Policy Shifts, Rising Tensions

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This report does not constitute a rating action.

Key Takeaways

- The potential that higher tariffs will reignite inflation and slow—or reverse—the descent in policy interest rates are key concerns for credit conditions in the region.
- Amid the strained relationship between the U.S. and China, and the escalation in the Russia-Ukraine war, intensifying geopolitical tensions could weigh on market sentiment, investment, and capital flows.
- Still, the U.S. economy remains resilient, and defaults look set to slow.

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As the U.S. economy settles into a soft landing, credit conditions for borrowers in North America look set to remain fairly favorable. However, amid the U.S. political transition, the prospect that materially higher tariffs will reignite inflation and force the Federal Reserve to halt—or even reverse—its cycle of monetary-policy easing poses a significant risk.

We expect U.S. GDP growth to slow to 2.0% next year, after expanding 2.7% this year. Our current assumptions of higher U.S.-China tariffs (i.e., the effective U.S. tariff rate on Chinese imports increases to 25%, from about 14%, and China retaliates in kind) won't materially dent U.S. economic growth. However, inflation will likely inch higher, possibly disrupting the Fed's monetary-easing path. We expect the federal funds rate will average about 3.9% in 2025 before declining to the neutral rate of about 3.1% in mid-2026.

Positive ratings trends continue, and defaults are poised to slow. The net outlook bias in the region has narrowed to 9.4% as of Nov. 8, and for issuers rated 'B-' and below it has also been steadily improving. S&P Global Ratings forecasts the U.S. trailing-12-month speculative-grade corporate default rate will fall to 3.25% by September 2025, from 4.4% in September of this year amid receding inflation, resilient economic growth, and interest-rate cuts.

However, heightened uncertainties around policies and their implementation could derail our fairly benign base case as the U.S. transitions to a new administration.

Materially higher tariffs and intensifying trade tensions between the U.S. and its major trading partners are key concerns heading into 2025. The protectionist measures suggested by President-elect Donald Trump could increase input prices for sectors exposed to imports and cross-border supply chains. Many industries, especially tech, could suffer from margin pressures. Any retaliatory measures could also hurt those relying on key components and foreign markets.

Borrowing costs could be overly burdensome if the Fed has to recalibrate its monetary easing. Also, investors could demand higher risk premiums amid slowing economic growth, rising policy uncertainty, and increasing market volatility. Borrowers, especially those at the lower end of the ratings scale, could face more challenges servicing debt or refinancing.

Meanwhile, geopolitical tensions continue. The U.S.-China relationship remains strained, and any worsening regarding tariffs or tensions over the South China Sea could weigh on market sentiment, investment, and capital flows. Elsewhere, the recent escalation in the Russia-Ukraine war somewhat raises the risk of a broader conflict, potentially involving NATO allies, which could deepen the effects on markets and credit.

Commercial real estate (CRE), especially the office sector, is still struggling. Lower demand for office space continues to weigh on valuations and cash flows, as financing costs remain elevated.

Read more

U.S. Elections 2024: How Could A Second Trump Term Affect U.S. Credit?

Top North American Risks

Tariffs reignite inflation, threaten credit quality

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

Trade tensions between the U.S. and its trading partners (e.g., China, Mexico, Canada) add uncertainty and pose a renewed threat to businesses. Materially higher tariffs suggested by President-elect Trump could increase input prices for U.S. sectors exposed to imports and cross-border supply chains at a time when they are grappling with high costs and a more difficult passthrough environment. Any retaliatory measures could also hurt those relying on key components and foreign markets. All this could result in more margin pressure for corporates, weighing on credit quality.

Escalating geopolitical tensions impede trade and investment, weighing on growth

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

Amid the U.S. political transition, any further worsening of the U.S.-China relationship regarding trade/tariffs or tensions over the South China Sea could disrupt supply chains and hamper sentiment, investment, and capital flows. While North American borrowers have had limited direct exposure to the Russia-Ukraine war, the recent escalation somewhat raises the risk of a broader conflict, potentially involving NATO allies, which could deepen the effects on markets and credit. The potential for the Middle East conflict to widen is also a concern.

Interest-rate descent disappoints, underpinning burdensome borrowing costs

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

The descent in the Federal Reserve's policy interest rate could be slower than markets expect, and could even stall, or reverse, if inflation returns in earnest. The tariffs and immigration controls that President-elect Trump has suggested implementing would likely be inflationary and act as a drag on GDP growth. Investors could demand higher risk premiums amid slowing economic expansion, rising policy uncertainty, and increasing market volatility. As a result, the cost of debt service and/or refinancing may be overly burdensome for some borrowers.

Falling asset values and cash flows, plus elevated financing costs, exacerbate CRE losses

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

Elevated financing costs are pressuring asset valuations and raising refinancing risk for most types of CRE. Lower demand for office space continues to weigh on valuations and cash flow dynamics. Certain segments and regions in the multifamily sector are also facing challenges as rent growth softens. All this may lead to more broad-based, and in some cases severe, loan losses for debtholders, such as U.S. banks (with regional lenders having higher exposure to CRE than larger lenders do), insurers, REITs, and CMBS. Higher office vacancy rates continue to affect cities' tax revenue.

The U.S. economy's soft-landing is derailed

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

Policy uncertainty, the prospect of stickier-than-expected inflation, as well as a slower-than-forecast drop in borrowing costs could cause companies and consumers to pull back spending, as Americans' financial cushions and purchasing power continue to erode. Such pressure is particularly acute for lower-income cohorts, especially if unemployment rises measurably. More subdued business investment and/or a sharper pullback in spending could lead to a deeper slowdown in growth or a recession, causing more credit stress.

Structural risks

Climate risks intensify, energy transition adds to costs

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

More frequent and severe natural disasters increase the physical risks that public and private entities face, adding to costs. Climate events also threaten to disrupt supply chains (such as for agriculture and food) and logistics. Moreover, the global drive toward a net-zero economy heightens transition risks across many sectors, requiring significant investments.

Accelerating tech transformation disrupts business models, cyberattacks threaten operations

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

Cyberattacks pose a systemic threat and significant single-entity event risk as new targets and methods emerge—with geopolitical tensions raising the prospect of major attacks. Organizations lagging on adapting to current and emerging technologies or lacking well-tested cybersecurity playbooks are more vulnerable, while adopting technological advances means more costs.

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.