

Emerging market resilience tested by energy shock and Fed hikes

(Abridged)

The US Federal Reserve (Fed) raised interest rates on 16 September for the first time since 2023, into an energy shock that is still working through global markets. In past cycles, a tightening Fed alongside an oil shock has produced sharp emerging market (EM) underperformance. So far, the reaction has been muted. The pillars of EM performance since the pandemic – improved fundamentals, the AI-driven global investment cycle and Chinese disinflation – are relatively insensitive to the Fed's reaction function, in our view. We remain constructive on EM equities and local currency debt, and would use the current uptick in the US dollar (USD) and rates as an opportunity to add exposure.

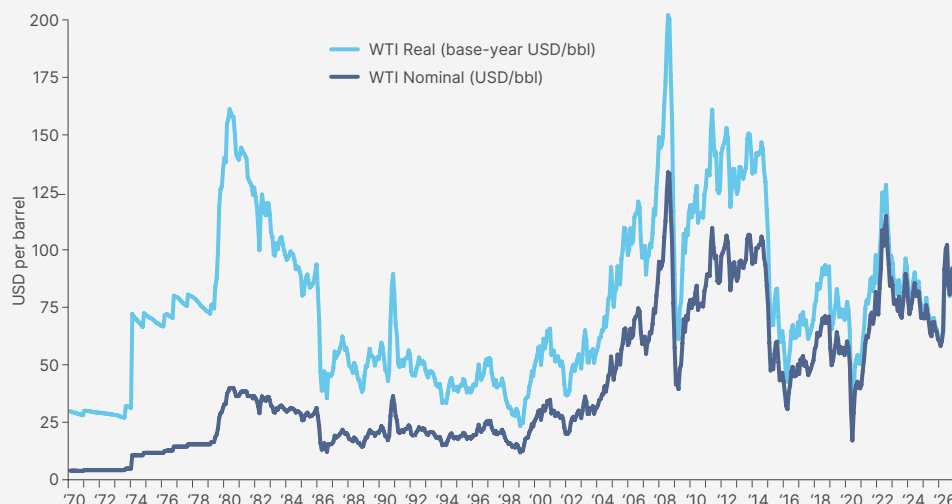
A hike into an energy shock, not an EM crisis

After two Federal Open Market Committee (FOMC) meetings at which rates were left unchanged, Kevin Warsh's first move as Fed Chair was to oversee a unanimous 25 basis points (bps) hike in September. The market is pricing an 85% probability of another hike before year-end, with the implied fed funds rate reaching circa 4.7% by December 2027 – at least three additional hikes. Warsh framed the pivot as a push to accelerate disinflation and stop the energy shock broadening into core inflation; slowing wage growth and broadly neutral policy are the main reasons it has not yet done so.

High energy prices alongside higher US policy rates triggered EM crises in the 1980s, 1990s and 2013. EM is more insulated this time, in our view, for four reasons. Fundamentals have improved meaningfully since the 'Fragile Five' episode: currencies are mostly fairly valued or undervalued, anchored by tighter policy than in developed markets (DM), and external accounts are robust. Higher fuel costs and bond yields are not yet slowing global capital expenditure. Chinese exports continue to anchor EM inflation lower. And the USD has failed to rally on events that should have lifted it.

The energy shock is also milder than its predecessors in price terms. In real terms, adjusted to 2026 prices, West Texas Intermediate (WTI) reached the equivalent of USD 150 a barrel in the late 1970s, rose above USD 200 ahead of the 2008 crisis and held in the USD 100-150 range for the best part of eight years, and averaged around USD 125 for several months in 2022. Despite the disruption in the Strait of Hormuz (SoH), we are not at a comparable level of stress.

Fig 1: WTI crude oil, nominal vs real



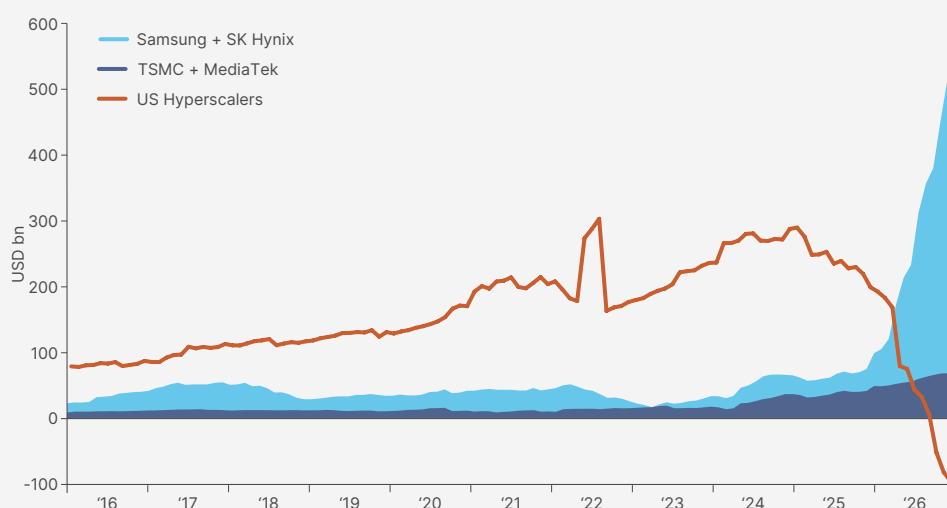
Sources: Bloomberg, Ashmore. Data as at September 2026.

Refined products are tighter than crude: US diesel is at an all-time nominal high around USD 6.20/gal, though the 2026 year-to-date average of USD 5.00/gal still sits below the USD 5.90 of 2008.

The investment cycle is funded by cash flow, not credit

The AI-led investment cycle is lifting EM growth through both commodity exporters and technology manufacturers, and has continued through tariffs and the SoH crisis, transferring capital on an enormous scale from US hyperscalers to EM technology companies.

Fig 2: **Free cash flow of US hyperscalers vs EM 4 (TSMC, MediaTek, Samsung, SK Hynix)**



Source: Bloomberg, Ashmore. Data as at September 2026.

This is already the largest capex cycle since the 19th-century railroad boom, with Goldman Sachs estimating hyperscaler capex will reach USD 1.2trn in 2027, equivalent to around 3.5% of US gross domestic product (GDP). AI investment is sufficiently strategic that a 25bps, or even 75bps, hike is unlikely to change the calculus. Critically, it is still mostly funded from operating cash flow rather than credit: debt financed just 9% of hyperscaler capex in FY24, rising to around a third by mid-2026, and the largest hyperscalers other than Oracle still carry positive net cash.

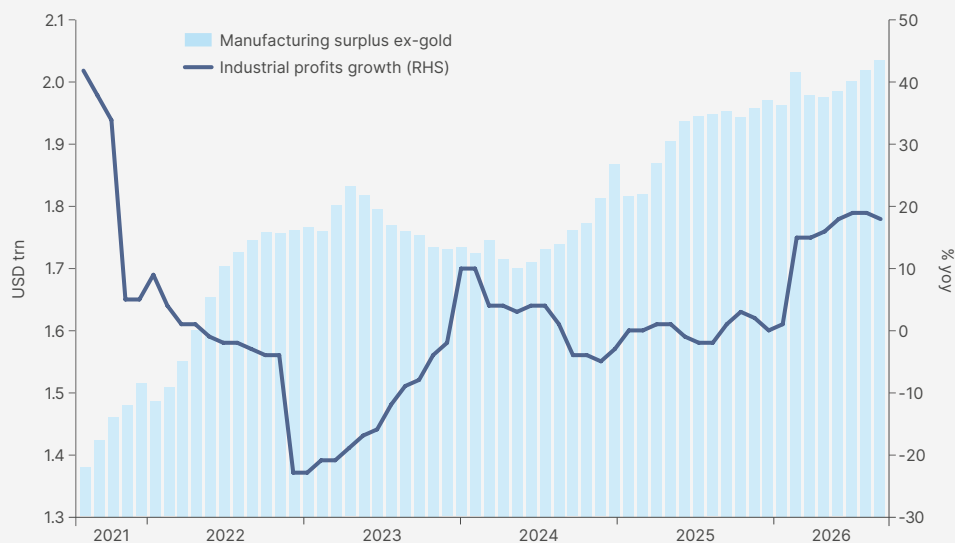
Return on investment, far more than Fed policy, will determine the trajectory from here – and the signs are encouraging. In Q2 2026, Google Cloud grew 82% year-on-year, Microsoft Azure 43% and Amazon Web Services 37%, its fastest growth in four years. Margins are also expanding. The three largest cloud providers have a combined contracted backlog of around USD 1.7trn and all remain capacity-constrained. Supply must therefore respond, and the EM semiconductor complex continues to benefit.

China continues to anchor EM inflation and growth is robust

China's export boom reflects private sector overcapacity amid weak domestic demand and the deleveraging of infrastructure and real estate. Low returns on assets in super-competitive industries force companies to pursue scale which translates into declining prices — and, alongside a historically weak Renminbi, means China continues to export disinflation to the world.

Chinese excess capacity therefore sets the price of tradable goods across EM ex-China, offsetting much of the energy and freight impulse into goods inflation. We believe investors underappreciate this dynamic; alongside subsidised fuel prices, it is a key reason why the SoH shock has not spread into EM inflation as much as it might have.

Fig 3: **China trade surplus ex-gold vs industrial profits**



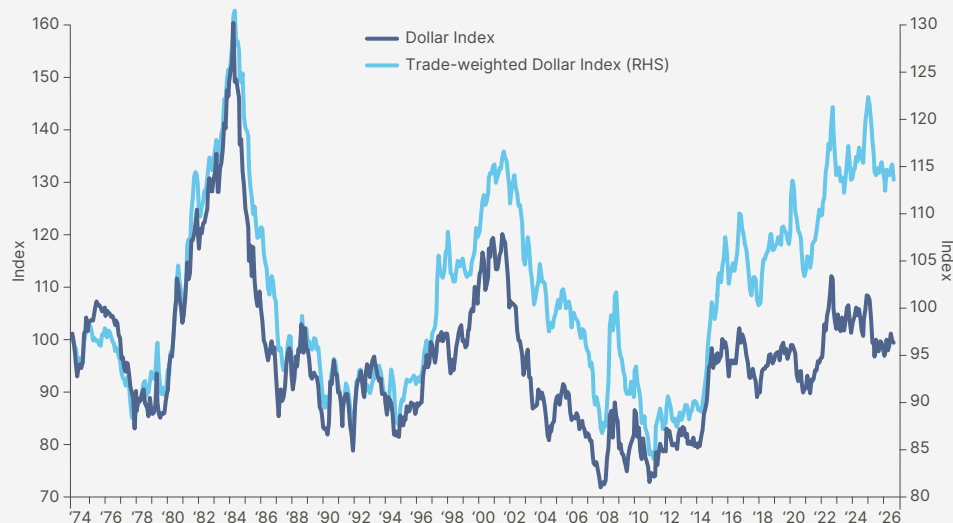
Source: Ashmore, Bloomberg, CEIC. Data as at August 2026.

Anchored EM inflation is arriving alongside stronger growth. EM ex-China GDP growth has edged up to a 2.2% premium over DM in 2026, from 1.7% in 2024, while the inflation differential has narrowed from 4.4% to 2.5%.

The USD remains in a downtrend, in our view

Interest rate differentials usually drive currencies, but structural factors sometimes take precedence. That fact that the USD has failed to gain traction despite higher US rates, bullish corporate earnings and a favourable terms-of-trade shock from higher oil prices strengthens our conviction that it is in the early innings of a multiyear downtrend, now four years old. Carry does not drive structural depreciation cycles. This one is driven by diversification away from US assets, the deterioration of US institutions and the US external imbalance – and a few 25bps hikes change none of them.

Fig 4: **Dollar Index (DXY) and real trade-weighted Dollar Index**



Source: Ashmore, Bloomberg, CEIC. Data as at September 2026.

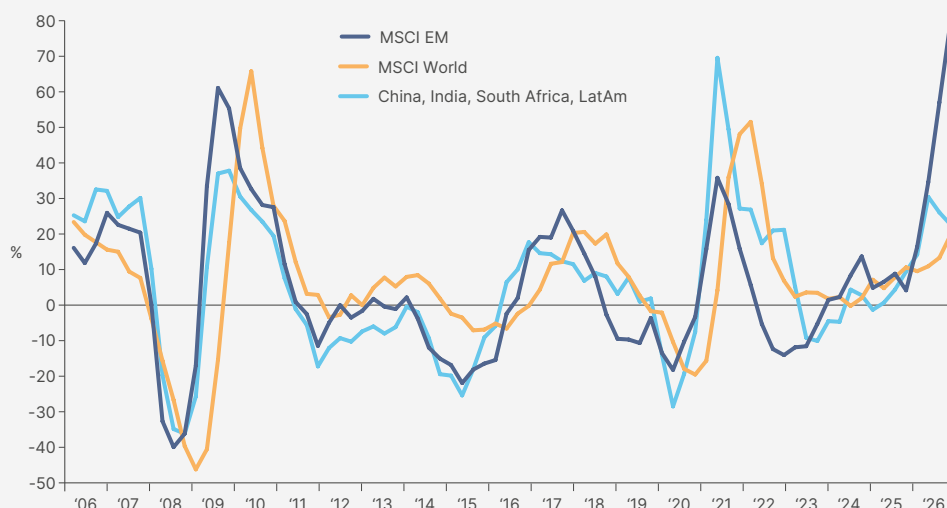
Current levels suggest the USD can decline considerably further. The real trade-weighted Dollar Index remains close to the highs reached at the dot-com peak in 2001 and at the 1985 peak that prompted the Plaza Accord – and today both dynamics are present: foreign investors hold a large overallocation to US assets, as in 2001, and the administration is actively working for stronger Asian currencies, as in 1985.

US fiscal policy reinforces the point. Bond vigilantes already demand a higher term premium, rising interest expenditure compounds the problem, and the US net investment income balance turned negative in 2024 as higher Treasury yields raised the interest bill paid to foreign holders. This limits the scope for further pro-cyclical expansion without a large USD depreciation via adjustments to the capital account.

Earnings, not multiples, are driving EM equities

EM earnings per share (EPS) have risen organically at their fastest pace in over 20 years. Taiwan and Korea are driving the headline growth through the memory and foundry cycle, and we believe we are in the middle of a semiconductor supercycle in which supply takes years to catch up with demand. However, EPS is rising across markets, including LatAm, South Africa, India and China. This matters for the durability of the rally: as capital diversifies away from the US, EM valuations have room to re-rate into robust earnings growth.

Fig 5: 12-month forward EPS in EM (MSCI EM) vs DM (MSCI World) & MSCI China, India, South Africa and LatAm



Source: Ashmore, Bloomberg. Data as at September 2026.

The tailwinds differ by region. Asia benefits from AI investment, led by South Korea and Taiwan, with the baton passing to adopters, where China is well placed. India offers returns independent of the global tech cycle. LatAm benefits from rising resource demand, a political shift to the right, and undemanding valuations. Eastern Europe benefits from European defence spending, with around two-thirds of the EUR 150bn Security Action for Europe package going to the region.

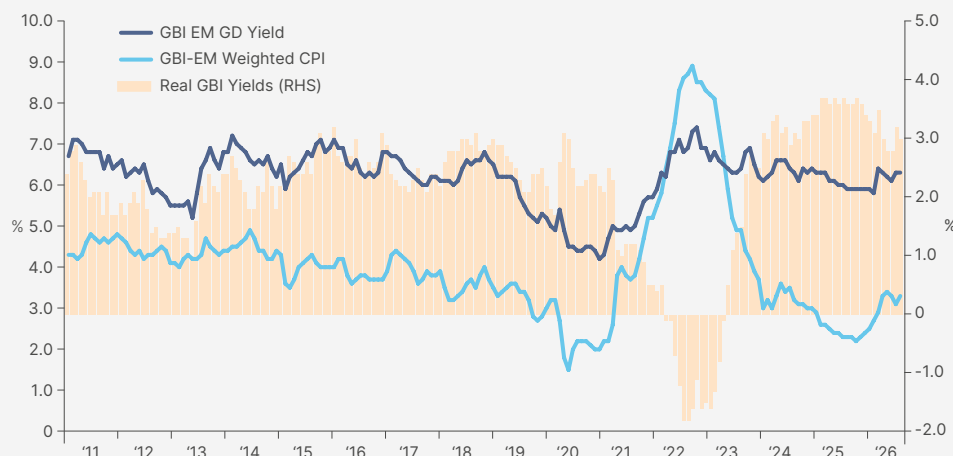
Frontier markets add a complementary story. Post-pandemic, many large frontier economies had to float their currencies, tighten policy and cut subsidies, creating a virtuous cycle of lower risk premium, falling inflation and faster growth. These economies have also become markedly less sensitive to Fed policy.

Risks to the view

Higher policy rates barely change funding costs for the high-quality hyperscalers undertaking today's capex, but they do hit lower-rated companies reliant on short-term or floating-rate debt, such as private credit borrowers. Historically, this brings a cyclical slowdown, or a deeper one if a weak link breaks. Lower-rated neoclouds and leveraged companies such as Oracle are worth watching. The backlash against data centres is real and bipartisan, with 71% of Americans opposing one locally, according to Gallup. However, the regulatory response is shifting from restriction to conditions, which is more likely to broaden the cycle into generation, grids and storage than to derail it.

A food price shock is the clearer risk to EM inflation. Higher fertiliser prices in combination with a super El Niño could significantly lift EM food prices in 2027, and food is a large component of EM consumer price index baskets. So far, inflation has remained subdued, with food inflation below 2% as of August and real rates in most large EM economies at 15-year highs.

Fig 6: **Nominal interest rates vs inflation in the GBI-EM GD (local currency benchmark)**



Source: Ashmore, Bloomberg. Data as at September 2026.

Fuel subsidies are a fiscal risk in smaller, fragile energy importers. Based on current energy prices, our modelling suggests annualised subsidy costs or lost fuel tax revenues exceed 2% of GDP in Ecuador and Egypt, with Brazil, India, Thailand, Indonesia and Malaysia facing hits of 1-2%. However, prices are unlikely to hold at these levels into 2027, and governments can pass more cost to consumers if they do. More broadly, EM fiscal accounts are in much better shape than DM, with Colombia and Brazil the critical outliers. Separating reformers from troubled credits will drive EM fixed income alpha over the next 12 months.

Summary & Conclusion

The Fed is tightening into an energy shock, which would typically be a strong headwind for EM assets, but so far has only produced a small correction. Cash flow rather than credit funds the capex cycle propelling EM earnings, Chinese overcapacity offsets the energy impulse to inflation, and USD strength in 2026 has been tepid despite a bullish backdrop. In our view, neither the energy shock nor the Fed hike will undermine the fundamentals behind EM outperformance, running since 2023 in fixed income and 2025 in equities.

We believe any USD strength on higher US real yields will provide an investment entry point. We prefer EM local currency debt, where real yields sit near 15-year highs and currencies have upside, and favour EM equities over DM, where outperformance has been earnings-driven rather than multiple expansion. The key risks are that the Fed hikes rates until a weak link, such as private credit, breaks, or that a food price shock tests EM central bank credibility.

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Emerging View

Emerging market resilience tested by energy shock and Fed hikes

8 October 2026

By Gustavo Medeiros and Ben Underhill



The Fed is tightening into an energy shock, a combination that has triggered EM crises before. This time the reaction has been muted. We explain why, and the four questions that will shape the outlook from here.

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Head office

Ashmore Investment Management Limited, 16 Palace Street, London, SW1E 5JD T: +44 (0)20 3077 6000

Local offices

Bogota T: +57 601 589 9000	Lima T: +511 391 0396	New York T: +1 212 661 0061	Tokyo T: +81 03 4571 1601	Fund prices www.ashmoregroup.com Bloomberg FT.com Reuters S&P Lipper
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