EM Sovereigns Amid U.S. Tariff Policy

Resiliency Study May 2025

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During periods of external shock like the Global Financial Crisis (2008) or COVID-19 (2020), the macro variables that impact EM sovereigns can change suddenly and dramatically, necessitating a rethink of our credit views. We believe that the recent shift in U.S. policy could be another such shock causing serious implications for the more vulnerable countries, while others prove to be more resilient. As we have learned from past events, it is an effective strategy to position more heavily in resilient names through the worst of a crisis, looking to reverse the trade later as the cycle begins to turn, and the risk factors become clearer for more vulnerable names.

MetLife Investment Management

To determine the resiliency of all 80 EM sovereigns under our coverage fully and expeditiously, we designed the following scenario and analytical parameters:

- **The shock scenario** – While this is not our base case, we could envision a global recession lasting as long as three to four quarters and driven primarily by weakness in the U.S. and China, with Europe also weak but comparatively less affected. Weak global demand would put downward pressure on commodity prices, particularly oil, with Brent crude sustaining depressed levels of $50 – $60 for this extended period.
- **Analytical parameters** – At a high level, we define resiliency as a country's ability to endure the entire downcycle while avoiding significant credit rating downgrades[1] and funding difficulties. We considered three additional criteria that are particularly relevant to this specific shock: 1. direct exposure to U.S./China economic malaise; 2. direct impact from lower oil prices; and 3. significant increases in funding needs directly owing to the shock.

Using these criteria, our sovereign analysts **assessed each individual country as resilient, vulnerable, or "cuspy"**—the latter indicating uncertainty that hinges on the severity and duration of the shock and the strength of a country's policy responses. As the cycle plays out, we would expect interesting alpha opportunities in cuspy names, either by actively reducing exposure to countries that become more vulnerable or overweighting the ones that become more resilient either through better policy implementation or external support (IMF, etc.).

Our analysis revealed that 30 of the 80 EM countries (38%) are resilient and would not experience impactful ratings migration or funding stress. By quality, as one would expect, higher quality tends to be more resilient. In our study, we conclude that 73% of all investment-grade (IG) countries are resilient, versus only 20% of the high-yield (HY) universe. Alternatively, among vulnerable countries, a mere 8% of IG countries were labeled as vulnerable, versus 31% of HY names.

Summary of Results:

	Resilient		Cuspy		Vulnerable		Total	
	Count	%	Count	%	Count	%	Count	%
Total	30	38%	31	39%	19	24%	80	100%
Elevated Rating Bucket Downgrade Risk	0	0%	6	8%	13	16%	19	24%
Funding Difficulties / Limited Market Access	1	1%	17	21%	19	24%	37	46%

Source: MIM as of May 1, 2025

Ratings Bucket Downgrade

Our analysis suggests that the stress scenario would increase the risk of significant credit rating downgrades in 19 countries, even while the actual timing of the downgrades may play out over a longer period. Some IG-rated issuers would face increased risk of becoming Fallen Angels (e.g., Mexico, Romania, Panama, Hungary), while a few BB sovereigns would risk falling into single-B territory (e.g., South Africa). A number of lower-rated countries, including Ecuador, Gabon, Ukraine, Maldives, Angola, Cameroon, and Senegal, would face elevated default risk.

Funding Difficulties / Limited Market Access

A country having higher funding needs, in and of itself, does not signify funding distress. Countries with low debt or high fiscal credibility tend to preserve access to markets during times of stress, even if the amounts are significantly larger than during normal times. This is often true in IG-rated sovereigns, where only 8% of the countries in our assessment would face actual funding constraints. However, approximately 65% of high-yield sovereigns would have an issue tapping the market if they needed to. Countries such as Angola, Kenya, Senegal, Ecuador, and Colombia may find access particularly strained or prohibitively expensive.

Secondary Criteria:

	Resilient		Cuspy		Vulnerable		Total	
	Count	%	Count	%	Count	%	Count	%
Total	30	38%	31	39%	19	24%	80	100%
Heavy Direct US/China Exposure	10	13%	12	15%	6	8%	28	35%
Oil Downturn Concerns	3	4%	10	13%	9	11%	22	28%
Heavy Funding Needs	6	8%	12	15%	15	19%	33	41%

Source: MIM as of May 1, 2025

Heavy Direct U.S./China Exposure

Interestingly, direct exposure to the U.S. and/or China is relatively low in EM, with just 35% of the analyzed countries affected. Of these, there is a skew toward HY countries, but more notable is the regional impact. Latin American countries see the heaviest effect given closer relations between the U.S. and Central American/Caribbean countries including Bahamas, Costa Rica, and Jamaica. Meanwhile, South American countries tend to have closer linkages to China through commodity exports, including some of the region's bigger economies such as Peru, Mexico, and Brazil.

Oil Downturn Concerns

Given the dependence of some of these countries' economies on oil exports, we believe that this is an impactful risk factor during this cycle. Out of the 80 countries analyzed, 29 are oil exporters. However, not all oil exporters would be deemed vulnerable in this environment, as some have low production costs, very low debt, or large savings resources to draw down during a shock. We identified seven such names in our survey, leaving 22 others that are indeed vulnerable to oil price decline, representing 28% of the EMBI Global Diversified universe.[2] Latin American countries are most at risk, with nine of the 21 countries analyzed flagging for this metric, including Suriname, Ecuador, and Colombia.

Heavy Funding Needs

The economic shock we are envisioning would tend to significantly increase funding needs relative to a normal market environment for 41% of countries, based on our analysis. Notably, these issuers are roughly split between IG (38%) and HY (42%). However, on a regional basis, there is a skew toward Middle East and Africa sovereigns, with 17 of the 29 facing heavy funding needs (mostly oil exporters), spreading across the rating spectrum from Gabon and Nigeria in the single-B and below space—all the way up to Abu Dhabi, Qatar, and Israel in the single-A and above rating bucket.

Summary

We always strive to adapt to an evolving global landscape and incorporate new risk factors within our process and in portfolios as seamlessly as possible. Given the current state of trade frictions, most notably between China and the U.S., it feels prudent to go through an exercise to identify new fragilities that will affect every economy in the world through a variety of channels. With a complete framework, we can make portfolio adjustments that feel measured and prudent, which could include investing with greater conviction in the more resilient sovereign issuers, as well as interesting alpha opportunities within the cuspy bucket. This may be seen through underweighting names that become more vulnerable, while overweighting countries that implement policies to help them become more resilient.

Endnotes

1 A significant rating downgrade is a decrease in rating "bucket", for example from BBB to BB

2 Source: JP Morgan

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