S&P Global
Ratings

Global Credit Outlook 2025

Promise And Peril

Dec. 4, 2024

This report does not constitute a rating action.

Foreword

Dear reader,

As we turn our gaze toward 2025, we see a year of promise and peril. The descent in policy interest rates and soft landings in many major economies may deliver on the promise of more favorable credit conditions. On the other hand, intensifying geopolitical and trade tensions increase the peril present in an already tumultuous environment.

As the Russia-Ukraine war approaches the end of its third year, the recent escalation in the conflict raises the risk of a broader impact on markets and credit. Likewise, the fighting in the Middle East still threatens to disrupt trade and investment flows and could increase market volatility. And President-elect Donald Trump's return to the White House will have ramifications not just for the U.S. but across the globe in terms of tariffs and geopolitics.

At the same time, the easing of monetary policy will come at an uncertain and unsynchronized pace in different regions, with the descent almost sure to be slower than the rise. If central banks are forced to curtail their interest-rate cuts, the costs of debt service and refinancing could remain burdensome for all debt issuers and existential for those at the very low end of the ratings scale.

In this context of heightened uncertainty, S&P Global Ratings' Global Credit Outlook 2025 presents our credit and macroeconomic expectations for the year ahead, including our base-case forecasts, assumptions, and key risks. We also address the questions that will shape the year, with insights drawn from our ongoing dialogues with market participants. We delve into critical topics such as sovereign debt, global trade, private markets, and the growth of AI and data centers.

This publication builds on the collective insights from our regional and global Credit Conditions Committees (CCCs), which meet quarterly to review conditions in Asia-Pacific, Emerging Markets, Europe, and North America, cascading into our global coverage. At the CCCs, we evaluate the trends affecting economies, industries, and credit markets—to identify our base-case assumptions and rank the exogenous risks that underpin our credit ratings and inform potential rating changes across various asset classes.

At a time when key themes and risks appear to be increasingly interconnected, we invite you to explore the depth and breadth of expertise offered by S&P Global Ratings' analysts and experts as we scan the horizon of what promises to be another tumultuous year for global markets.

Acknowledgements

We appreciate our many colleagues who have contributed to this report and provided you with S&P Global Ratings' essential intelligence.

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Contents

Global Credit Outlook 2025: Promise And Peril 4

Top Global Risks 12

Global Economic Outlook 14

Questions That Matter 18

Credit Headwinds

Monetary Easing | What If The Interest Rate Descent Disappoints? 19

Sovereign Debt | Is The Austerity Versus Growth Dilemma Back? 22

Capital Flows

Private Markets | How Will Private Credit Respond To Declining Yields? 25

Corporates | Can Monetary Easing Bring Enough Relief To Justify Current Market Optimism? 28

Geopolitical Uncertainty

Geopolitics | How Will Markets Navigate Ongoing Geopolitical Risks? 31

Global Trade | How Might Uncertain Trade Policies Affect Macro-Credit Conditions In 2025? 34

Energy and Climate Resilience

Commodities | Could Oil Prices Shock The Global Economy? 37

Energy Transition | How Will The U.S. And Europe Respond To China's Clean-Tech Leadership? 40

Cyber, Crypto, And Tech Disruption

Data Centers | Can Infrastructure Developments Keep Up With The Increasing Demand? 43

AI & DeFi | Can Crypto Innovations Offset Artificial Intelligence Concentration Risks? 46

Regional Credit Conditions 49

North America 50

Europe 52

Asia-Pacific 54

Emerging Markets 56

Contacts 58

Disclaimer 59

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As economic soft landings materialize in many major economies and policy interest rates begin their descent, global credit conditions look set to remain supportive in 2025—with the caveats that there will be region- and country-specific divergence, and a backdrop of geopolitical uncertainty that threatens to reignite risk-aversion among investors and affect capital flows.

With easing inflation, resilient labor markets, and sturdy consumer spending bolstering economic activity in most developed markets, we expect steady growth next year. **We forecast global economic expansion of 3% in 2025** as growth slows in the U.S. and China (the world's two biggest economies), the eurozone continues to recover, and emerging markets find their footing.

At the same time, central banks have started lowering their key interest rates, and we expect more monetary-policy easing to come, albeit at a variable pace among jurisdictions. More importantly, the descent will be slower than the rise, with rates certain to settle at higher levels than we saw during the long stretch of cheap money after the global financial crisis.

Global credit conditions: Key highlights

Slower GDP growth in 2025

Global

3.0%

U.S.	Eurozone	China
2.0%	**1.2%**	**4.1%**

Federal funds rate forecast

2025 average

3.9%

ECB refi rate (end-2025)

2.65%

'B-' and below corporate debt outstanding

Global

$1.3 trillion

U.S.	Europe	ROW
$875.0 bil.	**$308.8 bil.**	**$89.8 bil.**

Net outlook bias

As of Nov. 15, 2024

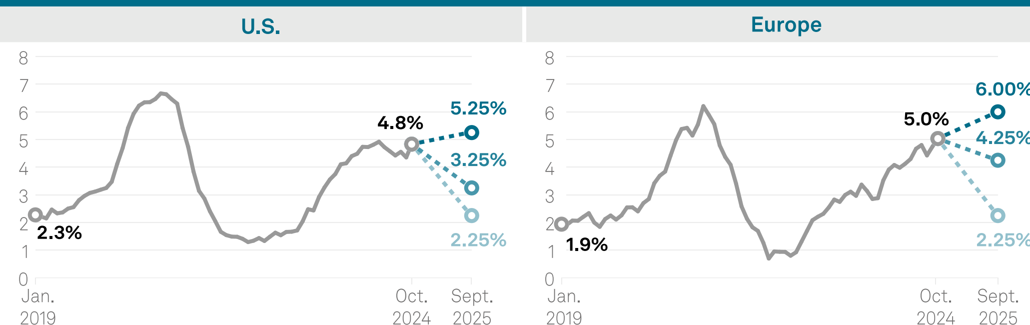
IG	SG	'B-' and below	'CCC' and below
-9.6%	**-17.6%**	**-31.6%**	**-66.8%**

Trade vulnerability

Imports and exports as a % of GDP

U.S.	China	ROW
27.0%	**38.4%**	**62.5%**

Trailing-12-month speculative-grade default rate and September 2024 forecast

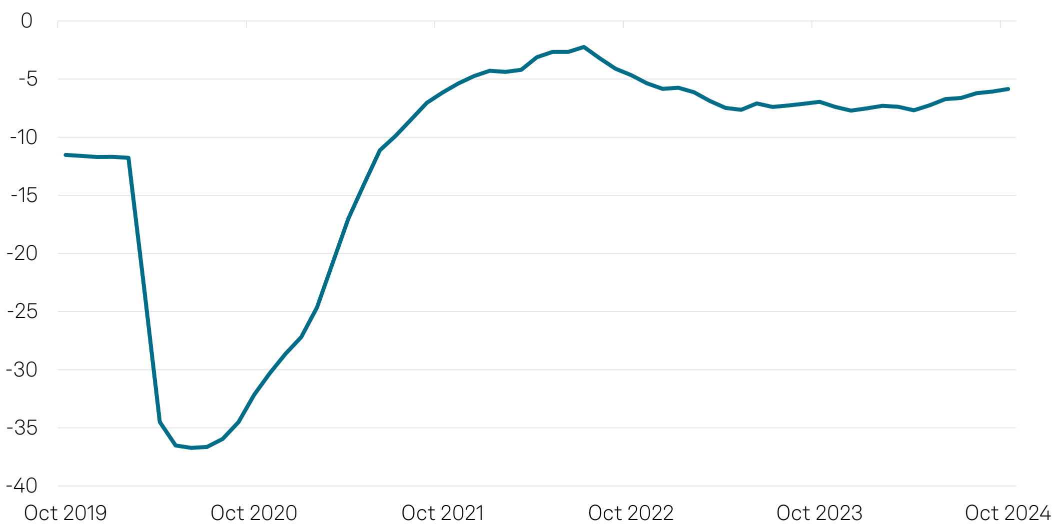


See: "U.S. Speculative-Grade Corporate Default Rate To Fall Further To 3.25% By September 2025," published Nov. 15, 2024, and "European Speculative-Grade Default Rate Should Fall To 4.25% By September 2025," published Nov. 18, 2024.
Sources: World Bank, S&P Global Ratings.

We also forecast a decline in defaults but, again, at a slower pace than the rise. The lowest-rated borrowers continue to face the strains of still-elevated borrowing costs, the lingering effects of permanently higher prices on consumer purchasing power, and heightened geopolitical uncertainty—most notably, increasing protectionism that will weigh on global trade. S&P Global Ratings expects the U.S. trailing-12-month speculative-grade corporate default rate to fall to 3.25% by September 2025, from 4.4% in September 2024 and a peak of 4.9% in April. In Europe, we expect a slower pace of improvement, with a default rate of 4.25% by September 2025, down from 4.7% in September and a peak of 4.8% in July.

The downgrade potential for speculative-grade issuers continues to slowly decline, as well. The negative bias (the proportion of issuers with negative outlooks or on CreditWatch with negative implications) has fallen below 18% for the first time in nearly two years. For investment-grade companies, the negative bias is below 10%.

Global net outlook bias: Financial and nonfinancial corporates (%)



Net outlook bias--The difference between ratings with a positive outlook or on CreditWatch with positive implications, and those with a negative outlook or on CreditWatch negative. Source: S&P Global Ratings.

Recovery rates are likely to be under pressure from the more leveraged and top-heavy debt structures that have become common in the speculative-grade universe. Our recovery expectations (which estimate future recovery rates) on first-lien debt have declined to the 60%-65% area in the past six years, compared to the long-term average actual recoveries of 75%-80%. A combination of increasing total and first-lien debt leverage, shrinking junior debt cushions, and the predominance of covenant-lite loan structures have weighed on actual recoveries. From 2018-2022, recovery rates on U.S. first-lien debt averaged 72%—which was 10 percentage points lower than the prior five-year period.

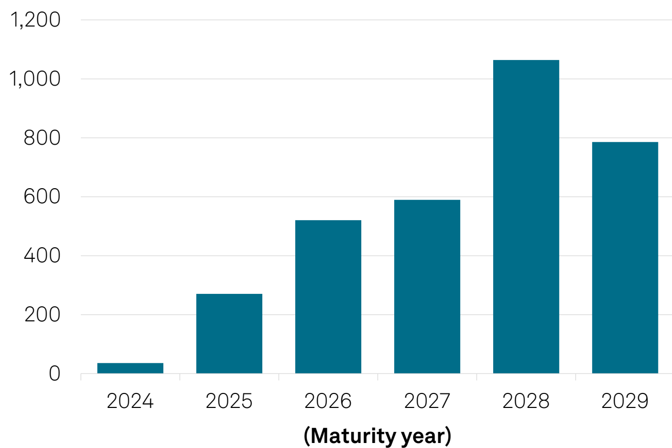
A surge in out-of-court loan restructurings, often referred to as liability management transactions (LMTs), in recent years poses another threat to recoveries on syndicated first-lien debt in the U.S. As the investor base for institutional loans has expanded and become more diversified, syndicated loan documents have become more bond-like and flexible. As a result, most now provide companies with numerous options to restructure their balance sheets in ways that can dramatically reorder the relative priorities of existing first-lien lenders (and other creditors).

Of the 38 loan LMTs by 35 companies that we've been tracking from mid-2017 through August 2024 (with some undergoing multiple transactions), 13 firms subsequently filed for bankruptcy (37%). Of the 22 that avoided bankruptcy, only five (14%) staved off a subsequent default or are

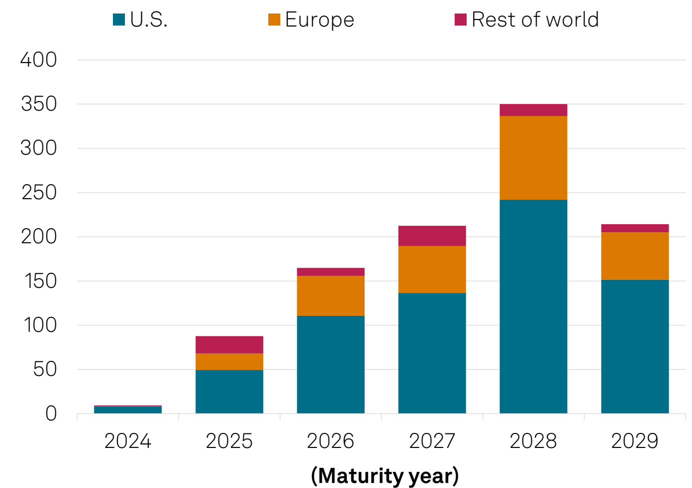
rated higher than 'CCC+.' Because issuer credit ratings of 'CCC+' or lower indicate our expectation that an eventual default is more likely than not, this means that another nearly 50% of the dataset has either subsequently defaulted (outside of bankruptcy) or is viewed as at risk of doing so.

Companies have made good progress in pushing out maturities. More than three-quarters of speculative-grade bond and leveraged loan issuance in 2024 has been for refinancing or repricing (in the case of loans). As of Oct. 1, there was just $144 billion of speculative-grade nonfinancial corporate debt maturing in 2025, 34% of which we rate 'B-' and lower. This has eased near-term liquidity pressure on many lower-rated borrowers, buying them time if market volatility arises and/or investors become more risk-averse.

Speculative-grade nonfinancial corporate maturities rise in upcoming years (bil. $)



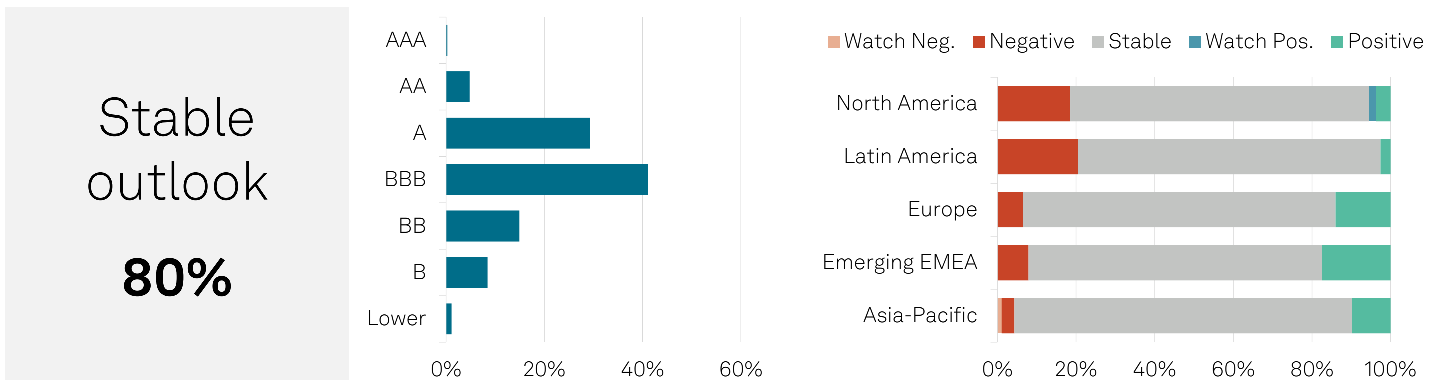
U.S. accounts for most of the upcoming 'B-' and lower maturities (bil. $)



Data as of Oct. 01, 2024. Includes nonfinancial corporate issuers' bonds, loans, and revolving credit facilities that are rated 'BB+' or lower by S&P Global Ratings. Foreign currencies are converted to U.S. dollars at the exchange rate on Oct. 01, 2024. Source: S&P Global Ratings Credit Research & Insights.

From a corporate-earnings perspective, growth is steadily improving, although it continues to come primarily from improved profit margins rather than increased revenues. In the third quarter, annualized EBITDA for companies we rate rose 3.6%—and 8.1% excluding commodities-linked sectors. Global revenues increased 0.9% and 2.2%, respectively. Moreover, interest-rate pressures continue to ease. Cash interest payments were up 12.3% on an annual basis, compared with 15% in the second quarter and a peak of 25% a year earlier.

Banks' stable outlook trends should persist in 2025



Data as of Oct. 31, 2024.
Source: S&P Global Ratings.

Meanwhile, about 80% of banking groups we rate globally have stable ratings outlooks, and we see this trend continuing. We forecast global credit losses will increase about 7%, to $850 billion, in 2025—within our base case at current rating levels for most banks.

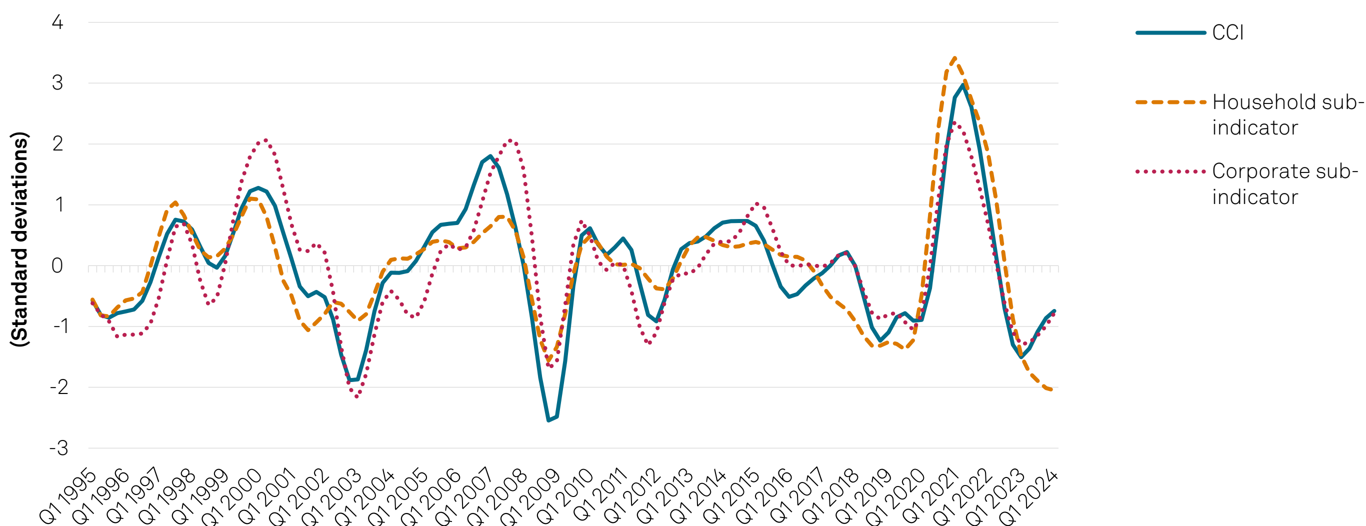
We see four key downside risks to bank ratings: a global economic slowdown outside our base case; a worse-than-expected property sector deterioration; still-high interest rates superimposed upon high government and corporate leverage; and evolving risks including new technologies, climate change, and cyber that could widen credit differentiation.

At the same time, private funding is pushing into new parts of the credit markets after years of rapid expansion. By providing multiple types of credit, arranging, and originating, alternative asset managers are filling roles traditionally operated by banks—and in cases where more debt is originated than can be placed within the lending platform, some are broadening the distributions of their originations to outside investors. And new opportunities for private funding in asset-based finance and project finance offer much larger investment opportunities and the potential for higher rates of return. However, this comes with risks—especially considering that project finance and asset-based finance are highly illiquid and complex investments, and the lack of systemic transparency in private markets compounds these risks.

More generally, S&P Global Ratings' Credit Cycle Indicator (CCI) is signaling a potential credit recovery in 2025. This forward-looking measure of credit conditions is showing positive momentum—a result of the continued rise in the corporate sub-indicator despite some offset by the household sub-indicator. The corporate sector is seeing recovering earnings and supportive financing conditions as interest rates begin their descent. However, households continue to deleverage amid caution over economic slowdowns and squeezed purchasing power.

We see an increasing divergence among our regional CCIs, spelling different paces toward a credit recovery. The eurozone and emerging markets (ex-China) CCIs continue to rise from a trough, while an earlier rebound in the North America and some Asia CCIs is stalling. In China's case, the country's CCI continues to fall, pointing to a continuing credit correction.

Global credit cycle indicator



Peaks in the CCI tend to lead credit stresses by six to 10 quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associate credit stress tends to be greater. Sovereign risk is not included as a formal part of the CCI. The CCI period ends in the first quarter of 2024. Sources: Bank for International Settlements, Bloomberg, S&P Global Ratings.

All told, any improvement in global credit conditions will be along a narrow path strewn with overlapping risks. Slowing economic activity, the prospect of resurgent inflation, and political polarization could lead to sustained bouts of market volatility.

Geopolitics Take Center Stage

Deepening geopolitical rifts pose the biggest risk to an improving credit landscape. The Russia-Ukraine war is approaching the end of its third year, and the conflict in the Middle East, along with domestic polarization in certain markets, could disrupt trade and investment flows, roil financial markets, and force governments to increase defense spending amid already-stretched budgets.

Donald Trump's return to the White House will have wide-ranging ramifications—with a high level of uncertainty attached to his second term.

On the trade front, the president-elect has suggested universal tariffs on all goods imported to the U.S. as well as sharply higher levies on all Chinese goods. He more recently vowed to enact 25% across-the-board tariffs on neighboring Canada and Mexico unless those countries stem immigration to the U.S. and flows of drugs, such as fentanyl, across the border. S&P Global Ratings believes that under such scenarios, the effects would be inflationary in the short term—with companies facing higher input costs and consumers paying more for finished goods; a drag on U.S. GDP in the medium term, while underpinning still-high benchmark interest rates; and an acceleration in the diversification of supply chains, in particular away from China.

President-elect Trump has suggested universal tariffs on all goods imported to the U.S.

The president-elect has also vowed to withdraw military funding for Ukraine, which will add to the pressures European governments face in supporting the country. And how he approaches the Israel-Hamas war, now in its second year, remains to be seen. Any additional escalation of the fighting could further disrupt supply chains and result in an energy-price shock that underpins inflation.

After a long stretch of large, expansionary fiscal stimulus around the world—and the associated rise in governments' debt leverage—policymakers will at some point have to unwind at least some of this support. This is especially true if the descent in interest rates is slow, and the cost of servicing debt remains elevated for longer than expected. Scaling back could prove difficult in an environment of increased geopolitical tension—particularly in Europe and the Middle East, where governments may need to ramp up defense spending. Either way, reduced stimulus will likely weigh on demand and dent economic activity.

For The U.S., Uncertainty Prevails

Policies that result in higher input prices will pressure profits for U.S. corporates. Industries with highly engineered products dependent on China for specialized manufacturing will likely suffer most because these facilities are the most expensive to relocate and hardest to staff. This includes such products as semiconductors and electrical components supplied to technology companies and applies to utilities and power sectors focused on renewable energy.

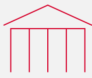
While, on balance, the effect of tariffs would be negative, some sectors in the U.S. could benefit from a more protectionist stance. Metals and mining companies tend to be higher on the cost curve, and tariffs could go some way to leveling the playing field in competing against imports. Chemicals manufacturers could similarly benefit, although they may be facing customers with heightened price sensitivity given recent quarters of softening demand.

Various provisions of the 2017 Tax Cuts and Jobs Act (TCJA) are set to phase out in 2025. At least some legislative action is likely, with interest deductibility, bonus depreciation, and deductions for research and development all up for debate and potentially made permanent.

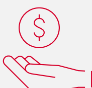
The TCJA lowered the corporate tax rate to 21%, from 35%, and Republican leaders have suggested further lowering the rate to 15% for U.S. companies that make their products in the U.S. Naturally, a lower corporate tax rate, where applicable, would benefit funds-from-operations metrics and boost cash available to service debt.

Key credit issues to watch under Trump 2.0

Nonfinancial Corporates: Future policies on tariffs and taxes will likely matter most for credit.

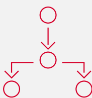


Financial Institutions: Material changes to prudential bank regulation are unlikely, but the supervisory approach could vary.



Public Finance: There could be pressure ahead for the tax-exempt status of municipal bonds—the sector's key foundation.

Insurance: We expect the biggest potential effects will be in health insurance—although any changes will likely be at the margins.



Structured Finance: The elections' impact is likely confined to certain products related to commercial credit (e.g., CLOs and transportation assets), and consumer credit ABS.

From a macroeconomic perspective, forecasting is a challenge amid significant uncertainty about the timing, magnitude, and effect of proposed tariffs, immigration reforms, tax cuts, and regulatory shifts. That said, we believe the new administration's proposed economic plans, taken at face value, would add to inflation and dent GDP growth relative to our baseline—with benchmark interest rates likely higher than in our current forecast.

At a minimum, we expect bilateral trade flows between the U.S. and China to be further strained. On top of that, Europe has added trade-protection measures to counter state subsidies to strategic industries in China. If a diversification of global supply chains away from China is the result, this would have a global impact, with as-yet-unknown winners and losers, the potential for increased complexities in supply chains, and could reignite inflationary pressure in certain markets.

The maturity wall for EMs peaks in 2025, with $80.5 billion in rated debt coming due.

All of this could throw central banks' monetary-policy plans into disarray and disrupt capital flows. In particular, any curtailing of the U.S. Federal Reserve's rate-cutting cycle will limit central banks in emerging markets (EMs) to also pursue monetary policy. Additionally, if the second Trump Administration's policies work to significantly strengthen the dollar, this will translate into domestic inflation for EMs, given the effect on weaker currencies, and will make debt-service more expensive, in view of the preponderance of dollar-denominated debt.

Emerging Markets Prepare For A Starring Role

The maturity wall for EMs peaks in 2025, with $80.5 billion in rated debt coming due—although the bulk of it ($65 billion) is investment-grade and concentrated in China and Mexico. Through 2026, 81% of rated maturities in EMs are denominated in U.S. dollars.

Despite the hurdles EMs face, S&P Global Ratings believes these markets will have more of a hand in shaping the global economy in the decade to come as supportive demographics and technological developments boost productivity and, consequently, economic activity. In fact, we estimate **EMs could contribute about 65% of global GDP growth by 2035** and average an economic expansion of 4.1% over that period (compared with just 1.6% for advanced economies).

Furthermore, the global energy transition and potential supply-chain reconfigurations could present opportunities for these economies to leverage their abundant natural resources, ample labor forces, and improving manufacturing capabilities.

Still, EMs face a fast-shifting geopolitical environment and will be forced to adapt to a world in which policymakers—particularly in developed markets—are less willing to embrace free trade and globalization. Against this backdrop, spending on technological advancements will be key to markets where research and development investment has been historically low, resulting in a lag in technological progress and adoption.

Europe Caught In The Crossfire

Europe has traditionally been the region most open to free trade. Sharply higher U.S. tariffs would hit productivity and competitiveness and act as a (marginal) drag on GDP, given the EU had a trade surplus with the U.S. of $170 billion in goods in 2023.

Perhaps more importantly, the country-specific effects could vary substantially, as just three members—Germany, Italy, and Ireland—account for more than half of all EU exports to the U.S. And we believe that a targeting of certain industries (e.g., autos, pharmaceuticals, metals) could be more damaging to credit for those sectors, even if it poses less of a systemic risk.

A 10% tariff on goods sent to the U.S. could shave 0.2 percentage point off eurozone GDP.

In the aggregate, **a 10% universal tariff on all European goods sent to the U.S. could shave roughly 0.2 percentage point off eurozone GDP annually.** This could push the European Central Bank to lower its policy interest rate faster than it otherwise would, which could reignite some inflationary pressures at a time when the euro looks set to lose value against the dollar (which a widening interest-rate differential could exacerbate).

Geopolitical instability remains our top risk to credit in the region. Even if political pressure from the new U.S. administration eventually leads to a wind-down in hostilities, the risks are enormous. Among them, the scale and costs of the Russia-Ukraine and Israel-Hamas wars, the potential for wider conflict, and, in the case of Ukraine, the concern that the Western allies could dial back military, intelligence, and financial support. This significant source of event risk could trigger investor risk-aversion, disrupt supply chains, and undermine the cohesion within NATO, while shifting European governments' spending priorities.

The challenge for European leaders to develop a cohesive policy response to increased trade tensions and shifting geopolitical winds is made more difficult by domestic political uncertainties in Germany and France, the EU's largest and second-largest countries, with regard to population size and economic output.

Both countries could hold elections next year, after Germany's three-party coalition collapsed over a budget dispute and the 2024 elections in France resulted in a hung parliament. German elections for the members of the Bundestag (the lower house of parliament) are slated for February, while in France, the absence of a legislative majority makes it likely that snap elections will take place well ahead of the next regularly scheduled presidential ballot in April 2027.

China Faces An Uphill Battle

Protectionism in Western economies is complicating global trade and poses a drag for the export-dependent Asia-Pacific region. In China, where a prolonged property crisis has weighed on consumer and business confidence, increased tariffs would add to economic headwinds. In this light, we've lowered our 2025 GDP growth forecast for China to 4.1%. Furthermore, economies and industries that depend on China as an end market could suffer.

We've lowered our 2025 GDP growth forecast for China to 4.1%.

Amid softening demand for Chinese goods abroad, businesses could slow capital spending and investments, compounding the effects of weak confidence and exacerbating the economic slowdown. If GDP persists below the country's long-term potential, the drag on credit could intensify. And if higher U.S. tariffs result in a sharp uptick in inflation that forces the Fed to halt its cycle of monetary-policy easing, Asia-Pacific central banks may need to follow suit to limit capital outflows.

China's policymakers took a range of stimulus measures in September and October, including lowering policy rates, in response to persistent downward pressure on growth and prices. Given our expectation for the effects on growth and inflation from higher U.S. trade tariffs, we see policy rates coming down more in 2025.

Real Estate Woes Won't Go Away

Real-estate sectors across many major economies continue to suffer amid still-elevated interest rates, declining demand for commercial properties that is pushing valuations lower, and, in some cases, high leverage among homebuilders.

In the U.S. and Europe, commercial real estate (CRE) remains the focus—particularly the office sector—given the ongoing declines in asset valuations in many cities. With the Fed's key rate unlikely to come down as quickly or as much as markets initially priced in, borrowers face significant refinancing risk and interest-coverage vulnerabilities.

This puts debtholders—including banks, insurers, and commercial mortgage-backed securities (CMBS)—at risk of elevated losses. In the U.S. (where certain segments in the multifamily sector are also facing challenges as rent growth softens) regional banks have proportionately higher exposure to CRE than larger U.S. lenders do. Higher office vacancy rates and shuttered ground-level businesses could also diminish tax revenue for cities.

The U.S. CMBS overall 30-day delinquency rate rose to 5.3% in October.

The U.S. CMBS overall 30-day delinquency (DQ) rate rose 10 basis points (bps) in October, to 5.3%, with the DQ rate for the office space jumping 92 bps, to 9.1%. At the same time, the share of office loans that were either modified or extended was 7.6%, suggesting that the delinquency rate for the sector would be notably higher if CMBS servicers weren't granted modifications.

Because office leases can last 10 years or more, pressures in the sector are unlikely to abate any time soon. And while lenders have been more willing to extend loan maturities as they waited for borrowing costs to come down, it's clear that the secular shifts accelerated by the COVID pandemic mean the office sector may need years to recover—if it ever does.

In Asia, the Hong Kong CRE sector is working through its worst downturn since the Asian financial crisis of 1997. A weak economy, a reduction of regional headquarters, and structural shifts in the retail sector will continue to weigh on Hong Kong's commercial property sector, with valuations continuing to fall. Smaller financial institutions may be underestimating their bad loans to the sector, and some property firms will likely find they can't service debt at current rental yield rates, potentially triggering asset sales at steep discounts.

In China, meanwhile, the relaxing of purchase restrictions in tier-one and higher tier-two cities is diverting demand away from lower-tier cities. For cash-tight local and regional governments, the recent "hidden debt" swap strategy will help reduce funding costs, providing some relief to cashflows. However, the swap also entails higher official debt, and risks may arise from debt redistribution.

Top Risks

In our economic forecasts, we assume President-elect Trump will use his executive powers to impose targeted tariffs on China by raising the bilateral (weighted average) effective tariff rate on Chinese imports to 25%, from an estimated 14% currently, and that Beijing would likely reciprocate with equivalent barriers on American exports to the country.

While credit ratings reflect our base-case scenario, our regional and global Credit Conditions Committees monitor top risks that could derail our baseline expectations, leading to further credit deterioration. For 2025, these include the risks that:

- Geopolitical tensions will disrupt supply chains, trade, and market sentiment;
- Growing protectionism will strain global trade;
- The decline in interest rates will be slower than markets expect, leading to volatility;
- A sharper-than-forecast global economic slowdown leads to heightened credit stress; and
- The challenges facing the global real estate markets deepen.

Looking ahead at the structural risks that will shape the future of credit, we see greater pressure on credit from the physical and transition risks associated with climate change, along with rising systemic risks from cyberattacks.

Top Global Risks

Geopolitical tensions threaten supply chains, market sentiment, and budgets

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

The protracted Russia-Ukraine and Middle Eastern conflicts, combined with the upcoming change in the U.S. government, entail greater unpredictability in policy responses and could force increased spending on already stretched government budgets. Any further escalation could materially disrupt investment flows and lead to durable financial market volatility.

Growing protectionism threatens global trade

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

The incoming U.S. administration has prioritized increased tariffs on trade partners, including China. We anticipate retaliatory actions. Europe, a traditionally open trading bloc, has also recently decided to adopt trade protection measures to counter Chinese state subsidies to strategic industries, including electric vehicles (EVs). All of this could have a global impact, produce as-yet-unknown winners and losers, increase supply chain complexities, and create inflationary pressure in certain markets. It will also complicate the path forward for central banks.

The interest rate descent could disappoint

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

Excluding the Bank of Japan, central banks have started cutting rates. Yet persistent U.S. economic growth and potential tariff-induced inflation are headwinds to further cuts. Regardless, rates will likely settle at higher terminal rates than prior to the pandemic. Weaker borrowers with higher interest expenses remain particularly vulnerable, and new-issue coupons are still 150-200 bps above those on maturing debt. Divergent rate trajectories could impact foreign exchange rates, capital flows, and weigh on emerging market debt.

A sharper global economic slowdown would lead to greater credit stress

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

Resilient economies have reduced the likelihood of a global recession this year, but we expect many countries will see slower growth in 2025. China, in particular, faces the risk of structural deflation and increased tariffs from the U.S. Fiscal headwinds are building, with many countries having taken on increased debt since the pandemic. Labor market resilience will remain a key economic tailwind, but global consumer strength is showing some cracks, with increased delinquencies in the U.S. and still low and "sticky" consumer confidence in China.

Global real estate markets are facing multiple challenges

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

High interest rates, falling valuations and cash flow, hybrid work environments, some homebuilders' high leverage, and the potential for continued selective market access and high financing costs have combined to weigh on both the commercial and residential real estate sectors. The U.S. office sector remains particularly vulnerable. China's sticky property crisis has yet to find a bottom despite government stimulus. These pressures could spill over to banks and negatively affect consumer confidence, spending, employment, and tax revenues.

Structural risks

Climate risks intensify, energy transition adds to costs

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

Larger and more frequent natural disasters threaten to disrupt supply chains and insurance markets. At the same time, the global drive toward a "net-zero" economy heightens transition risks and will require significant investments. COP29's finance goal represents progress but falls short of the needed investment. Geopolitical fragmentation raises the risk of abrupt and potentially contradictory changes in climate policies.

Cyberattacks and the potential for rapid technological change threaten global business and government infrastructure

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

Cyberattacks pose potentially systemic threats and significant single-entity event risk. State-sponsored cyberattacks are likely to increase, and with hackers becoming more sophisticated, new targets and methods are emerging. Resilience will rely on robust cyber security systems, from internal governance to IT software, that will require ongoing investment. Meanwhile, increased digitalization and the introduction of AI by public and private organizations could foster broader operational disruptions.

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.

Global Economic Outlook Q1 2025

Buckle Up

Key Takeaways

- Even before taking office, a second Trump administration is already moving the macro-financial needle and raising downside risks for the global economy. The degree of ultimate policy implementation is a key unknown.
- Our preliminary policy read on the new U.S. administration is that positive growth effects will be minimal, inflation pressures will rise, and the Fed is likely to stop cutting rates earlier. This will lead to tighter financial conditions, a stronger dollar, and a more complicated macroeconomic picture elsewhere.
- Owing to a "wait and see" approach, our GDP growth forecasts have not moved much since the previous publication, other than incorporating changes related to base effects.
- Risks include the full implementation of the proposed U.S. agenda on taxes, trade, and immigration; the end of resilient consumer spending and labor demand; and bond market stress. AI is an upside.

Editor's note: This is an abridged report. For the full version, see: "Global Economic Outlook Q1 2025: Buckle Up," published Nov. 27, 2024.

The global macroeconomic outlook is hostage to the policy implementation of the new U.S. administration. The recent macro pattern featuring an outperforming U.S. economy continues. But potentially large changes in fiscal, trade, and immigration policy from the U.S. are significant unknowns at this juncture. Specifically, it is unclear to what extent campaign promises will translate into policy, and when.

Given the size of the U.S. economy, policy action on any of these fronts can move the global needle, affecting some economies more than others. For now, S&P Global Ratings has taken a probabilistic approach and is assuming partial implementation of U.S. campaign promises. Of course, to the extent that U.S. policy actions spill over to the rest of the world, other countries may respond in kind. We plan to update our forecasts, narratives, and risks as the picture becomes clearer.

Global Macro 2025: Fasten Your Seatbelts

The global economy will start 2025 in a relatively good position. Macro resilience has been a key theme over the past few years. Higher interest rates in response to an unexpectedly sharp rise in post-pandemic inflation have not caused the sharp slowdown feared by most forecasters. Services spending has remained strong and labor demand robust. Losses in output and employment have been modest. Asset prices have risen and volatility has been low. Central banks are now cutting interest rates, and a normally elusive soft landing appears within reach and remains our baseline scenario.

The U.S. has been central to this positive global macro story. The world's largest economy has continued to outperform and steady the global macro picture. That could be about to change. The new administration looks to "juice up" an economy that is already running at or above potential, raising the specter of higher inflation pressure, higher U.S. rates along the curve, and a

stronger dollar. This tightens U.S. financial conditions and will spill over to a swath of other economies, mainly emerging markets.

More critically, U.S. trade policy could turn much more disruptive if implemented along the lines promised in the campaign. Maximum U.S. tariffs on Chinese imports could significantly damage that economy. And, like before, China is almost sure to retaliate. Tariffs on other trading partners are likely to cause commensurate damage to their economies, with the risk of retaliation as well. On balance, we think tariffs will be growth-destroying and further contribute to ongoing economic (and political) fragmentation. Moreover, none of this will help narrow the U.S. trade and current account deficit, which reflects a lack of U.S. savings relative to investment.

How much of the proposed policy agenda was campaign bluster versus actual intent remains to be seen. But one thing is clear: volatility will be a feature, not a bug. Buckle up.

Our Broadly Unchanged Forecasts Have Widening Confidence Bands

Our new baseline growth forecasts are broadly in line with our previous quarterly Credit Conditions Committee forecasts (see table 1). U.S. GDP growth will slow gradually to 2% or below starting next year, consistent with a soft landing, before rising back to potential. The eurozone will continue its gradual recovery in 2025 to reach its potential growth rate. China's growth will slow toward 4% as the U.S. tariffs weaken exports and investment.

Elsewhere, the picture is mixed. In the advanced economies, Japan will rebound next year and settle at about 1% growth, with the U.K. following a similar pattern toward its trend growth of 1.5%. In the major emerging markets, India retains the global growth baton, where the rate of expansion should stay just below 7% over the next few years. Elsewhere in emerging markets, Brazil and Mexico should eventually converge to about 2% growth (with Mexico having a weaker 2025), while South Africa should pick up to about 1.5% growth in the next few years.

GDP growth forecasts

In annual percent

	Actual		Forecast			Change			
	2023	2024	2025	2026	2027	2024	2025	2026	2027
U.S.	2.9	2.7	2.0	2.0	1.7	0.1	0.1	0.1	-0.1
Eurozone	0.5	0.8	1.2	1.3	1.2	0.0	-0.1	-0.1	-0.1
Germany	-0.1	-0.1	0.9	1.1	1.1	-0.2	-0.3	-0.2	0.0
France	1.1	1.1	1.0	1.2	1.1	0.0	-0.2	-0.3	-0.1
Italy	0.8	0.5	0.9	1.1	1.0	-0.4	-0.2	-0.1	-0.1
Spain	2.7	3.1	2.5	2.0	2.0	0.4	0.4	0.0	0.0
U.K.	0.4	0.9	1.5	1.6	1.5	-0.1	0.3	0.0	-0.2
Asia-Pacific									
China	5.2	4.8	4.1	3.8	4.3	0.2	-0.2	-0.7	-0.2
Japan	1.7	-0.3	1.3	1.0	1.0	-0.3	0.0	0.1	0.1
India*	8.2	6.8	6.7	6.8	7.0	0.0	-0.2	-0.2	0.0
Emerging economies									
Mexico	3.2	1.5	1.2	1.9	2.2	-0.1	-0.2	-0.4	-0.1
Brazil	2.9	3.1	1.9	2.1	2.2	0.2	0.1	0.0	0.0
South Africa	0.7	1.0	1.6	1.4	1.3	0.0	0.2	0.2	0.1
World	3.5	3.3	3.0	3.1	3.2	0.0	-0.1	-0.2	-0.1

*Fiscal year, beginning April 1 in the reference calendar year.
Sources: S&P Global Market Intelligence and S&P Global Ratings (forecasts)

Our detailed regional forecasts are as follows:

- We forecast the U.S. economy will expand 2.0% in the next two years (incorporating a partial implementation of proposed Trump policies), following 2.7% GDP growth in 2024. At face value, President-elect Trump's policy proposals could result in higher inflation in the near-term and lower growth in the medium- to long-term. We expect the Fed to reduce its policy rate more gradually and reach an assumed neutral rate of 3.1% by fourth-quarter 2026. The probability of a disruption to the Fed's easing bias over the next two years has risen. (For further details, see "Steady Growth, Significant Policy Uncertainty," published Nov. 26, 2024.)
- We project eurozone GDP growth of 0.8% in 2024 and 1.2% in 2025, with Germany lagging its peers and Spain continuing to outperform. Due to a more pronounced drop in energy prices, we expect inflation will be marginally lower next year. We anticipate the ECB will cut interest rates more quickly due to persistently weak confidence and better visibility on the disinflation trajectory—to reach 2.5% before summer 2025. A long period of very stable macroeconomic forecasts may end as new leaders in the U.S., EU, and Germany are likely to make decisions early next year that could reshape the outlook. (For further details, see "Next Year Will Be A Game Changer," published Nov. 26, 2024.)
- While China's stimulus measures should support growth, we expect its economy to be hit by U.S. trade tariffs on its exports. In all, we now project 4.1% GDP growth in 2025 and 3.8% in 2026. Asia-Pacific's growth will be impeded by slower global demand and U.S. trade policy. But lower interest rates and inflation should ease their drag on spending power. Swings in capital flows driven by shifts in expectations about U.S. interest rates and trade policies require central banks to be vigilant and cautious. In turn, we expect Asia-Pacific central banks to take their time bringing policy rates down. (For further details, see "U.S. Trade Shift Blurs The Horizon," published Nov. 25, 2024.)
- A likely increase in protectionist trade policies among major economies will hurt GDP growth in most emerging markets over the next couple of years—of which the magnitude of the effect will depend on the details. For now, we assume only a modest increase in tit-for-tat tariffs between the U.S. and China in 2025 and no new tariffs for the rest of the world, which would produce a relatively modest net impact on GDP in most major emerging markets outside China. However, downside risks to our forecast are high, and potential tightening in financial conditions because of trade-related uncertainty adds another hazard. (For further details, see "Trade Uncertainty Threatens Growth," published Nov. 26, 2024.)

Risks Shift To Near-Team U.S. Policies

The main risk to our baseline is the exact policy implementation of the incoming U.S. administration on tariffs, taxes, and immigration. In our current forecast round, we have assumed only partial implementation of campaign promises. Once the new administration takes office, actual policy implementation will become clearer.

Looking at a scenario in which the U.S. imposes a 60% tariff on all imports from China plus new tariffs on other trading partners, cuts personal and corporate taxes, and deports millions of illegal immigrants, we anticipate lower U.S. output, higher inflation pressures, and increased volatility and rates along the yield curve. These effects will spill over to other economies—very asymmetrically—in terms of activity, trade, and key financial variables.

The durability of the nexus of strong services spending and labor demand also constitutes another downside risk. While in our baseline scenario we assume continued resilience, services spending could begin to crack, given still-high interest rates and rising uncertainty about U.S. policy. Should services spending slow and labor demand begin to fall, we would likely enter into a sharp slowdown/recession scenario.

Another downside risk is the end of quiescence in the U.S. bond market. While 10-year yields rose before and after the election, the market has so far remained orderly. Stress in the bond market cannot be ruled out, given that deficits under the Trump administration are projected by the U.S. government as being higher than under a Harris administration, plus the uncertainties discussed above. A failed auction or a spike in yields could lead to higher volatility and spreads, closed access for parts of the market, and tighter financial conditions.

On the upside, recent productivity gains in the U.S. could broaden and deepen. These gains have come from investments and new technologies around the energy transition, as well as AI, and have boosted potential growth by 40 bps-50 bps. While energy transition gains might be limited elsewhere, given the specific characteristics (subsidies) of the U.S. Inflation Reduction Act, AI capabilities are more widespread and only at a very early stage. This could boost productivity across a range of economies.

Questions That Matter

Monetary Easing | What If The Interest Rate Descent Disappoints?

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Continued U.S. outperformance driven by higher investment implies that equilibrium rates may have risen. To date, borrowers have largely been able to deal with higher rates due to resilient growth. Donald Trump's reelection increases the risk rates will rise.

How this will shape 2025

Globally, our current soft-landing baseline includes gradually falling policy rates. The resilience of services spending and labor demand in the face of sharply higher rates has been a surprise in most economies in the post-pandemic period. This resilience gives us confidence that a soft landing—where output, employment, and inflation do not undershoot—is likely. In a soft-landing scenario, central banks are able to lower rates steadily, gradually moving away from tight financial conditions to bring economies onto sustainable paths with potential growth, full employment, and inflation on target.

The path of the U.S. economy—and interest rates—is central to the global macro view. Despite the rise of China and the "Global South," the U.S. remains the world's largest economy, the dollar remains the main global currency in terms of reserve holdings and trade and capital flows, and U.S. Treasury bonds remain the world's risk-free asset. As such, what happens in the U.S. has an outsize influence in the global economy. The ongoing outperformance of the U.S. economy and the re-election of Donald Trump seem likely to materially influence the global economy.

But we've seen "disappointments" already, with minimal impact for most borrowers. Market expectations for rate cuts are often more aggressive than those of central bankers, and this has been the case since 2022. In fact, 2024 has arguably played out as a year of disappointments for rate-cut expectations. At the beginning of the year, markets expected the U.S. Federal Reserve to cut interest rates roughly 150 basis points (bps), but this quickly changed to as few as one 25-bps cut in April-May. Speculative-grade bond spreads subsequently fell to new all-time lows (at approximately 230 bps in early May), setting off more than 60% growth in high-yield bond issuance and roughly one-third ($400 billion) of the U.S. leveraged loan market securing lower spreads via repricing on average of 50 bps through mid-year. Despite what may have played out to be a disappointing path for interest rates, this hardly got in the way of a productive year for issuers and even credit quality. We've downgraded about 49% of the global speculative-grade corporations we rate (including financial services)—well below the annual average of 62% and the lowest since 2021's record of 33%. And in a pivot since midyear, rate cut expectations increased to 100 bps at the end of October and have unsurprisingly become even more likely.

Read more

After Trump's Win, What's Next For The U.S. Economy?, Nov. 7, 2024

What we think and why

The U.S. neutral interest rate (which neither stimulates nor constricts the economy) has risen in the post-pandemic period. Consensus has moved the post-pandemic U.S. neutral interest rate to around 3%—from around 2.5% prior to the pandemic. The higher U.S. neutral rate mainly reflects two factors. First, the artificial intelligence (AI) boom and continued commitment to the energy transition spurred a productivity boom and raised investment. Because interest rates equate to investment and savings, this implies that interest rates should rise. Second, U.S. government debt continues to climb—implying that a higher interest rate is needed to entice agents to buy and hold U.S. debt.

A Trump victory increases risks that inflation and interest rates will rise. While the Trump economic program aims to stimulate potential growth, a more likely outcome is higher inflation. Supply side measures—such as reducing regulations and increasing efficiency—should help spur growth, but their impact might be limited because potential U.S. growth recently increased by 40 bps-50 bps (to around 2.25%). Tax cuts are unlikely to boost growth by much because the economy is already operating above potential. Tariffs will raise inflation pressures, particularly if there are second-round effects following the initial rise in the level of import prices. And deportation will reduce the labor supply and therefore put upward pressure on wages and prices. Each of these developments is likely to raise inflation.

A Trump victory puts upside risks on inflation and therefore rates.

Long-term rates could ultimately remain higher than levels seen in recent years globally, even while still declining. Corporations, governments, and individuals fund most of their debt based on long-term interest rates, and these do not always move in lockstep with more short-term policy rates. Long rates may rise or fall ahead of policy rates in anticipation of moves by central banks. On the other hand, moves in long rates may be delayed relative to policy rates if markets are less convinced of central banks' commitments to move rates.

Upwardly revised expectations for interest rates in 2025 may not pose a burden, so long as growth remains solid. The experience of 2024 has proved the resilience of corporations and governments in the face of higher interest rates, with an overall improvement in relative credit quality, sustained positive earnings, and falling defaults (with a majority of those being less-punitive distressed exchanges). Perhaps the major contributor has been the indefatigability of economic growth, particularly in the U.S. Positive corporate earnings have provided firms with room to deal with higher interest rates, although this has been driven by cost-controls more than sales growth.

But dynamics are rarely this simple. Our base case for 2025 calls for falling interest rates and a soft-landing for most economies—and experience has shown that higher interest rates can be a manageable headwind, if a consequence of above-trend growth. Still, the year ahead may be facing increased risks to this baseline. Nonfinancial corporations and financial institutions globally have faced higher borrowing costs post-pandemic than at any time in at least the past 10 years, and current coupon rates are roughly 150 bps to 200 bps above those for maturing debt. The interest rate gap has been manageable for most borrowers thus far—but could become more challenging the longer it persists.

What could change

If inflation pressures reemerge, central banks will halt the rate cutting cycle. Led by the Fed, this would also include other countries—especially emerging markets. Should the pressures from the Trump administration's likely inflationary economic program reverse the recent fall in core inflation, the U.S. central bank is likely to end its rate cutting cycle earlier than previously thought on the rationale that tighter-than-expected financial conditions would be needed to ensure that the Fed achieves its 2% inflation target. Indeed, the October 2025 fed funds rates expectation rose by 100 bps in the past two months, taking the anticipated weighted average rates to around 3.9% from 2.9%. Dollar-dependent emerging markets are likely to mirror the Fed's moves.

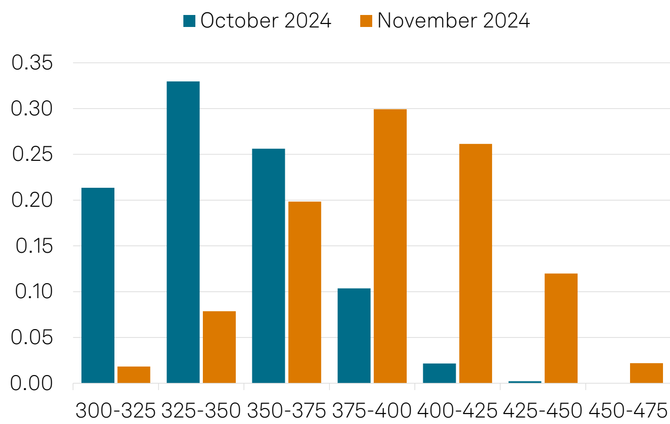
Bond market quiescence could end, forcing longer-term rates to rise sharply. Long-term U.S. government bond yields have already moved up in recent months, rising 80 bps from mid-September to almost 4.5%. This move initially showed the market factoring in a higher probability of Trump winning—reflecting a higher trajectory for the deficit compared with candidate Kamala Harris' plan—and has continued post-election. While the rise has been orderly so far, we foresee a risk from the potential for market participants to go on a "buyer's strike." In this disorderly scenario, yields would jump, volatility would rise, and liquidity and market access could dry up for

some borrowers. While intervention by the Fed in such a scenario cannot be ruled out, the government would ultimately need to commit to some form of fiscal restraint to calm markets.

A sustained period of elevated rates could force borrowers to adapt. The current interest rate gap may persist for some time, even if it tightens in 2025—considering our expectations for cuts in U.S. Treasury and other benchmark rates ahead, which are more modest than our expectations for cuts to policy rates. This elevated cost gap is nothing new to corporations but may have arguably influenced funding decisions (given its presence over the last two years). Issuance in 2024 has been dominated by refinancing activity as many issuers have finally come to grips with higher-than-desired rates. As 2025 unfolds, many more borrowers may face this reality, pushing up all-in costs of debt. This could force companies to adjust costs in other areas to compensate—such as via adjusting investment and labor-related decisions, shareholder rewards, or simply via lower profit margins.

Fed funds rate expectations

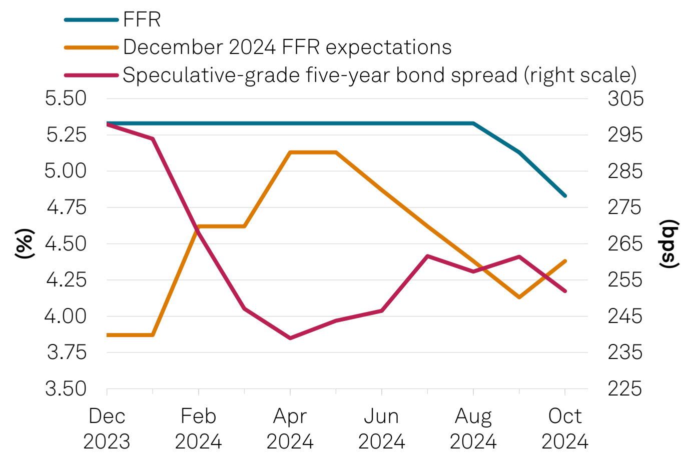
October 2025 meeting (basis points)



Source: S&P Global Ratings.

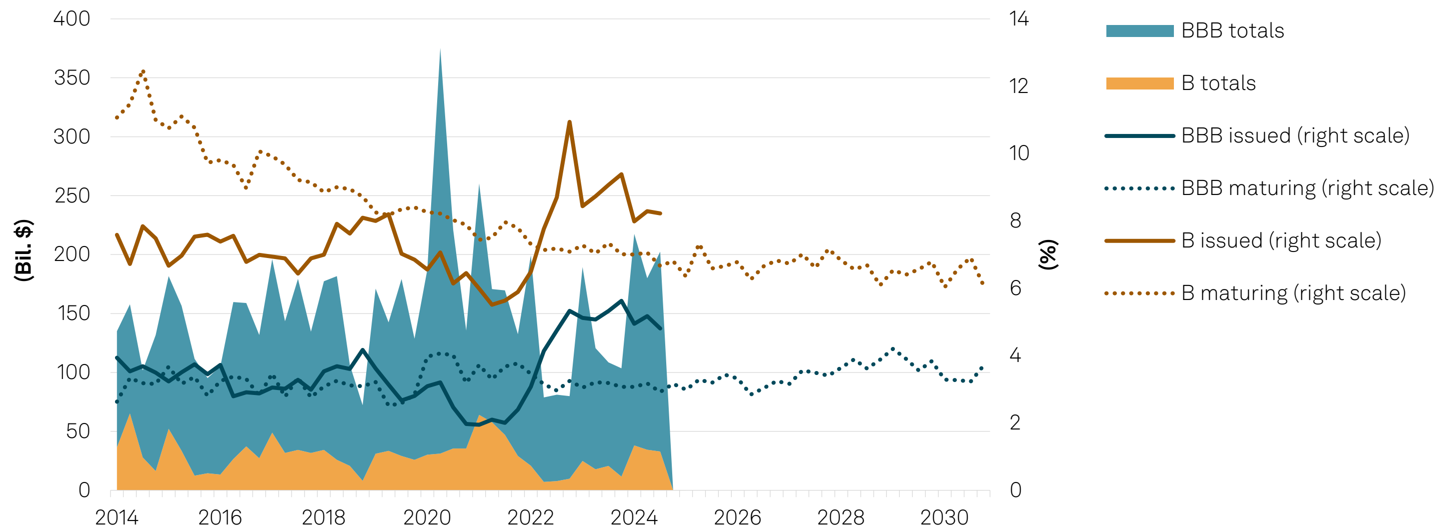
Who's disappointed?

Scuttled rate cut expectations didn't stop optimism



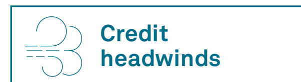
FFR--Effective federal funds rate. Sources: S&P Global Market Intelligence, S&P Global Ratings Credit Research & Insights.

Global coupons are falling, but the current "gap" remains large



Quarterly data beginning March 2014. Sources: Refinitiv, S&P Global Ratings Credit Research & Insights.

Sovereign Debt | Is The Austerity Versus Growth Dilemma Back?



The EU's reactivation of its fiscal rules should help stabilize sovereign debt in member states. At the same time, by reinforcing low private investment and consumption, the return to austerity could--as was the case for Greece between 2009 and 2013--worsen the outlook for debt sustainability and hence prove to be self-defeating. This is because the EU, particularly Germany, faces structural challenges to its export-driven growth model and underinvests, compared with the U.S. and China.

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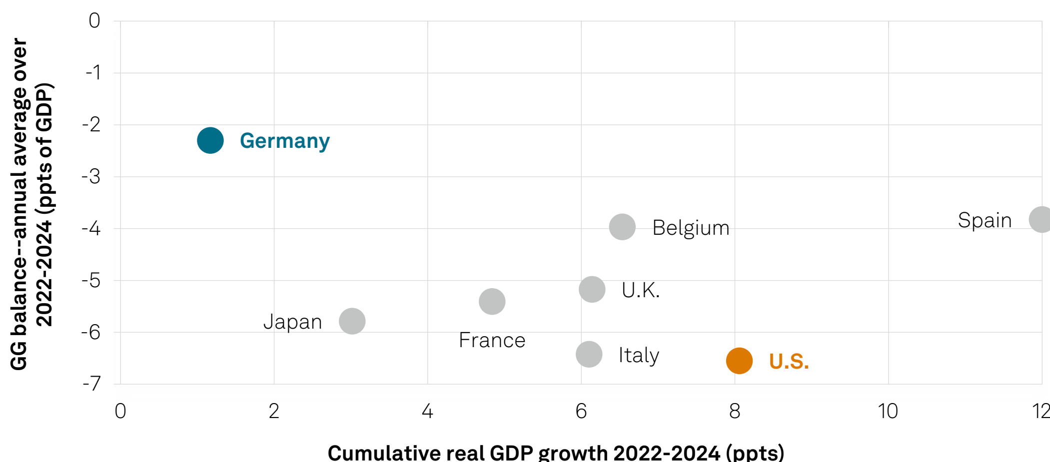
How this will shape 2025

Over the past four years, the cost of providing budgetary support to households and companies to face economic emergencies amounted to about 10 percentage points (ppts) of developed economies' GDP. For 2024-2027, we project that larger advanced sovereigns will accumulate another 5 ppts of GDP in public debt. Indeed, new spending pressures are emerging for G7 governments in connection with security risks, trade conflicts, and increasing competitiveness. Moreover, the two largest economies in the world, the U.S. and China, are both operating expansionary fiscal policies that include generous subsidies for the private sector, especially in manufacturing. The question for European governments--particularly manufacturing-heavy Germany--is whether they need to match this generous support or continue to cap public debt, as required by EU fiscal rules.

Read more

Sovereign Debt In Large Advanced Economies: Up, Up, And Away, July 2, 2024

Germany's economic growth and spending are lower than those of other developed economies



GG--General government. ppts--Percentage points. Source: S&P Global Ratings.

Germany--set to post negative growth for the second consecutive year--has historically been committed to prudent fiscal management. German policymakers have watched with concern the post-pandemic trend of rising government deficits, which have, in some cases, eroded ratings and debt sustainability in G7 sovereigns, such as France. Yet there is a price to be paid for overly cautious fiscal policy. This is why the austerity versus growth debate has returned.

In Berlin, the current domestic debate primarily focuses on the debt brake rule, which aims to prevent federal deficits exceeding 0.35% of GDP (plus an economic adjustment component) at the federal level and forbids net new borrowing at all lower government tiers. Overall, Germany's

fiscal prudence has been, and still is, a ratings strength. The 'AAA' sovereign rating on Germany reflects its strong public balance sheet (we expect gross general government debt to GDP of below 59%), low deficits (we forecast a 2025 budgetary deficit at -1.7% of GDP), net external creditor position, and wealthy and diversified economy.

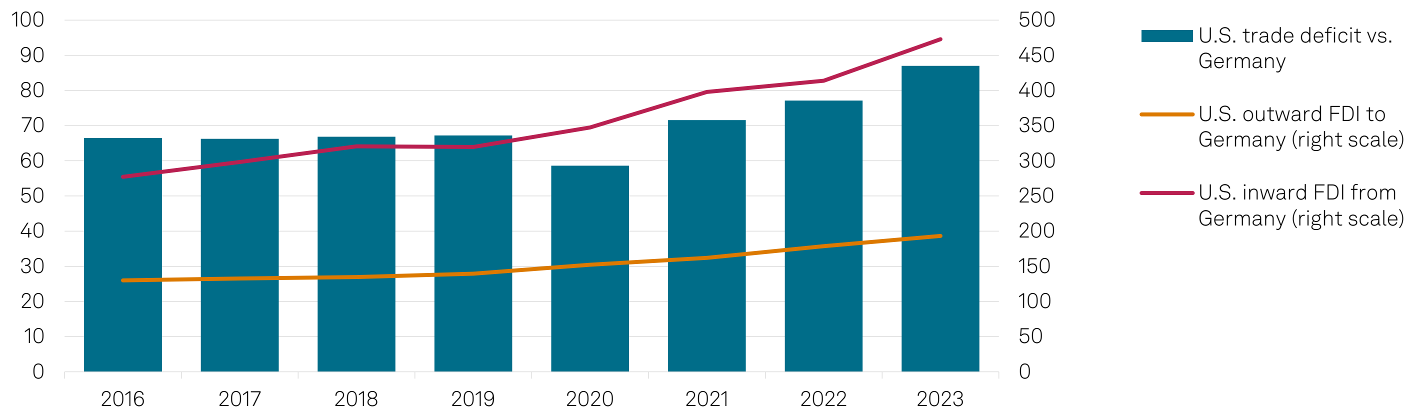
The question is whether such a cautious fiscal policy--by exacerbating the confidence shock to Germany's even more cautious private sector--will permanently lower Germany's capital stock, and hence its growth potential, to such an extent that it will also undermine the country's creditworthiness and therefore prove to be self-defeating. So far this year, German households have saved a record 24% of disposable income versus the sub-5% rate in the consumption driven U.S. economy. The propensity for public and private sectors to save at the same time, rather than to consume or invest, is a fundamental reason for Germany's weak growth and explains why Germany is generating large external surpluses with key trading partners, such as the U.S. The European Commission considers these current account surpluses to be evidence of Germany's macroeconomic imbalances, and of low public and private investments.

The propensity for public and private sectors to save at the same time, rather than to consume or invest, is a fundamental reason for Germany's weak growth.

Germany's private sector invests a large portion of these surplus savings not in Germany, but in the rest of the world--particularly in the U.S. Among other factors, this is due to tax incentives launched by the Biden administration, lower U.S. energy costs, and the U.S. dollar's status as the preeminent global reserve currency. Germany's preference for investing in factories, laboratories, and training programs in the U.S., rather than in Europe, also helps explain the widening investment and productivity gap between the eurozone and the U.S.

Germany's re-investments in the U.S. exceed its U.S. trade surplus almost sixfold

Bil. $



Goods and services international trade balance. FDI--Foreign direct investment.
Sources: U.S. Bureau of Economic Analysis, S&P Global Ratings.

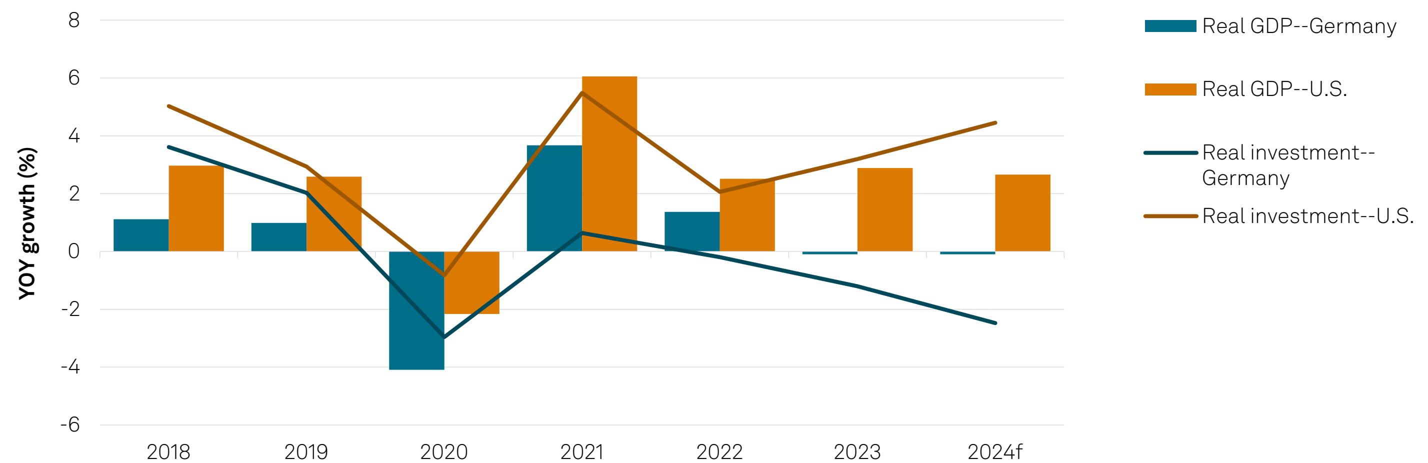
What we think and why

The austerity versus growth trade-off is relevant to U.S. and German sovereign credit stories. The U.S. continues to run large fiscal deficits, which the Treasury has been able to finance at a low cost, not least thanks to the U.S. dollar's role as the preeminent global reserve currency. We project that U.S. general government deficits will likely exceed 6% of GDP by 2026, pending more clarity on actual policy implementation and provided net general government debt rises toward 100% of GDP. In our view, the fiscal profile is the key sovereign rating weakness for the U.S. In contrast, we project Germany's fiscal policy will continue to be tight and remain among Germany's rating strengths. The U.S. dollar's status as the world's premier reserve currency affords the U.S. significant flexibility in its fiscal and external accounts. We expect this status will remain intact, albeit any unexpected efforts to weaken the independence of the Federal Reserve would test this assumption.

Germany's ratings strength--its commitment to prudent finances--could become a ratings weakness if it contributes to low and declining potential growth. In contrast, growth has not been a problem in the U.S. We consider that the resilience, strength, diversification, flexibility, and wealth of the U.S. economy is central to the 'AA+' sovereign rating on the U.S. To be clear, the U.S.'s historically stronger growth outcomes, compared with Europe, result from more than just favorable fiscal policy. The U.S.'s enormous domestic energy endowment, flexible labor market buoyed by high levels of net immigration, the significant size of capital markets, and the country's rule of law support its vibrant economy. In comparison, Europe's single market is fragmented, with national regulators impeding the potential for cross-border investments, competition, and economies of scale.

U.S. growth increased considerably after significant investments

Year-over-year growth (%)



f--Forecast. Source: S&P Global Ratings.

What could change

In 2025, the political situation in Europe and the U.S. could become more volatile, against a backdrop of geopolitical conflicts and rising trade disputes. After France's centrist alliance lost its majority following this year's election, the now minority government struggles to pass the 2025 budget. The political landscape in Germany is similarly fragmented, with the country heading toward snap elections on Feb. 23, 2025. Yet German policymakers across the political spectrum remain supportive of free trade, while the U.S. is pulling back from globalization. So far, president-elect Donald Trump has promised tariff increases and tax cuts, but has yet to propose a plan to reduce the U.S.'s large budgetary deficits. U.S. trade tariffs against Europe and other key trading partners could add further pressure to Europe's already soft economy.

Any significant deterioration in economic relations between the U.S. and the EU could increase consensus among European policymakers to finance investments and support reforms--including those proposed by Mario Draghi in his Competitiveness Report--to mitigate Europe's productivity malaise. The post-election German government could find a way around the debt brake and support joint EU financing efforts, including for Common European Defense (something that the U.K. may also consider supporting). This could increase public investments, advance the Capital Markets Union, and unify Europe's single market for services and labor.

Alternatively, EU policymakers may remain embroiled in domestic policy--unable to reform and invest to rise to the competitiveness challenge. Under this scenario, the productivity gap between Europe and the U.S. could increase, and public and private incomes, as well as sovereign credit quality, could decline across Europe.

Private Markets | How Will Private Credit Respond To Declining Yields?

Recent and upcoming rate cuts will provide relief for private credit borrowers through lower funding costs in 2025, even as many have already benefitted from repricing and improving financing conditions.

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How this will shape 2025

Repricing will continue to change market dynamics. Repricings have defined recent broadly syndicated loan (BSL) activity, with spreads narrowing on more than 40% of loans in 2024. To a smaller degree, this is affecting private credit as well, reducing the overall cost of funding for many issuers. New issue 'B' rated leveraged BSL yields have fallen by a full percentage point since the beginning of the year (to 9% in the U.S. and close to 7% in Europe), with their spreads holding below 400 basis points (bps). While potential competition between public and private markets is supporting tight pricing, yields have already started falling as investors take a more constructive view of credit in light of rate cuts and the increased prospect of a soft landing.

Companies should see a bigger benefit from rate cuts in 2025 than this year. We expect lower rates will take some time to flow through corporate financials, eventually improving borrowers' coverage ratios and free operating cash flows. Where cash flow pressure from higher interest rates increased payment-in-kind (PIK) interest payments, falling rates will eventually ease pressure on liquidity and cash flows. We are already seeing a small dip in instances of collateralized loan obligations (CLO) managers' specified notifications of conversion of cash-paying tranches to PIK. For spreads, we are also seeing a tightening between the yields on broadly syndicated loans and private credit lending.

Competition and convergence between public and private markets will continue. With growth and innovations in private markets, some borrowers have the luxury of choice between broadly syndicated or private credit. This is leading to competition and tighter pricing. For instance, the spread between private credit loans and BSL is narrowing to less than a percentage point within the portfolios of business development companies (BDCs). While BSL pricing is often lower, transparency marks another fundamental difference. Transparency is embedded in public and BSL markets through systems such as market pricing, data on deals and issuance, or the availability of public ratings. In private markets, transparency varies, with larger managers seeing a greater share of deal flow. Some investors are approaching the private markets with caution, given this asymmetry in information and transparency.

Read more

Private Credit And Middle-Market CLO Quarterly, Oct. 18, 2024

Documentation, Flexible Structuring Continue To Reign In Private Credit, Sep. 17, 2024

BDCs Extend Private Credit Maturities As Financing Eases, Aug. 15, 2024

What we think and why

As private credit matures, we expect size and sophistication to scale. As private credit finds its balance with BSLs and high-yield bonds, this offers borrowers more diversification in funding. Private credit is best-positioned to provide execution speed, certainty, and flexibility in terms and structure of payment, such as delayed draws and PIK toggle options, as well as recurring revenue deals with revenue-based leverage covenants. Private credit also meets the needs of lower and traditional middle markets where smaller loans do not offer the scale needed for syndication.

Naturally, there is some overlap in the upper middle market and the syndicated loan market where borrowers have options for private or public credit. We expect some borrowers operating in this zone of overlap will continue to refinance BSLs with private credit (and vice versa) as they seek the best possible terms and pricing. While this competition can improve financing

conditions for borrowers, it also brings the potential risk of more aggressive underwriting and looser documentation.

Documentation and covenants will likely continue to ease. While the lower middle market features financial maintenance covenants, an increasing number of upper-middle-market entities and even some core-middle-market entities are dispensing with these. Possibly, competition with the BSL market is leveling the playing field. We reviewed more than 1,000 credit agreements from loans executed last year and found maintenance covenants were less common among larger deals. Increasingly, private debt borrowers are also shedding financial maintenance covenants through amendments.

One of the stronger points for middle-market loans has been the quality of documentation. Even as other aspects of the terms remain intact, the elimination of maintenance covenants takes away a strong point of negotiation and leverage for lenders in this space. With weaker documentation and fewer covenants, credit quality is of even greater importance.

The cohort of ratings may evolve, and this could affect the asset mix of investor vehicles. Strong demand for credit and the compression of 'AAA' rated liability spreads improved the economics of lending through investor vehicles, spurring CLO issuance up more than 50% in the U.S. (and more than 80% in Europe) over 2023's volume.

In Europe, the population of 'B-' and 'CCC+' rated issuers has shrunk following several upgrades. Despite this, European CLOs' exposure to the 'B-' and 'CCC+' baskets has increased in the past year, largely due to a few downgrades of widely held issuers such as Altice. In the U.S., by contrast, CLO holdings of 'B-' credit is declining. While managers generally prefer to hold higher-rated credits, the 'B-' cohort has also shrunk as some have refinanced through private credit.

Resounding CLO issuance is also seen among middle-market CLOs. Issuance of these in the U.S. is reaching a new all-time high, and Europe is reportedly preparing for its first middle-market CLO launch. Initial declines in benchmark interest rates in 2024 have led to modest improvements in the credit quality of credit estimated companies (borrowers with loans held by middle-market CLOs). While the impact of lower rates so far has been modest, we expect the improvements will be more pronounced in 2025.

What could change

Private equity may find new exit opportunities. The decline in merger and acquisition activity in 2022 and 2023 has left financial sponsors searching for exit opportunities. Many private-equity funds are approaching or well into their harvest period--the time to exit their investments of portfolio companies to pay back their investors. The average holding period of portfolio companies is the highest it's ever been (based on PitchBook LCD), further pressuring sponsors to look for exit opportunities through sponsor-to-sponsor sales, sales to strategic buyers, IPOs, or secondary funds. To close valuation gaps, sellers and potential buyers are testing new deal features, including delayed payments with a pre-arranged price (such as TPG Capital's and GIC Private Ltd.'s recent acquisition of Techem from Partners Group). We're also seeing an uptick in dividend recaps funded through BSL and private credit as general partners source ways to return capital.

More certainty on rates and valuations could increase mergers and acquisitions and leveraged buyouts, providing more loan paper to a CLO market that's hungry for deals as long as financing and macro conditions remain supportive.

Private markets may tap new sources of liquidity. Private credit is traditionally an illiquid, buy-and-hold asset, with little secondary-market trading. New structures and vehicles may provide new sources of liquidity, or they may expose risks of the assets' underlying illiquidity. At the

holding company level, fund managers have been turning to fund financing options such as net asset value (NAV) loans, subscription lines, and capital call facilities to source more liquidity. Beyond this fund financing, asset managers reportedly have proposed private credit exchange-traded funds (ETFs), some of which include plans for secondary trading desks to provide liquidity. But new structures and market innovations need to be assessed with care, especially when increased complexity is not accompanied by increased transparency.

We expect investors' demand for some type of secondary market will continue to rise with newer parties and larger funds entering the private credit market. For instance, portfolio trading is reportedly gaining traction because such loans may be easier to model and price than individual private credit loans. These loans are often inefficient or difficult to trade because the instrument is too small, too niche, or too little is known about the borrower. Even as markets are finding innovative approaches to trade private credit, many of these individual instruments will likely continue to present challenges to trading.

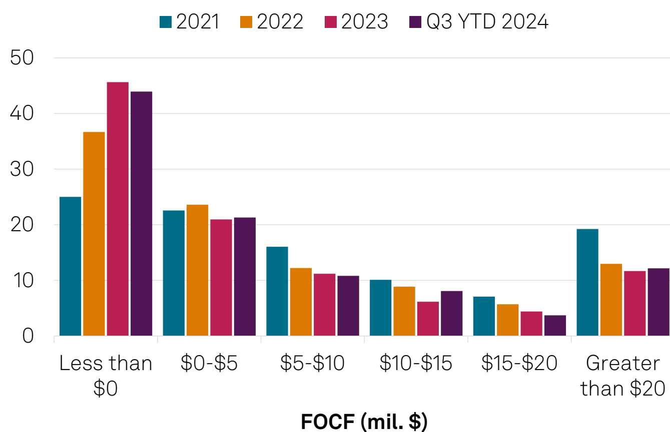
Convergence may bring new cooperation. The market continues to evolve with more strategic tie-ups between banks and private credit, as well as between insurance and alternative asset managers. As the Basel III endgame proposal brings clarity to banks' capital reserve requirements, this could lead to derisking balance sheets and moving away from financing risk assets. As banks derisk, alternative asset managers are expanding beyond middle-market and corporate lending, private credit is expanding into asset-based finance, including consumer lending and esoteric assets, along with project finance and infrastructure. While this expansion may offer much larger investment opportunities at higher rates of return, but also with more complexity.

While this could set the stage for increased competition, it also provides opportunities for cooperation. Private credit is gaining capital to deploy, just as the banks and other lenders may be pulling back from some of their traditional areas. While falling yields and improving financing conditions appear to be supporting the growth of this market, transparency, liquidity, and credit quality remain central challenges for investors in this space.

The market continues to evolve with more strategic tie-ups between banks and private credit, as well as between insurance and alternative asset managers.

Cash flow is starting to improve

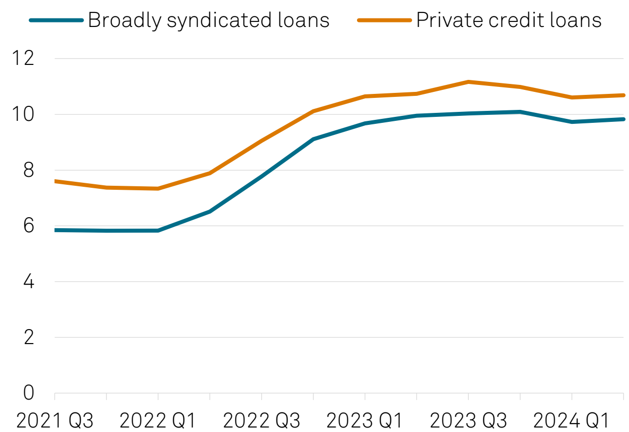
FOCF distribution of credit estimated companies (%)



FOCF--Free operating cash flow. Source: S&P Global Ratings.

Loan yields are coming down

Average yields, broadly syndicated and private credit loans (%)



Estimate of average yields from business development company loan assets. Source: S&P Global Ratings Private Markets Analytics.

Corporates | Can Monetary Easing Bring Enough Relief To Justify Current Market Optimism?

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Monetary easing and accelerating growth should improve corporate credit fundamentals, but trade tensions and sticky inflation are significant risks.

How this will shape 2025

Further monetary easing in 2025 should help ease financial pressures on corporates. The rate of increase in interest costs has already started to slow down as policy rates fall and favorable financial sentiment makes refinancing easier and cheaper. With financing costs steadying, recession seemingly avoided, and EBITDA growth recovering, we anticipate a strong rebound in interest coverage after a period of weakness. However, there are still significant variations likely in the degree of improvement across credit ratings, with stronger entities seeing a more decisive improvement. Even so, we expect EBIT interest coverage for entities in the 'B' category will return to its 20-year average in 2025.

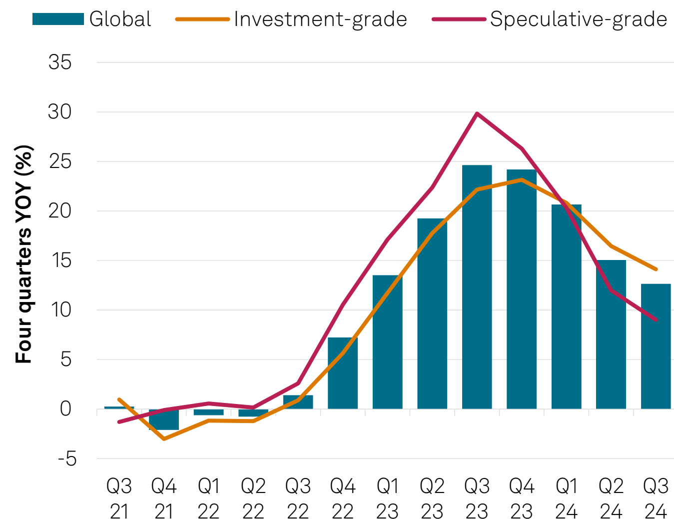
Read more

Corporate Results Roundup Q3 2024, Nov. 25, 202

Chart 1

Interest-cost pressures are easing as policy rates fall

Cash interest paid
Global rated nonfinancial corporates

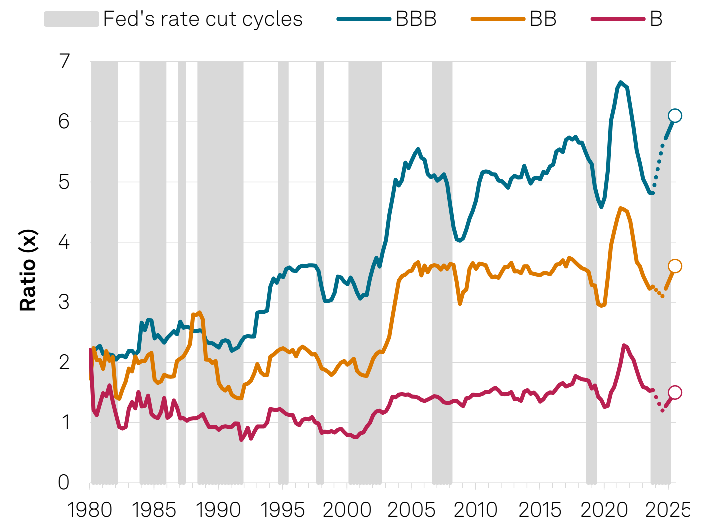


Data to Nov. 12, 2024. Measured in U.S. dollars, at historic rates. Only includes companies reporting quarterly. Latest quarter only includes companies that have reported Q3 2024 results. YOY--Year-on-year. Sources: S&P Capital IQ, S&P Global Ratings.

Chart 2

Interest coverage to recover, but less so for weaker credits

Median EBIT interest coverage by rating category
Global rated nonfinancial corporates



Shows data for the contemporaneous nonfinancial global corporate rated universe through time, excluding real estate. Financial data from Compustat from 1982 to 1994, and S&P Capital IQ thereafter. LTM data to Q3 2024, with the marker indicating S&P Global Ratings estimate for year-end 2025. Sources: S&P Global Market Intelligence CreditPro®, Compustat, S&P Capital IQ, NBER, S&P Global Ratings.

Historically, periods of falling interest rates have been difficult for corporate credit. It's possible that receding recession risks, dwindling inflation, and buoyant financial markets may be as good as it gets for a while. There have been seven major interest rate cutting cycles in the U.S. since 1980 (excluding the short-lived adjustments amid financial market volatility in 1987 and 1998). Default rates rose in all but one of those episodes (the dot.com crash), with an average increase of 2.1%, and the mid-1980s and mid-1990s soft landings also saw defaults rise. The year ahead will need to deliver the improving fundamentals that tight credit spreads imply if risk premia are not to widen again.

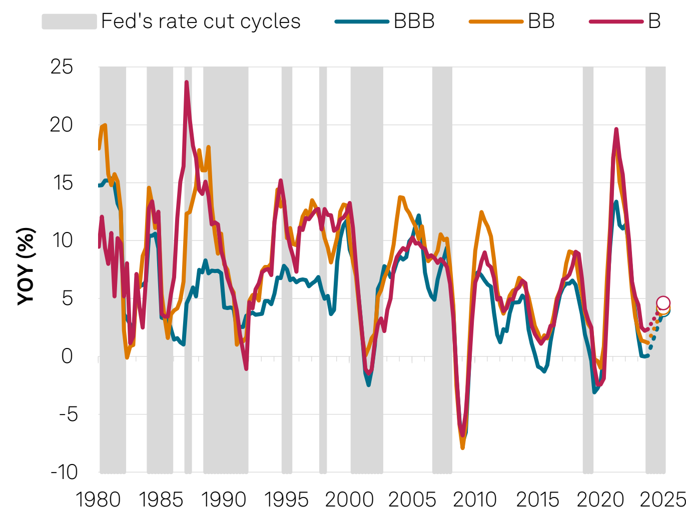
What we think and why

Growth will likely take over as a cash flow driver, rather than profitability. Sales and EBITDA growth have been relatively modest in recent results seasons. Chart 3 shows median revenue growth for three ratings categories of U.S. rated nonfinancial corporates, overlaid with rate cutting cycles since 1980. Revenue growth improving as rates fall is not the historical norm. Our base-case economic outlook, however, is more akin to the mid-decade rate adjustments of the 1990s, when revenue growth didn't see precipitous declines, and our analysts expect revenue growth to accelerate in the year ahead. Improving growth would help justify current risk premiums.

Chart 3

Sales growth is expected to recover, albeit slowly

Median revenue growth by rating category
U.S. rated nonfinancial corporates

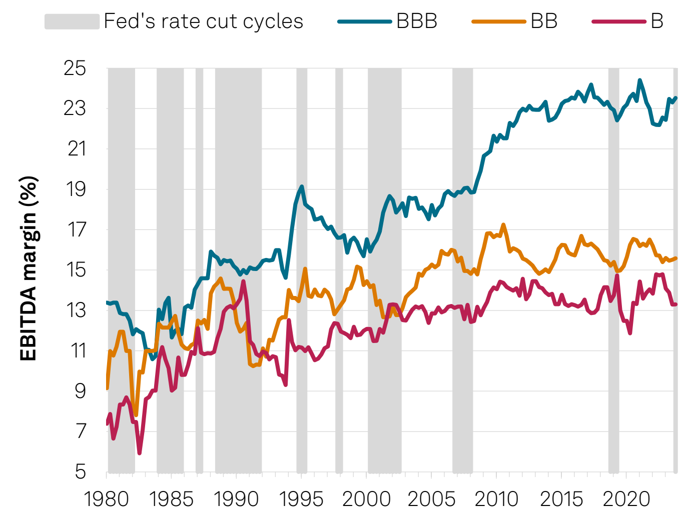


Shows data for the contemporaneous nonfinancial U.S. corporate rated universe through time, excluding real estate. Financial data from Compustat from 1982 to 1994, and S&P Capital IQ thereafter. LTM data to Q3 2024, with the marker indicating S&P Global Ratings estimate for year-end 2025. YOY--Year-on-year. Sources: S&P Global Market Intelligence CreditPro®, Compustat, S&P Capital IQ, NBER, S&P Global Ratings.

Chart 4

Investment-grade margins benefitted from globalization

Median EBITDA margin by rating category
Revenue growth, U.S. rated nonfinancial corporates



Shows data for the contemporaneous nonfinancial U.S. corporate rated universe through time, excluding real estate. Financial data from Compustat from 1982 to 1994, and S&P Capital IQ thereafter. LTM data to Q3 2024. Sources: S&P Global Market Intelligence CreditPro®, Compustat, S&P Capital IQ, NBER, S&P Global Ratings.

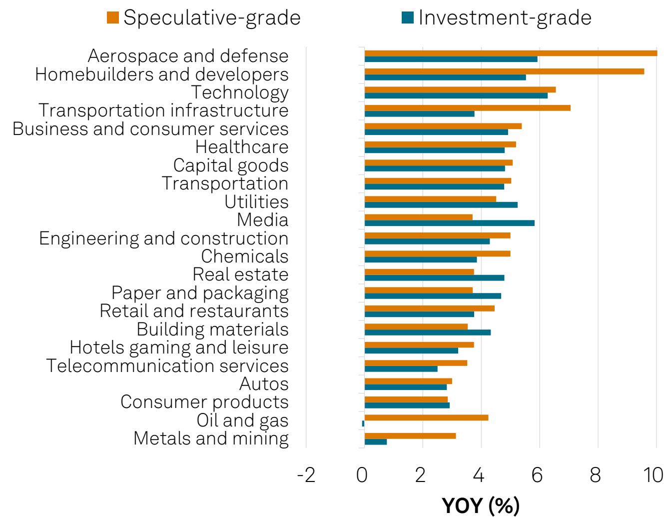
Margin improvement is unlikely to be such a prominent driver of corporate performance in the years ahead. In the last decade, a trend of rising margins has largely been confined to stronger credits. Chart 4 shows the contrast between the sustained rise in profitability of 'BBB'-rated entities versus the much more modest upswing seen for the strongest speculative-grade credits. We suspect secular increases in profitability are unlikely to continue, with the gains from global outsourcing played out and at risk from political and social pressures, costly energy transitions under way, and upward pressure on labor costs in the wake of higher prices and interest rates. New technologies like AI offer the clearest opportunity for a productivity-linked boost to profits, but outcomes are uncertain even if the investment costs are real.

Encouragingly, we expect to see positive revenue and EBITDA growth for almost all sectors in 2025. Charts 5 and 6 show our analysts' median revenue and EBITDA growth projections by global industry, both for investment and speculative grade. With the sole exception of flat revenues expected for investment-grade oil and gas, we currently anticipate growth in every other sector, in both rating groupings. With policy rates falling, significant refinancing achieved this year, and healthy growth projected, this suggests a favorable fundamental credit environment for the year ahead.

Chart 5

Positive median revenue growth is expected in 2025

Median industry revenue growth
Global rated nonfinancial corporates

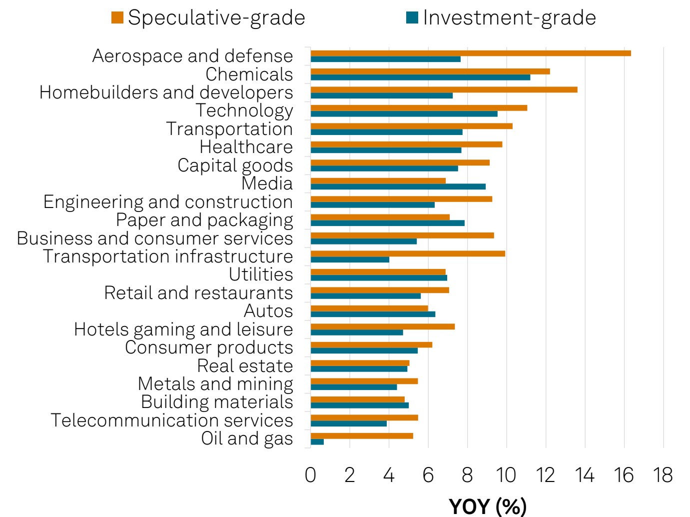


Calculated as of Oct. 31, 2024. All units are USD. Charts are ranked in descending order of the average estimated median industry growth for investment grade and speculative grade. YOY--Year-on-year.
Source: S&P Global Ratings.

Chart 6

EBITDA will also grow in 2025

Median industry EBITDA growth
Global rated nonfinancial corporates



Calculated as of Oct. 31, 2024. All units are USD. Charts are ranked in descending order of the average estimated median industry growth for investment grade and speculative grade. YOY--Year-on-year.
Source: S&P Global Ratings.

What could change

Inflation could be stickier and rates consequently higher than we anticipated. Although not our base case, cost of living pressures, trade tariffs, and the reshoring of supply chains for geopolitical reasons could lead to higher inflation and constrain central banks' ability to lower policy rates. A more stagflationary growth environment would likely be less favorable for corporate credit.

Trade disputes and environmental transitions could also hamper revenues and profitability. Europe and Asia-Pacific could take retaliatory measures if the incoming Trump administration applies tariffs as intended. This could also lead to higher input costs, as companies adjust supply chains to a bloc-based trading environment. Ongoing efforts to curb emissions are already necessitating significant capital expenditure in sectors such as utilities and autos. This also brings risk of new competition, as we have seen in autos where electrification has weakened European and Japanese automakers' competitive positions, relative to new competitors from China and the U.S. Elevated energy input costs are also a concern for heavier industrial sectors.

On the positive side, AI-induced productivity enhancements and emerging clean energy technologies could generate significant opportunities. For example, we expect generative AI will transform pharmaceutical research and development by strengthening innovation, offering cost efficiencies, and accelerating the traditionally ponderous research-to-market cycle. In the tech sector, insatiable demand for AI services is causing capital expenditure to skyrocket. This is leading to deals for new nuclear electricity to power data centers and reach clean energy goals.

Geopolitics | How Will Markets Navigate Ongoing Geopolitical Risks?

Financial markets in 2024 remained remarkably resilient to multiple sources of material geopolitical uncertainty. More volatility may be in store for 2025 in the face of what could be the resolution or escalation of some of the uncertainties.

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How this will shape 2025

After half of the world's population voted in 2024, the coming year is shaping up to be a year of policy uncertainty. Forthcoming decisions by new governments could heighten market volatility. Former President Donald Trump's successful bid to return to the White House means geopolitical, trade, and fiscal policy choices are all in play and are likely to be the most impactful election outcomes for the global agenda. The 2025 election calendar appears lighter, with less than 15% of the global population going to the polls next year (see chart).

Protectionist policy agendas have taken greater prominence as advanced economies strive to protect key domestic industries. Trade conflicts and tariffs between key blocks (notably the U.S., EU, and China) could affect growth and the prices of imported goods. Trade flows could also be exposed to geopolitical threats, as is the case in the Red Sea. More restrictive measures on immigration could affect labor supply, and therefore stoke inflation.

Military conflicts are expected to continue to dominate regional and global agendas. The Russia-Ukraine war continues. Although a ceasefire between Israel and Hezbollah came into force at the end of November, the peace may remain fragile, and the Israel-Hamas war continues. The positions taken by the incoming U.S. administration could influence the direction of efforts to end active fighting in those conflicts.

Fiscal flexibility for many governments remains constrained against the backdrop of rising debt levels. We expect heightened security concerns to result in increased defense spending. More expansive fiscal policies could be pursued in an attempt to address the electorate's concerns regarding cost of living, infrastructure, and growth, but it could also maintain inflation at higher-than-expected levels.

Markets remained remarkably sanguine given the geopolitical risks faced in 2024. Despite the risks and still elevated interest rates, we witnessed significant credit resilience in 2024. Upgrades outpaced downgrades over the course of the year across all regions, while issuance was strong over the entire rating spectrum. Significant capital inflows, combined with attractive yields pushed credit spreads to their tightest levels in 17 years. Borrowers made material progress in refinancing upcoming corporate debt with maturities, which will now peak in 2028 in the U.S. and 2026 in Europe. That said, it is unclear if the economic backdrop in 2025 will prove as supportive of markets.

Read more

After Trump's Win, What's Next For The U.S. Economy?, Nov. 7, 2024.

Floating-Rate Debt Is Still A Cause For Concern Despite Rate Reductions, Oct. 17, 2024

Widening Middle East Conflict Poses Risks For Regional Sovereign Ratings, Oct. 9, 2024

Evolving Political Priorities Could Affect Energy Transition, Aug. 8, 2024

What Will Recent European Election Results Mean For Sovereign Debt And Ratings?, July 18, 2024

The Next European Commission's Policy Choices: A Credit Perspective, July 17, 2024

What we think and why

Short-term global financial risks seem manageable. The past five years have been characterized by several shocks, notably including the COVID-19 pandemic, U.S.-China trade tensions, Brexit, and armed conflicts. The global policy rate easing cycle is now in full swing although macro developments in the three major economies (U.S., Eurozone, and China) remain on different paths. S&P Global still expects a soft-landing for global economies as central banks pursue their 2% inflation targets.

Disappointing rate trajectories and external shocks could upend market sentiment. Expectations of material rate cuts supported debt pricing and availability in 2024. Yet, new protectionist measures and higher government spending could underpin higher inflation in some areas, which could curtail the pace of reductions in central bank rates. Our expectation that U.S. policy rates will fall to 3%-3.25% by the end of 2025 is also exposed to geopolitical risk factors and market volatility, particularly if external shocks materialize.

Weaker issuers are most exposed to changing market conditions. Speculative grade corporate issuers (and particularly those with inadequately hedged floating-rate debt) will likely be most affected by market shocks that drive up borrowing costs or limit access to funding. Past financial and geopolitical market disruption has resulted in wider speculative-grade spreads in secondary markets. Some emerging market borrowers could prove particularly sensitive to higher Fed rates and a stronger dollar. Energy and commodity prices could also feel the effects of geopolitical uncertainties, though oil prices will also depend on production developments, including in the U.S.

Government policies are likely to be more difficult to predict. Uncertainty and potential polarization resulting from looming changes to fiscal, trade, energy transition, and immigration policies could affect economic performance, credit quality, and social stability. Financial markets' initial response to a Trump presidency has been positive, yet the transition to a new administration brings greater policy uncertainty.

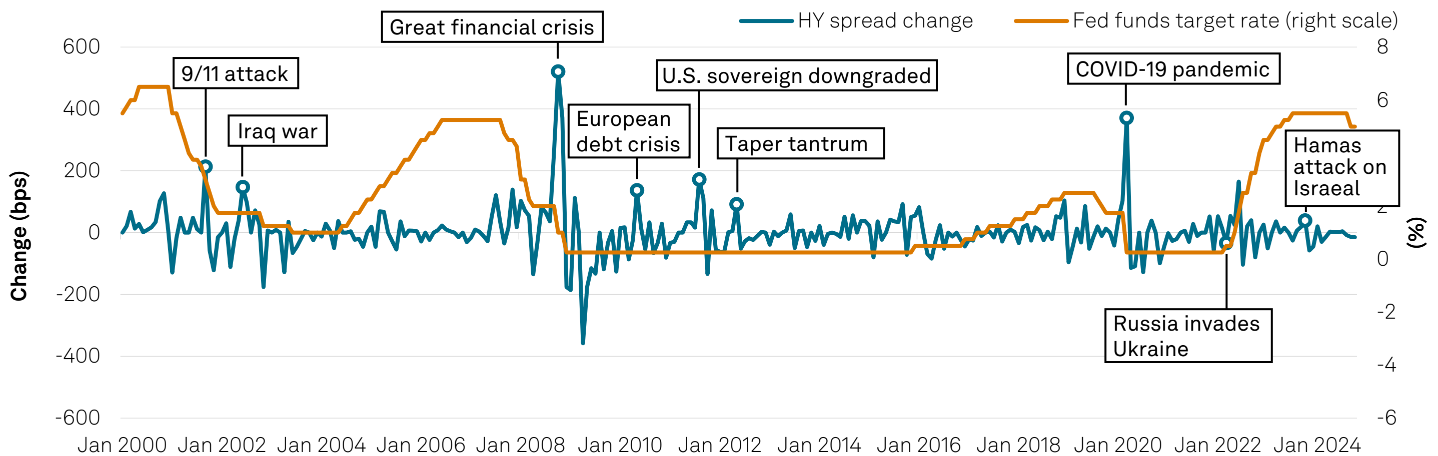
Myriad possible scenarios, including retaliatory actions, complicate the market's ability to price the tariff-related risk.

What could change

Regional conflict resolutions could be preceded by a surge in tensions and heightened geopolitical uncertainty. Credit markets remained relatively stable (and focused on the pace and scale of central bank rate cuts) even when geopolitical tensions rose in 2024. For example, the largest month-over-month change in high-yield credit spreads in 2024 was 20 basis points (bps), well below the 371 bps jump in March 2020 during the onset of the COVID-19 pandemic (see chart). That could change if a significant escalation in perceived geopolitical risks prompts a flight to safety and tighter credit conditions. Potential catalysts for that shift in sentiment are numerous. The Israel-Hamas war remains unresolved. The reported deployment of North Korean troops by Russia could link conflicts in Europe to tensions in Asia. And rising threat levels in the South China Sea could disrupt supply chains globally and spark investment outflows from the region.

Recent geopolitical events have little affected credit markets

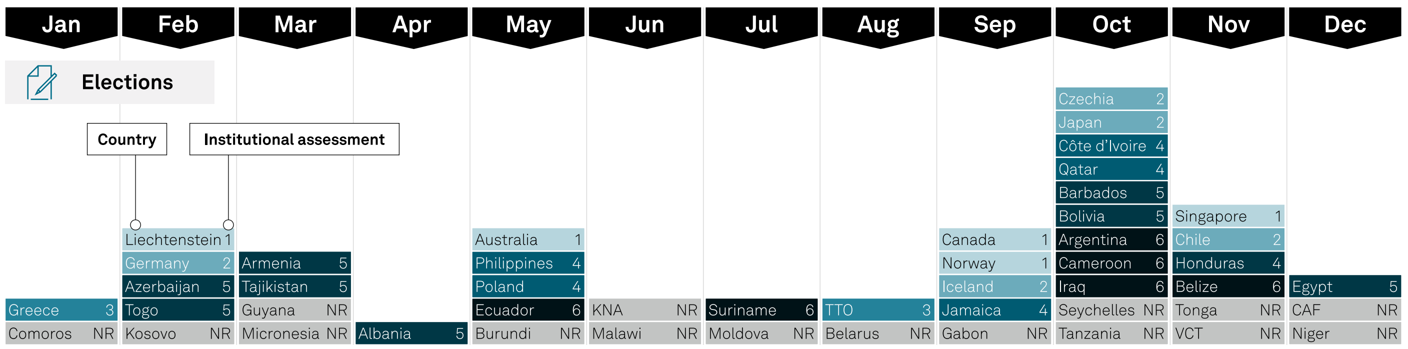
High yield month-over-month change (bps) vs. fed funds target rate

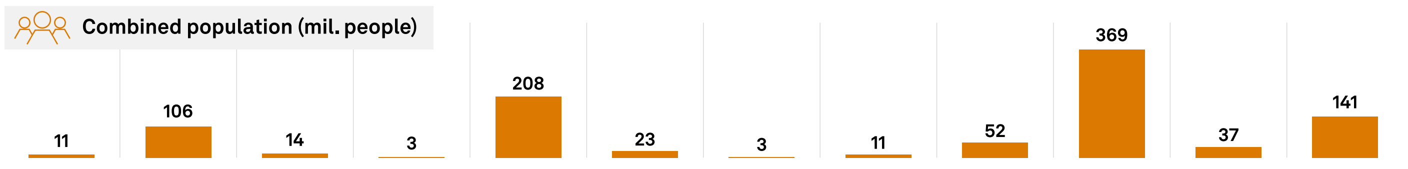


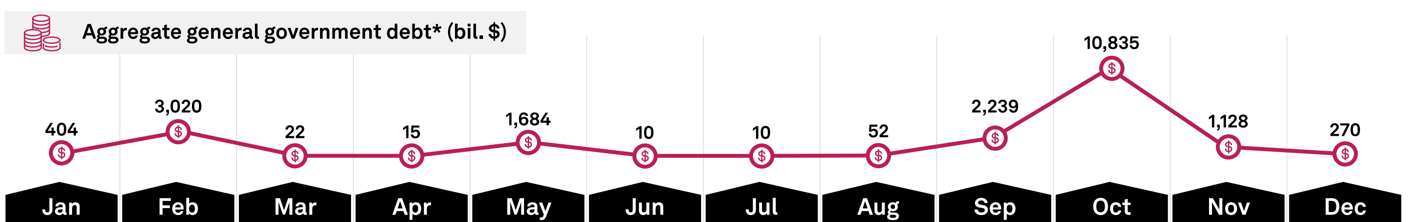
Source: ICE BofA Option-Adjusted Spread, retrieved from Federal Reserve Bank of St. Louis. S&P Global Ratings.

Tariffs could affect markets, though regional nuances and other policies will determine the extent of their impact. The potential for disruption was demonstrated by President-elect Trump's recent announcement of a 25% tariff on Mexican and Canadian goods and an additional 10% tariff on China, which sparked a flight to safety that sent the U.S. dollar and gold prices higher and European equities lower. Myriad possible scenarios, including retaliatory actions, complicate the market's ability to price the risk; however increased short-term inflation is likely in the U.S. (where we now expect fewer rate cuts in 2025), while we recently reduced our 2026 GDP growth projection for China, down 0.7 percentage points to 3.8%. Forecasting the effect of tariffs is complicated, as their impact on the market will depend on various domestic policies. While time will tell what proposals are adopted, market volatility should be expected.

The 2025 election calendar is lighter than 2024, but policy uncertainty will increase







Note: The institutional assessment is one of the five factors for the sovereign rating. It comprises our analysis of how a government's institutions and policymaking affect its credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks. *As of year-end 2024. CAF--Central African Republic. KNA--Saint Kitts and Nevis. NR--S&P Global Ratings does not assign an issuer credit rating to the entity. TTO--Trinidad and Tobago. VCT--Saint Vincent and the Grenadines. Source: S&P Global Ratings.

Global Trade | How Might Uncertain Trade Policies Affect Macro-Credit Conditions In 2025?

Trade protectionism has been rising globally in recent years, as is the risk for more, rather than fewer, of these policies in 2025. Tighter restrictions on global trade often have a negative impact on real GDP growth and could weaken financial conditions if they materially increase inflation and, consequently, interest rates.

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How this will shape 2025

Uncertainty over trade policy adds complexity. Amid two protracted military conflicts and ongoing U.S.-China diplomatic tensions, the global credit landscape is already fraught with challenges. The situation is set to become noisier with more trade protectionism likely in 2025 following the outcome of the U.S. presidential election. At present, the lack of clarity from the incoming administration about additional tariffs (scope, severity, and timing) introduces volatility. Furthermore, a cascade of second order effects, such as retaliatory tariffs, could occur. This uncertainty alone could keep higher-than-normal risk premia on credit. As expectations shift and specific trade policies are announced, periods of high volatility are likely.

Higher costs, higher inefficiencies. The backdrop of higher trade protectionism and geopolitical tensions could speed up the ongoing relocation of supply chains. This surety of supply comes at a cost premium. Starting with Trump's first term and accelerating during the COVID-19 pandemic, manufacturers sought to improve resiliency of input shipments while maximizing profitability. Even before the U.S. elections, issuers in certain labor-intensive sectors, such as textiles, have relocated manufacturing production outside of China due to favorable trade terms (less expensive and large labor force). This is less of a concern for more capital-intensive sectors, such as tech and pharma, given need for specialized workforce and higher barriers to entry from established logistic chains. Relocating further production in those sectors could take time, especially if they receive government support. In the meantime, businesses may need to contend with higher costs and lower productivity.

Some wins, some losses. Higher tariffs would benefit certain domestic-focused sectors, but many companies could face more challenging operating conditions. However, tariffs may bring a host of economic risks for those that cannot compete with cheaper imports. Higher input costs will at least partially be passed on to consumers, reducing their buying power and potentially depressing demand. In extreme cases, certain products may no be viable for production as they are no longer profitable. In such cases, limited top-line growth and narrower margins would pressure credit quality. Meanwhile, trade protectionism initiatives (e.g., EU's levy of high tariffs on electric vehicles [EVs] from China) could also be used to give time for industries to adapt to greater foreign competition.

Consumers draw the shorter end of the stick. A wedge between winners and losers is set to deepen. Higher tariffs would benefit certain domestic-focused sectors amid higher barriers of entry, limiting competition. However, many companies could face more challenging operating conditions with costlier inputs. Although companies could pass some of these costs on to consumers, high prices could prompt consumers to reduce purchases, testing the elasticity of demand. Limited top-line growth and narrower margins would pressure corporates' credit quality.

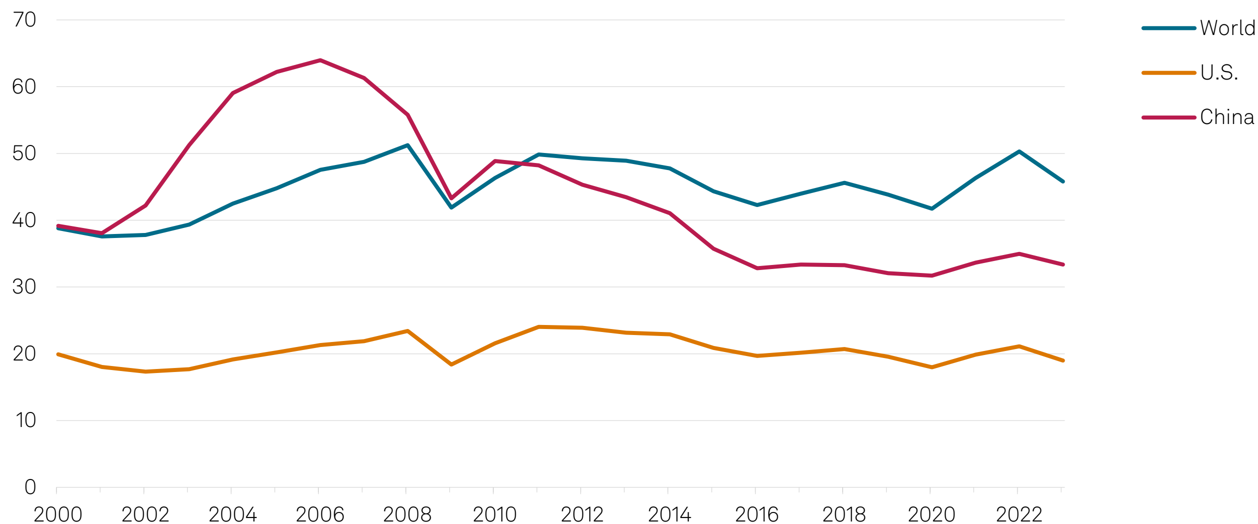
Read more

How Could A Second Trump Term Affect U.S. Credit?, Nov. 7, 2024

How Would China Fare Under 60% U.S. Tariffs?, Nov. 18, 2024

Protectionist policies in the past have shifted, not lowered trade

Goods trade as a percentage of GDP (%)



Source: World Bank.

What we think and why

Real GDP growth could suffer. The higher associated costs of inputs for manufactured goods, as well as for final goods could result in lower consumption. The potential for re-location in supply chains to adjust to a new tariff regime could also increase costs of production, lowering firms' margins and increasing the prices of final goods. For producers, a test on cost pass through to customers will ascertain the extent of margin compression. Through the recent inflationary period—initiated partially by supply chain shocks—the companies that have fared best against margin pressures have included primary health care providers, regulated power companies with profitability protections, and essential transportation sectors, along with the industries that provide related fuels.

Goes beyond China. While the focus of the incoming U.S. administration is likely to remain on lowering imports from China, tit-for-tat retaliatory measures are likely to spread around the globe. Goods with Chinese content produced in third parties could also be targeted. For instance, Vietnam has become a large exporter of goods to the U.S. while increasing its imports of intermediate goods from China (which are now 35% of total imports). Mexico, the largest source of imports to the U.S., has also seen a steady increase in intermediate Chinese imports. A review clause due on 2026 for the U.S.-Mexico-Canada (USMCA) trade agreement could also lead to uncertainty on trade policy among those countries throughout 2025, when negotiations will likely start.

Tension to rise. Fears of Chinese manufacturers flooding markets with cheaper products could spike tension among some domestic producers. This is already seen in the European auto sector, where concerns of influx of Chinese EVs could weaken sector dynamics. Similarly, small medium enterprises may falter against price wars amid high-cost bases.

Tighter financial conditions. The initial increase in inflation that would follow higher tariffs would likely at least slow the U.S. Federal Reserve's (the Fed's) efforts to ease interest rates, as well as other central banks around the world. The combination of higher interest rates, U.S.-centered tariffs, and risk aversion would likely strengthen the U.S. dollar. Higher risk aversion, combined with uncertainty over the fiscal path of the U.S., could increase term premiums, pushing up long-

term U.S. treasury yields. Outside of the U.S., issuers with large external financing needs (particularly, emerging market borrowers) could be vulnerable to a costlier dollar. With offshore or USD financing options narrower, onshore financing activities will likely dominate.

As expectations shift and specific trade policies are announced, periods of high volatility are likely.

"National security sectors". Certain sectors that have been identified as associated with national security are likely to be the main source of trade tensions. These sectors have already been targeted by the outgoing U.S. administration, and there is political consensus to continue pursuing those policies under the incoming administration. There are significant efforts underway to "re-shore" the production of those goods. Concerns related to national security can range from direct threats to the development of defense capabilities to indirect impacts on economic stability. In certain cases, new restrictions go beyond tariffs and ban the imports and outside investments in certain products entirely.

Specialized manufacturing could be vulnerable. We expect the hardest hit industries will be those with highly engineered products dependent on international suppliers for specialized manufacturing. The facilities required to make these types of products are expensive to relocate and hardest to staff. Additionally, sensitivities around intellectual property and proprietary manufacturing processes tend to encourage avoiding redundant facilities or elevated levels of turnover. Components in this category include semiconductors and electrical components supplied to technology companies, but also apply to utilities focused on renewable energy. Utilities with renewable energy investments require highly engineered components for solar panels, wind turbines, and battery chemistries. Fortunately, the end products associated with these components tend to have the highest margins and may therefore have some room to absorb rising input costs.

Adjusting quickly. We anticipate sectors with more commoditized international inputs will be able to adjust more quickly. Sectors such as consumer products, retail & restaurants, health care, and homebuilders/building materials will be affected as well. However, to the extent that they are dependent on more commoditized imports, they should have more success finding alternative suppliers or moving operations quicker and at a lower cost. Nevertheless, they are likely operating under tight margins and will be vulnerable to anything that extends their transition period.

What could change

Tariffs could turn out to be a negotiation tactic to secure non-trade-related interests. While some extent of higher tariffs announced by the next U.S. administration is very likely, the magnitude and duration of those policies could be lower and shorter-lived than what most anticipate. Tariffs, under the previous Trump administration were used as a bargaining tool to achieve other objectives (higher purchases of U.S. agricultural products, for example).

Stimulus measures could offset the economic impact of tariffs. The impact of tariffs on real GDP growth could be offset by fiscal measures, especially if those policies take a toll on strategically important sectors. Some of these measures could include subsidies to affected sectors and/or support for households to manage higher prices of final goods. However, this pushes back fiscal consolidation across governments, ensuing higher government debt stock.

Retaliatory tariffs and other second-order effects could change the trajectory of current protectionist policies. As trade policies continue to unfold and national economies react, trading agreements will naturally be fine-tuned. In the past, we have seen specific sectors excluded or certain nations benefiting from favorable terms of trade. These developments would likely also incorporate how ongoing geopolitical conflicts evolve and the extent to which sanctions among countries strengthen or weaken.

Commodities | Could Oil Prices Shock The Global Economy?

Sustained high prices would be a challenge for many issuers, but physical oil market fundamentals look soft into 2025.

How this will shape 2025

Oil prices have been falling, and we expect them to stay contained in 2025. But commodities markets can be highly unpredictable, and conflicts involving major crude-producing nations or close to oil-transporting facilities typically add a risk premium to prices. This is especially true when the Middle East is involved, given that the region contributes one-third of the world's crude oil production. Despite the escalating conflicts, oil prices have fallen in the second half of 2024—and both futures and our price assumptions point to moderately lower prices next year. S&P Global Ratings' base-case price assumption is that Brent oil prices will average $75 per barrel in 2025, compared with the average of $82 per barrel in 2023 and roughly $80 per barrel in 2024.

Oil supply remains a key factor for prices as demand growth looks to moderate. An important factor for oil prices through 2025 will be the rate at which OPEC+ countries increase their supply. OPEC+ countries (led by Saudi Arabia) have been holding back supply, totaling 5.8 million barrels per day (bpd). After planning to start unwinding 2.2 million bpd in cuts in October and release more production, OPEC+ delayed this extra supply to year-end. This represents an overhang for the market as demand looks likely to be already met by new production from the Americas.

Demand for oil remains resilient, even as the energy transition slowly advances. S&P Global Ratings expects moderate demand growth of above 1 million bpd in 2025, compared with an average of 1.7 million bpd for the past decade. This is correlated with economic activity and expectations for softer GDP growth, alongside ongoing shifts in transport fuel usage. But spare production capacity and inventories also indicate the market looks well supplied in the coming quarters—and should have flexibility in the event of a supply shock. We estimate unused production capacity at more than 5 million bpd, partly because of the OPEC+ supply restraint.

We expect oil prices to remain contained in 2025

Brent (US$/bbl)

Source: S&P Global Market Intelligence.

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Widening Middle East Conflict Poses Risks For Regional Sovereign Ratings, Oct., 9, 2024

S&P Global Ratings Revises Its Oil Price Assumptions; North American And Dutch Title Transfer Natural Gas Price Assumptions Unchanged, Oct. 1, 2024

What we think and why

Additional disruption in critical seaborne routes could lead to a surge in oil prices. The conflict in the Middle East hasn't materially disrupted global flows of crude. But any delays or stoppages—especially in the chokepoint Strait of Hormuz between Iran, and Oman and United Arab Emirates, where roughly 30% of global seaborne crude and liquified natural gas supply also transits—could have significant implications as the market digests the severity and length of the disruption. While closure of the Strait of Hormuz is a low-probability scenario, we believe reluctance from shippers or difficulties obtaining affordable insurance could also delay or constrain transit even without a full blockage. This could prompt sustained high prices (above $100 per barrel) that would likely reduce demand and incentivize further moves away from oil for transport. Higher average prices would likely have a greater economic impact than short-term spikes alone.

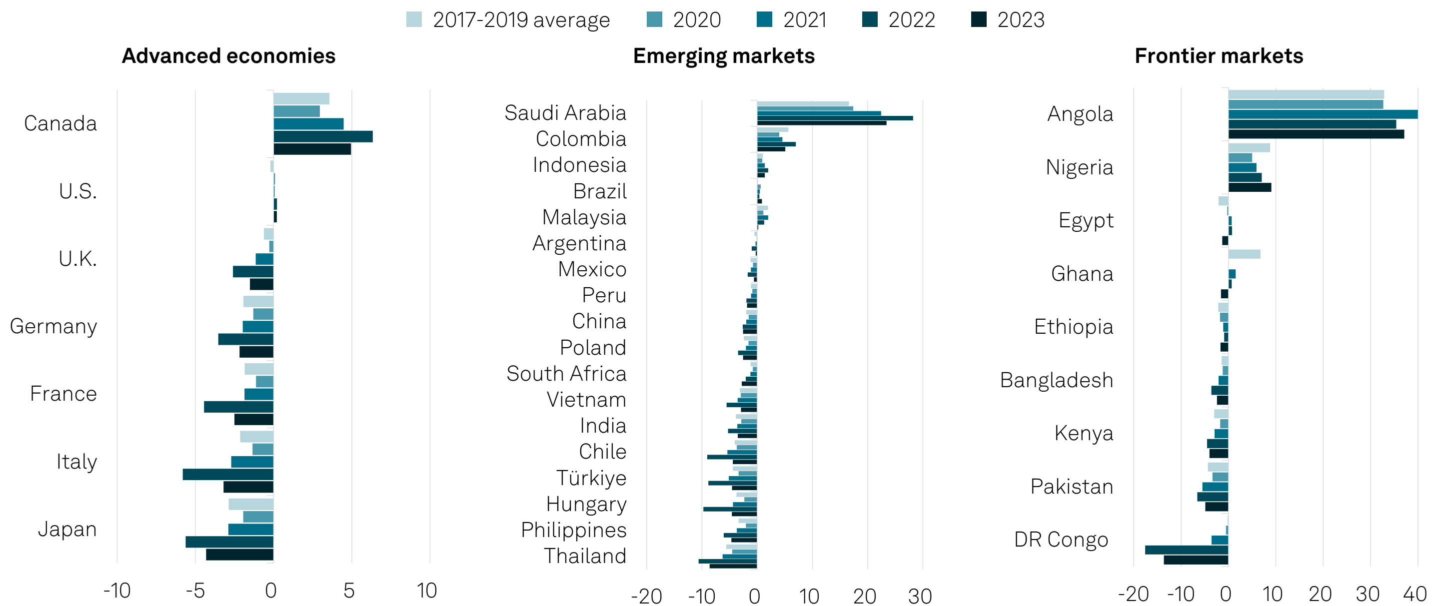
Global flows of crude have not been disrupted materially by the conflict in the Middle East.

Higher energy prices could disrupt ongoing disinflation efforts. Falling oil prices have largely helped lower inflation globally, giving central banks room to begin normalizing interest rates. But the effect of energy prices varies significantly by country, with emerging markets (EM) often the most affected due to energy's prominent role in their consumer baskets. If energy prices rise, EM central banks may be forced to recalibrate monetary policy. On the downside, this could result in a slower interest rate normalization in most EMs. On the upside, this would potentially provide additional fiscal opportunities through higher oil-related tax receipts.

A shock to energy prices could directly affect energy-intensive sectors, such as aviation and shipping. The impact in energy-intensive sectors could be reflected in margin erosion—though some firms may be able to pass these costs onto the consumer by increasing the final price. As such, second-order effects from a protracted period of high oil prices could pose a higher risk for credit. Many sectors without direct exposure to commodities markets—including restaurants, leisure, and lodging; homebuilders; and container and packaging—could be affected by prices increasing in industries that are directly affected. Perhaps most notably, the potential erosion of households' purchasing power could dent demand for all goods and services.

Most emerging markets and frontier economies we rate are net energy importers

Trade balance as a percentage of GDP (%)



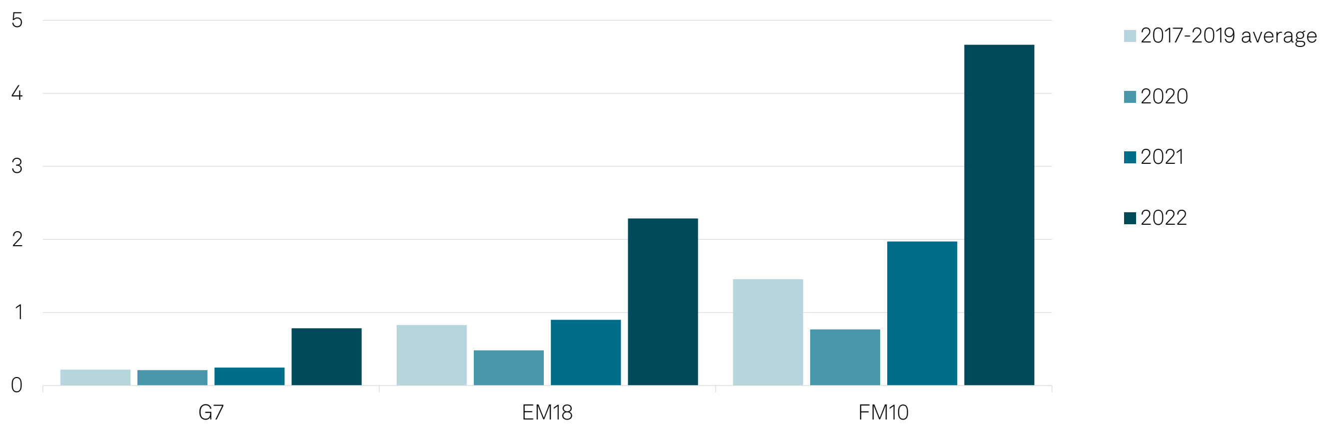
Source: S&P Global Ratings.

Only a handful of countries are net beneficiaries of high oil prices. When looking at the energy trade balance of the world's largest economies, most of the systemic EMs and largest frontier economies we rate are net energy importers. In other words, only a few countries that are net energy exporters benefit from higher oil prices—mainly through windfall fiscal revenues or royalties. Conversely, countries that are net energy importers often need to deliver fuel subsidies to stem inflation and its implications on households. In the case of EMs, this could strain fiscal accounts. In 2022, fuel subsidies reached record highs when the Russia-Ukraine war led to supply concerns and a surge in oil prices (even though Russian supply remains significant, at roughly 9 million barrels per day [mbd]). High energy prices, compounded with lingering spillovers from the pandemic during that year, ultimately led to high negative rating bias across most EMs and frontier economies. This was primarily driven by delayed fiscal consolidation for the 18 sovereigns with negative outlooks during the period.

About 30% of global seaborne oil supply transits the Strait of Hormuz.

Fossil fuel subsidies to consumers may staunch inflation effects

Total subsidies (% of GDP)



EM18--Key emerging economies in our definition. FM10-- largest 10 frontier markets. Sources: Organization for Economic Co-operation and Development, International Energy Agency, International Monetary Fund, S&P Global Ratings.

What could change

Conflict in the Middle East could disrupt energy markets. We view the likelihood of a protracted, direct conflict between Iran, and Israel and the U.S. as limited. But it now appears more likely that regional military forces aligned with Iran will seek to inflict damage on Israel and its allies' assets. This aligns with our moderate stress scenario. Iran-supported military forces have frequently sought to disrupt commercial economic interests. Related conflict has encompassed proxy strikes throughout the region, typically involving actions or threats that could hamper shipping through globally significant economic and trade routes. Such trade disruptions could increase oil prices and pose fiscal risks to energy importers.

Policy uncertainty could lead to a sharper-than-expected decline in oil prices. This could occur if rising protectionism dents global trade and weakens global growth—consequently depressing demand for oil. The magnitude and scope of any new tariffs imposed on China will be critical to measure the potential impacts in both the U.S. and China. For example, a large increase in U.S. tariffs on all Chinese imports could significantly hurt its economic growth. U.S. President-elect Donald Trump suggested a 10% tariff on all goods imported into the U.S., as well as levies of 60% on all Chinese goods. The overall drag on real GDP could be as much as 1 percentage point, including both the income loss to U.S. households and the hit to American exporters. Further weakness in Chinese demand is another risk to oil prices because the country is the world's second-largest oil consumer (representing 15% of the global share).

Energy Transition | How Will The U.S. And Europe Respond To China's Clean-Tech Leadership?

China has established, over the past twenty years, an unrivaled dominance in electric vehicle (EV) technologies and supply chains. Midway through this critical decade in the energy transition, the U.S. and Europe's lagging capabilities mean they face complex trade, cost, and affordability dilemmas that could affect their automotive original equipment manufacturers (OEMs).

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How this will shape 2025

The automotive sector is one of the most visible parts of the energy transition. About 90% of countries have set some form of greenhouse gas (GHG) emissions reduction target as part of their Paris Agreement commitments, according to the United Nations Environment Programme (UNEP), while a similar number have specific goals to increase their share of clean technologies, including electric vehicles. Though global emissions are expected to reach an all-time high in 2024, the road transport sector (mainly light vehicles) is showing signs of change, with investment in clean transportation technologies starting to reduce transport-related emissions and energy demand in major markets such as China, the U.S., and Europe.

China has accelerated away from the competition in clean tech. In 2023 alone, the world's second-biggest economy added more solar power capacity than the total capacity of the U.S., and it launched more new EV models than any other market. China's manufacturing dominance in EVs relies on a combination of relatively simple technology, superior operating efficiency, and control of the supply chain. Despite a dip in local demand, China has resisted adjusting its domestic production capacity. The resulting domestic price war incentivizes the exporting of excess production, often at prices that some consider "dumping." That has prompted the U.S. and Europe to introduce trade tariffs on EVs and key EV components, aimed at protecting their OEMs' competitiveness.

Read more

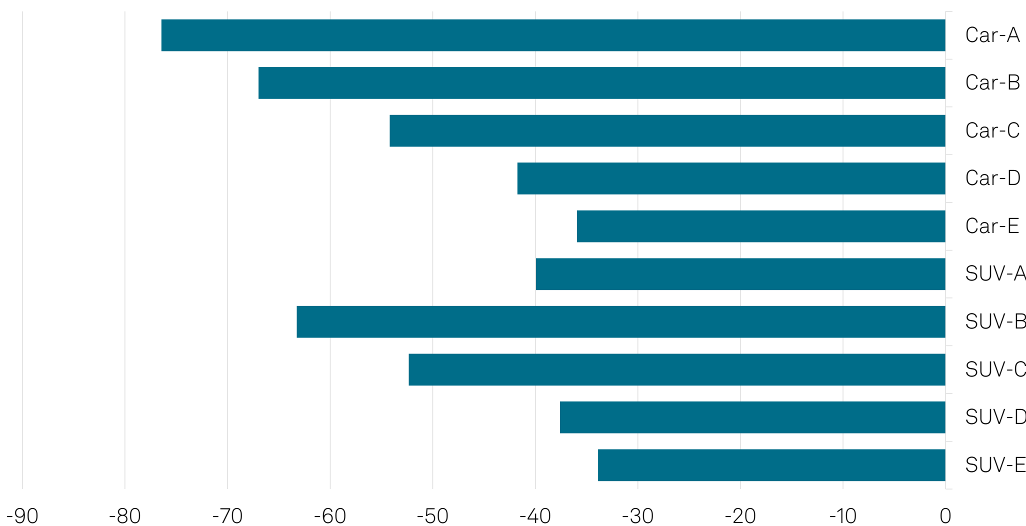
How Could A Second Trump Term Affect U.S. Credit, Nov. 7, 2024

Evolving Political Priorities Could Affect Energy Transition, Aug. 8, 2024

China ahead in delivering affordable electric mobility, May, 29, 2024

China's price advantage could absorb trade tariffs in many auto segments

China versus EU: Difference in manufacturers' suggested retail price by market segment (%)



Source: S&P Global Mobility.

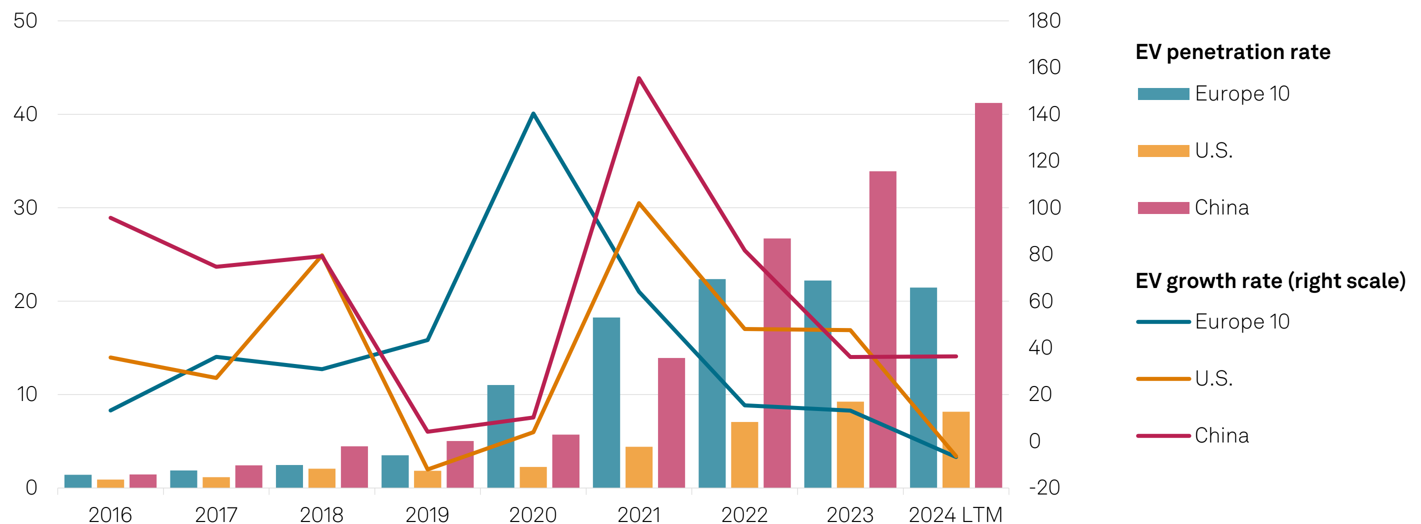
China's dominance should be good news for climate targets, but piles pressure on legacy OEMs already facing wider challenges. Demand for EVs outside of China has weakened and is likely to remain soft in 2025, with total cost of ownership (which includes the purchase price) a key factor. Non-Chinese players are under pressure to improve manufacturing efficiency (through restructuring and rightsizing of production capacity) and to speed up their time to market, while also maintaining strong investment capacity. They will continue to face unprecedented cost-reduction pressure in 2025, especially amid ongoing cost of living pressures. The EU, in particular, could see its ambition to decarbonize road transportation jeopardized by higher energy prices and insufficient government support for EV adoption, both of which discourage consumers from choosing cleaner mobility options. Additionally, the EU's carbon dioxide regulatory framework could leave some of its most important manufacturers with a share of as much as €15 billion in regulatory fines in 2025 (about 25% of the region's annual investment in R&D). This could divert much-needed capital away from investment and hurt the competitiveness of the domestic industry to the benefit of emerging Chinese competitors.

What we think and why

The introduction of tariffs on EVs from China looks untimely, given EU climate targets for the light-vehicle industry. The European auto industry has so far managed to balance progress on electrification with the preservation of investment capacity and credit quality. Responding to Chinese manufacturing supremacy with traditional protective measures, such as tariffs, could prove ineffective, given the complexity of international trade flows, but also detrimental to EV adoption if they raise prices overall. The tariffs could also prove a headache for the very sector they are aimed at protecting. EU auto manufacturers are obliged to meet certain EV sales and fleet-averaged emission thresholds, which would be less earnings dilutive if companies could sell cost-competitive vehicles produced in China. From a credit perspective, 2025 could prove a particularly challenging year for manufacturers with sizable operations in Europe, which face both potential compliance-related costs and the need for continued restructuring to adjust to the post-pandemic demand decline. In the U.S., the Biden administration has already raised tariffs on Chinese EV imports to 100%, while postponing fuel efficiency targets to 2027-2032, which should buy time for the "Detroit Three" (General Motors, Ford Motor Co., and Stellantis) to reduce their EV production costs and ease pressure on their credit quality.

EV penetration is in reverse gear in Europe and the U.S.

EV sales growth and penetration rate (%)



2024 LTM reflects data until September 2024. LTM--Last 12 months. Source: EV Volumes.

Developing localized, competitive, and reliable clean-tech supply chains in the U.S. and EU will be costly and slow.

Chinese partnerships (outside China) could help close the gap in technology, research and development (R&D), and manufacturing efficiency. EV uptake in China will likely be close to 50% in 2024 (compared to 15%-20% in the EU and 10% in the U.S.). Chinese expertise could benefit OEMs beyond China's borders. For example, Volvo, controlled by China's Geely, has a more advanced and competitive EV sales mix than its traditional/legacy brand peers due to the benefits of sharing technology and supply chain expertise with its Chinese parent. Lower cost bases would allow European and U.S. OEMs to offer mass-market products at lower prices without disrupting their profitability, potentially alleviating the main credit risk we see for the legacy automotive industry. Developing localized, competitive, and reliable clean-tech supply chains should boost security and create jobs, but it is likely to be a costly task that will last beyond 2025 and will ultimately contribute to higher EV premiums in the U.S. and Europe.

Affordability could be a game changer. Chinese EVs' lower prices mean a potentially lower total cost of ownership that will appeal to price-sensitive consumers. At legacy automakers, EV prices typically remain higher than traditional vehicles, yet smaller and cheaper EV models will narrow that premium over 2025-2026. The end of the EV premium (as in China) will encourage consumer neutrality to powertrain options and support countries' energy transition goals. Whether that alone is enough to entice consumers remains unclear, especially amid high interest rates, high energy costs, and ongoing perceptions of limited public charging infrastructure.

What could change

Regulatory intervention is likely to play a significant role, one way or another. With transport-related emissions representing about 25% of global energy-related emissions, many governments have introduced policies aimed at either increasing EVs' share of sales or limiting emissions on an average fleet sold basis. Some in the European autos sector are calling for potential emission regulation fines to be delayed, citing weak sales, higher-for-longer interest rates, and Chinese competition. A delay would lessen regulatory risks to OEMs' earnings and investment at the cost of potential emission reductions. In the short term, that could be credit positive, but structural issues would remain. The evolution of tariffs is also highly uncertain, and the protectionist policies deployed by different countries could affect trade and potentially increase volatility.

Political risks on the path to clean technology persist in the U.S. The U.S.'s Inflation Reduction Act (IRA) and CHIPS Act have driven hundreds of billions of dollars of private-sector investment in clean energy and domestic manufacturing and created hundreds of thousands of jobs. Removing IRA support for the EV or semiconductor industries could prove a major blow to investment. The U.S. election results have created uncertainty regarding the future focus of these policies. A narrower focus on energy security and costs could reduce funding and tax breaks for some cleaner energy solutions, potentially affecting companies that have used this support and altering consumers' buying decisions.

Countries' priorities could have a big effect on emissions. Progress on emissions reduction has so far fallen short of requirements to meet global warming targets. Countries are due to submit new climate goals next year, as per the Paris Agreement. Some may pursue more ambitious reductions, while others could opt to ease climate goals, particularly given competing pressures. The resulting policies could determine the future of EV adoption.

Data Centers | Can Infrastructure Developments Keep Up With The Increasing Demand?

Since the significant speed and extent of data center growth have taken many by surprise, there are only a few plans in place to provide the physical infrastructure that these power-hungry assets require. We expect sectors exposed to data centers will continue to benefit from favorable tailwinds in 2025. After that, pressure could likely increase as bottlenecks materialize.

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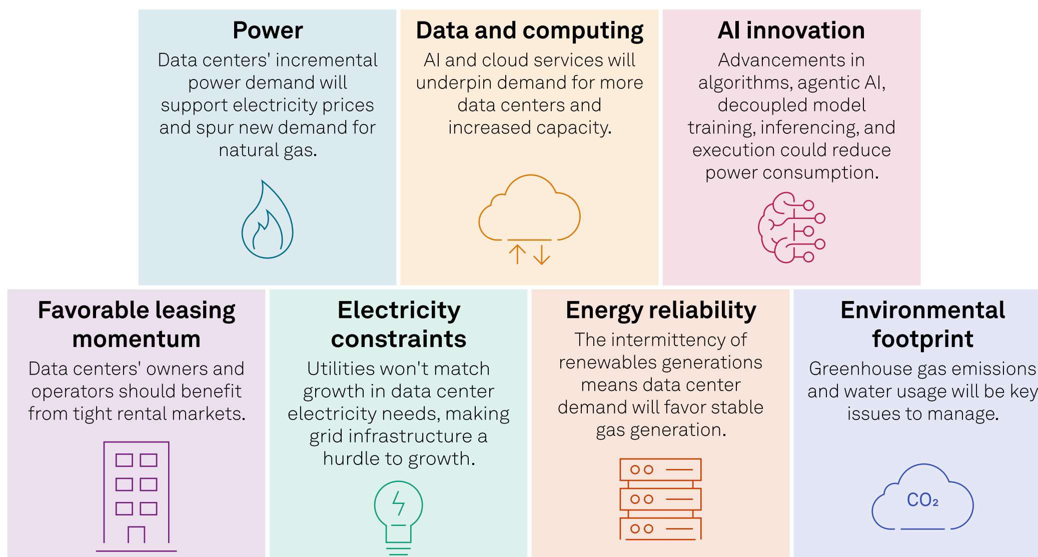
How this will shape 2025

Growth potential in the data center sector is significant. Advances in artificial intelligence (AI), 5G adoption, and cloud services increase the demand for data centers, whose numbers and growth rates are highest in the U.S. This is notably due to the country's high concentration of major technology companies, which invest heavily in capacity expansion to support their global operations. The AI revolution constitutes an exceptional growth opportunity for the technology sector. We forecast that global AI-related revenues will increase at a compound annual growth rate (CAGR) of about 25%-30% to nearly $650 billion by 2028, from less than $200 billion in 2023. This is a global trend: In South Asia and Southeast Asia, for instance, we anticipate that data center capacity will increase at a CAGR of 10%-25% over the next few years, spurring investments and funding opportunities.

Data center growth: Key considerations



Source: S&P Global Ratings.

The increase in the number and capacity of data centers requires ample physical infrastructure. For 2025-2030, we expect U.S. data centers could require 150 to 250 terawatt hours annually, which is equivalent to the power demands of New York City. The speed and extent of data center growth have taken a significant portion of the market by surprise, meaning there are few plans in place to accommodate it. After two decades of stagnating power demand, insufficient grid infrastructure--which results in long interconnection queues--will likely be the biggest hurdle to meeting data centers' energy needs. In our base case for the U.S., we assume that the increase in annual electricity sales will not cover the technology industry's electricity needs after 2026.

Read more

Private Credit Could Bridge The Infrastructure Funding Gap, Nov. 20, 2024

Data Centers: Rapid Growth Creates Opportunities And Issues, Oct. 30, 2024

Data Centers: Rapid Growth Will Test U.S. Tech Sector's Decarbonization Ambitions, Oct. 30, 2024

Data Centers: Computing Risks And Opportunities For U.S. Real Estate, Oct. 22, 2024

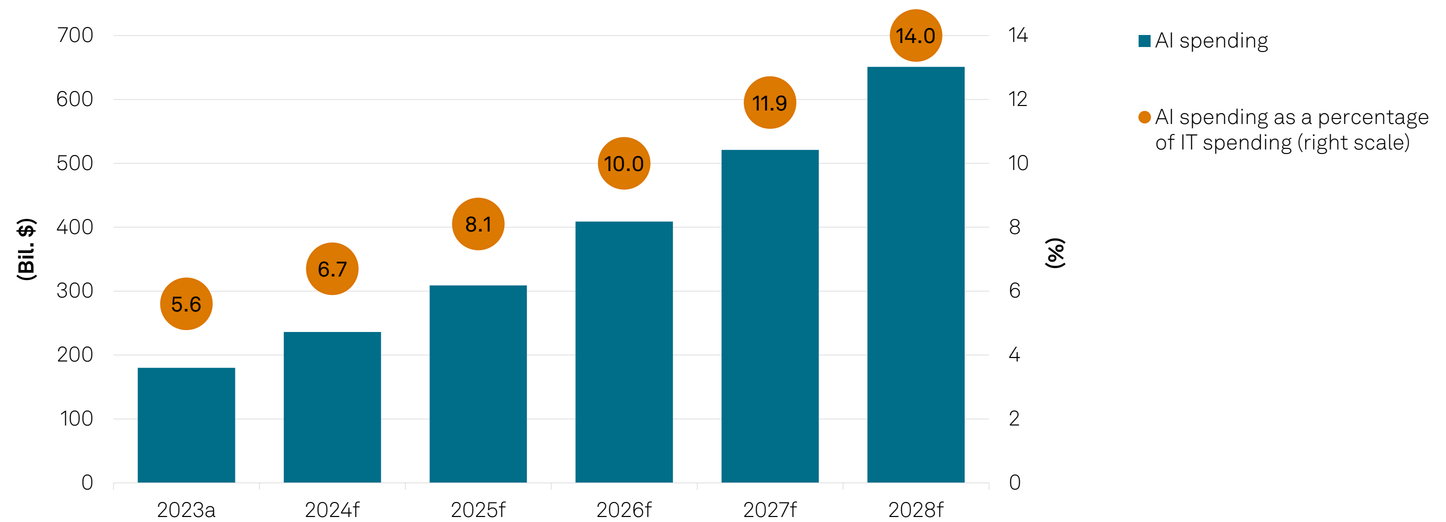
Data Centers: More Gas Will Be Needed To Feed U.S. Growth, Oct. 22, 2024

Data Centers: Welcome Electricity Growth Will Fall Short Of U.S. Data Center Demand, Oct. 22, 2024

Credit FAQ: Can Operators Navigate Pitfalls In Asia-Pacific's Data Center Boom?, Sept. 17, 2024

The surge in data centers will increase funding requirements in 2025. Given the pace and extent of capital deployment required, careful and consistent funding will be key to support data center operators' credit quality. Private credit has emerged as a more prominent financing source for data centers since it provides flexible capital solutions that support the rapid growth and technological advancements in this asset class. In some markets, sustainability-linked or green bonds could play an increasingly important role, notably to fund green initiatives that aim to increase energy efficiency or provide renewable energy solutions.

Worldwide AI spending is increasing



Excludes communication services. a--Actual. f--Forecast. IT--Information technology.
Source: S&P Global Ratings.

What we think and why

Data center developers and operators will benefit from the demand for new facilities and support high rental prices. We expect the leasing environment for data centers will remain strong in 2025. This should result in positive re-leasing spreads and low vacancy rates. We expect strong demand, limited near-term supply, and improved pricing dynamics will bolster data centers' earnings and valuations, at least over the next few years. The location of data centers, similar to other real estate assets, is critical for their valuations. Tier 1 assets, which are interconnected and have access to reliable power supplies, will likely continue to benefit the most.

Positive credit developments will likely offset credit challenges in the energy sector in 2025. The surge in the number and capacity of data centers will support credit quality in 2025 for sectors exposed to the trend, including power generators, electricity utilities, and midstream gas companies. In an already tight power market, additional demand will result in tighter supply and higher power prices through 2030. We believe this trend will support earnings growth and visibility for all power generators--particularly green power generators--due to the increase in long-term contracts. We view this as credit positive for companies operating in the competitive power markets. Additionally, data centers' increased electricity demand will support regulated utilities' credit quality. That said, the rising electricity demand could introduce funding and billing risks, which utilities will have to consider to protect existing clients from cost increases.

Data centers provide an additional lifeline for gas and nuclear assets. Low-risk gas projects with manageable capital expenditures will likely meet the rapid growth in data centers' energy demands over the near term, despite long-term decarbonization trends. Additional electricity

demand from data centers will hence spur supply growth over the next decade and support credit quality in the gas midstream sector. Over the longer term, we expect nuclear power will potentially provide a low-carbon, reliable solution to power data centers. Consequently, financing needs for new projects--notably for small nuclear reactors--could increase in 2025.

Insufficient grid infrastructure will likely be the biggest hurdle to meeting data centers' energy needs.

What could change

Increasing risk appetite could curb real estate companies' overall credit profiles. Real estate companies remain exposed to development risks. So far, the sector has been prudent, with fit-for-purpose, pre-leased new builds and a limited risk of overbuilding over the next two years. Yet more speculative development approaches and risks related to unmanaged power price exposures could emerge and increase credit risk considerably. If demand for data centers declines due to slower AI adoption, vacancy rates could increase significantly, notably for tier 2 assets. Prudent expansion will also be key in emerging markets due to evolving regulations, interconnectivity issues, and insufficient power supply infrastructure in these regions.

Inflation and increasing financing needs could become a bigger challenge. Data center construction costs could increase substantially due to expenses related to construction, inflation, and financing. Rental rates and construction costs do not necessarily increase in tandem, even though they did so over the past two years. Data centers' inability to cover rising construction costs by increasing rental rates could derail growth prospects. Utilities will also have to increase capital spending considerably to meet the demands of relatively few, but very large, data center customers. Simply passing on a significant portion of these infrastructure costs to existing residential customers would increase customer bills, lead to more complaints, and potentially impair utilities' ability to manage regulatory risk.

Environmental constraints may rise. Despite securing renewable energy supply and improving efficiencies, data centers could nearly double their emissions by 2030. These projected increased carbon emissions are unlikely to pose a material credit risk to operators in 2025, given their key role in supporting AI-based technologies and economic growth. Yet data centers could face several headwinds since their power use will rapidly expand. We expect continuous improvements in energy efficiency will only partly offset the risks. Data centers' exposure to environmental restrictions, which is currently low, could increase as several countries across the world tighten regulations and local resources come under increased pressure. This could lead to long-term challenges, including increased scrutiny from regulators, investors, and other stakeholders over data centers' environmental effects.

AI & DeFi | Can Crypto Innovations Offset Artificial Intelligence Concentration Risks?

The rapid expansion of generative AI exacerbates existing dependencies on big technology firms. Advancements in decentralization, such as crypto and edge AI, could offset some of the associated centralization risks if they are adopted rapidly.

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How this will shape 2025

Accelerating AI implementation will introduce new operational challenges. Much of the past two years was spent assessing the potential of generative AI (genAI)--until the first quarter of 2024, only 18% of companies had adopted and fully integrated genAI tools within their operations, according to the S&P Market Intelligence "Voice of the Enterprise" survey. Companies are now starting to shift from experimentation to broader use. Key challenges ahead include the management of large volumes of unstructured data, oversight of large complex models, and the significant energy consumption inherent to large generative AI models. Meanwhile, the storage of data at third-party, cloud-based data centers will give rise to issues of latency, privacy, and data sovereignty. Specifically, most organizations' AI models are utilizing the public cloud for training (63%), data storage (68%), and to perform inference (62%), according to S&P Market Intelligence's report "The Rise of Edge AI".

Big Tech concentration risks are increasing and are likely to be exacerbated over 2025. The increasing reliance of companies on a few third-party providers of hardware, cloud services, specialized software, and advanced genAI models exacerbates single-provider risk (see chart). Related dependencies increase systemic risks, particularly in the financial and public sectors (e.g., defense and healthcare). The CrowdStrike outage, in July 2024, highlighted some of the possible issues inherent to tech concentration risks and the interdependency of critical systems and software. Such incidents tend to impact credit risk related to revenue loss, reputational damage, and the financial costs of responding to and remediating issues.

Read more

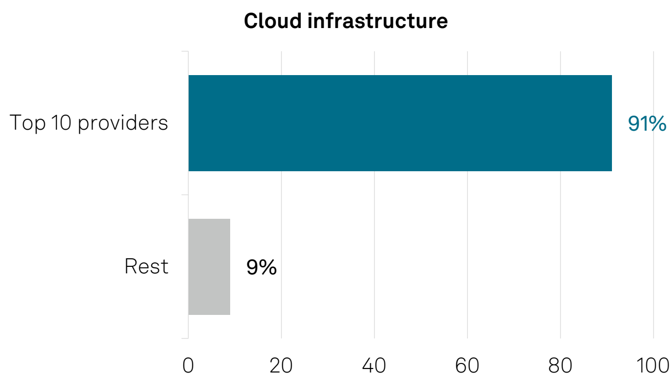
Agentic AI, Artificial Intelligence Insights Podcast, Oct, 30, 2024

Financial Systems Will Face New Systemic Risks, Oct. 4, 2024

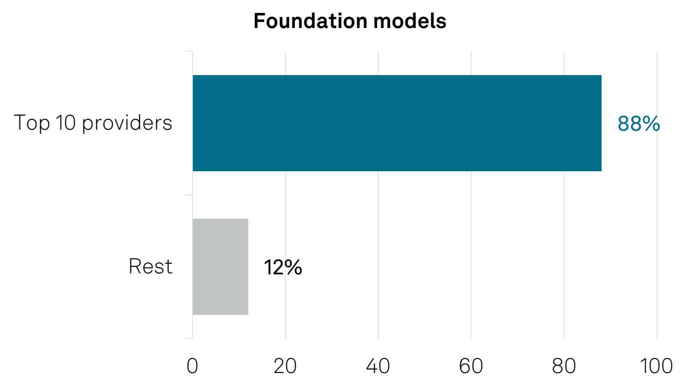
Crypto and AI: Shaping the Future of the Internet, Oct. 1, 2024

Single-provider risk concentration is increasing

A few companies dominate the cloud and generative AI segments (market share, %)



Note: Cloud infrastructure service revenue in 2023 (includes PaaS, IaaS, and hosted private cloud services).
Sources: 451 Research, S&P Global Market Intelligence, S&P Global Ratings.



Note: Market share by revenue of foundation model providers in 2023.
Sources: 451 Research, S&P Global Market Intelligence, S&P Global Ratings.

Edge AI and smaller models will support more sustainable and resilient use. AI computation at the edge describes operations that occur on an organization's network (e.g., on their PCs, smartphones, or Internet of Things devices), rather than on centralized infrastructure, such as the public cloud. Companies are primarily opting to run and use AI models (known as inferencing)

at the edge, with 82% of respondents choosing the edge over cloud for inferencing, according to a survey by 451 Research. However, large, frontier genAI models (chat GPT, Gemini, Claude) may struggle to run at the edge as they require significant computational power and training data to perform. That challenge is prompting companies seeking to deploy AI for more specific purposes to turn to small-language models (SLMs), which have lower computational requirements (and thus consume less energy), are more cost-effective to train and deploy, and can generate responses quicker, which is valuable in applications like virtual assistants. That makes SLMs more suited to run in edge environments and suggests a likely commercial shift from large to small models, at least in the short run.

Crypto technology supports security and data privacy, two key drivers for companies adopting edge AI.

Crypto technology can mitigate risks and support edge AI adoption. The emergence of decentralized physical infrastructure networks (DePINs) was a key crypto theme in 2024. These networks use blockchain technology to connect servers, sensors, phones, and wireless networks. They use crypto tokens as an economic incentive for users to participate. When applied to edge AI, DePINs can support networks of devices and AI models that don't rely on central entities for data storage and computation. They can also facilitate information traceability, identity management, model complexity, and reduce energy used in computation.

What we think and why

Security and data-privacy concerns will drive adoption of SLMs and edge AI. Security and data privacy are key drivers for companies adopting edge AI, according to a survey by S&P Global Market Intelligence. The technologies enable data to be processed locally, on handheld or desktop devices, which limits data transfer to a cloud server. The resultant reduction in interdependency can limit the potential for contagion from third-party cyber incidents (e.g., data poisoning or backdoor attacks) and can improve safety with regards to the use of sensitive data for personalized AI-powered services, which can be further enhanced with various cryptographic methods. Applications could include the provision of genAI virtual agents that provide personalized financial or medical advice to clients using their private data. Blockchain could also be used to verify the authenticity of AI-generated content and distinguish between humans and bots, potentially mitigating risks of deepfakes and misinformation.

Open-source small genAI models that run on edge devices will remain popular in 2025. This should support the widespread diffusion and adoption of these models. It should also encourage competition by opening genAI development and usage to small- and medium-sized enterprises, which have typically found barriers to entry--in terms of required investment--difficult to overcome. For example, French AI-startup Mistral, released new open-source edge AI models in October.

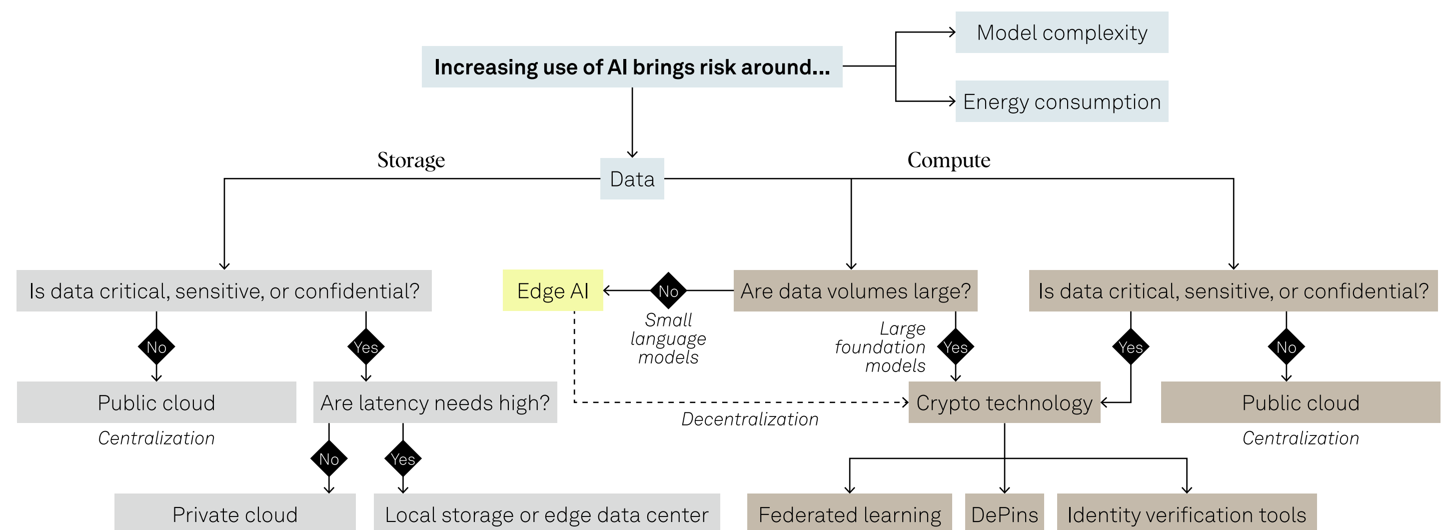
Devices and infrastructure networks will become key. We expect the continued adoption and development of DePINs and edge AI to offer improved computational power usage because of their complementary strengths in decentralization, which reduces the need for constant data transmission and leverages computational power from devices within a network. Furthermore, these technologies can enable companies to collaborate in training AI models without sharing data (a process known as ‘federated learning’).

As AI deployment expands, identity verification and proof of personhood tools will gain relevance. The most immediate use case for those technologies is the protection of personal data. Decentralized identity tools already help users safeguard their personal information and share only the minimum required information when interacting with a digital platform. In October, the city of Buenos Aires rolled out digital identities for its residents, using Zero Knowledge (ZK) proof technology. The system enables users to hold identification information in a "self-sovereign

wallet" on the ZKSync Era network and retain control over how they share this data with the government, businesses, and individuals.

Beyond 2025, we expect that AI may gain in autonomy. Agentic AI (AI that independently makes decisions and takes actions, based on a human-defined goal) will place greater emphasis on the identification of human and AI agents in digital interactions. AI agents are already common in manufacturing, logistics, and social media platforms, and will increasingly find applications in a wide range of other fields. Use cases will take years to develop at scale, but Coinbase's October launch of a tool for building AI agents and Microsoft's November announcement of its Copilot AI agents highlight the work already under way. Blockchain technology can support proof-of-personhood applications. For example, the Worldchain project (launched by Open AI's CEO Sam Altman) supports only human-to-human transactions, using wallets attached to an iris scan to identify human transactors.

AI data risks: Storage and computing solutions



Note: The selection of data storage solution (e.g. public cloud, private cloud, hybrid, or local) is a business decision. Our analysis showcases options based on a risk-analysis of alternatives to the public cloud. Source: S&P Global Ratings.

What could change

Exacerbated centralization risk. The pace of adoption of blockchain and edge technologies may not keep pace with the fast implementation of genAI. Competitive pressures could push corporations to overlook broader systemic concentration risk and focus on the convenience and ready availability of Big Tech solutions. The resulting increased reliance on a few companies and centralized data centers may exacerbate vulnerabilities to single points of failure, cyber attacks, and physical and geopolitical risks.

Nascent technology comes with evolving risks. Beyond a reliance on Big Tech, a rapid rollout of genAI tools could bring operational risks, cyber vulnerabilities, and legal risks--particularly with regard to the unforeseen liabilities that AI agents might create for developers and end users. Technological solutions addressing identification and verification are nascent, and failures could lead to data breaches and/or breaches of regulatory data-protection obligations.

The push for energy sustainability could backfire. While edge AI can, in theory, reduce overall computational demand and reduce computational power usage, that may not occur if the technology evolves in silos rather than networks. Siloed edge AI could increase computational demands for an organization and reduce computational power efficiency at centralized datacenters, resulting in greater energy consumption and increased sustainability risks.

Regional Credit Conditions

Credit Conditions North America Q1 2025

Policy Shifts, Rising Tensions

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.

Regional Credit Conditions Chair

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Editor's note: S&P Global Ratings' North American Credit Conditions Committee took place on Nov. 21, 2024.

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.

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.

Credit Conditions Europe Q1 2025

Fusion Or Fission?

Regional Credit Conditions Chair

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Key Takeaways

- 2025 marks another watershed moment for Europe and the EU. If the region does not rise collectively to the challenges from increasing geopolitical instability and fails to improve economic resilience, fragmentation could increase further.
- Regional wars and their potential effects on energy prices remain the key risk for Europe, at least over the short term. Other elevated risks that we monitor include protectionist trade policies, faltering growth, and tightening financing conditions.

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

The macro-credit outlook would be relatively sanguine if geopolitical uncertainty were not that high. Rating actions and outlooks in Europe have largely normalized, following the upheaval caused by the COVID-19 pandemic and the war-induced energy shock. Inflation has returned close to target and the rate cycle has turned. Financing conditions have improved, with M&As and shareholder-friendly payments likely forming a larger part of primary debt issuance in 2025. This cautious optimism is reflected in our forecast, which projects a modest 6.9% increase in median earnings for European rated nonfinancial corporates in 2025.

However, as Mario Draghi stated, the EU faces an existential challenge. It must increase investments to digitalize and decarbonize the economy, beef up its defense capabilities to counter Russian aggression and U.S. ambivalence, and provide necessary support for Ukraine--and all that in light of a possibly damaging trade war with the U.S.

The EU's challenges are most evident in the vehicles and vehicle parts sector that accounted for just above 11% or $56.7 billion of the EU's goods exports to the U.S. in 2023. We have already expected European carmakers' margins to come under pressure due to increasing price competition and lackluster demand. This stems partly from European original equipment manufacturers' (OEMs') ambitious goals to reduce their carbon footprints to meet net zero regulatory targets, but also cut-throat competition from China, where OEMs and suppliers have established market leadership in electric vehicles. Consequently, the large rating headroom built over the past few years will likely erode, as evident in the heightened negative outlook bias of almost 30% in the sector.

Additional U.S. tariffs on Europe and wavering U.S. NATO support could either spur the implementation of Mario Draghi's suggestions after Germany's elections in February 2025 or expose cracks in EU unity. With the important exception of Germany, few major eurozone governments have fiscal space on their national balance sheets to provide the necessary financial support for investment as flagging growth, ageing populations, and fragmented politics are strong headwinds that will keep borrowing and debt levels high--key factors constraining their ratings. Eight out of 27 EU member states have been placed in the excessive deficit procedure since they failed to comply with the 3% GDP deficit target. On the other hand, Germany has remained committed to maintaining its constitutional debt brake for now.

On a positive note, the outlook for European banks remains stable and benefits from solid fundamentals. The decline in most banks' net interest margins due to decreasing interest rates will be partially mitigated by increases in lending and fee earning activity, as well as stable credit costs. Yet German banks could continue to see additional provisioning in commercial real estate. Banks will preserve strong capitalization, which will enable them to maintain shareholder payments and deploy excess capital in M&As.

Top European Risks

Russia and Israel seek to press home their military advantage

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

Geopolitical risk remains high, with two regional wars ratcheting up in intensity as Russia and Israel press home their military advantage, albeit with Israel now tentatively prepared to scale back hostilities in Lebanon. The risk remains considerable, given potential triggers for a broader conflict and implications for Europe if the U.S. unilaterally reduces its support for NATO or Ukraine. The fallout could trigger risk aversion, a flight to quality, disruption to supply chains--with a severe effect if oil supply was disrupted significantly--and a shift in European governments' spending priorities.

Material trade restrictions extend to Europe

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

The U.S. election has provided a strong mandate to implement aggressive trade protection measures that could affect allies in Europe. The risk, beyond a uniform tariff of at least 10% on all European goods exports, is that specific sectors--such as automotive, pharmaceuticals, chemicals, and metals--could be targeted with higher tariffs. U.S. investigations into European Digital Service Taxes or the proposed EU Carbon Border Adjustment Mechanism would intensify trade tensions. The development of a coherent, unified policy response is among Europe's key political challenges.

European growth falters in an uncertain environment

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

A more hostile and uncertain global environment could further erode Europe's economic security, weigh on consumer confidence, and increase savings at the expense of consumption and growth in Europe. Stagnating growth would be detrimental to corporate credit performance and could weaken sovereign debt ratios further. Even if the political will to tackle Europe's productivity gap existed, few governments have fiscal space for contra-cyclical support, while Germany remains restricted by the debt brake. With national leaders focused on domestic politics, the likelihood of support for EU joint financing of security and energy independence also seems remote for now.

Financing conditions tighten as yield curves steepen in Europe

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

A combination of higher inflation, a recalibration of the U.S. rate path, and a potentially stronger U.S. dollar could slow the pace and extent of rate cuts from the Bank of England and the European Central Bank, compared with our base case. This, together with an increase in bond supply, could also put upward pressure on longer-term benchmark yields in Europe. Tighter financing conditions could increase financial market volatility and affect vulnerable issuers that exhibit weak cash flows, excessive leverage, and face near-term refinancing needs.

Real estate risk to the broader economy remains

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

While real estate issuers' liquidity has benefited from improving financing market conditions and lower interest rates, certain segments, such as non-prime office, remain vulnerable to secular trends, a further economic slowdown, or disruption in financial markets. Distressed sales could reset appraised price levels in local markets, particularly if financial market access became difficult and elevated financing costs persisted. Adverse developments could spill over to the broader economy and impair consumer confidence, spending, employment, and European banks' asset quality.

Structural risks

Disruptions linked to climate change and the energy transition could increase

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

Growing tensions arising from the EU's goal to reduce net emissions by 55% before 2030 and the need to improve industrial competitiveness increase the risks of political pushback and disruptive changes in climate targets and regulations. This could derail business plans and deter investments in decarbonization in key industries, notably in the automotive, building, cement, steel, chemicals, transportation, and utilities sectors.

Cyber and digital transformation risks are gaining ground

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

The pace of digitalization--including the advance of AI--and heightened geopolitical discord expose corporates and countries to mounting cyber risks, with targets ranging from utilities to insurers and government agencies. Despite advanced cyber defenses, this cyber arms race can still result in business disruption, monetary loss, and reputational damage, weigh on credit quality, and undermine public confidence in critical infrastructure.

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 on whether the risk level could increase or decrease over the next 12 months.

Credit Conditions Asia-Pacific Q1 2025

Bracing For Volatility

Regional Credit Conditions Chair

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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.

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.

Credit Conditions Emerging Markets Q1 2025

The Tariff Trials

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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.

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