Tale of two markets: why EM airline bonds are flying higher

From Emerging Market Debt

Emerging market airline bonds have been one of the stronger credit stories of 2026. In the first half of the year, EM airline bonds delivered a positive return of 2.7%, while developed market airline bonds returned -1.1%, based on ICE global high yield index. The performance gap is not simply about higher yields. More importantly, it reflects a market reassessment of EM airline fundamentals: stronger liquidity, better cost structures, improving balance sheets and more visible growth runways than many investors previously assumed.

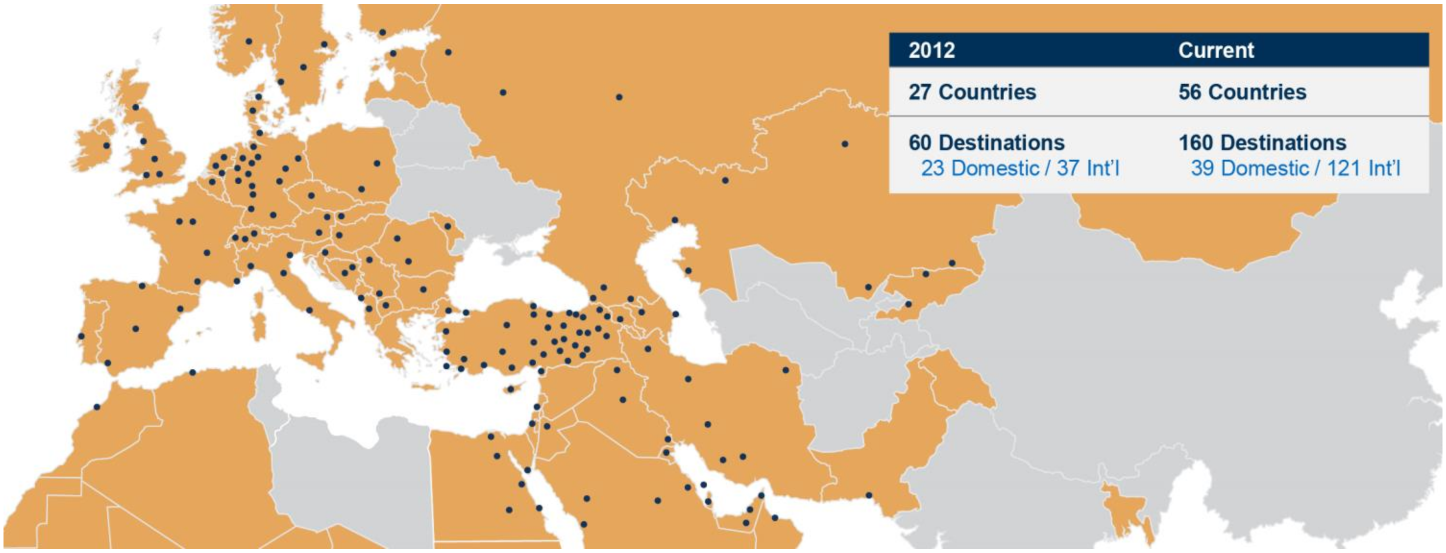
The starting valuation helped, but fundamentals have done the heavy lifting. EM airline bonds began the year with a wider spread cushion[1] than DM peers, giving investors more protection against volatility. The outperformance has persisted because several EM carriers have delivered credible credit-improvement stories, rather than simply benefitting from a post-pandemic rebound. In many cases, they are structurally stronger businesses than they were before the pandemic, particularly in Latin America, where most airlines used pandemic-era restructurings to reduce debt, reset cost bases and emerge with more disciplined financial policies.

A leading Latin American airline group is a good example of the new EM airline profile. It has emerged with a more disciplined balance sheet, diversified regional and international operations, strong liquidity and a more rational competitive environment. Its network spans domestic, regional, North American and transatlantic routes, giving it multiple demand pools rather than dependence on one market. The key bondholder appeal is not just growth, but quality of growth: strong margins, positive free cash flow and leverage metrics that compare favourably with many global airline peers.

However, one of the important lessons this year is that EM airline performance has not been uniform. Selected higher-beta issuers[2] have offered more complicated but potentially rewarding recovery stories. A good example is a leading Turkish low-cost carrier sold off sharply after regional conflict disrupted routes and pushed fuel costs higher. The near-term impact was visible: weaker first-half profitability, temporary route suspensions and pressure from jet fuel. But the underlying credit story remains compelling. The airline has a young, fuel-efficient fleet, a competitive cost base, strong liquidity, limited non-lease debt and a distinctive network connecting Türkiye, Europe, the CIS and the Middle East.[3] As suspended routes reopen and fares adjust to higher fuel costs, the recovery path is visible.

1. A spread cushion is the extra yield gap (or credit spread) a corporate or riskier bond offers over a risk-free benchmark like a U.S. Treasury, which acts as a safety buffer against price drops or market volatility
2. A high-beta issuer is a corporate or governmental borrower whose issued securities (such as bonds or shares) exhibit a high beta—meaning they are significantly more volatile or sensitive to broader market movements than the average baseline.
3. Source: Pegasus Airlines.

Figure 1: A distinctive and diversified route network | International route network spans 121 destinations currently



Source: Official website of the above-mentioned leading Turkish airline

Therefore, the sectoral EM airline outperformance has not required perfect conditions. In fact, some of the best opportunities have emerged where headline risks looked severe but balance-sheet resilience remained intact. Investors have been willing to look through temporary disruption when liquidity is strong, refinancing risk is manageable and the business has clear operating levers to restore margins.

Fuel has been one of the biggest differentiators across the sector. Higher oil prices and wider jet fuel crack spreads have affected all airlines, but not equally. Some carriers hedge fuel more effectively, while the majority hedge crude oil but remain exposed to the refining margin between crude and jet fuel. That distinction has mattered. Airlines with flexible networks, strong pricing power, efficient fleets or better fuel-cost pass-through have been better positioned to protect margins. In EM, the market has rewarded operators that can combine cost discipline with fare adjustment and route flexibility.

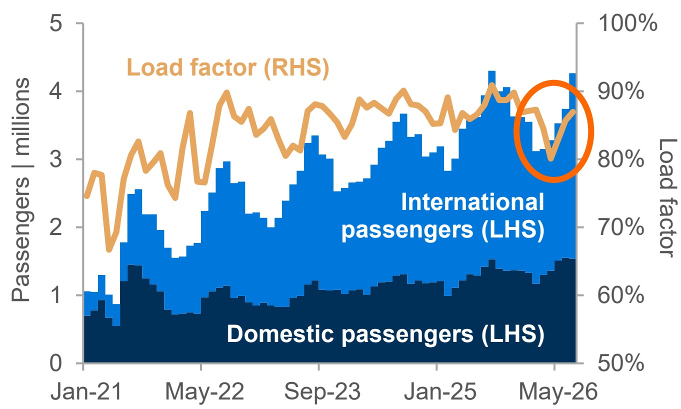
Demand fundamentals also favour selected EM carriers. In many emerging markets, air travel is still underpenetrated. Rising middle-class incomes, tourism development, weak rail alternatives and expanding regional connectivity create a longer growth runway than in more mature DM markets. This does not eliminate cyclicality, but it gives well-run EM airlines an organic demand tailwind. For bondholders, that supports revenue growth, aircraft utilisation and operating leverage, provided capacity is managed prudently.

It is important to acknowledge that many DM airlines remain high-quality credits, particularly those rated investment grade. They benefit from deeper capital-market access, larger loyalty programmes, more established funding channels and potentially lower jurisdictional risk. That said, dispersion within DM airlines has increased. Some DM high yield issuers are facing more pressure from fragile capital structures, transition risk and the fuel shock.

The thesis, therefore, is not that DM airlines are fundamentally weaker across the board. Rather, many of their strengths have already been well recognised in bond valuations, while EM airlines offer more room for positive catalysts because investors have been slower to price in balance-sheet repair, operational discipline and structural demand growth.

Technical factors have reinforced the move. The EM high yield segment has attracted demand from investors looking for carry and idiosyncratic credit improvement. Airline bonds are a relatively small subsector, so when fundamentals improve and supply remains limited, spread moves can be meaningful. In this environment, EM airline bonds have benefited from both sector-specific recovery and broader demand for higher-quality EM high yield, from both dedicated EM and crossover communities.

Figure 2: Resilient load factor despite of the Middle East conflict



Data as of July 2026
Source: Official website of the above-mentioned leading Turkish airline; Load factor: the percentage of available seats on an airline's flights that are filled with paying passengers.

Conclusion

EM airline bonds have outperformed this year compared to DM airlines, driven by a combination of the market becoming more comfortable underwriting improving fundamentals and attractive starting yields. Several EM carriers are now more liquid and more resilient than their spreads previously implied, supported by young fleets, low-cost operations, disciplined financial policies, manageable maturities and clear catalysts such as route normalisation, fare catch-up, margin recovery and continued travel demand growth. The sector remains selective, but we believe the best credits offer a compelling mix of structural growth, operational improvement and balance-sheet recovery. The main downside risks are overly extended geopolitical disruption, higher oil prices or wider jet fuel crack spreads, which could delay margin recovery and pressure cash flows. A second risk is that capacity growth or fleet commitments outpace demand recovery or slowing deleveraging.

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