SCOPE | Ratings

Sovereign rating implications of shifts in US trade policy

Uncertainty, policy divergence and underlying vulnerabilities to inform rating actions

The United States' recent announcement of trade tariffs marks a notable escalation in the protectionist policy adopted by the Trump administration. If implemented, the tariffs would represent the biggest peacetime trade shock to the global economy in more than 100 years. If sustained, this policy shift will have important credit implications for both the US (AA/Negative) and for sovereigns globally. Conversely, even their full reversal, though unlikely, would not fully restore the confidence of previous alliances and supply chains, indicating a degree of durable economic loss.

Given the significant uncertainty, we identify three scenarios to inform our growth and fiscal forecasts as well as other credit-relevant factors: i) 'tariff-light' scenario, ii) a full-scale trade war, and iii) economic and financial crisis. The eventual impact on growth, inflation, public debt, external credit metrics and thus sovereign credit ratings, will ultimately depend on the macro-economic environment that emerges from the polices the US adopts, the responses by trading partners, and the underlying credit strengths and vulnerabilities of sovereigns before this trade shock.

In our assessments, we will evaluate both the scale of the trade shock as well as the adequacy and quality of regional and national monetary and fiscal policy responses, focusing on the fiscal adjustment capacity and underlying economic resilience of sovereigns to absorb and reverse the impact of the shock over the longer run. The most exposed sovereigns are the US itself as the epicentre of this unorthodox policy shift as well as countries with significant trade surpluses and/or financial exposure to the US.

Table 1: Three scenarios and potential implications

Scenario	Description	Potential implications
Tariff-light	Tariffs are starting point for negotiation; most sovereigns appease the US; slightly more protectionist equilibrium emerges	Short-term growth, inflation volatility; confidence shock, investment uncertainty; US technical recession; modest demand and supply chain disruptions; growth and credit risks contained
Trade war	Tariffs are high and permanent; significant escalation and counter-tariffs (on goods and/or services)	Medium-term growth and inflation pressures; major shifts in global supply chains; US to enter full-year recession; growth, credit impact depends on trade linkages and existing vulnerabilities
Economic & financial crisis	Tariffs are permanent; US-China escalation intensifies, EU imposes broad countermeasures; US introduces capital controls; doubts grow about USD as global safe asset	US enters multi-year recession; global financial stability at risk; profound disruption to capital flows; sovereigns with large economic/financial exposure to the US would be highly impacted

Source: Scope Ratings

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1. Three scenarios to inform forecasts and credit views

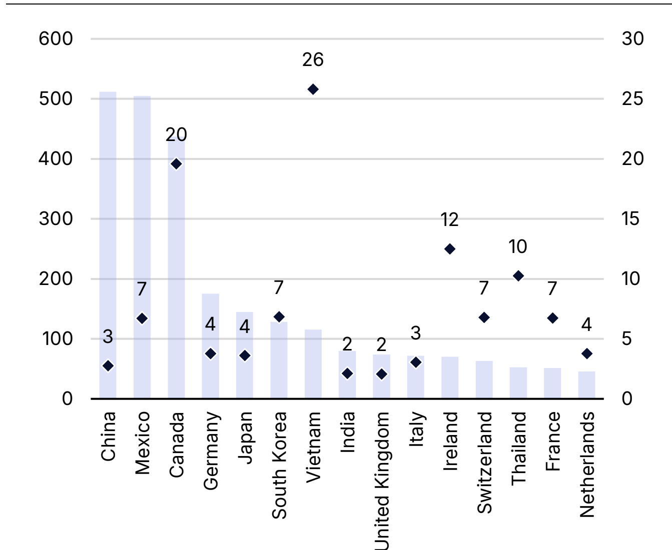
Several factors will determine the extent to which the US tariff shock impacts economic growth, inflation, public balance sheets and external metrics, and thus shape our sovereign rating assessments.

Vulnerabilities to US trade and financial policies

The extent to which shifting US policies impact other sovereigns depends on their reliance on goods exports to the US as well as countries' financial linkages. In terms of goods exports in USD, the most exposed sovereigns are China (A/Stable), Mexico, Canada, and Germany (AAA/Stable), while in terms of GDP, the most exposed nations are Vietnam (with goods exports worth 26% of GDP), followed by Canada (20%), Ireland (12%) and Thailand (10%).

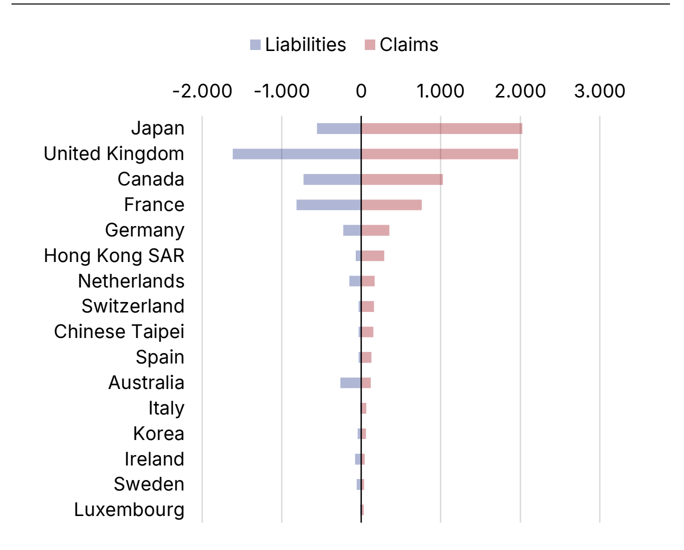
Looking at banking sector linkages with the US, the most exposed nations are the G7, led by Japan (A/Stable), the UK (AA/Stable), Canada, France (AA-/Stable) and Germany.

Figure 1: Exports of goods to US
Four quarters to Q3 2024, USD bn (LHS), % of GDP (RHS)



Source: IMF DOTS, National statistical offices, Scope Ratings

Figure 2: Banking sector linkages with US
as of Q3 2024, USD bn



Note: Cross-border banking sector claims and liabilities vis-à-vis the USA.
Source: Bank for International Settlements, Scope Ratings

Are US tariffs permanent?

Given the erratic nature of the Trump administration's policymaking, it is not clear whether the announced tariffs for individual countries represent a floor or a ceiling, or whether they are permanent measures or rather a negotiation strategy. It is also uncertain whether the announced tariffs represent the end of the administration's disruption of international trade or rather the starting point, with other barriers to the free flow of goods, services, capital and migrants still to come.

Will capital controls follow?

Specifically, if tariffs on goods were to stay, could restrictions on trade in services or controls on capital follow? At this point, we do not yet know which tariffs and other trade and economic shocks the US administration will ultimately impose on the global economy, and for how long.

Evolving global response to US policies

Similarly, the response by trading partners to the US policies is also evolving and matters significantly for our forecasts and credit assessments. Countries can choose between several strategies, including appeasing the US, for example, by cutting existing tariffs, pursuing bilateral trade arrangements or increasing US imports, all with the aim of securing lower 'reciprocal' tariffs.

Conversely, countries can also introduce counter-tariffs on US exports, potentially triggering a broader trade war.

Finally, countries can refrain from adjusting their trade exposure with the US, and instead focus on boosting their domestic demand, introducing supply-side reforms to boost their economic growth potential, and/or develop strategic (free) trade arrangements with like-minded countries.

Table 2: Policy strategies to US trade shock

Appease	Counter	Alternatives	Ignore
Reduce US tariffs;	Increase tariffs on US goods;	Seek trade arrangements with like-minded sovereigns	
Seek special trade agreement;	Impose additional trade barriers on US services;	Boost domestic demand	Maintain status quo; no immediate action
Increase US imports	Reduce US asset exposure, lower purchase of US debt instruments	Implement reforms to raise growth potential	

Source: Scope Ratings

Appeasement, reforms, alternative FTAs could partly offset US tariffs

The policy response to US tariffs is critical. The impact on growth from adopting "appeasing" strategies and/or alternative reforms is less severe and may even partially offset some of the negative effects from the tariffs even if this may prove politically challenging.

The extent to which sovereigns use this crisis to deepen trade arrangements with non-US trading partners to partially absorb the loss of exports to the US and/or implement reforms to stimulate domestic demand will be critical to cushion the tariff shock in the medium term. Based on this assessment, we identify three scenarios for our expectations on growth and credit risks for the US and sovereigns globally.

i) Tariff-light scenario

The announced tariffs represent a ceiling and thus a starting point for negotiation. The combination of appeasing the US and implementing structural reforms to stimulate domestic demand will lead to a new equilibrium, which is slightly more protectionist than before but ultimately not too damaging to trade and financial flows. The US enters a technical recession, but growth remains marginally positive over 2025. Global uncertainty is sustained but limited in scope.

ii) Trade-war scenario

The announced tariffs are largely implemented and become a permanent feature of US trade policy. In response, most major economies, including the EU and China, counter with retaliatory measures. This results in a significant reduction of global demand, a redirection of supply chains, and significant uncertainty over 2025. Capital flows remain free, however. The US enters a full-year recession in 2025. The adverse effects on global growth and credit conditions become more pronounced, especially among economies closely tied to US trade.

iii) Economic and financial crisis scenario

The announced tariffs are largely permanent and are countered by reciprocal tariffs from most major economies, including the EU and China. In addition, the Trump administration accelerates its isolationist path introducing capital controls. The global rules-based trading and financial system is at risk of collapse and confidence in the USD as the global safe asset weakens significantly, resulting in a sharp revaluation of US assets triggering a financial crisis. The US enters a multi-year depression in 2025-26. The severity of the crisis poses major credit risks for sovereigns.

2. Impact on US economy and credit rating

Economic growth

US is the most impacted sovereign

The United States is the most impacted sovereign by recent developments. The weakening in the US of independent institutions, the erosion of the rule of law, the undermining of the judiciary system, and the monopolisation of power at the White House, have contributed to a loss of confidence in the quality of US policymaking. In addition, actions that undermine traditional allies and close business partners, combined with economic policies focused on protectionism have introduced significant policy uncertainty. Moreover, the recent volatility in global stock markets disproportionately affects US households as they hold a relatively high share of equities, weighing on household wealth and confidence. These developments are negative for US households' real income, businesses, investment, and innovation, and thus economic growth.

The uncertainty introduced to the global trading system reduces the prospects for long-term investment, also limiting the attractiveness to invest in the US. While President Donald Trump's protectionist policies could temporarily accelerate investment in US production as countries try to win concessions, a decline in corporate earnings, higher production costs and a slowdown in the US economy accelerated by the tariffs could curb investment.

Tariffs reduce competition, increase inflation, and slow growth

If sustained, Trump's protectionism is likely to reduce competition, increase inflation, slow economic growth, and may lead to arbitrary policymaking by giving government officials the power to grant exceptions to tariffs on a case-by-case basis. Our growth forecasts will depend on which of the three trade scenarios is most likely to materialise.

We have lowered our growth expectation for the US in 2025 to around 1% (down from 2.7% in our December forecast) and between 1.5% and 2% in 2026 (down from 2.2%). This compares with an average annual growth of 2.7% in the past three years. This corresponds to the scenario of light tariffs. Conversely, we expect significantly greater downside risks in a scenario of a trade war (full year recession in 2025) or economic and financial crisis (depression in 2025-26).

Credit rating trajectory

In addition to assessing the impact on economic growth, we will also evaluate other credit-relevant factors, mostly pertaining to governance and the role of the dollar as the world's global reserve currency in line with the rating triggers stated in our latest rating action.

i) Federal reserve independence

Any indication that the Federal Reserve may be constrained in delivering on its mandate to maintain price stability and full employment, for example, by lowering interest rates despite a tariff-induced rise in inflation, would be credit negative.

Will the Fed provide dollar liquidity in all circumstances?

Moreover, given the Fed's global financial stability role, and its past commitment to provide dollar liquidity to other central banks in times of crisis is essential to assure US bond holders that enough dollar liquidity will always remain available. Any perceived change to that prospect, which could materialise under an escalation of the Trump administration's protectionist stance, would be credit negative.

ii) Institutional checks and balances

Our assessment of the US credit outlook will also depend on whether the country's institutional checks and balances, a long-standing key credit strength, withstand the pressure from the Trump administration.

Short-term (3-6m)

Over the coming weeks and months policy reversals remain possible. For example, Congress could take back the power to set tariffs, which however would likely require a two-thirds majority in the House and the Senate if Trump vetoes the respective law. Pressure from the Republican party, the markets, or even a "change of heart" from the president could also result in a significantly less adversarial and unorthodox trade and economic policy, as demonstrated by the 90-day pause on most 'reciprocal' tariffs.

Medium-term (12-36m)

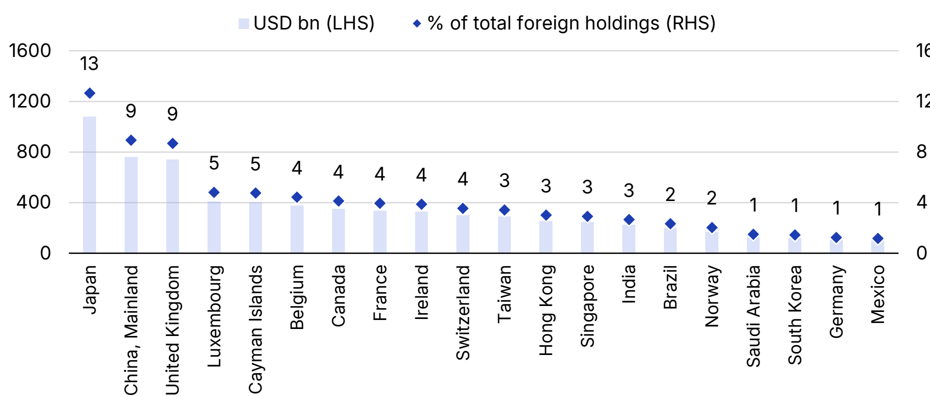
Mid-terms in November 2026 key event

Over the medium-term, the most important event will be the mid-term elections on 3 November 2026, which will decide whether Republicans maintain their majorities in the House of Representatives and the Senate. The next presidential elections are scheduled for 7 November 2028.

iii) US fiscal outlook and changes in debt holders

We expect US fiscal deficits of 6-8% of GDP without any meaningful correction over coming years. The risk of sudden increases in long-dated US treasury yields will intensify depending on the broader US growth outlook and the extent to which governance-related factors, including the independence of the Fed, develop. Any material change to the holdings of US Treasuries from foreign official institutions will be critical (including shifts to gold), as these have sharply accelerated since the full-scale Russian invasion of Ukraine and the introduction of sanctions.

Figure 3: Main foreign holders of US Treasury securities



Source: US Treasury Department, Scope Ratings

iv) US exceptionalism and the global role of the USD

Policies that undermine the rule of law, independent functioning of courts and/or the introduction of capital controls would likely call into question the extent to which the dollar is perceived as the global safe asset.

Significant policy changes needed to boost dollar alternatives

So far, the lack of reliable alternatives has always shielded the US from this risk. However, in a scenario of a protracted trade war and/or the introduction of US capital controls, viable alternatives to the dollar could emerge. For example, China and the EU could decide to deepen their trade relationship, and/or China could decide to further open its capital accounts, and/or the EU could accelerate its Savings and Investment Union. These developments are unlikely to happen swiftly, but if doubts about the exceptional status of the dollar were to increase, this would be very credit negative for the US.

3. Impact on Europe and other sovereigns

In early 2025, European governments faced low economic growth, increased security and defence spending needs, high taxes, increasing welfare spending, and rising interest payments. These fiscal challenges have been compounded by the US trade shock, which for Europe is in effect a negative demand shock due to lower exports. The 20pp tariff increase results in an average tariff of 13.3% after sectoral exclusions.

The credit impact on EU member states (and other sovereigns) will depend on their trade and financial exposure to the US as well as China, their respective policy response, and the pre-existing vulnerabilities relative to their rating peers.

These vulnerabilities include: (i) high openness to global trade and business cycles (e.g. Ireland), (ii) sensitivity to higher financing rates (e.g. Italy), (iii) exposure to weaker currencies (e.g. Turkey,

Georgia) and/or (iv) dependence on oil prices (oil-exporting sovereigns) that could materialise in a scenario of a synchronised trade war and/or an economic and financial crisis.

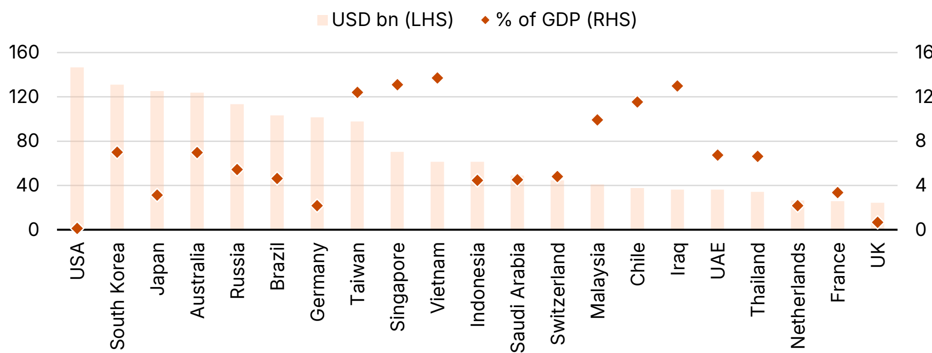
Exposure to China

US tariffs on China to hit Germany most among EU sovereigns

Among European sovereigns, escalating trade tensions between the US and China are likely to have a disproportionately adverse impact on Germany given the country's close trade ties with China.

China is Germany's second largest trading partner in 2024 with a trade volume of EUR 246bn, after the US with a trade volume of EUR 253bn. There are significant supply chain interlinkages as China is Germany's largest source of imports (12% of imports) while the US remains Germany's largest export destination (10% of exports).

Figure 4: Exports of goods to China
Four quarters to Q3 2024, USD bn (LHS), % of GDP (RHS)



Source: IMF DOTS, National statistical offices, Scope Ratings

Policy response: trade

To mitigate risks associated with shifting US trade policies and reduce reliance on Chinese imports, Europe has several strategic policy options, broadly categorised as appeasing, de-risking, and countering.

US appeasement could include buying more gas, military equipment

Policies aimed at appeasing the US administration could include higher purchases of US gas and military equipment, adapting the EU's forthcoming carbon border adjustment mechanism, effective January 2026, or reducing existing tariffs on US imports and raising tariffs on China to demonstrate alignment with the US. These measures could ease near-term economic and political concerns and potentially lead to the reduction or suspension of tariffs. However, appeasing strategies would likely increase the EU's dependence on the US on energy and defence while also potentially undermining the EU's leadership in advancing the green transition.

Imposing counter-tariffs targeted at politically sensitive sectors in the US may result in renegotiated tariffs, which could be credit positive, or alternatively lead to an escalation of trade tensions, a credit negative. Policies and strategies that aim to reverse the protectionist US policy overall, rather than obtain minor US tariff concessions would be credit positive.

Potential gains from strategic FTAs and/or Brexit re-negotiation

Advancing strategic free trade agreements (FTAs) with other jurisdictions such as the UK, Canada, Japan and Mercosur would help to partially mitigate the adverse impact of US tariffs. There are likely even greater economic advantages to be gained by reversing some of the damage caused by Brexit through bolder renegotiations with the UK that go beyond security and defence, and by deepening strategic trade arrangements with G20 economies committed to preserving the multilateral trading system.

Policy response: boosting domestic demand

ECB crisis mechanisms and asset purchases to cushion near-term shocks

The extent to which the ECB continues its easing monetary policy and especially its willingness to intervene via its asset purchasing programmes in the event of "unwarranted" yield spreads will be key for cushioning near-term shocks.

Investment and growth-enhancing reforms key

In the medium term, deepening the integration of the EU single market as well as accelerating the savings and investment union are critical for growth-generating policies as laid out in the Draghi and Letta reports. Increasing domestic demand (infrastructure, defence, green transition) to compensate for the loss of US demand and implementing structural reforms to raise Europe's growth potential are key.

Internal EU barriers still higher than US tariffs

As highlighted by the IMF, intra-EU trade barriers are much higher than the newly imposed US tariffs. The remaining barriers to trade within the EU are equivalent to a 44% tariff on trade in goods and a 110% tariff on trade in services. Deepening the single market is thus a critical priority and could compensate significantly for the US trade shock.

Moreover, Europe's response should include significant public and private investment (in line with Germany's fiscal stimulus), partly facilitated by a full capital markets union to allocate private capital more efficiently, along with deregulation to improve competitiveness.

Finally, reforms and/or financial incentives to increase the labour force participation and/or the number of hours worked, as well as additional resources for education and research to help raise productivity and push Europe up the technology value chain are also needed.

Related research

US trade policy: wide-ranging tariff increases heighten global credit risk, April 2025
UK sovereign rating affirmed, but fiscal pressures intensify; tariffs harm growth, April 2025
European rearmament plans: national policy choices will shape fiscal impact, March 2025
Germany’s borrowing to rise by EUR 625bn for infrastructure and defence, March 2025
France: meeting higher defence spending will complicate fiscal consolidation, March 2025
Germany’s inflection point: new coalition government needs multi-pronged approach to reform, February 2025
EU sovereigns face multiple risks to credit outlook from shifts in US policy, February 2025
Higher defence spending to weaken EU credit profiles, even if fiscal rules eased, February 2025
Germany: industrial, labour, tax reforms essential to revive growth amid geopolitical challenges, February 2025
CEE Sovereign Outlook 2025: risk balance to ratings broadly neutral for 2025, December 2024
Sovereign Outlook 2025: robust fundamentals, rising fiscal pressures and geopolitical uncertainty, December 2024
Supranational Outlook 2025: credit quality remains strong amid rising geopolitical challenges, November 2024

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