuring and reform implementation offers attractive returns for investors willing to engage with longer-term adjustment stories in an environment where inflation and policy uncertainty remain key risks. Elsewhere, improving macro stability in Ivory Coast supports continued rating momentum, while oil exporters such as Angola and Nigeria benefit from stronger terms of trade that help offset inflationary pressures and support fiscal dynamics, with Nigeria in particular showing signs of strengthening policy credibility. Finally, in Romania, despite lingering downgrade risks linked to fiscal and inflation challenges, current valuations already reflect a significant degree of pessimism, leaving room for upside should policy adjustments prove sufficient. Overall, in a world where inflation remains uneven and central banks retain a cautious, often hawkish stance, the most compelling EM sovereign opportunities are those where reform credibility, external buffers, and pricing dislocations align.

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