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For investment professionals only

Ashmore

Disinflation, not debasement points to 'goldilocks' in 2026 (Abridged)

In 2025, emerging markets (EM) enjoyed their strongest year of asset outperformance since 2017. As we expected, broad-based rate cuts and a weaker US dollar supported the rally. Amid macro uncertainty stemming from US trade policies, the flexibility of global supply chains shone through, as did the resilience of EM economies. This was reflected in the second consecutive year where credit rating upgrades surpassed downgrades.

With peak tariff risk in the rear-view mirror, the market is now focusing on new narratives. We think these will ultimately converge around lower rates and lower inflation in 2026, providing a 'goldilocks' backdrop for EM countries to continue outperforming.

These views are anchored in five main themes:

1. **The AI capex cycle:** In our view, the sequencing of the impact of AI on macro will be the key dynamic to monitor in 2026. We see AI's first-order effect as disinflationary, or outright deflationary, in 2026 via the labour markets.
2. **China doubling-down on its export-led development model** will keep sending a deflationary impulse to its trading partners.
3. **The monetary debasement narrative is stale** and not aligned with recent macro dynamics or the outlook, particularly as...
4. ...**geopolitical risks are easing**, with certain exceptions such as in Venezuela.
5. **EM ex-China GDP growth** keeps inching up. We see upside risks for GDP growth in many key EM countries, including China, India, Indonesia, Mexico, Brazil, South Africa and frontier market (FM) economies implementing reforms.

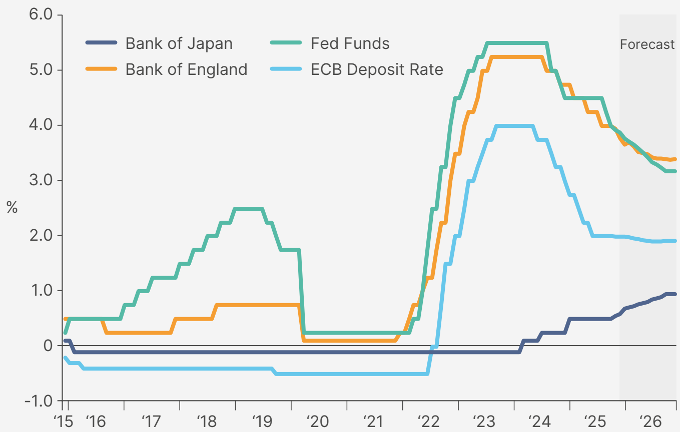
AI capex cycle and its macro effects

The AI capex super-cycle remains in its early innings and continues to be the engine driving GDP growth in the US, exports in North Asia and to a certain extent, global risk sentiment.

Though the epicentre of investment remains the US, China is also making significant capex commitments and further upstream in supply chains, many of the companies that stand to benefit most are EM-based, such as semiconductor manufacturers and metal miners. Underpinning the strength and length of this investment cycle will be global liquidity conditions and borrowing costs.

If AI proves to be deflationary next year, driving productivity up and employment down, as we suspect it will, the US Federal Reserve (Fed) and other central banks will have more room to ease monetary policy. This would support a broadening of economic activity, particularly in cyclical sectors such as manufacturing.

Fig 1: **G4 policy rates implied forwards**



Source: Bloomberg, Ashmore. Data as at 25 November 2025.

The Fed is already expected to cut rates by 75 basis points (bps) next year while the European Central Bank is expected to hold rates, and the Bank of Japan is expected to hike rates. This is likely to reduce interest rate differentials between US Treasuries and European and Japanese bonds, keeping the USD soft into 2026 and EMFX to keep performing.

Deflationary, then inflationary

If AI maintains its breakneck pace of development and growth, increased adoption will eventually lead to bottlenecks in supply of energy, chips, and metals. From an inflation perspective, the most important of these will be energy. The US Energy Information Administration (EIA) and JP Morgan see the oil and gas markets in a surplus throughout 2026. However, several studies suggest electricity and some energy sources, including natural gas, could become a constraint towards the end of 2026 and into 2027.

Bubble?

AI has already been driving tangible increases in productivity and good return on invested capital (ROIC) for the leading adopters. Tech companies have been increasing earnings while reducing headcount.

In our view, hyperscalers investing in their cloud businesses do not face a material risk of malinvestment, given their oligopolistic position providing the lifeblood of the modern and future economy: computing power. While revenues of the core AI-enablers continue to increase rapidly, and free cash remains the main source of capex funding, it is hard to call it a 'bubble' akin to the dotcom era, where the leading tech companies were not profitable. Nevertheless, US tech companies are expensive, and we see much better valued opportunities to play the AI trade within EM.

China exporting deflation to the RoW

The other macro trend justifying a goldilocks environment for asset prices next year is the ongoing downward pricing pressures from China. Its "high savings, high investment" economic structure has led to structural deflation problems which will not be straightforward to solve. Boosting domestic consumption is key to rebalancing the economy, but for now China is only taking incremental measures to support retail sales. Further, the readout of the 15th Five Year Plan (2025-2030) put the clearest emphasis on investing further to boost productivity across the Chinese high value-add manufacturing sector.

Export volumes will likely continue to increase as producer prices remain in deflation which could bring risks to growth for China's competitors in the long term.

In 2026, however, we think the primary macro lever will be disinflation, prompting EM central banks to cut policy rates further and setting up a 'goldilocks' macro environment of stable growth amid very low price pressures.

Monetary debasement, the narrative versus reality

Few believe that major governments can impose fiscal discipline over the long term. Many are expecting 'fiscal dominance' dynamics to re-emerge, with central banks accommodating fiscal indiscipline by financing deficits. This year, the narrative has intensified due to the risk of the Fed losing its independence. We think the zeitgeist is exaggerated here. With tariffs, the US has consolidated its primary deficit from 3.8% in 2024 to 2.7% as of Q3 2025. Nominal US bond yields have come down and implied inflation on linkers has fallen.

Real rates have also declined, but if what we were seeing was a pricing of debasement, we would expect to see inflation expectations rising and compressing real rates further, not falling as they have this year.

If AI is indeed disinflationary in 2026, the global macro picture will turn closer to goldilocks than to debasement next year. As central banks cut further, we may see a broadening of GDP growth across sectors which were struggling with high rates. In this environment, government debt ratios can stabilise (nominal growth > interest rate) but for healthier reasons. Declining geopolitical risks at a time when the global oil supply is in surplus may reduce inflation pressures further in 2026.

Global economic growth vs. Inflation, where consensus can be wrong

Consensus estimates are for growth to stabilise across DM and EM next year. EM GDP is likely to decline at the margin due to China, where the median forecast has GDP growth falling from 4.8% in 2025 to 4.3% in 2026.

EM ex-China is expected to inch up, although India – the largest country in EM-ex China – is expected to flatline at 6.7%. DM growth is expected to tick down, with Japan and the US the main culprits of softness. But macro uncertainty is less elevated than it was last year.

Thus, we think that risk is skewed to the upside for large EM countries, given our view that global interest rates continue to fall, and the passing of trade war uncertainty releasing pent-up demand for capex.

In our opinion, the key risk to global markets in 2026 is an early end to the easing cycle in the US if inflation accelerates, or a true equity bubble scenario, driving rates wider and the Dollar higher.

2026 Outlook for EM equities

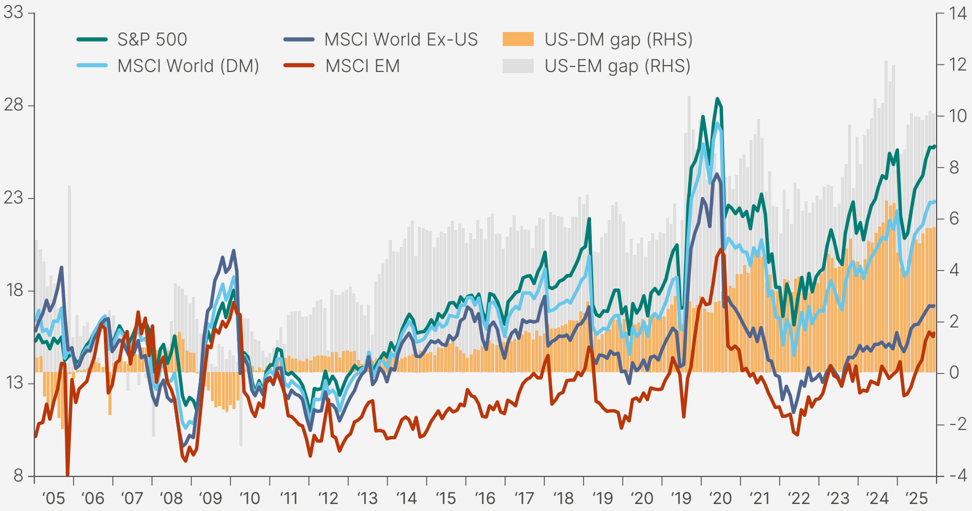
A mild convergence in valuation explains about half of the outperformance of EM stocks year-to-date (YTD), with currency also playing a role. But the key has been the second consecutive year of higher earnings. MSCI EM has seen 13.5% growth in earnings-per-share (EPS) YTD, vs 11% in US stocks.

EPS growth expectations in EM continue to rise, keeping forward-looking valuations attractive. Consensus estimates now indicate 18% earnings growth in EM over the next 12 months. Much of this growth is expected to come from some of the largest companies in the index, such as TSMC and SK Hynix, which are levered to the global technology cycle.

Earnings growth drivers across the EM index are diverse, with other countries such as Brazil expected to post very strong earnings growth, with 20% the consensus for 2026.

If EM stocks can meet these earnings expectations, or even get close, they are likely to attract further capital flows. The prospect of high-teens EPS growth next year, and further valuation convergence to the US, should be front-of-mind for any global asset allocators, particularly as most still have a tiny exposure to EM equities.

Fig 2: **Price to earnings valuations, DM vs EM**



Source: Ashmore, Bloomberg 8 December 2025.

2026 outlook for EM debt

Over the last three years, EM local currency bonds (EM LC) outperformed the global aggregate bond index by more than 20%. EM corporate and sovereign high yield outperformed the US by 10% and 20%, respectively. We expect this outperformance to continue as EM macro stability keeps improving, especially relative to DM.

In EM hard currency debt, tight credit spreads are justified, in our view, by improving economic fundamentals and credit rating upgrades: over the last two years, all three rating agencies have delivered net upgrades to EM countries. Valuations are also supported by technicals. In total, the EM hard currency bond universe is valued at less than USD 3trn, just 10% of the total US Treasury stock in issuance.

We see particular value in EM LC bonds in 2026, given our view that the USD will continue to weaken on Fed cuts, which will also allow EM central banks to cut rates more. In our view, investors will keep diversifying away from USD assets, driving inflows into EM LC bonds, which have already turned net positive in 2025 for the first time since 2021.

We wrap up the fixed income outlook with our total return scenario analysis. The starting point is three scenarios for the US rates curve in different economic environments: soft landing, no landing and hard landing. The spread forecasts follow the historical relationship with yields in different scenarios.

This year, the stress test includes some spread widening if US Treasury yields increase in a no-landing scenario in Fig 3 (the Fed doesn't cut) as this would likely signify a tightening of financial conditions. Notably, EM LC offers the highest upside for only a moderate downside in a no-landing scenario, meaning it remains our preferred asset class across EM debt to increase exposure to in 2026.

Fig 3: **Fixed income ex-ante returns scenarios 2026**

Economic Scenario	Current Levels			10-year UST Level			1-year Return Scenario		
10yr UST	8.1	4.01%	–	3.88%	4.50%	3.00%	5.1%	0.0%	12.2%
Asset Class	Duration	Yield	Spread	Soft Landing	No Landing	Hard Landing	Soft Landing	No Landing	Hard Landing
				Spread Change Over 1yr			1y Ann. Return Scenarios		
EM USD Sov (EMBI GD)	**6.6**	**6.31%**	**273**	**-7**	**25**	**161**	**7.1%**	**1.4%**	**1.1%**
USD Sovereign IG	7.5	5.31%	103	-4	15	106	6.5%	0.5%	4.7%
EM USD Corp (CEMBI BD)	**4.5**	**6.35%**	**251**	**-8**	**30**	**181**	**6.4%**	**2.6%**	**0.5%**
USD Corporate IG	4.9	5.24%	140	-3	10	96	6.0%	2.3%	4.7%
Local Currency	Duration	Yield		LC Yield & FX Change			1y Ann. Return Scenarios		
GBI EM GD	5.3	5.91%	Yld Chg	-0.1%	0.4%	-1.0%	14.6%	-2.0%	8.2%
			FX Chg	7.5%	-5.0%	-2.5%			

Source: Bloomberg, JP Morgan, Ashmore.
Data as at November 2025.

*Default Assumptions: Base Case = Average of 10yrs Bear case: Worst 10yr Bull case = Best 10yr (Rolling 5yr defaults).
**Spreads: Widen to 100bps below Covid-19 levels on hard landing. Tighten more on a soft landing than no-landing.

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