

EMD report. The end of exorbitant privilege?

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Fast-developing economies are reshaping global markets

The shift in U.S. trade policy under the new administration has exposed deep structural issues in developed markets (DM). While initial fears of a collapse in asset flows were exaggerated, the long-term fundamentals are shifting. Post-global financial crisis, DM governments absorbed private sector debt, creating a cycle of easy money and rising public debt. The pandemic intensified this trend, pushing debt-to-GDP ratios beyond national income in many DM countries.

Now, with COVID-19 in the rearview mirror, policymakers continue to borrow and spend, driving debt-to-GDP ratios to unsustainable levels. The U.S. Congressional Budget Office estimates the 'One Big Beautiful Bill' will reduce tax revenues by \$3.7 trillion over the next decade, while proposed spending cuts save only \$1.3 trillion. Moody's downgrade of U.S. debt in May has fueled the 'sell America' narrative.

Emerging market (EM) local currency yields have compressed relative to U.S. Treasuries, reflecting growing confidence in EM debt. This narrowing risk premium suggests investors are reassessing the relative safety and returns of EM assets.

Dollar weakness and global repositioning

By mid-2025, the U.S. dollar hit its weakest level since 1973. President Trump's push for a weaker dollar to boost competitiveness has led to reduced global exposure to U.S. assets. Despite market stabilisation, the fundamentals behind the dollar's decline remain. The DXY index fell while EM currencies strengthened, reflecting shifting investor sentiment.

Opportunity in transition

The 2013 taper tantrum exposed EM vulnerabilities, but many have since converged with DM standards. EMs lack the 'exorbitant privilege' of reserve currency status, yet they've shown resilience and reform. Today, EMD presents compelling opportunities:

- Ownership at 20-year lows post-COVID.
- Weaker USD benefits EM currencies.
- Attractive yields and diversification in both USD and local currency debt.

Uncertainty around U.S. policy is reflected in

yield volatility. Many EM economies now offer more attractive investment opportunities than their DM counterparts.

EM country profiles

Turkey

Since adopting orthodox policies in late 2023, Turkey has made significant progress. FX reserves rose due to dedollarisation, and inflation dropped from 80% (2022) to 33.5% (July 2025). The policy rate remains high at 43%, showing commitment to stability.

Local bonds and currency are attractive due to high carry interest. Hard currency bank bonds and select corporates offer value, though caution is advised for firms reliant on domestic consumption.

Nigeria

Under President Tinubu, Nigeria has implemented bold reforms including fuel subsidy removal and FX market liberalization. Central bank financing has been halted, boosting investor confidence. Portfolio inflows reached \$3.48 billion in H1 2024, and GDP growth hit 3.4% in 2024.

Despite challenges like poverty and infrastructure gaps, reforms have laid a

foundation for inclusive growth and resilience.

Colombia

Colombia faces fiscal challenges, with a deficit near 5% and debt/GDP over 61%. President Petro's approval has dropped to 29%, raising hopes for regime change. FX reserves are strong (~15% of GDP), and the current account deficit improved from 6% to 2%.

Colombia offers potential through diversified exports and a robust banking system. Fiscal discipline could unlock further foreign investment.

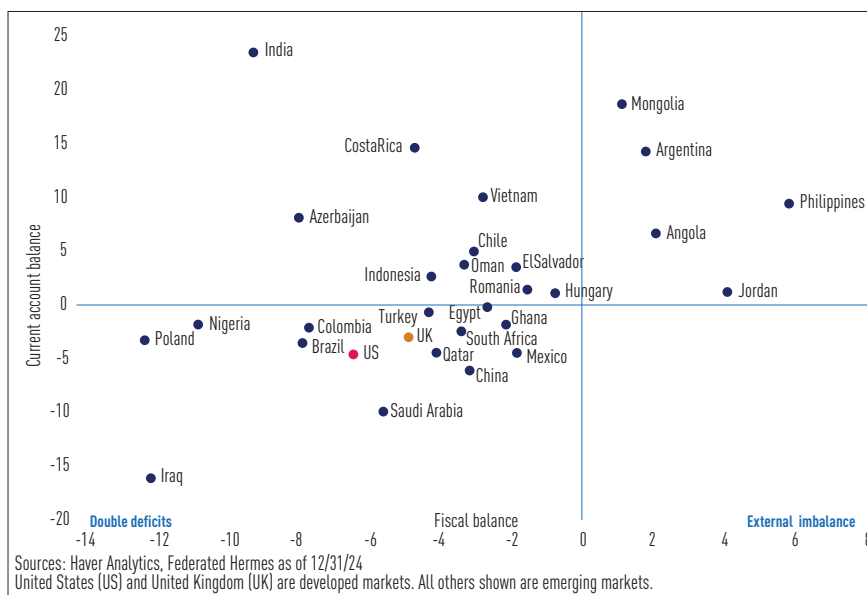
Brazil

Political uncertainty persists, with President Lula's approval below 50%. Legislative checks have curbed excessive spending, and central bank independence has maintained high rates to control inflation. Interest expense adds nearly 6% to the fiscal deficit.

Brazil's institutional strength and potential political transition enhance its investment appeal.

Fiscal and current account balances

The chart below highlights the transition of EM countries from double deficits to surpluses. Countries like Turkey, Nigeria, and Colombia are moving toward fiscal and external stability, while some DMs like the U.S. and UK remain in deficit territory.



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