Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

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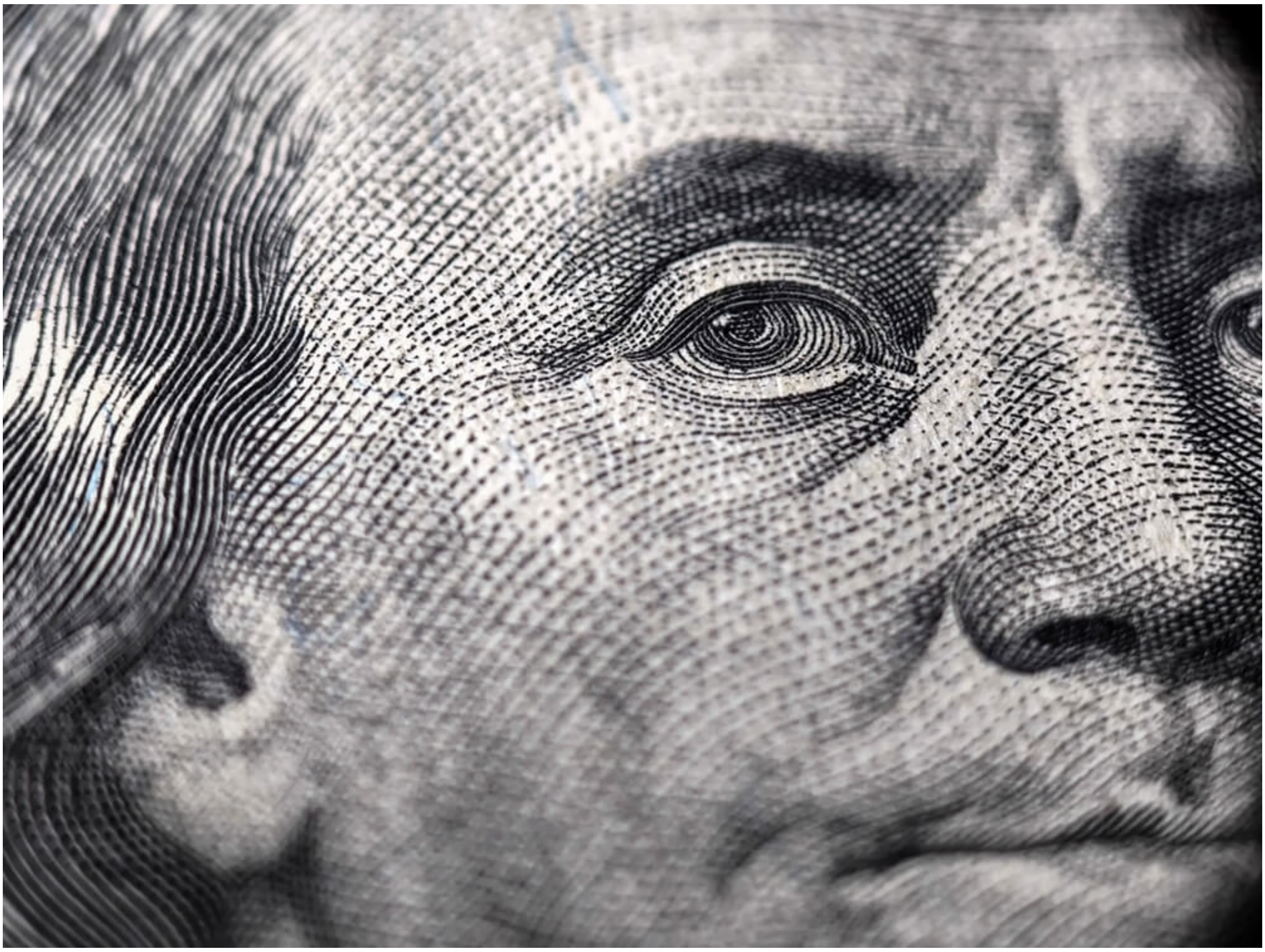
Is the weakening of the dollar heralding a new era for emerging markets?



Global financial flows have undergone a major transformation in recent months that could permanently change the way investors around the world manage their capital. After more than a decade of the dominance of the US dollar and US bonds as safe-haven financial instruments, emerging markets have once again become an attractive alternative.

The decline in the value of the US dollar in 2025 was the main reason for the change in the behaviour of international investors. According to the DXY index, which tracks the value of the US currency relative to a basket of other leading currencies, the dollar had lost almost ten per cent of its value by mid-June this year. The last time such a decline was recorded was almost four decades ago.

Financial analysts explain this trend with a combination of factors, including the uncertain economic policy of the United States of America and the growing budget deficit, but also geopolitical tensions that affect confidence in the dollar as a reserve currency.

Turning towards emerging markets

In such a context, investors who traditionally seek security are increasingly turning towards countries such as Brazil, Mexico, India, Indonesia and Malaysia. Emerging market local-currency bonds attracted over thirty billion dollars of net capital in the first five months of this year, according to recently published data.

Malaysia is a particularly intriguing example. In May alone, this country recorded a capital inflow of three billion US dollars, the highest monthly inflow since 2014.

> Investors are seeking security in the higher real returns outside the developed economies

What distinguishes this trend from previous cycles of capital inflows into developing countries is its stability and diversification. This time, it is not just short-term speculative capital but a significant number of long-term investors. They are seeking security in the higher real returns now available outside the developed economies.

At a time when inflation remains relatively low and interest rates in America, Europe, and Japan are at very low levels, the attractiveness of a market like Brazil, where the yield on ten-year government bonds is above nine per cent, is logical and expected.

Optimistic forecasts for developing economies

However, the entry of capital into these countries also brings with it certain challenges. The main risks include currency volatility and political stability.

In Brazil, for example, despite attractive yields, there is still political turmoil that can lead to sudden changes in the exchange rate of the local currency. Indonesia, on the other hand, faces challenges arising from international trade conflicts, particularly in connection with China and the United States.

The issue of liquidity in local markets is also becoming increasingly important. As capital inflows increase, so does the need for adequate market infrastructure that can support greater trading volumes.

For now, most countries are managing to fulfil these requirements, but a further increase in trading volumes could expose weaknesses in their financial markets.

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The most crucial question in the short term is whether this trend is sustainable and will persist in the months ahead. Based on current indicators, forecasts for developing countries are optimistic.

If interest rates remain low in the leading economies, capital is likely to continue to flow into markets that offer higher yields. Analysts at major investment banks are already predicting that this trend will continue at least until the end of the year, with the dollar possibly stabilising at a lower level.

On the other hand, the United States faces complex problems that could exacerbate the dollar's weakness. A growing budget deficit, trade policy uncertainties and a general decline in confidence in dollar assets could put further pressure on the currency.

Should these factors intensify, it cannot be ruled out that the dollar will lose a further significant portion of its value before the end of the year, which would further accelerate capital flows to emerging markets.

A new global financial reality

In the long term, this situation could also be the prelude to a broader shift in global finance, with the dollar slowly losing its dominant role as a reserve currency.

Such a change, even if gradual, would have long-term implications not only for the financial markets but also for the global political balance. Europe and China are already exploring alternative options that would make it possible to reduce dependence on the dollar in international trade.

Regardless of the potential global impact the emerging markets are benefiting directly from the current situation

- Central Bank of Malaysia

Regardless of the potential global impact, however, the emerging markets are benefiting directly from the current situation.

The appreciation of local currencies is helping to reduce inflationary pressures while lowering the cost of financing government debt. Such conditions create a positive feedback loop in which a more stable and attractive market attracts even greater capital inflows.

Given the current state of the global economy and investor sentiment, it is realistic to expect this trend to continue for at least the next medium-term period.

Investors have sent a clear message that traditional approaches are no longer sufficient in a rapidly changing world where stability comes from unexpected sources. This is an important warning not only for the US but also for other industrialised countries, which may have to adapt to the new global financial realities much faster than expected.