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EM outlook: shifting sands

Conflict in the Middle East clouds the near-term EM outlook, while US tariff policy and a busy electoral calendar also introduce large uncertainties. But EMs should benefit from the striking down of IEEPA, while the breakneck artificial intelligence rollout suggests external demand should remain robust.

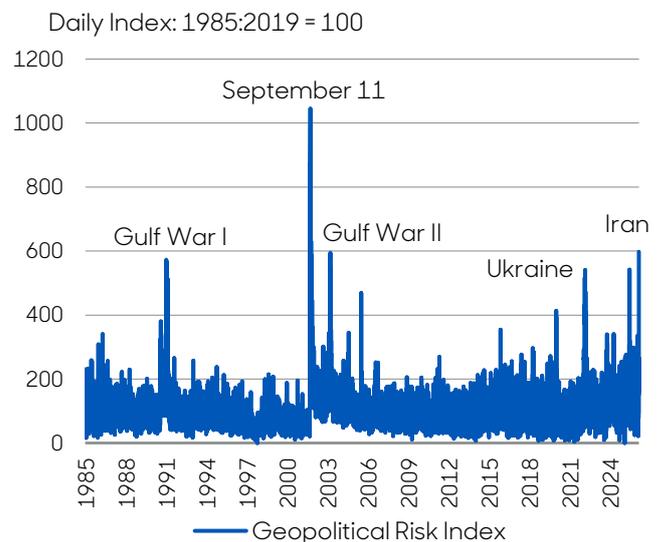
Key Takeaways

- Incentives to draw the US-Israel-Iran conflict to a close within weeks rather than months remain, but a more protracted conflict could shock the global economy via energy prices, putting pressure on EMs via risk-off dynamics.
- Prior to the Iranian conflict, investor sentiment towards EMs had turned increasingly positive as EM fundamentals improved. Most recently, the striking down of IEEPA has opened the door to lower tariffs.
- The accelerating global AI capex cycle is a structural tailwind for global trade and high-tech Asian manufacturing. Large Sovereign Wealth Funds (SWFs), abundant energy, and access to the US technology stack suggest that Gulf states could rapidly roll out data centres after the conflict ends.
- A busy electoral calendar will keep politics and fiscal prudence (or lack thereof) front and centre this year. Latin America has the largest number of elections this year and is most likely to garner US attention given the hemispheric importance within the "Donroe Doctrine".
- Pressure from the Trump administration to boost military spending will add to the risks of fiscal slippage, while Gulf states are also likely to increase defence spending on missile shields and military capabilities following on from the Iran conflict.

Fog of war

The scale and duration of the US-Israel-Iran conflict remains highly uncertain. Reflecting this, measures of geopolitical risk have increased sharply (see Figure 1).

Figure 1: Geopolitical risk has spiked to a level not seen since the 2003 invasion of Iraq



Source: Caldara & Iacoviello, Geopolitical Risk (GPR) Index, March 2026

At the time of writing, markets appear to be pricing in a relatively short-lived shock to the global economy. In particular, oil and gas prices have risen and remain very volatile, while the US dollar has strengthened, but market moves are still relatively contained.



The longer the conflict – and crucially disruption of oil flows through the Strait of Hormuz – lasts, the greater the risk that oil prices spike and broader negative market moves unfold, adding to challenges facing emerging markets (EMs).

Tariffs revisited

Prior to the Iranian conflict, investor sentiment towards EMs had at least turned increasingly positive as fundamentals improved: global growth proved resilient to the "liberation day" tariff shock and the US dollar weakened, for example.

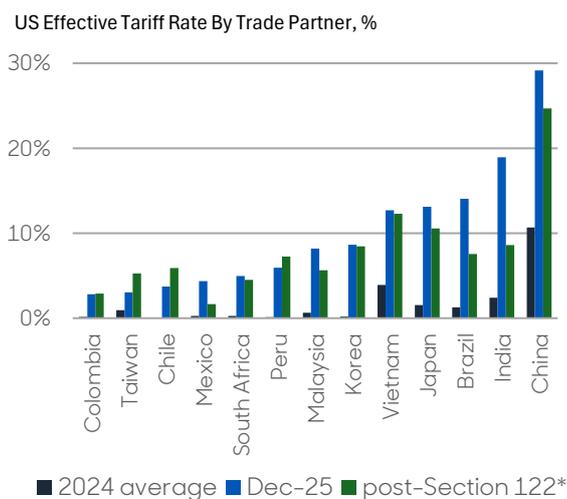
The decision by the US Supreme Court on 20 February to strike down tariffs under the International Emergency Economic Powers Act (IEEPA) once again increased uncertainty over US tariff policy, but this is still a positive for most countries.

President Donald Trump's use of Section 122 is time limited to 150 days, and, in practice, it will be difficult to use this to fully replace IEEPA levies, resulting in a modest reduction in average tariffs in the interim.

The bigger question is what follows on from Section 122. Specifically, whether other legislation can be used to rebuild the 'tariff wall'.

Our best guess is that the US will largely rebuild its tariff wall on China because it can use existing Section 232 and 301 legislation, but many other countries may see a reduction, albeit an uneven one (see Figure 2).

Figure 2: Tariffs are likely to moderate as alternative legislation substitutes for Section 122



Source: Aberdeen, Haver, March 2026. *Note: we assume Section 122 tariffs are rebuilt to between 10% - 15%.

Indeed, the Supreme Court decision has called into question the validity of US trade agreements, giving

other countries leverage to re-open negotiations. And regardless of the status of deals, politics suggests there are incentives for Congress to lower tariffs ahead of the US midterms to assuage cost of living concerns.

This *de facto* fiscal loosening will add to global growth tailwinds from a further Fed rate cut and scheduled fiscal easing across both the US and Europe, supporting external demand conditions for EMs.

Artificial Intelligence: blessing or bubble?

Of course, another notable factor behind the resilience of global growth and external demand has been the Artificial Intelligence (AI) capex cycle, which has driven demand for semiconductors and other inputs.

Taiwan has been the clear beneficiary of the surge in semiconductor demand, seeing its total integrated circuit exports rise 60% year on year in January, while exports to the US surged a staggering 150%.

Other countries have also benefited both directly and indirectly.

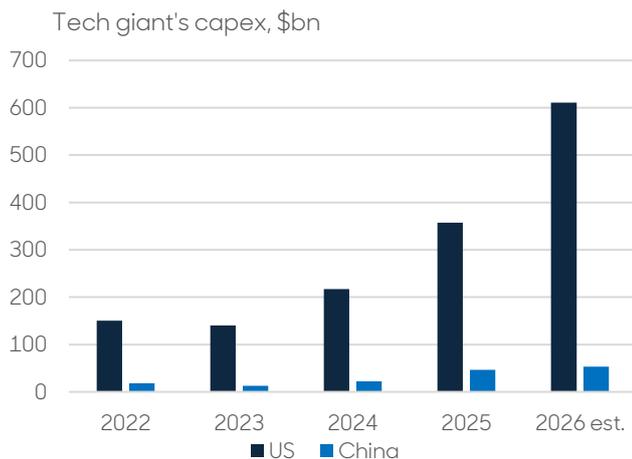
South Korean total exports are up 34% year on year, while the share of semiconductors within exports has risen by more than 10 percentage points to over 30%. Korean tech-related exports to Taiwan have also risen sharply. More generally, APAC trade strength has broadened out to markets such as Malaysia and Thailand, while Vietnam continues to be a strong performer.

Most importantly though, we expect AI to remain a tailwind for the region – and for EMs overall – as AI-related spending is set to move up a gear in 2026.

US tech companies have spent more than \$865 billion since 2022 on capex already, and plan to spend more than \$610 billion in 2026 alone (see Figure 3).



Figure 3: AI-related capex will support EMs in 2026



Note: US tech giants = Alphabet, Meta, Microsoft, and Amazon.
Chinese tech giants = Tencent, Alibaba, and ByteDance
(ByteDance numbers unavailable for 2022/2023)

Source: Aberdeen, FactSet, Financial Times, Silicon UK, March 2026

On this metric, Chinese tech firms' spending seems modest at 'only' \$67bn. However, this understates China's spend as capital-intensive investment sits with a more diffuse array of firms, including state-backed telecom companies, rather than just its high-profile tech behemoths.

Other EMs will add to the data centre boom. India and Malaysia are well placed, while large Sovereign Wealth Funds (SWFs), abundant energy and access to the US technology stack suggest that Gulf states could expand their AI capabilities rapidly once conflict abates.

There seems little chance of the near-term investment surge being derailed, but this is not without its risks.

The AI boom may be masking more lacklustre external demand for non-tech products. In South Korea, the only major export sector outside of semiconductors to see strong growth has been shipping. In Malaysia, electronics manufacturing has seen its share of total employment fall to an eight-year low.

Over the long-term, the dominance of semiconductor exports in the Taiwanese economy raises the spectre of 'Dutch disease' (i.e. the dominance of one sector distorting others). Consumption and infrastructure spending have failed to find momentum despite the record trade surplus, for example.

China's 'AI+' strategy – focused on boosting its vast manufacturing ecosystem and gaining a foothold in 'future industries', such as robotics, biomanufacturing and quantum computing – could put further pressure on manufacturing in the rest of APAC if successful.

And while not our core view, there are clearly risks of an abrupt AI-related equity and capex collapse. The impact would be most pronounced on EMs in Asia, but the market sell-off would likely ripple through risk appetite across the EM universe.

Monetary tailwinds

We expect domestic credit conditions to become more favourable across EMs, as monetary easing laggards deliver rate cuts and those still with policy space deliver their final reductions.

Regionally, central banks in Central and Eastern Europe (CEE) are most likely to remain on hold in 2026 given electoral pressure on government coffers and some lingering stickiness in core inflation.

In EM Asia, policy rates have broadly returned to their pre-pandemic levels and we expect central banks to opt to pause more frequently to observe the impact of delivered monetary easing. Indeed, we think the region's central banks are approaching their terminal rates and final rate cuts will be delivered in the Philippines, Indonesia and Thailand in early 2026.

In contrast, LatAm remains the region with historically elevated real policy rates and some of the biggest nominal rate differentials relative to the US. We expect the Banco Central do Brasil (BCB) to begin cautiously easing and Mexico to deliver further cuts. The outlier is Chile, where the central bank may hike before end-2026.

Overall, higher yielding LatAm economies should still be able to remain independent of Fed's rate path, and where rate differentials are already low, such as in Asia, further Fed cuts in 2026 could be supportive for their currencies.

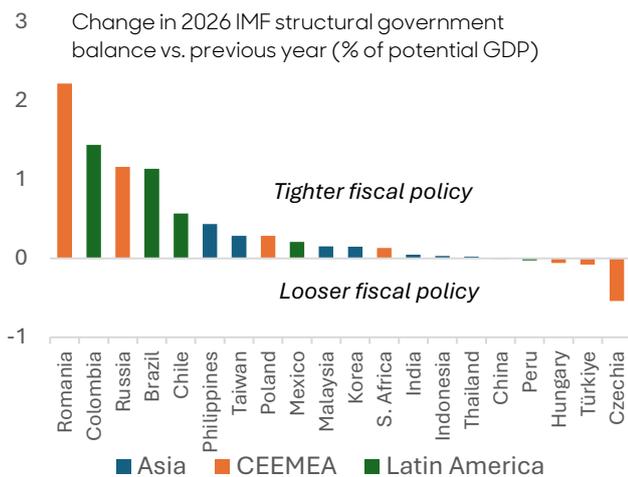
Fiscal exhaustion?

Fiscal consolidation in several major EMs (Mexico, Malaysia, India) helped bond spreads to narrow and made it easier for central banks to cut in 2025. But consolidation proved elusive in others (Colombia, Romania and Indonesia), contributing to selloffs.

A busy electoral calendar will keep politics and fiscal prudence (or lack thereof) front and centre this year. The International Monetary Fund (IMF) expects fiscal consolidation in most of the major EMs in 2026 (Figure 4), but we think this may be too optimistic given political incentives.



Figure 4: Risk of fiscal slippage is high



Source: Aberdeen, Haver, March 2026

Latin America has the largest number of elections this year, which will determine policy trajectories and their ties with Washington.

Colombia’s recent legislative election and polls for the presidential race currently put incumbent President Gustavo Petro’s chosen successor, Iván Cepeda, ahead of right-wing candidate Abelardo de la Espriella. But the race remains competitive, as voter concerns around security are a challenge for the current government.

Meanwhile, Peru’s presidential race remains wide open, with over 30 candidates running in the first round ahead of the June runoff, though right-wing figures currently hold an edge in polls.

Market attention will be most acute for Brazil’s October elections, given its fragile fiscal dynamics.

President Luiz Inácio Lula da Silva remains the slight favourite to win re-election. But his lead in the polls has been eroded, as Flavio Bolsonaro has gained momentum as his father Jair’s chosen right-wing successor.

It would be unsurprising to see Trump show support for a Bolsonaro-led opposition ahead of the election, seeking to have an ideological ally helming Brazil and its critical mineral reserves.

A Lula victory would likely entail weaker prospects for much needed fiscal reform than a right-wing victory, though details on Flavio Bolsonaro’s policy plans are currently lacking.

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Outside of LatAm, the Hungarian election in April will be a key focal point. Prime Minister Viktor Orbán’s Fidesz party trails in opinion polls, behind the pro-EU Tisza party. To boost support, Orbán has undertaken a slew of fiscal measures, including discount mortgages.

Elsewhere, Thai elections are yet to be scheduled, but the minority government of Prime Minister Anutin Charnvirakul risks a no-confidence vote in 2026. The minority government has conditional support from the opposition People’s Party, on the condition that Anutin calls an early election and backs constitutional reform.

The bar for Thai political instability is low, particularly amid ongoing border tensions with Cambodia and weak economic growth. Thus, the potential for fiscal slippage is high, even with the fiscally conservative Anutin government in power.

Political instability has also been evident in Thailand’s regional peers: Indonesia and the Philippines. Perceived fiscal mismanagement and evidence of corruption have led to significant protests in both countries.

Indonesia’s protests turned deadly and led to the departure of market-friendly Finance Minister Sri Mulyani. The temptation may be for more fiscal populism to boost growth and appease the electorate.

While the country’s 3% of GDP budget deficit limit will likely be maintained, fundraising at the sovereign wealth fund (via so-called ‘patriot bonds’ sold to Indonesia’s wealthy families and businesses) signals a desire to expand public spending through other means, and there has been increased pressure on Bank Indonesia.

Fiscal tensions are also likely to emerge elsewhere given the Trump administration’s pressure on its traditional allies to boost military spending.

The US National Security Strategy 2025 highlighted the growing expectation on the governments of South Korea and Taiwan, among others, to step up defence spending or risk losing US support.

Given the Russia-Ukraine war, the US stance also puts the onus on markets like Poland to maintain strong military spending as a deterrence. Gulf states are also likely to increase defence spending on missile shields – and their military capabilities more broadly – following on from the Iran conflict.



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