H2 2026

Emerging Markets Outlook

Drivers, Dynamics, and Opportunities:
Emerging Markets Go Their Own Way

Lazard
Asset Management

Executive Summary

Today's emerging markets (EM) bear little resemblance to the asset class that first captured investor attention decades ago. What was once a relatively straightforward story—high-growth economies catching up to the developed world, driven by commodity cycles, cheap labor, and capital inflows—EM has now transformed into something far more complex and, for the active investor, potentially far more interesting.

Entering the second half of 2026, the EM environment continues to be characterized by divergence and resilient performance amid ongoing geopolitical uncertainty. The Iran conflict has introduced a new macroeconomic variable that interacts with the existing themes—including the artificial intelligence (AI) technology cycle, uneven global growth, and evolving supply chains—that shape our EM outlook. While the war's direct economic effects remain concentrated in energy markets and shipping routes, the broader implications are being felt unevenly across emerging economies.

As a result, we believe understanding emerging markets today requires a far more differentiated, country- and region-specific framework than in prior cycles.

Geopolitics Deepens EM Divergence

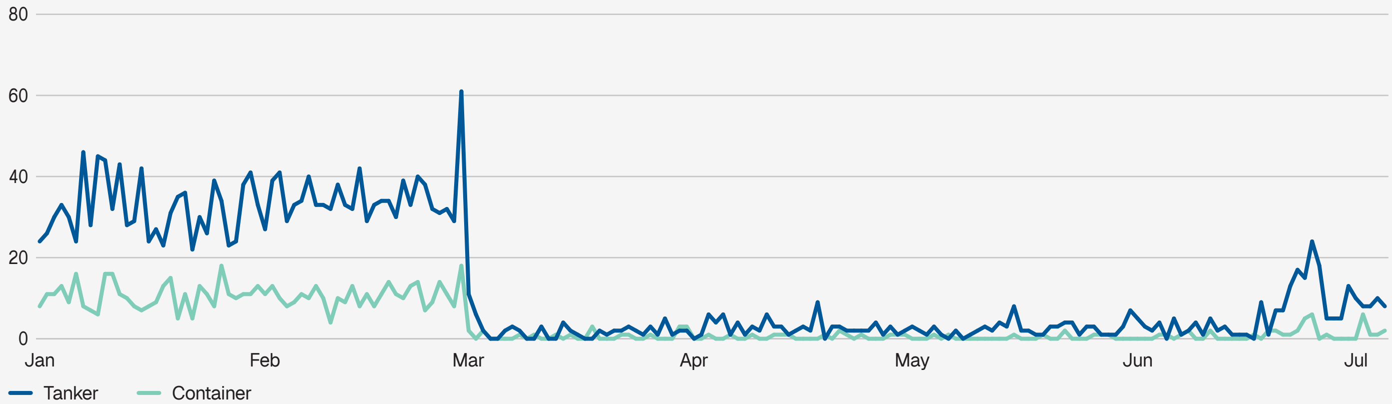
Within the energy sector, oil prices experienced significant volatility following the outbreak of the Iran conflict, briefly exceeding $120 per barrel. Shipping disruptions through the Strait of Hormuz, one of the world's most important energy transit corridors, amplified supply concerns and contributed to elevated risk premia in energy markets (Exhibit 1). Even under future scenarios where physical supply disruptions remain contained, sustained oil prices near or above $100 per barrel would represent a meaningful shock relative to conditions at the start of 2026.

For emerging markets, the economic implications of this shock vary significantly depending on a given country's energy import dependence, fiscal capacity to absorb higher fuel costs, and the sensitivity of domestic inflation to global commodity prices—dynamics increasingly reflected in EM currency movements against the US dollar (Exhibit 2).

Exhibit 1.

Strait of Hormuz Disruptions: A Shock to the System

Tankers, Containers: Number of Ships Departing Eastbound from the Strait of Hormuz

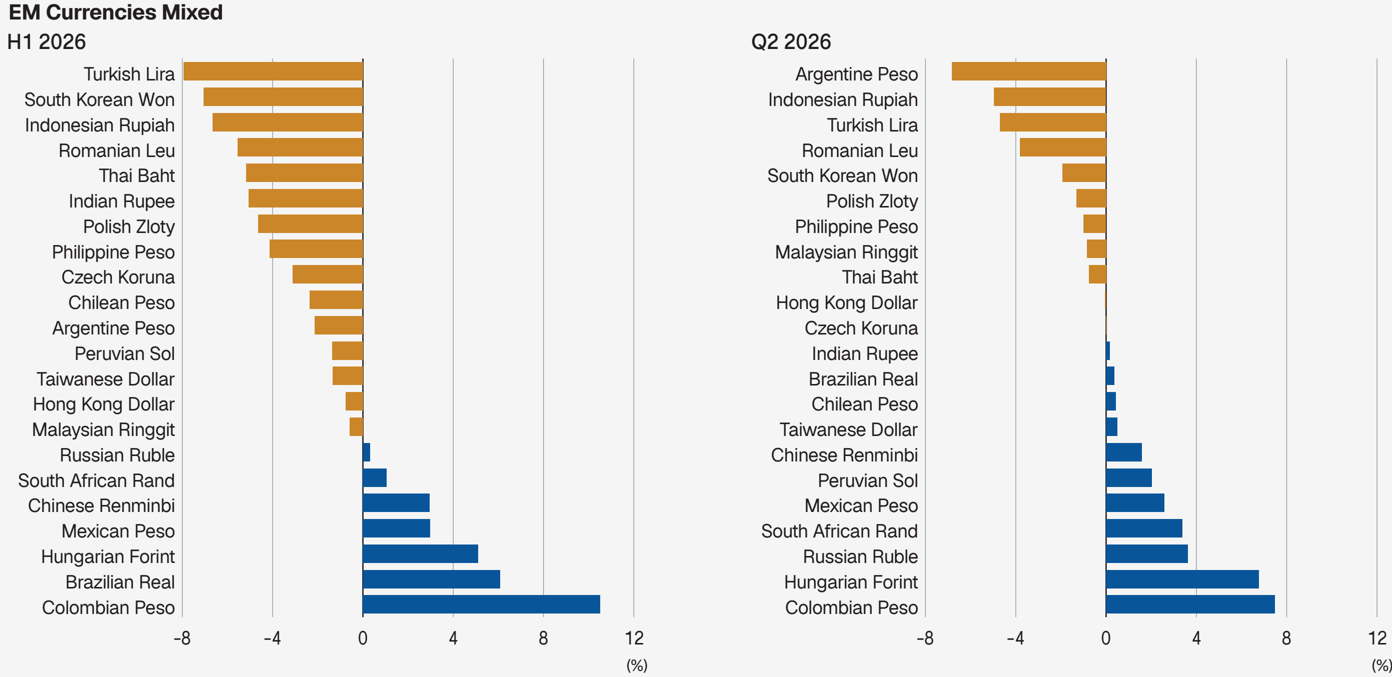


As of 5 July 2026

Source: UBS Evidence Lab, includes content supplied by S&P Global Market Intelligence (Maritime & Trade); Copyright © S&P Global Market Intelligence (Maritime & Trade), 2026.

Exhibit 2.

EM Currencies Mixed



As of 30 June 2026

Source: Bloomberg

Commodity Exporters Benefit from Higher Prices

Not all emerging markets are adversely affected by higher energy prices. Commodity-exporting economies—particularly those with diversified resource sectors—may experience improved terms of trade and stronger fiscal balances in an environment of elevated energy and commodity prices.

Some Latin American economies, like Colombia and Ecuador, fall into this category. The region's relatively limited direct exposure to Middle Eastern energy supply disruptions, combined with its commodity export profile, has contributed to increasingly positive investor sentiment. Higher prices for energy, metals, and agricultural products could provide incremental support for growth and fiscal revenues across parts of the region.

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Managing the Shock: Energy-Importing Asia

Energy-importing economies across Asia appear most exposed to the consequences of sustained energy price volatility. EM countries like India, South Korea, Indonesia, the Philippines, Thailand, and Vietnam rely heavily on imported hydrocarbons to support industrial activity and domestic consumption. Higher oil prices can translate quickly into inflation pressures, widening current account balances and adding fiscal strain.

Governments across the region have largely relied on a combination of policy measures to cushion the near-term impact. These include drawing on strategic reserves, expanding fuel subsidies, reducing fuel taxes, and securing alternative supply arrangements. In several Southeast Asian economies, fiscal policy has absorbed the initial shock, allowing central banks to maintain relatively stable monetary settings.

However, should energy prices revert higher for an extended period, the adjustment is likely to shift increasingly toward monetary policy. Several Asian central banks may need to maintain a cautious or slightly hawkish stance to contain second-round inflation effects.

India represents a particularly important case. The country faces both direct exposure to higher energy prices and indirect effects through increased fertilizer and food costs, given its reliance on imports of certain energy-related inputs. Policymakers have responded through targeted subsidies and supply management measures aimed at limiting the pass-through of global price increases to consumers.

Inflation Weighs on Türkiye and Frontier Economies

Beyond India, Türkiye faces some of the most pronounced near-term inflation pressures from higher energy prices. A combination of high energy import dependence and strong pass-through from global prices to domestic inflation has required a policy response focused on stabilizing the currency and anchoring inflation expectations.

Measures have included tighter financial conditions, foreign exchange interventions, and macroprudential adjustments. The policy environment in Türkiye illustrates how external energy shocks can quickly translate into domestic financial stability considerations in economies with existing inflation vulnerabilities.

Several frontier and highly externally exposed economies face a different set of challenges stemming from the Iran conflict. Countries such as Egypt, Pakistan, and Sri Lanka are vulnerable not only to higher energy prices but also to potential increases in global food costs, transportation expenses, and financing conditions.

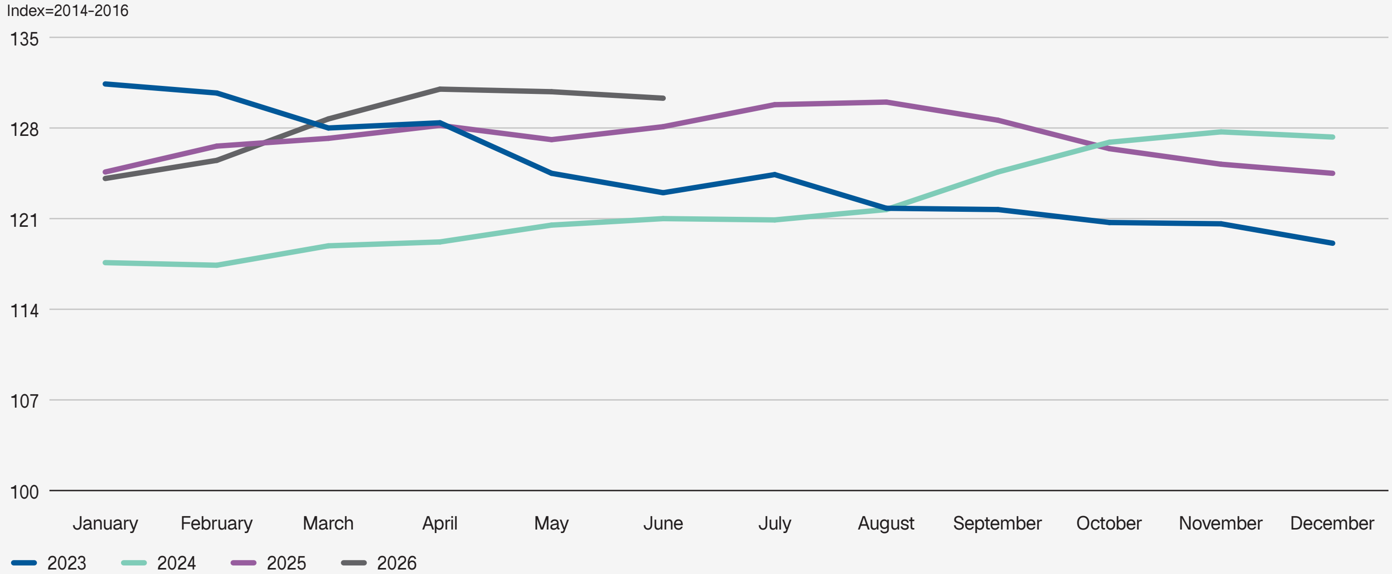
Egypt is a prime example. Higher energy import costs combined with less natural gas availability and capital outflows are expected to increase the country's external financing needs in 2026. While foreign exchange buffers and ongoing policy reforms provide some resilience, the Iran war illustrates the continued sensitivity of frontier economies to commodity price shocks.

High food prices are a problem globally, but particularly in economies where food makes up a large share of the inflation basket or food supplies are reliant on imports. The Philippines is an example of both. For many emerging markets, food transportation costs are a larger share of the costs than in advanced economies, while higher fertilizer prices could affect food-producing nations as much as those that rely on imports. Amid higher vegetable oil, meat, and cereal prices, the FAO Food Price Index continues to push higher (Exhibit 3).

Exhibit 3.

Food Prices Become a Pressure Point

Index=2014-2016



As of 3 July 2026

Source: FAO Food Price Index

The Gulf and Middle East: A Mixed Picture

Within the Middle East, the economic impact of the Iran war has been uneven. Higher oil prices have boosted fiscal revenues for many hydrocarbon exporters, supporting public investment programs and strengthening medium-term fiscal balances.

At the same time, non-oil sectors in some Gulf economies have experienced disruption due to the conflict. Tourism, logistics, and aviation activity—particularly in regional transportation hubs—have faced temporary headwinds as travel patterns and shipping routes adjusted to heightened security risks.

Over the medium term, however, higher hydrocarbon revenues could reinforce fiscal capacity across several Gulf economies, supporting continued investment in diversification initiatives and infrastructure development. For example, there is likely to be a large investment cycle to build out infrastructure like pipelines and ports across the region.

China and North Asia: A Show of Relative Resilience

China appears comparatively insulated from the direct energy supply disruptions affecting parts of Asia. Large strategic reserves, diversified import channels, and the ability to substitute across different energy sources provide China with a degree of flexibility that many other Asian economies lack.

The primary risks for China are, we believe, indirect. Slower growth among major trading partners, rising industrial input costs, and potential supply chain disruptions in petrochemicals or other industrial inputs represent the most significant transmission channels.

More broadly, we think the war in Iran does little to alter the structural forces supporting North Asia's technology sector. The continued expansion of AI infrastructure, semiconductor production, and data center investment remains one of the most important drivers of earnings growth across emerging markets. Demand for advanced semiconductors, high-bandwidth memory (HBM), and related components continues to underpin strong export performance in markets such as Taiwan and South Korea.

South Korea and Taiwan: AI Cycle Is Key to Outperformance

The technology sector and semiconductor industry in South Korea and Taiwan have been among the strongest performers across emerging markets in 2026, reflecting the continued build-out of AI infrastructure globally. Demand for leading-edge logic chips, advanced packaging, and HBM has accelerated well beyond earlier consensus expectations, driven by a sustained surge in capital expenditure from hyperscale data center operators in the United States and, increasingly, in Asia.

Taiwan Semiconductor Manufacturing Company remains the critical node in this supply chain. Its capacity utilization and pricing power have improved meaningfully as AI-related orders have displaced more cyclical consumer electronics demand. In South Korea, memory manufacturers have benefited from a structural repricing of HBM, with supply constrained relative to the pace of demand growth from AI chip designers. Equity performance in Taiwan and South Korea, up 62% and 119% year to date, respectively, in US dollar terms and as of 30 June 2026, has reflected not merely cyclical recovery but a genuine re-rating of earnings power. The secular AI-infrastructure cycle has extended the near-term visibility of revenue streams for the region's leading semiconductor franchises, though this visibility diminishes beyond next year.

The geopolitical backdrop has added a further dimension to the investment case. Concerns over supply chain concentration and export controls have intensified Western and Japanese efforts to onshore or re-shore semiconductor capacity. But building new semiconductor fabrication plants outside Taiwan and South Korea will likely take years. In the near term, in our opinion, this dynamic reinforces the competitive position of incumbent manufacturers in both markets. It also elevates the strategic importance of the South Korea–Taiwan technology corridor within EM portfolios.

These are not simply growth stories but geopolitically critical assets with earnings supported by structural demand, limited substitutability, and increasing pricing discipline.

Latin America: Election and Trade Uncertainty

In Brazil, voters head to the polls in October for the general election, where incumbent President Luiz Inácio Lula da Silva (Lula) is seeking an unprecedented fourth term. The electoral race remains close and fluid. Lula entered 2026 with a clear polling lead over Senator Flávio Bolsonaro, son of the imprisoned former president and standard-bearer of the opposition Liberal Party. That lead steadily evaporated, but the contest has taken another turn after leaked audio tapes revealed that business-friendly Flávio Bolsonaro allegedly received illicit funding from Daniel Vorcaro, the jailed former CEO of Banco Master.

> We believe the near-shoring investment cycle has been one of the most important drivers of the Mexican equity story, which rests on a stable, predictable trade framework.

The central economic dividing line between the two main candidates remains the spending framework. The opposition is campaigning on fiscal discipline and reform while Lula favors redistribution and state-led investment. Election years in Brazil have historically brought heightened volatility in the currency and equity markets. The scandal-driven swings of 2026 suggest this cycle will be no exception.

The macroeconomic backdrop begs further consideration. Brazil sits in an unusually favorable external position. It benefits both from resilient Chinese demand for its agricultural commodities, such as soybeans and meat, and the early stages of supply chain realignment across the Americas as US policy increasingly favors regional partners over Asia.

Meanwhile, the path of interest rates remains as important as the election results. The Selic, Brazil's benchmark interest rate, began 2026 at 15%, nearly a 20-year high. The Brazilian central bank only began its easing cycle in March, with consecutive quarter-point cuts taking the rate to 14.25% by June. Expectations for further easing came under pressure as the Iran war lifted fuel and food prices, drove inflation forecasts higher, and pushed local yields up, with the central bank raising its own 2026 inflation projection well above target. The interplay between the rate cycle and policy direction that emerges from October will be key to the outlook for domestically exposed Brazilian equities through the second half of the year.

Elsewhere in Latin America, the 1 July United States–Mexico–Canada Agreement (USMCA) review carries significant structural implications for Mexican equities. We believe the near-shoring investment cycle has been one of the most important drivers of the Mexican equity story, which rests on a stable, predictable trade framework. At the review, the United States declined to renew the agreement in its current form, stopping short of a clean extension without tipping into termination. While the USMCA remains in force, with tariff preferences, rules of origin, and investment protections all intact, the decision moves the agreement into a cycle of annual reviews running through 2036 unless the three parties agree to extend sooner. The process was complicated by US demands around Chinese-origin inputs, energy sector access, and labor standards, all sensitive points for the current US administration, with the next bilateral round with Mexico set to focus on rules of origin for autos and industrial goods. Continuity of the existing framework keeps the near-shoring cycle intact for now. The real risk is the shift to open-ended annual reviews, which sustains the kind of uncertainty that weighs on corporate capital allocation, and on the industrial and manufacturing companies that have anchored Mexico's recent equity performance.

A Resilient but Increasingly Divergent Outlook

Taken together, the Iran conflict reinforces a broader theme already evident across emerging markets: divergence. Aggregate EM growth remains resilient, supported by relatively strong external balances, improved policy credibility in many economies, and continued structural demand for technology-related exports.

Yet beneath this overall stability lies increasing dispersion across countries and regions within the EM sphere. Energy-importing economies face renewed inflation and fiscal pressures, while commodity exporters and technology-focused markets benefit from supportive external dynamics.

For investors, the evolving geopolitical environment reinforces the importance of country-level differentiation. Structural growth themes—including the global expansion of AI infrastructure and the ongoing reconfiguration of supply chains—remain intact. However, near-term macroeconomic outcomes will depend increasingly on how individual emerging economies navigate the intersection of energy markets, geopolitical developments, and domestic policy responses.

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