S&P Global Ratings

The Tariff Trials

Dec. 3, 2024

This report does not constitute a rating action.

Regional Credit Conditions Chair

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Key Takeaways

- **U.S. protectionism will test credit conditions in emerging markets (EMs).** Our baseline assumptions include moderate new tariffs primarily on Chinese imports. Despite potential impacts on China's economy, we anticipate that EMs' credit conditions will remain resilient, bolstered by declining interest rates, and sustained--albeit slower--economic growth.
- **The balance of risks has clearly worsened for EMs.** Higher than expected tariffs on China and/or a generalized levy on U.S. imports could have ripple effects on global demand, inflation, interest rates, and currencies. These factors will likely slow EMs' economic growth, resuming inflationary pressures and worsening financing conditions, which will likely lead to a growing number of downgrades and defaults.
- **In our baseline, EM rated issuers should benefit from ongoing monetary easing**, supportive financing conditions and economic activity, despite the expected slowdown. This should reflect in stable rating activity.

Editor's Note: S&P Global Ratings' Emerging Markets Credit Conditions Committee took place on Nov. 21, 2024.

Ongoing growth and monetary easing will support EMs' credit conditions. Our base-case scenario assumes the U.S. economy to grow about 2% in 2025 and 2026. We also expect monetary easing to continue, although the expected tariffs could lead to higher terminal rates and inflation in the U.S. Furthermore, the assumed first round of tariffs will primarily dent China's economic growth, and to certain degree, its key trading partners, mostly in Asia. Consequently, we expect lower growth across EMs, but not a severe drop. In other words, EMs should be able to weather a scenario of moderate tariffs. We expect these will likely blunt the benefit of the currently positive momentum in rating activity, although we don't not anticipate the negative bias to increase materially.

A drastic rise in tariffs could impair credit conditions. A substantial increase in U.S. tariffs on imports as suggested by President-elect Trump (for example, a 10%-20% universal tariff excluding China, a 60% tariff on China, and renewed threats of tariffs on Mexico) could have a material impact on U.S. economic growth and inflation, potentially derailing the Fed's monetary easing path. Furthermore, tariffs could slice off by up to 2.3 percentage points from China's economic growth in 2025 and 2.8 percentage points in 2026. The spillovers to EMs would be meaningful, as global economy slows, trade volumes decline, and financing conditions become restrictive on the back of high interest rates and a stronger dollar. In such a scenario, we expect a quick erosion of credit fundamentals for most sectors.

The shifting global trade landscape creates uncertainties regarding potential winners. Short-term effects of growing U.S. protectionism measures would likely influence various macroeconomic variables. Over the medium term, we expect considerable changes in trade flows, and new commercial agreements. For example, China has diversified its export destinations over the past years. Other countries have increased trade with the U.S. Nevertheless, we cannot rule out additional protectionist measures from the U.S. to distance itself from Chinese goods, including tighter rules of origin to reduce Chinese components in final goods. At the same time, we cannot rule out the possibility of other countries, including EMs, imposing tariffs on Chinese imports to protect domestic industries. Retaliatory measures from China are also likely, especially in critical minerals and technological components, in which China dominates. All factors considered, it's highly uncertain which countries and sectors could benefit from a new global trade landscape.

Top EM Risks

Geopolitical tensions erode credit fundamentals

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

The Israel-Hamas and Russia-Ukraine conflicts will likely linger into 2025, causing disruption in supply chains and the production of important commodities. For the conflict in the Middle East, the key risk remains its further escalation and spread wider in the region with significant repercussions that could extend globally. The risks are also significant for Europe if the U.S. unilaterally reduces its support for NATO or Ukraine. The fallout could trigger risk aversion and a flight to quality, disrupt supply chains – with a severe impact if oil supply was disrupted. Markets could react abruptly to major conflict developments; EMs would be the most vulnerable to a risk off environment.

Increasing protectionism disrupts global trade

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

President-elect Trump has promised to impose hefty tariffs to protect U.S. industries. These measures are expected to be more severe for Chinese imports. Such measures will likely have unintended consequences that could be detrimental for global trade, but also for many EMs. While its exports to advanced economies wane, China is increasing its share of exports to EM trading partners. Domestically, this could squeeze profit margins for companies competing against cheaper Chinese imports. A significant increase in tariffs on Chinese imports will likely undermine its growth while boosting inflationary pressures in the U.S. In the medium term, the drive to reshore or relocate business operations may result in additional costs and operational challenges, hurting local economies, employees, and suppliers.

A deepening property crisis, weak confidence, high debt levels, and trade tensions slow China's economic growth

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

Rising trade tariffs would amplify strains on China's economy--where a persisting property crisis has hit confidence and economic activities. Downward price pressures could intensify amid manufacturing over-production and softer demand for Chinese goods abroad. Businesses could slow capex and investments, compounding the hit to the economy. China's sluggish economic growth could spill over to the region's economies and EMs reliant on China for tourism, exports, and finance.

Higher interest rates linger upon a sudden stop of monetary easing in the U.S.

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

New protectionist measures have the potential to boost inflation in the U.S. and halt the Fed's monetary easing, which could lead to worsening financing conditions for EMs. A pause or slower Fed monetary easing could remove space for EM central banks to maintain interest rate cuts. Lingering high interest rates in the U.S. could strengthen dollar further, which could trigger inflation for EMs.

A sharper-than-expected downturn in advanced economies weighs on global trade

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

Compounding risks could pressure economic growth in advanced nations. New U.S. protectionist measures could dent both China's and U.S. economies, while the spillover could depress global growth. The spike in U.S. inflation could prevent monetary easing from cushioning against the potential economic downturn. The escalation of ongoing conflicts could disrupt energy prices, causing inflationary pressures and erosion of households' purchasing power, and global goods and services demand.

Structural risks

Climate change and more frequent natural disasters

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

Larger, more frequent natural disasters increase physical risks for public- and private-sector entities and threaten to disrupt supply chains such as for agriculture and food production in some EMs. At the same time the has been limited progress on global efforts to tackle emissions and to support adaptation and transition financing.

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.