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#EMs / #Monetary policy / #AI

EM outlook Q3 2026: storm eases, clouds remain

The oil shock is just one of the winds buffeting emerging markets (EMs). From energy to technology to food, they have had to deal with a mix of supply and demand shocks. Further diplomatic progress in the Middle East will help take pressure off vulnerable EMs, although El Niño risks are rising.

Key Takeaways

- The oil shock has been a stress test for EMs. Oil-importing Asia has been on the front line, with FX pressure, inflation surprises and intervention needs rising faster than in other economies.
- The Middle East conflict remains a source of uncertainty, but some diplomatic progress has been made, suggesting the oil shock may abate.
- The surge in capital expenditure (capex) related to artificial intelligence (AI) should help counter the drag on consumption from this period of high oil prices, particularly for those deeply embedded in global supply chains.
- That said, the disappearance of petrodollars – as Gulf nations rebuild and re-arm – could keep markets sensitive to balance of payments and fiscal dynamics.
- Indeed, fiscal space will remain an important dividing line, influencing the ability of EMs to cushion any new energy or food price shocks on households. Although now looking less probable, a prolonged closure of the strait would likely result in further steps to roll back subsidies, even in fiscally strong tech exporters.
- Weather is the next wild card: a strong El Niño risks another supply shock, pushing inflationary pressure beyond oil and AI and into food.

EMs facing both inflation and market uncertainty

The war-induced surge in oil prices and broader supply disruptions, alongside shifting global rate expectations and the AI-driven capex surge, have created a series of heterogeneous shocks across EMs.

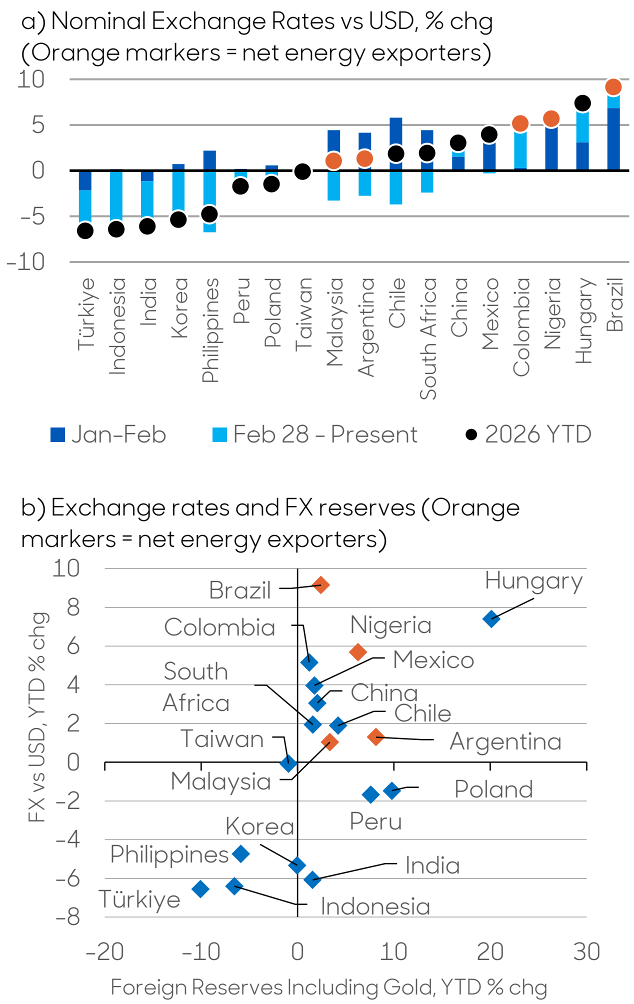
While the US and Iran signed a Memorandum of Understanding (MoU) to end the war in June, which had allowed traffic through the strait to recover, the recent flare-up in tensions has reversed this progress. And there is still a risk that neither side is willing to give enough ground to resolve key issues. As such, we cannot rule out the return of risk-off dynamics that exacerbate FX pressure on vulnerable markets.

Pressure has been most notable in Asian markets, which are heavily dependent on oil imports from the Middle East (see Figure 1), while the slide in the Turkish lira is a long-running affair that has been little changed by the conflict.

Central banks in the likes of the Philippines and Indonesia have opted to increase FX interventions at the expense of draining their foreign exchange reserves.

In other economies, including India and South Korea, the central banks have allowed the terms of trade shock to be reflected in their exchange rates, instead intervening only during bouts of excessive speculative pressures.

Figure 1: The duration of the war and closure of the strait will determine divergences between EM winners and losers



Source: Haver, Aberdeen, June 2026

Net oil exporters have been better insulated from depreciation pressure, though to varying degrees. The Nigerian naira has made notable year-to-date gains: oil makes up a larger share of the country's exports compared to other major EMs, being a tailwind for reserves. Meanwhile, the Brazilian *real* has been supported by still elevated real rates, even as the Banco Central do Brasil (BCB) carries out a very cautious easing cycle.

Amid the tense geopolitical backdrop, idiosyncratic factors have helped to insulate some EMs, while aggravating the market impact on others.

Hungary's exchange rate outperformance since the start of the war was chiefly driven by its April election resulting in a leadership change that markets see as conducive for reform and capable of unlocking EU funding.

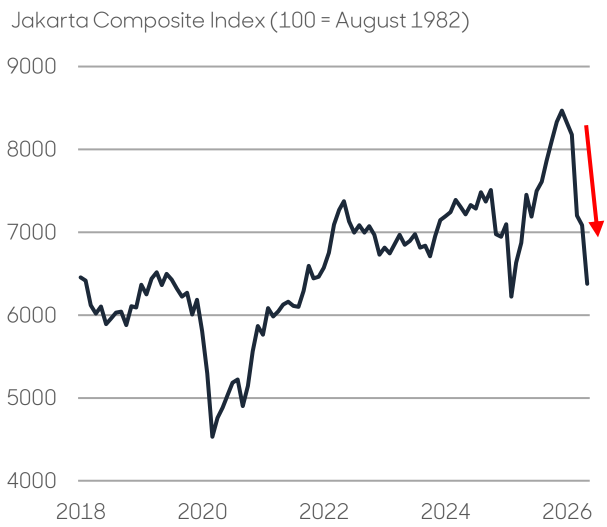
Colombia's peso has also seen renewed strength as markets have welcomed the win of right-wing candidate Abelardo de la Espriella in the presidential election. They hope it will result in a more fiscally prudent government, though whether that will occur remains uncertain.

In contrast, investor sentiment towards Indonesia had been worsening ahead of the conflict, owing to concerns over the direction of policymaking and the investment environment.

The response to the energy crisis has furthered the rout in Indonesian assets. The continued use of fuel subsidies has brought fresh fears that the government could suspend its 3% of GDP fiscal deficit limit, while announcements of a new state-owned monopoly on key commodity exports may have contributed to increased uncertainty for private investors.

To add to the concerns, Parliament passed a bill that increases oversight over the central bank and requires Bank Indonesia (BI) to place stronger consideration on growth. The central bank has hiked a combined 75bps to bolster credibility and support the rupiah, but the economy and market sentiment are vulnerable to a renewed rise in energy prices.

Figure 2: Indonesian equities under pressure



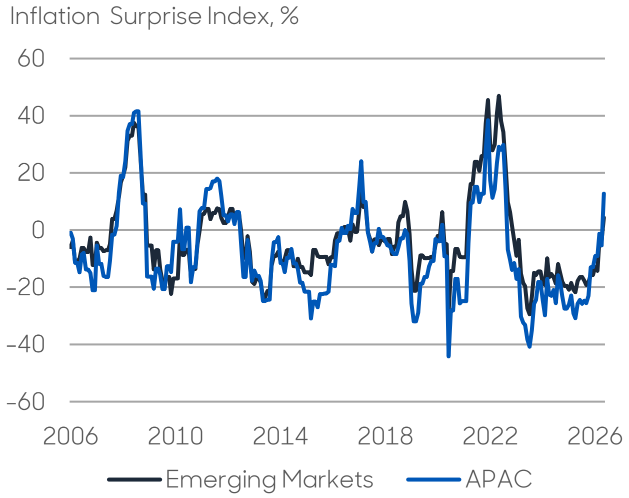
Source: Haver, Aberdeen, June 2026

Not just oil... EMs must contend with a series of supply shocks

The deteriorating inflation outlook has also contributed to market pressures on EMs.

The mix of higher energy prices and currency weakness has amplified price pressures, leading to upside inflation surprises, particularly in APAC, where the bulk of oil shipped through the strait would ultimately be delivered (see Figure 3).

Figure 3: APAC accounts for most of the inflation surprises



Source: Haver, Citigroup, Aberdeen, June 2026

Positively, inflation across most major EMs was consistent with or below central bank targets before the onset of the Middle East crisis (Türkiye, Romania and Colombia were notable exceptions).

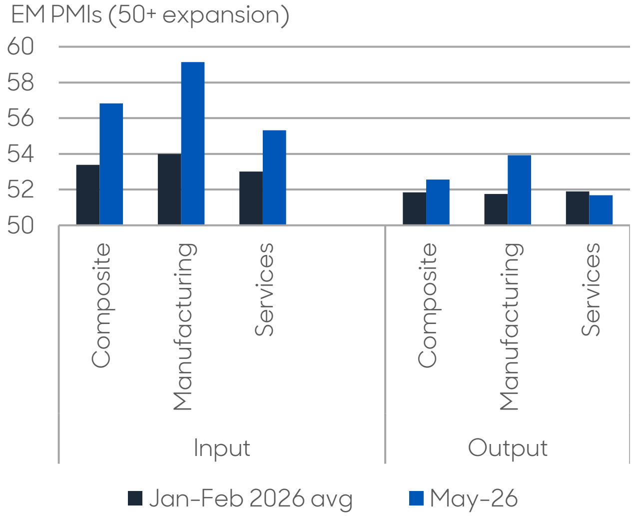
The rate of passthrough to consumer prices has also diverged across economies. Using the EM median annualised month-on-month change in CPI, we see a sharp spike from 2.7% in February to 9.0% in April, with the interquartile range widening as well.

Notable headline CPI increases have been observed in the Philippines, Brazil, Chile, Czechia, Peru, Romania, South Africa and Thailand, among others. However, the increases have been more muted in economies such as Hungary, India, Indonesia and Malaysia.

The use of subsidies and tax cuts but also idiosyncratic factors have driven these divergences. That said, leading indicators point to further pressure on consumer prices in the coming months, which could see more convergence.

PMI indicators suggest strong input pressures in the manufacturing sector and to a lesser extent services, albeit with firms taking some of the hit in their margins rather than fully passing on costs, particularly for services (see Figure 4). Moreover, supply disruptions are now emerging, with Malaysian businesses reporting the worst supplier delivery disruption since May 2022.

Figure 4: The passthrough to headline inflation will be partly determined by the margin squeeze



Source: Haver, Aberdeen, June 2026

Producer prices have been climbing more sharply, reflecting their greater exposure to raw materials and to supply disruptions. A composite of EM economies' producer price growth has risen to 10.8% year on year in April, the highest since November 2022. This suggests that a delayed passthrough to consumer prices can be expected. However, the extent of this will depend on the demand backdrop, while falling oil prices should help.

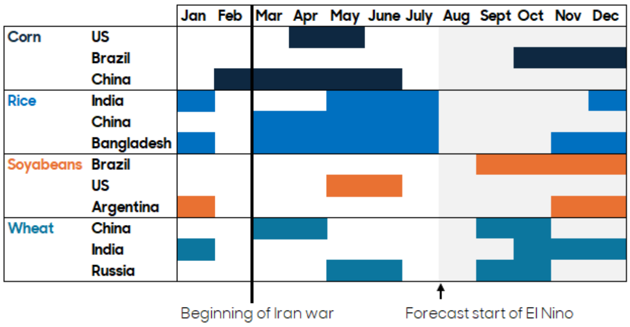
One area where demand will support a passthrough of costs is in artificial intelligence (AI) related exports. A sharp rise in AI-related capital expenditure (capex) has led to surging export prices in Taiwan and South Korea.

For example, Taiwanese electronic integrated circuit export prices climbed 13.6% year on year in May. This in turn will add to electronic goods inflation across both EMs and DMs.

Even the persistent deflationary effect from Chinese exports may be challenged, with producer price growth exiting deflation since March and our estimate of China's export price deflator up 11% since February.

We are also monitoring how potential climate impacts of El Niño may affect global agriculture activity and, by extension, food prices. Major meteorological projections have raised their probabilities for a particularly strong El Niño to begin over the summer and last potentially into early 2027 (see Figure 5).

Figure 5: Planting seasons for major agricultural exporters are nearing, suggesting disruption will be hard to avoid



Source: Aberdeen, Financial Times, June 2026

We have noted before how this could overlap with planting seasons for key crops and would risk exacerbating the fertiliser-related supply issues caused by our more adverse Iran scenarios, with EMs more exposed to the brunt of food costs.

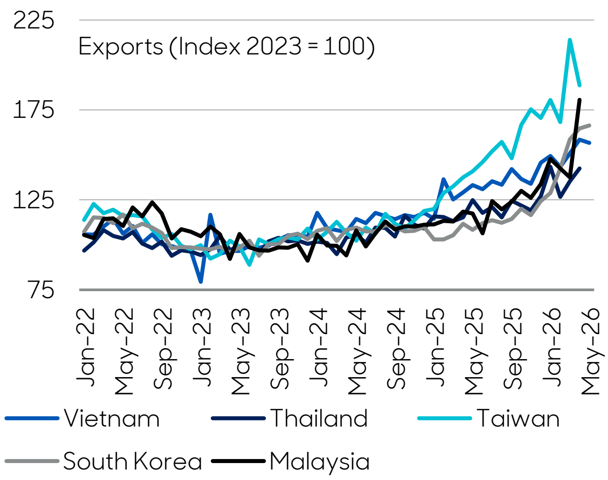
Potential drought conditions also pose additional risks for electricity prices in countries, like Brazil, that depend on hydropower, and could disrupt shipping via waterways such as the Panama Canal. The coming weeks and months will allow us to better gauge the extent of El Niño's potential ramifications.

AI to the rescue?

One positive for the EM outlook has been the AI capex cycle, which has boosted global export activity.

Strong demand associated with the AI rollout has led to surging exports for Taiwan and more recently for Korea and Malaysia, while indirect channels appear to be supporting Vietnam and Thailand within APAC (see Figure 6).

Figure 6: External demand is robust, benefiting the tech exporters in particular, but also creating an indirect boost



Source: Haver, Aberdeen, June 2026

Strong exports have not always been enough to protect against downward pressure on currencies and upward pressure on rates.

As shown in Figure 1, the Korean won is down ~5% year to date as of June, despite a 33% rise in exports since December and an estimated tax windfall worth 5% of GDP.

While the Korean case is not what macro textbooks would suggest, rapidly rising sales and a lack of repatriated earnings could partly explain the FX dip. And while unhelpful for the Bank of Korea (BOK), it may help shield other countries from the disappearance of petrodollars.

Gulf nations will not be adding to their sovereign wealth funds (SWFs) while oil revenues are curtailed, and a pause or even a period of drawdown to allow for repairs and an expansion of defence capabilities is plausible after the strait of Hormuz reopens.

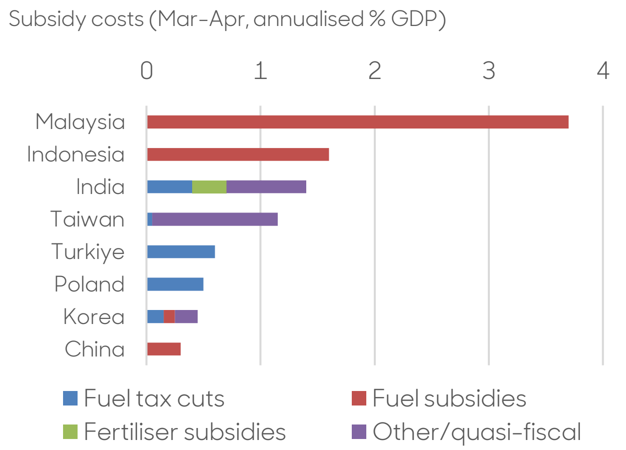
Policymakers mull their next steps

Economies with strong tech or commodity exports generally have more room for manoeuvre.

Taiwan's quasi-fiscal exposure to energy subsidies is estimated by Goldman Sachs to be around 1.25% of GDP, while Korea's combined bill is around 0.4% – both are easily manageable while chip sales are booming.

Malaysia's exports may be strong, but its fuel subsidies of more than 3.5% of GDP are unusually high (see Figure 7). Indonesia's 1.6% adds to heightened market concerns, while India has already begun to scale back its subsidies, following on from the conclusion of state elections.

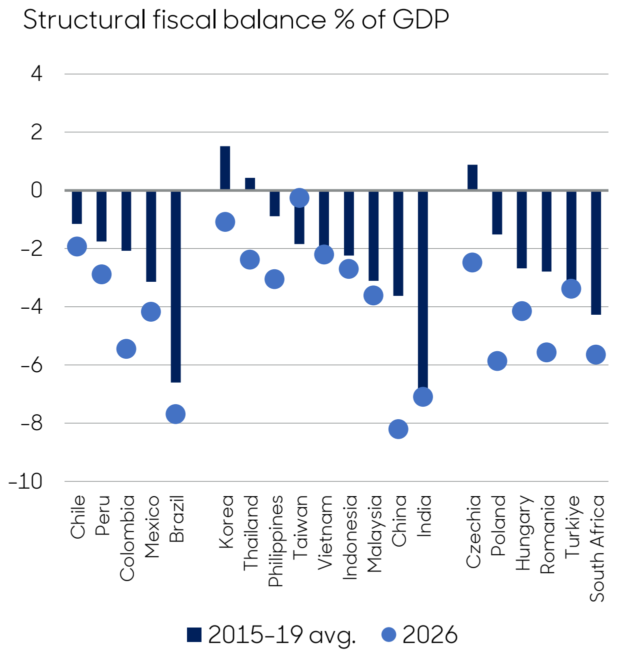
Figure 7: Only a few EMs can sustain their fuel subsidies if the strait of Hormuz remains shut



Source: Goldman Sachs Global Investment Research, Aberdeen, June 2026. Note: quasi-fiscal reflects costs imposed on state-owned companies to protect households from higher energy bills.

The longer energy prices remain elevated, the more challenging it will be to provide the fiscal offset. Many EMs are running structurally wide deficits (see Figure 8) and further fiscal slippage risks aggravating capital outflow pressures.

Figure 8: Both EMs and DMs are struggling to revert to pre-pandemic fiscal stances



Source: Haver, Aberdeen, January 2026

As such, the onus may increasingly fall on EM central banks to respond. Their playbook so far has been to turn more cautious, flagging the inflation upside risks and growth downside risks.

A few major EM central banks have already delivered rate hikes in response to FX and inflation concerns. Alongside Indonesia, the Philippines and South Africa each raised rates by 25bps, while in Türkiye the overnight lending rate was hiked 200bps.

However, others – such as India – have focused more on combating capital flow pressures via tax cuts, FX hedging strategies or swap provisions, as well as changing regulation to encourage a repatriation of capital by exporters or citizens abroad.

A reopening of the strait should take some of the immediate pressure off these central banks, but hikes may still become necessary if second-round effects or other supply shocks materialise.

Several EMs were in easing cycles before the conflict and had monetary conditions in restrictive territory. As such, rate cuts have been delivered in Brazil, Israel and Mexico since the onset of the conflict.

In Brazil's case, the BCB ex post real rate of 10.1% as of April remains high by its own standards and well above those of other EMs. This has provided room for the BCB to continue cutting. But, as external price pressures overlap with lingering stickiness in domestic services inflation and resilient activity, the Monetary Policy Committee will retain a cautious and gradual approach to cutting over H2.

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