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# Not all Emerging Markets are equal: Hormuz, triple deficits, and the new energy risk premium

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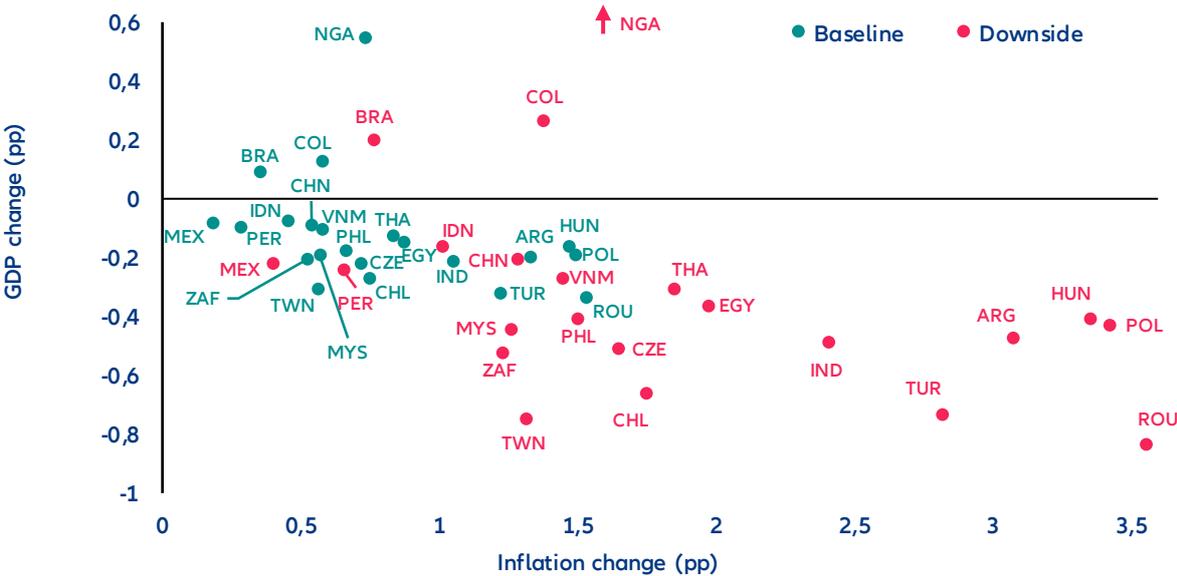
## In Summary

- **Less than 2 months' disruption of the Strait of Hormuz could push average EM inflation higher by +0.8-1.0p with limited recessionary effects – apart from GCC countries.** We estimate that the closure of the Strait of Hormuz up to six weeks would result in a -1.6pps decrease in GDP for Saudi Arabia and -3.3pps for the UAE. Tourism – a key pillar of diversification across the Gulf – would also be hit in the short term, with knock-on effects on FDI and mega-project timelines including AI.
- **From price shock to supply shock? As the conflict drags on, Asian economies could face supply disruptions on top of stronger inflationary shocks, given that 56% of their oil imports and 30% of their total gas imports originate from the Middle East.** In Asia, Taiwan, Vietnam, Thailand, Pakistan, Bangladesh and Sri Lanka are more exposed to a supply shortage while in Africa, Egypt, Ethiopia, Kenya and Tunisia would suffer the most from a global oil supply shortage, given their exposure to Middle Eastern hydrocarbons. A temporary shortfall could be partially mitigated through adjustments in the energy mix (i.e. coal and renewables to a lesser extent), but energy supply disruptions for an extended period would require demand rationalization of -5 to -7% in the final energy consumption should prices double.
- **Beyond three months of closure for the Strait of Hormuz, many more EM countries are at high recession risk as they run triple deficits (fiscal, current account, energy).** GDP growth impact would average at least -0.5pp to 3.1% for emerging markets excluding China. Bangladesh, Egypt, Ethiopia, Jordan, Kenya, Morocco, Pakistan, Poland, Romania, Sri Lanka and Tunisia would be most at risk. Meanwhile, a second group of economies sits in moderately high risk as they have more room to maneuver to support their economies: Chile, China, Hungary, India, the Philippines, Taiwan, Thailand and Türkiye. By contrast, large commodity exporters such as Brazil and Mexico appear structurally resilient despite fiscal deficits as energy exports cushion the impact of higher prices.
- **The shock came at a supportive moment for EM carry. It calls for selectivity along a targeted energy risk premium.** Early market repricing has begun: FX markets reacted quickly, with the Egyptian pound experiencing the largest depreciation (-9.2%), followed by the Hungarian forint (-8%) and the Chilean peso (-4.9%). Repricing in local bond markets reveals a highly differentiated picture. In Mexico, the rise in nominal yields is largely explained by higher inflation expectations, while in Central and Eastern Europe – where the sell-off has been strongest – markets are pricing a larger share of risk and liquidity premia. The shock also complicates the policy outlook: With energy-driven inflation risks rising, many EM central banks are likely to remain on hold for longer despite slowing growth. A prolonged conflict could see inflation expectations repricing more forcefully across EM curves, steepening local yield curves and delaying monetary easing cycles. Overall, the adjustment is likely to remain selective rather than systemic. The most likely outcome is therefore the emergence of a targeted energy risk premium across vulnerable EM economies rather than a broad-based sell-off across the asset class.

### From price shock to supply shock?

The 40% spike in energy prices in the first week of the conflict is the most rapid transmission channel to the global economy. On 9 March, the oil benchmark briefly reached USD120/bbl, later dropping to USD80/bbl. At the time of publication, oil remains around 15% above its pre-conflict level. Even if energy transportation is disrupted for only a short period, the conflict will still have a lasting impact on energy prices as it would take several weeks for production and supply to go back to pre-conflict levels. We expect prices to return closer to USD70/bbl, which would still be 16% above the pre-conflict baseline. This shift could push average EM inflation higher by 0.8-1.0pp, but the magnitude will depend on countries' energy exposure (particularly across Asia and energy-importing EMs). CEE economies – particularly Hungary and Romania – face the largest GDP hit given acute energy import dependency, followed by Thailand and Chile. Oil exporters such as Nigeria, Colombia, and Brazil would be relatively shielded, while Indonesia stands out among importers as more resilient given significant domestic energy production capacity.

Figure 1: Change to inflation and GDP growth rates in 2026 in selected EMs, baseline vs downside scenario



Sources: Oxford Economics, Allianz Research

The most immediate economic consequences are concentrated in the countries closest to the conflict — across the Gulf and the wider Middle East — where normal economic activity has been directly disrupted by the conflict. Early estimates of a short-term conflict show a GDP drop for Saudi Arabia and the UAE of -3pps and -4.3pps, respectively, considering major economic disruptions, the fall in tourism and a temporary drop of energy exports due to the effective closure of the Hormuz Strait. However, a short-lived conflict would also bring a quick rebound, with rates of +6.5% in Saudi Arabia and +7.6% in the UAE. The GDP loss in the entire Gulf Cooperation Council would be -3.3pps, with a considerable rebound of +6.4% of GDP growth in 2027. Dubai's real estate sector — one of the world's most dynamic property markets in recent years — took a significant hit on the Dubai financial market in the week since the conflict began, with main listed developers repricing sharply between -13% and -17%. The rest of the region, specially Kuwait and Bahrain, will be the most impacted given its dependence on the Hormuz Strait for both exports and imports. Bahrain's sovereign CDS spreads have widened by nearly 40% since the outbreak of hostilities — the sharpest move within the GCC complex and a clear market signal that investors are differentiating sharply between Gulf credits on the basis of fiscal resilience and hydrocarbon self-sufficiency.

The long-term war scenario would result in harsher consequences via a large drop in hydrocarbon exports and reduced confidence in the region. History indicates several scenarios for how the conflict could impact the region. The Iraq-Iran tanker war in the 1980s, which threatened the closure of the Strait of Hormuz, had large long-term

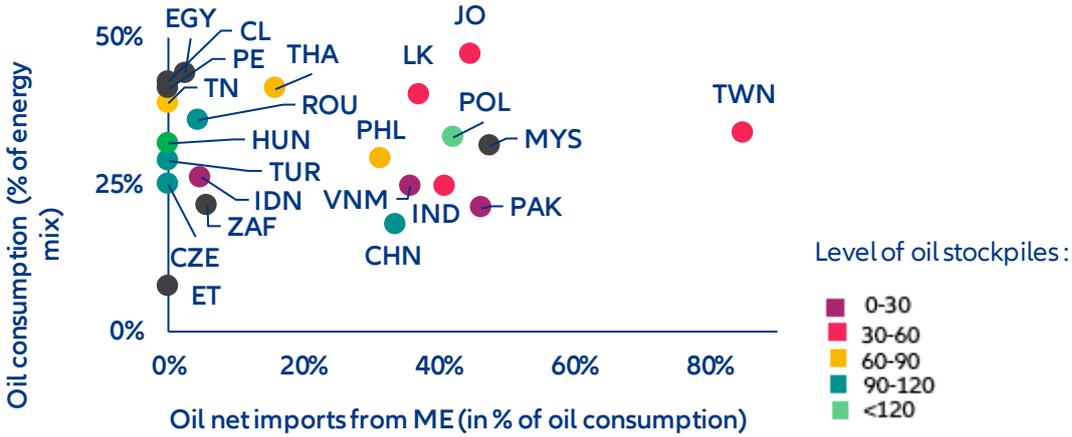
implications for Saudi Arabia, with the Kingdom growing at an average of +0.5% between 1981-1988 due to lower exports of oil. While both Saudi Arabia and the UAE both have some capacity to continue oil exports through different pipelines that connect their oil fields to ports outside of the Gulf, a sustained closure of the Hormuz Strait would greatly reduce both countries' hydrocarbon exports. Kuwait, Qatar, Bahrain and Iraq, which do not have much capacity to export without circulating the Strait of Hormuz, would suffer the most. Saudi Arabia and the UAE have both also enjoyed large inflows of investment and people, especially since the pandemic due to their open borders, tax exemptions for residents and increasing leisure and tourist attractions. Historical precedent suggests Gulf tourism could recover within one to two years. But if the conflict drags on and reshapes the region's security perception durably – as happened with Egypt between 2013 and 2017 – the recovery timeline extends to five to seven years, with compounding effects on FDI, mega-project timelines, the broader Vision 2030 ambitions and the region's ambition to become a global AI hub. The physical risk of data centers (Iran has targeted at least three data centers operated by Amazon in the UAE and Bahrain) and the consequences that this brings to economic activity in the country as it could paralyze banks, government offices, etc. Beyond the GCC, the rest of the region could be further impacted, with countries as far as Egypt or Türkiye recording drops in tourism.

**A second wave of impact would come from hydrocarbon shortages from a longer closure of the Strait of Hormuz. This would turn into a significant supply shock – a qualitatively different and more damaging scenario that in most cases would lead to a recession in countries dependent on energy from the Gulf.** Asia would be the most impacted region, given the high dependence on Middle Eastern hydrocarbons, with 56% of the region's oil imports coming from the Gulf. Gas prices could potentially double, which could trigger a fall in gas consumption of 5-7% in Asia. Building from the European precedent, we estimate that every -1% drop in gas consumption would equal 0.08–0.10pp GDP growth loss. Hence, for Asia, this could mean an impact above -0.5pp of GDP for the most impacted countries such as South Korea (-0.7pp) or a drop below 0.2pp as it is the case for India (-0.1pp).

**The impact across Asian economies would be asymmetric, with Taiwan, Pakistan and Vietnam among the most impacted while Malaysia, Indonesia and China would remain shielded.** Taiwan emerges as the most exposed country through its high dependence on Middle Eastern hydrocarbons, high dependence on oil in the energy mix and very low levels of oil stockpiles domestically. Pakistan and Vietnam are also in a delicate situation, with around 40% of oil consumption dependent on Middle East sources and very low reserves. However, their energy mix is slightly less dependent on oil than other EMs with a similar dependence on the Middle East but higher reserves. Despite reserves of around a month, India, and more particularly Sri Lanka, present similar characteristics and are also highly exposed. Thailand is another economy at risk: Despite relatively well-filled reserves and a low dependence on the Middle East, the country's high reliance on oil in its energy mix could result in a higher inflationary impact as it will need to buy more oil compared to peers. Similarly, if the conflict and closure of the Hormuz strait were to last, the Philippines and Indonesia could also start seeing some inflationary impact as more and more countries start competing for new partners. Despite a relative dependence on imports from the Gulf, China benefits from one of the highest levels of reserves in the region combined with a relatively low dependence on oil in its energy mix. And Indonesia should be shielded from an inflationary shock despite low reserves, given its low dependence on the Middle East, but also on the rest of the world.

**Non-Asian emerging markets are comparatively better insulated from the Strait of Hormuz disruption.** European emerging markets are relatively shielded by their low exposure to Middle Eastern crude – with the exception of Poland – relatively low oil dependency in the broader energy mix and solid strategic reserves. Despite higher reliance on oil, Latin America countries are amongst the most isolated from the shock due to a very low reliance on Middle East imports.

Figure 2: Oil dependency on the Middle East in selected EMs



Note: Oil dependency is computed as net imports of crude oil from Middle East divided by total oil consumption.

Sources: IEA, UN Comtrade, Allianz Research

**The final macroeconomic impact would also depend on the scale of government support measures implemented to cushion households and firms.** Policy responses could significantly mitigate the inflation shock, as seen during the 2022 energy crisis in Europe. At that time, European governments deployed energy-support measures equivalent to roughly 4% of GDP over a year, including price caps, tax cuts and transfers. Assuming the shock remains roughly half the size of the 2022 European energy shock, Asian economies, given their higher dependence on imported energy, would likely require subsidies of around 0.25% of GDP (or about 2% annualized) to smooth the impact on households and firms. In the CEE region, Hungary has already introduced fuel price caps, increasing pressure on the fiscal deficit running already at -5.1%. In Asia, Indonesia, South Korea, and Japan are providing continued support to their populations through energy subsidies and oil price caps. In the Middle East, Egypt sits in a precarious position, subsidies remain substantial, with the 2025/26 budget already allocation 0.6% of GDP, with a fiscal deficit already at -10% and a matched external deficit, Cairo could fall into fiscal slippages. During the last shock, UAE and Qatar supported Egypt with large transfers of capital, but with new priorities in the Gulf capital's due to the war, it remains a question how Egypt could sustained a long-period of high energy prices.

**Despite potential mitigations channels, energy supply disruptions would require demand rationalization.** While part of the shortfall could be mitigated through adjustments in the energy mix – for instance via a temporary ramp-up in coal generation – and roughly half of the disrupted volumes could potentially be rerouted or offset by higher oil production elsewhere (notably in the US or Russia), supply substitution would only partially compensate for the disruption. In that scenario, energy-demand rationalization would become unavoidable, affecting both companies and households. Several Asian economies — from Japan to Thailand — are feeling the strain of the Hormuz closure and have moved quickly to manage supply, implementing measures ranging from fuel export bans and energy-saving policies such as four-day workweeks and remote working mandates, to ramping up oil purchases from Russia. The European experience in 2022 illustrates the scale of adjustment that may be required. At the peak of the crisis when gas prices tripled to 330 EUR/MWh, and for a dependency to Russia of more than 40% of total EU gas imports, Europe managed to reduce gas consumption by almost -20% driven by high prices, supply shortages and emergency policy measures.

**The Middle East represents 30% of total natural gas imports to Asia, again with some disparities across individual countries.** With 80% of its imports coming from the Gulf, India is the most exposed to the repercussions of the conflict on gas prices, followed by Vietnam and Indonesia. However, as natural gas does not represent a high share of these countries' energy supply, the impact should remain relatively muted. Though the shock will be much less than that of oil, Thailand, Taiwan and Pakistan should be carefully monitored as they present a larger share of

natural gas in their consumption mix compared to the region combined with a relative dependence on imports from the Middle East, especially for Taiwan and Pakistan where the Gulf represents more than 25% of their consumption.

**More severe and systemic spillover effects would materialize if the Strait of Hormuz remains closed beyond the short-term threshold, transforming what began as a price shock into a structural disruption.** Each additional week of Hormuz closure compounds recessionary pressure as reserves deplete and supply shortages broaden. In a scenario extending beyond three months, EM GDP takes an average hit of -0.5pp or more, with the most energy-dependent economies bearing a disproportionate share. In that scenario, emerging markets running twin deficits – fiscal and current account – would face acute pressure as deteriorating energy import bills compound already-stretched external balances and financing needs. Those carrying a triple deficit – where an energy balance deficit layers on top – would be most severely impacted, facing simultaneous pressure on their currencies, sovereign spreads and growth trajectories, with limited policy space to respond.

**Countries combining fiscal deficits, external imbalances and energy import dependence emerge as the most exposed to a prolonged disruption in Middle Eastern energy supply.** Economies such as Romania, Poland and Tunisia display the clearest triple-deficit configuration, where sizeable fiscal deficits coincide with current account gaps and structurally negative energy balances. In these cases, higher oil prices would simultaneously widen external deficits, worsen fiscal dynamics through energy subsidies or weaker growth and weaken currencies through deteriorating terms of trade. Several frontier and lower-income importers – notably Egypt, Sri Lanka, Kenya, Ethiopia, Jordan, Morocco and Bangladesh – also appear particularly vulnerable given already elevated financing needs and limited macroeconomic buffers. In contrast, commodity exporters such as Nigeria, Colombia and Indonesia remain comparatively insulated as positive energy balances provide a natural hedge against higher oil prices, supporting both fiscal revenues and external accounts.

**A second group of economies sits in an intermediate zone where vulnerabilities stem primarily from energy dependence rather than broad macroeconomic imbalances.** Chile, China, India, the Philippines, Hungary, Taiwan, Thailand and Türkiye fall into this category. These economies run structurally negative energy balances and would therefore face pressure on external accounts if prices remain elevated, but the overall macro impact depends on policy space and external buffers. In several cases, relatively manageable current account positions, diversified economies or stronger reserve coverage could mitigate the shock. By contrast, large commodity exporters such as Brazil and Mexico appear structurally resilient despite fiscal deficits, as energy exports cushion the impact of higher prices. Overall, the table highlights that the transmission of a prolonged oil shock across emerging markets would remain highly uneven, with risks concentrated in economies where external imbalances, fiscal constraints and energy dependence overlap.

Table 1. Emerging markets exposure, market reactions and coping mechanisms

Country	Exposure to the Middle East crisis				Market reaction since Feb 27		Coping mechanisms					
	Energy balance (% of GDP)	Strategic oil reserves (days of consumption)	Vulnerability to energy price shock	Vulnerability to ME supply shock	FX (% change vs USD)	Bond yields (bps)	Fiscal balance (% of GDP)	Current Account (% of GDP)	FX reserves (months of imports)	FX outlook	Central Bank stance (by mid-)	Risk of fiscal slippage throughout
Argentina	0.6	NA	Medium	Low	-0.04	11.0	-1.5	-0.4	3.8	Neutral	On hold	Low
Bangladesh	-3.5	49	High	High	-0.41	32.1	-3.9	-0.9	4.9	Negative	On hold	High
Brazil	0.9	NA	Low	Low	-3.77	88.3	-7.5	-2.3	12.1	Positive	On hold	Medium
Chile	-4.4	25	High	Medium	-4.94	18.5	-0.6	-2.2	6.7	Negative	On hold	Low
China	-2.4	100	Medium	Medium	-0.56	38.0	-5.0	2.8	12.3	Neutral	On hold	Medium
Colombia	3.9	NA	Low	Low	1.31	N/A	-5.7	-2.6	9.6	Negative	Hike	Medium
Czechia	-2.4	117	High	Medium	-4.47	58.8	-2.1	0.4	9.3	Negative	On hold	Medium
Egypt	0.0	NA	Medium	High	-9.16	40.0	-10.7	-4.3	4.3	Negative	On hold	High
Ethiopia	-4.0	NA	High	High	-0.47	N/A	-1.7	-2.6	3.7	Negative	On hold	Medium
Hungary	-3.6	215	High	Medium	-8.02	94.0	-5.1	0.9	3.7	Negative	On hold	High
India	-3.7	30	High	Medium	-1.61	2.0	-1.8	-1.4	9.1	Neutral	On hold	Medium
Indonesia	1.1	20	Low	Medium	-1.04	40.7	-2.7	-1.2	7.1	Negative	On hold	High
Jordan	-8.0	45	High	High	0	-50.7	-3.5	-5.5	7.7	Negative	On hold	Medium
Kenya	-4.5	NA	High	High	-0.27	10.0	-5.6	-3.4	5.7	Negative	On hold	High
Malaysia	-0.4	NA	Medium	Medium	-1.23	7.6	-3.6	1.8	5.3	Negative	On hold	High
Mexico	0.7	NA	Low	Low	-4.25	48.5	-4.1	-0.3	4.3	Neutral	On hold	Medium
Morocco	-5.0	30	High	Medium	-3.28	21.5	-4.5	-1.5	7.4	Neutral	On hold	Medium
Nigeria	12.2	NA	Low	Low	-1.91	61.3	-3.7	3.6	12.0	Neutral	On hold	Medium
Pakistan	0.0	28	High	High	0.02	66.0	-4.1	-0.4	11.6	Negative	On hold	High
Peru	-0.5	NA	High	Low	-3.1	30.7	-2.2	1.2	14.8	Negative	On hold	Low
Philippines	-4.2	60	High	Medium	-3.59	68.8	-0.3	-3.5	8.2	Negative	On hold	Medium
Poland	-2.1	121	High	Medium	-4.86	83.1	-6.3	-0.8	5.7	Negative	On hold	High
Romania	-1.7	92	High	Medium	-3.54	101.0	-6.2	-6.6	6.0	Neutral	On hold	High
South Africa	-2.3	NA	Medium	Low	-6.39	96.0	-5.6	-1.2	5.6	Neutral	On hold	Low
Sri Lanka	-4.5	35	Medium	High	-0.63	4.4	-6.5	0.5	4.5	Negative	On hold	High
Taiwan	-5.1	40	Medium	High	-2.25	4.0	-0.2	13.1	15.9	Negative	On hold	Medium
Thailand	-7.8	60	High	High	-4.58	33.5	-2.5	1.3	8.9	Negative	On hold	Medium
Tunisia	-4.0	60	High	High	-3.07	N/A	-6.0	-2.0	4.9	Negative	On hold	High
Türkiye	-3.6	94	High	Medium	-0.64	233	-0.7	-1.3	2.7	Neutral	Hike	Medium
Vietnam	-2.5	15	Medium	High	-0.89	7.7	-2.3	2.4	2.3	Negative	On hold	Medium

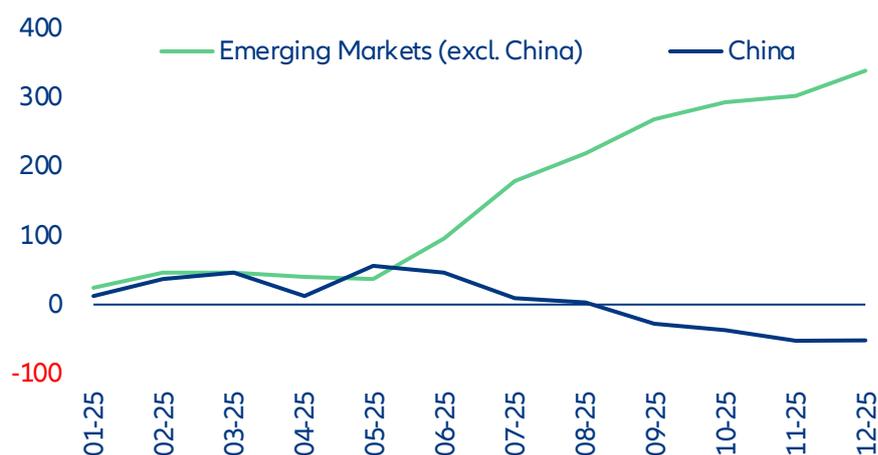
Sources: LSEG, Allianz Research. Note: Data as of 13/03/2026. In green central banks that were cutting before the conflict in the Middle East escalated.

Türkiye and India in particular sit at the intersection of competing blocs – geographically indispensable, politically non-aligned, economically interdependent – and risk paying a price. From a market perspective, both countries continue to post twin deficits (fiscal and current account balance). Last year, Türkiye returned to a positive primary balance for the first time since 2022, while India has had positive primary balance for some time. In the case of Türkiye, recent history shows that when energy prices were at their highest (2022, but also in the 2012-2014 cycle), Ankara has maintained a positive primary balance – at the expense of inflation. The current account will tend to be more negative this year, potentially hitting 2-2.5% of GDP if energy prices remain elevated, with effects on the lira and domestic inflation, but there may be room for subsidies. Fiscal discipline remains in place, but with debt/GDP at 25%, the value of gold reserves increasing further and the ever-present debate about bringing forward the presidential elections before their natural schedule in May 2028, the temptation to mitigate the effects of price increases in some way could also increase. India is also positioned with better footing than the 2022 scenario, with the fiscal deficit improved from the 2022 period (-0.8% in 2025 vs -2% in 2022) and the external balance at -0.2% of GDP. While an energy shortage could harm the country, India could shift oil and natural gas imports to domestic coal consumption, mitigating part of the shock. FX reserves remain very high at 11 months of imports.

### Energy price premium ahead for emerging markets?

The new escalation in the Middle East could reverse the record gains of emerging markets. 2025 began with pronounced outflows for emerging markets (excluding China), reaching a cumulative low of -USD10.8bn around the implementation of President Trump’s “Liberation Day” tariffs. But that marked a turning point as market sentiment and dollar depreciation turned in EMs’ favor, bringing back flows. As a result, 2025 ended with record portfolio flows (USD410bn), almost double from the previous year, much above the historical average and a turnaround from the capital outflows experienced after the pandemic. EM bond funds concluded 2025 with their first annual net inflows since 2021, totaling +USD31.8bn.

Figure 3: Capital flows towards emerging markets, USDbn



Sources: LSEG Workspace, Allianz Research

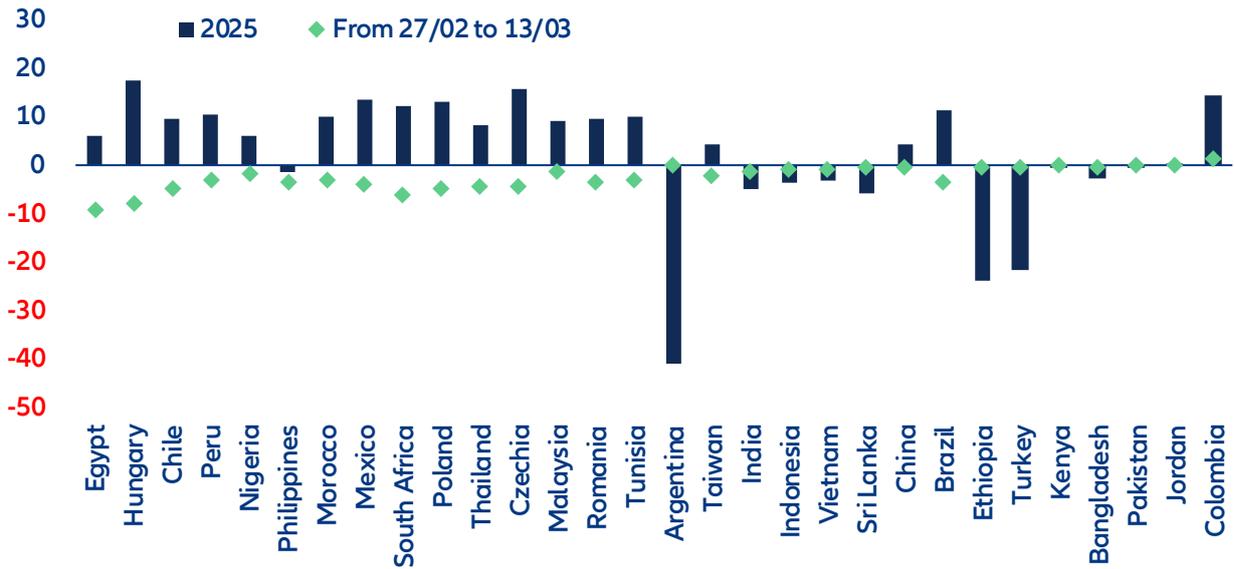
**Looking to 2026, while the EM asset class is structurally stronger, selectivity will be an essential aspect of the path ahead.** Direct benchmark exposure to the most vulnerable countries (Egypt, India, the Philippines, Thailand, Türkiye) remains limited, as they represent less than 3% of the MSCI Emerging Markets ex-China index. The most vulnerable European economies (Poland, Romania) would indeed feel the pinch of higher inflation but the risk of supply shortages would probably be offset by European mechanisms likely to be reinstated should the conflict last for longer.

**Foreign exchange markets reacted quickly to the escalation in the Middle East conflict, with most emerging market currencies weakening over the week.** Between 27 February and 13 March, several currencies recorded sharp declines as higher oil prices and a stronger US dollar triggered a broad risk-off move (Figure 4). The Egyptian pound saw the largest depreciation (-9.2%), reflecting its vulnerability as a large net energy importer with significant fiscal and external deficits. Central European currencies also weakened notably, with the Hungarian forint (-8%), Polish zloty (-4.9%) and Czech koruna (-4.5%) under pressure as the region's strong dependence on imported energy combined with the unwinding of investor positions. In Latin America, the Chilean peso (-4.9%) stood out among the underperformers given its negative energy balance, while in Asia the Philippine peso (-3.6%) and Thai baht (-4.6%) also weakened in line with the region's heavy reliance on Middle Eastern oil supplies. Part of the sell-off reflects the unwinding of earlier investor positioning: several currencies that had performed strongly earlier in the year were among the largest underperformers during the recent risk-off move.

**As market conditions stabilize, currency movements are likely to more clearly reflect differences in countries' energy exposure.** Higher oil prices tend to support currencies of energy exporters while weighing on importers, suggesting that the currencies of some Latin American exporters, such as the Brazilian real and Colombian peso, could stabilize once the initial risk-off adjustment fades. By contrast, currencies such as the Hungarian forint, Korean won, South African rand and Chilean peso appear to have already incorporated part of the energy shock and may remain sensitive to how the conflict and oil prices evolve.

**Some currencies have remained relatively resilient despite their exposure to higher oil prices, notably the Indian rupee and Turkish lira, where active central bank management has helped limit volatility.** However, the longer energy prices remain elevated, the harder it may become to maintain this stability. Looking ahead, the duration of the disruption in the Strait of Hormuz will remain the key factor determining further FX pressure: a prolonged disruption would keep energy prices elevated and sustain US dollar strength, while a faster resolution would likely allow part of the recent currency weakness to unwind.

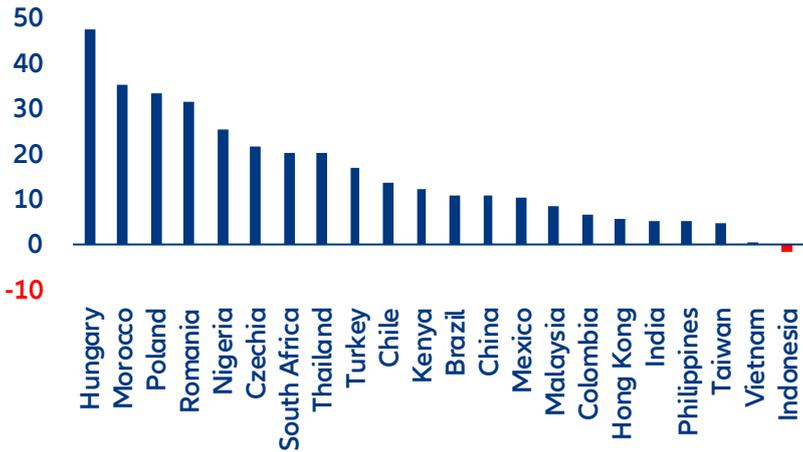
Figure 4: FX moves since the start of the Middle East conflict



Sources: LSEG Refinitiv, Allianz Research

**Even with the ongoing shock, we continue to see EM fundamentals as strong, partially mitigating part of the war impact.** FX reserves have remained elevated as many EMs used 2025 conditions to rebuild them, despite the challenges of US tariffs. India, South Korea, Taiwan and several Southeast Asian central banks recouped about USD132bn in FX reserves in late 2025 and early 2026, more than half of what they lost during earlier defensive currency interventions, aided by a weaker dollar and inflows. The Indian central bank has been particularly aggressive in rebuilding stockpiles to better defend the rupee on dips.

Figure 5: FX reserves have grown across most EMs over the last year (y/y growth)



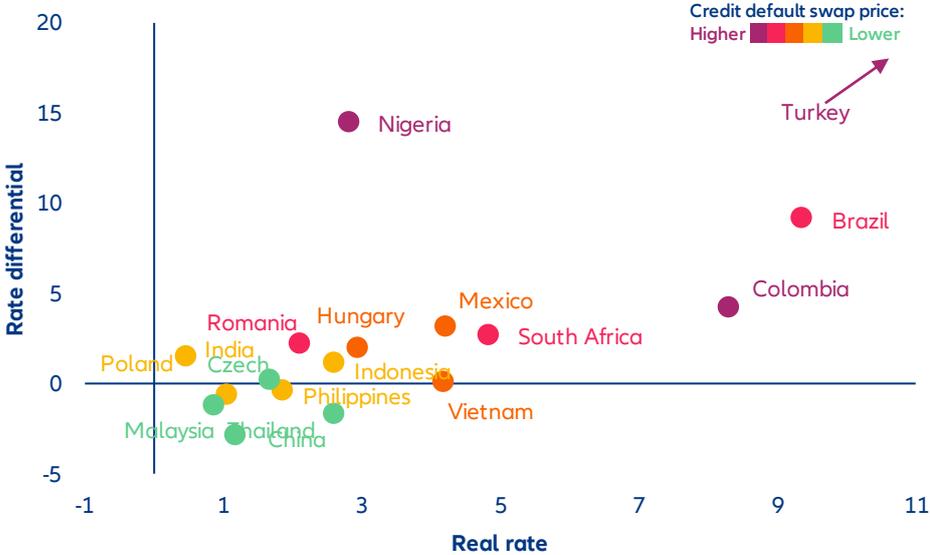
Note: International reserves including gold

Sources: LSEG, Allianz Research

**In this context, the Middle East escalation arrives at a positive moment for rate differentials as the US benchmark Treasury saw a broad fall, defined by a structural repricing of the US fiscal risk premium during 2025.** During 2025, real rates improved as inflation across EMs decelerated faster than nominal rates, allowing central banks to preserve a meaningful real rate buffer without undermining currency stability or triggering disruptive capital outflows. This parallel configuration revealed a broad improvement the EM universe while highlighting clear groupings within the universe. Türkiye, Brazil, Colombia, Nigeria, stand out with the widest nominal differentials to UST, though the investment case differs substantially across these markets. Türkiye, Brazil and Colombia also offer

elevated real rates, creating a rare alignment of internal and external value. South Africa, together with Mexico sit in an intermediate position, with an elevated differential and a high real rate, though less extreme than Brazil and Colombia. Meanwhile, China, Thailand and Malaysia offer small rate differentials to the US, suggesting these markets are priced primarily for domestic investors.

Figure 6: Real rate, rate differential and credit default swaps in selected EMs



Sources: LSEG Workspace, Allianz Research

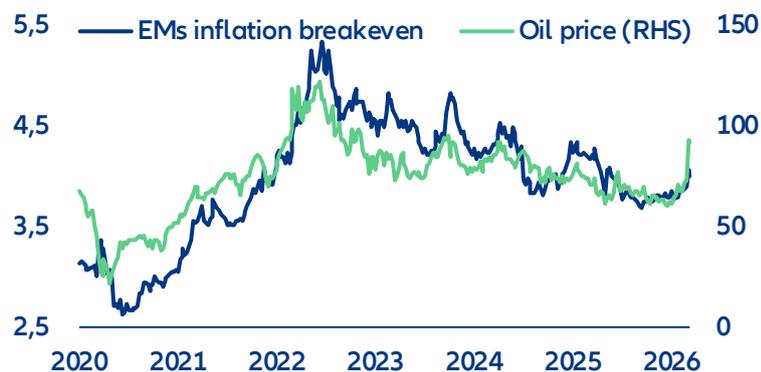
**However, this new geopolitical shock renews stagflationary fears, with central banks on hold due to higher inflationary pressures.** Inflation expectations have surged given the quick increase in prices during the one week of closure of the Strait of Hormuz – a dynamic already visible in US Treasury markets, where yields have risen sharply rather than fallen, as bond markets price the conflict primarily as an inflation shock rather than a growth one. This puts central banks in an acutely uncomfortable position: slowing growth would ordinarily call for rate cuts, but persistent energy-driven inflation prevents them from acting. The Fed, which had been on a gradual easing path, could now change path and keep on hold, or even hike through the rest of 2026. For emerging market central banks – many of which, like Egypt and Türkiye, are already navigating fragile disinflation paths – the constraint is even more binding, as currency depreciation pressures compound imported inflation, leaving little room to support growth without risking a renewed inflation spiral.

**Emerging-market sovereign spreads have widened modestly, reflecting the tone of cautious sentiment.** The move has been more pronounced across Africa, the Middle East and CEE Europe. The sharpest adjustments have occurred in the most directly exposed countries, such as Bahrain or Pakistan, where acute energy-import vulnerabilities have intensified market sensitivity. In contrast, the rest of the Gulf has remained relatively tight, supported by strong oil-related revenues that partially offset elevated geopolitical risks. This resilience should nonetheless be interpreted carefully. Historically, spread markets have tended to reprice geopolitical shocks with a delay, responding more forcefully once hard economic data begins to reveal the underlying impact. Should the Strait of Hormuz remain closed beyond roughly four weeks, and supply disruptions start feeding into macro indicators, a broader and more disorderly widening across EM credit, particularly among energy-import-dependent sovereigns, cannot be ruled out.

**The critical question is whether local bond markets are beginning to price the inflation risk.** Breakeven inflation (BEI) offers a real-time measure of market-implied inflation expectations. Since oil prices are an important driver of inflation compensation (Figure 7), a rise in oil should normally push EM breakevens higher. However, before the strikes, inflation protection across EM looked unusually cheap. For a representative basket of economies, the average 10-year breakeven stood at just 3.89%, while the historical sensitivity to a 10% rise in oil prices averaged

only +8bp in BEI – well below what our simulations suggest on actual inflation rate. In other words, inflation expectations were still responding to oil, but much less than in past stress episodes. This matters because the sensitivity of BEI to oil tends to rise when markets start to view the shock as more persistent and structural. If the conflict proves prolonged, inflation expectations across EM curves are therefore likely to adjust more forcefully.

Figure 7: EM 10Y inflation breakeven (excl. Türkiye) and oil price

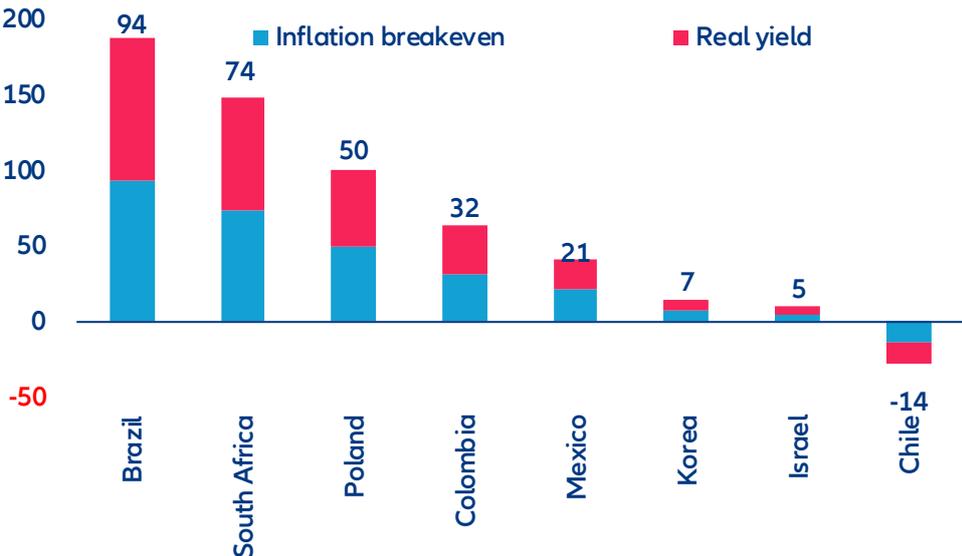


Sources: Bloomberg, LSEG Datastream, Allianz Research. Notes: Inflation breakeven is derived only for countries that have an active inflation-linked bond market. Countries considered are Brazil, South Africa, Poland, Mexico, South Korea, Türkiye, Chile, Israel and Colombia.

**Has that adjustment already begun?** Early evidence suggests that repricing is underway, but not uniformly. In the first week after the strikes (27 February to 9 March), South Africa recorded the largest breakeven widening, at +57bps, from 4.32% to 4.89%, consistent with its current-account vulnerability and energy import dependence. Poland's breakeven rose by +34bps and Mexico's by +28bps – meaningful moves in markets where pre-shock inflation expectations were running close to, or even below, central bank targets. However, the adjustment has not been universal. Colombia's breakeven fell by 45bps, as markets priced in the terms-of-trade gains of a net oil exporter, while Israel's rose only +10bps.

**A look at nominal 10-year yield moves helps clarify the forces behind the repricing and the extent to which it reflects inflation versus broader risk aversion (Figure 8).** Chile now stands out as the clearest case of inflation-led repricing: its +18bps rise in nominal yields was more than explained by a +33bps widening in breakevens, while real yields fell by 15bps, indicating that the move was entirely driven by higher inflation expectations. Turkey (+233bps nominal, including +181bps from breakevens) and Korea (+26bps, of which +20bps came from breakevens) also saw most of their repricing driven by inflation compensation. Mexico, which initially looked almost entirely inflation-driven, has since experienced a broader sell-off: nominal yields are now up +49bps, with +28bps attributable to breakevens and +21bps to real yields. This still points to an inflation-led move, but with a more visible risk-premium component than before. Brazil presents a much sharper contrast. Nominal yields rose by +88bps even as breakevens fell by 6bps, implying a +94bps increase in real yields and pointing clearly to higher credit and liquidity premia rather than inflation. South Africa has also moved in that direction. With nominal yields now up +96bps, breakeven widening has largely reversed to just +22bps, leaving +74bps accounted for by higher real yields, suggesting that the move is now dominated by risk aversion rather than the inflation repricing seen initially. Colombia (-13bps) remains the outlier, with nominal yields still rallying as markets continue to price terms-of-trade gains for a net oil exporter, while Israel (+14bps) has shifted from a modest rally to a mild sell-off. In CEE, Türkiye, Romania, and Hungary have recorded the sharpest sell-offs in local rates markets, with Poland not far behind. Türkiye's move (+233bps) – the most pronounced across all EM – reflects a confluence of acute oil import dependency, geographic proximity to the conflict, and a market that was already pricing fragile disinflation dynamics. Romania (+101bps) has overtaken Hungary (+94bps) as the second-largest mover in the region: both had benefitted from a strong rates rally going into the conflict, and the sell-off is in part a technical correction as investors take profit on stretched long positions, compounded by the region's energy vulnerability and broad CEE risk-off repricing. Poland (+83bps) and the Czech Republic (+59bps) round out a picture of broad-based CEE weakness.

Figure 8: EM 10Y local yield moves after the conflict: inflation breakeven vs real yield contribution, bps



Source: Bloomberg, LSEG Datastream, Allianz Research. Notes: Changes in yield from 27/02/2026 to 13/03/2026.

**The outlook for EM capital flows in 2026 is now firmly scenario-dependent. In a short-lived conflict – contained within four to five weeks – EM inflows should remain broadly positive, with markets normalizing relatively quickly toward pre-Liberation Day conditions.** Investors would nevertheless become more selective, differentiating more sharply between countries on the basis of energy exposure and inflation vulnerability rather than treating EMs as a homogeneous asset class. A prolonged conflict would alter that picture materially. Flows would rotate toward safer assets, while the most exposed economies – Egypt and Pakistan foremost among them – would face the sharpest outflow pressure as the combination of currency stress and imported inflation reshapes their risk profile. In this environment, the repricing is likely to take the form of a selective energy risk premium, differentiating sharply between exposed and insulated sovereign issuers rather than triggering a broad-based EM sell-off.

**This scenario dependency comes against the backdrop of an exceptionally strong year for EM debt issuance.** On the hard-currency side, sovereign issuance rebounded from roughly USD72bn in 2022 to around USD236bn in 2025 – the highest level on record – reflecting genuinely renewed access to international funding markets. Saudi Arabia and Türkiye were the primary drivers, with Türkiye’s issuance alone rising from USD12bn in 2022 to roughly USD31bn in 2025. Poland also contributed significantly, with issuance climbing to around USD30bn in 2024, while the UAE and Mexico provided additional support. Local-currency issuance expanded in parallel, led by Brazil, Poland and India, with the Czech Republic emerging as a particularly notable issuer at USD195bn – the largest absolute increase over the period – further supported by Thailand and Mexico. The scale of this recovery underscores how much is at stake: a prolonged conflict risks interrupting a multi-year rebuilding of EM market access at precisely the moment it had regained its strongest footing in years.

**Slightly more than two weeks into the conflict, we observe modest underperformance among the more exposed sovereign issuers.** While the Philippines continues to trade broadly in line with the wider market, Egypt – and in particular Türkiye and India – have experienced more pronounced spread widening. If the Ukraine conflict is taken as a reference point, spreads could widen by roughly one-third to one-half of pre-crisis levels. In practical terms, this would imply an estimated widening of around 80bps for Türkiye, 35bps for the Philippines, 180bps for Egypt and 35bps for India. It is worth noting, however, that Türkiye’s macro-financial position is materially stronger today than in early 2022, and that energy-related risk premia during the Ukraine episode ultimately proved short-lived.

These assessments are, as always, subject to the disclaimer provided below.

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