Bracing For Volatility

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S&P Global Ratings

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Key Takeaways

- **Trade complications.** Asia-Pacific's credit landscape is set for more volatility and slower growth in 2025, amid uncertain trade and foreign policies by the incoming U.S. administration. That said, more tariffs against Chinese exports are likely. Our base case factors in a rise in the effective U.S. tariff rate on Chinese imports to 25% from 14% from the second quarter of 2025, and retaliation by China in kind. China's GDP growth could slow to 4.1% in 2025 and to 3.8% in 2026, amid limited stimulus to bolster consumption.
- **Growth at a crossroads.** Countries with a large trade surplus with the U.S. (Vietnam, Thailand, Malaysia, and India) could be vulnerable to universal tariffs. To cope, Chinese producers may cut prices to stay competitive, while increasing exports to outside the U.S. The global trade slowdown could curb growth and squeeze Asia-Pacific currencies and exporters' revenues. We expect the region's growth to slip to 4.2% in 2025 and 4.1% in 2026, even as domestic consumption in emerging Asia remains supportive.
- **Financing hurdles.** Geopolitical tensions complicate the credit landscape. More volatility could reverberate across capital markets, energy prices, and supply chains. Should tariffs prompt a resurgence in U.S. inflation, the Fed's monetary easing may slow. In response, Asia-Pacific central banks could keep rates high to limit outflows. A strong U.S. dollar, narrower offshore funding access, and costlier interest may strain credit further.

Editor's Note: S&P Global Ratings' Asia-Pacific Credit Conditions Committee took place on Nov. 22, 2024.

Trump 2.0. Prospective policies from the incoming U.S. administration remain unknown, but we expect more tariffs against China's exports. This could slow China's export growth driver, depress investments, and worsen deflationary pressure. Although Beijing's recent stimulus helps plug further dips in property sales, a structural glut of unsold inventory in lower-tier cities remains problematic. Amid limited fiscal support to boost household and consumption and trade policy shifts, we foresee China's growth slowing to 4.1% in 2025 and 3.8% in 2026.

Trade and geopolitics. For export-centric Asia-Pacific, a slower China and softer global trade will hit revenue and growth. Furthermore, China's overproduction could suppress prices, raising margin pressures for competing producers in the region. More trade protectionism could arise. The risk of widening tariffs (against China and the rest of the region) and intensifying geopolitical tensions (e.g., Middle East conflict, Russia-Ukraine war, and U.S.-China friction) could hit energy prices, and supply chains. For net-energy importing Asia-Pacific economies, energy price shocks could worsen external balances and raise manufacturing costs. The ability of companies to pass through costs is uneven, causing divergences in margin pressure across sectors.

Rates and currencies. A resurgence in U.S. inflation could slow the U.S. Federal Reserve's rate cuts, keeping the dollar strong. We expect Asia-Pacific central banks to stay cautious amid capital outflow pressures. Wider spreads and narrower offshore funding windows could hit highly leveraged and emerging market borrowers. If markets see the Bank of Japan pursuing more aggressive rate hikes, domestic investors may turn toward onshore investments, and a sharp repricing of assets and derivatives. An abrupt unwinding of the yen carry trade may lead to funding gaps for some borrowers, while Japan's high debt stock means larger interest burdens.

Noisy backdrop. Volatility could rise amid uncertain U.S. trade and foreign policies. Further, structural risks are adding complexity across Asia-Pacific's credit landscape. These risks include increasing climate physical risks, energy transition, the widening adoption of technology, and vulnerabilities to cyber-attacks. These compounding obstacles could make lenders more risk-averse and seek higher premia for compensation. For borrowers, this could mean more pain.

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Top Asia-Pacific Risks

Global trade: Widening tariffs to weigh down exports, confidence, and growth

Risk level	Moderate	Elevated	**High**	Very high	**Risk trend**	Improving	Unchanged	**Worsening**

Higher trade tensions could weaken global trade and economic growth, hitting export-dependent Asia-Pacific. For China, materially higher trade tariffs on Chinese exports could hit its manufacturing growth engine, exacerbating domestic economic drags. Meanwhile, Vietnam, South Korea, and Taiwan's trade surpluses with the U.S. put them at risk of universal tariffs. Efforts by businesses to reshore operations entails more capex needs.

China's economy: Pressure on growth to intensify on higher trade tariffs, risking deflationary spirals

Risk level	Moderate	Elevated	**High**	Very high	**Risk trend**	Improving	Unchanged	**Worsening**

Higher tariffs and a sticky property crisis could slow China's growth further. Prices could fall further amid low demand for Chinese goods, squeezing margins for manufacturers. Slower investments could drag growth. Should authorities embark on more fiscal stimulus to reflate growth, this can exacerbate the country's already-high leverage. A slower China could spill over to Asia-Pacific entities, particularly those reliant on Chinese demand.

Geopolitics: Escalating geopolitical tensions could hinder policy predictability and increase financial market volatility

Risk level	Moderate	Elevated	**High**	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

Worsening geopolitical tensions add to credit stresses (energy and commodity price swings, volatility, and risk-off sentiment). Protracted military conflicts (Russia-Ukraine and Middle East) and more trade protectionism (West against China) could hit supply chains and hurt trade, investment.

Financing: Higher spreads amid market uncertainty could spike all-in financing costs

Risk level	Moderate	**Elevated**	High	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

Inflation fears could slow the Fed's policy rate descent; Asia-Pacific central banks could follow suit to limit capital outflows. More uncertainty could widen spreads. High interest burdens, weak currencies, and narrower access against a backdrop of high debt stock could skew financing conditions.

Japan's monetary policy: A more aggressive rate hike than expected to trigger abrupt capital inflow and asset repricing

Risk level	**Moderate**	Elevated	High	Very high	**Risk trend**	Improving	Unchanged	**Worsening**

Narrower interest rate differentials between the BOJ and the Fed could prompt more unwinding of the yen carry trade. Should markets perceive the BOJ to hike rates more aggressively, domestic investors could turn to more onshore investments, and spur repricing of assets and derivatives.

Real estate: Negative equity and shrinking demand to exacerbate property devaluation and liquidity strains on developers

Risk level	**Moderate**	Elevated	High	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

Changing demand for office and retail spaces are hitting commercial real estate valuations. Falling sales demand, lower occupancies, and weaker rents could hit already-tight cash flows, raising credit stress. Should unemployment rise, loan repayments could fall and spike loan loss provision.

Structural risks

Climate change: Extreme weather and energy transition to pose business challenges and raise costs

Risk level	Moderate	**Elevated**	High	Very high	**Risk trend**	Improving	Unchanged	**Worsening**

Intensifying physical risks are causing a more pronounced financial impact globally. Climate-driven disruptions in agriculture, food production and energy supply, may fan inflation and social unrest. Transition to a net-zero economy requires significant investments, adding costs to businesses.

Technology: Accelerating technological advancement and mounting cyber-attacks to disrupt business operations

Risk level	Moderate	**Elevated**	High	Very high	**Risk trend**	Improving	**Unchanged**	Worsening

While technological advances enhance productivity, business landscapes and regulatory oversight could become more complex. Costs to manage and maintain could spike. Cyber-attacks could rise amid increasingly interconnectedness of economic activities and rising geopolitical tensions.

Source: S&P Global Ratings.
Risk levels may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating assumptions unless the risk level is very high.
Risk trend reflects our current view about whether the risk level could increase or decrease over the next 12 months.

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