February 2025

# Tackling tariff risks

## A framework to assess sovereign vulnerability to US trade tariffs

**Thys Louw**
Portfolio Manager

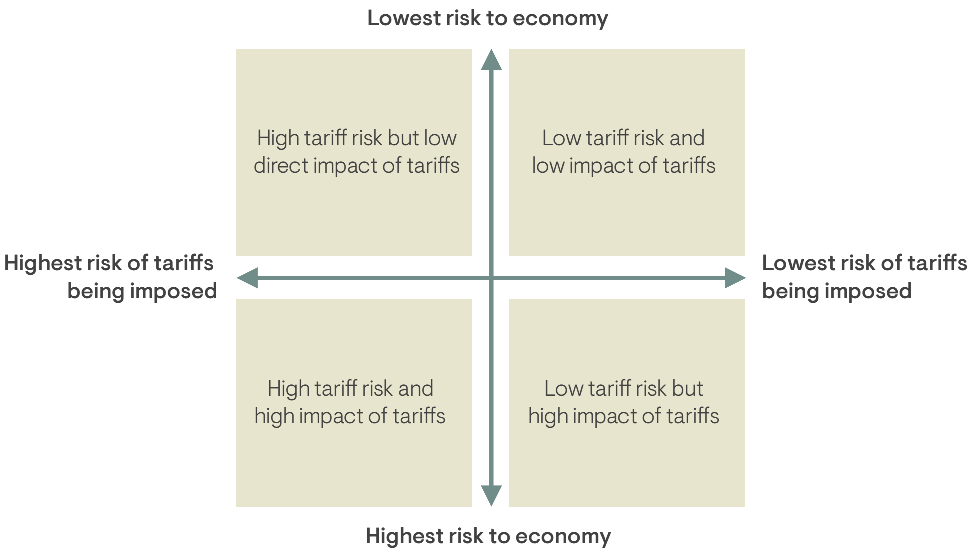
**Aurelie Martin**
Analyst

### Key considerations

While the initial reaction in EM debt markets to Donald Trump's recent US election win was relatively benign by historical comparison, tariff-related uncertainty is now top-of-mind for investors and likely to remain a driver of market volatility in the coming months. Behind the noise, the key considerations boil down to the likelihood of a country being subjected to tariffs and the impact they would have on its economy. An understanding of them can help shift a situation of 'known unknowns' to a tangible framework for making country-level assessments. That's the broad aim of our Tariff Vulnerability Assessment Framework.

### Tariff Vulnerability Assessment Framework

The framework provides a starting point for assessing both the risk that the US levies tariffs on a country and the impact that these tariffs and a US-led trade war could have on that country's economy. It divides sovereign debt issuers into four broad categories:




Source: Ninety One. For illustrative purposes only.

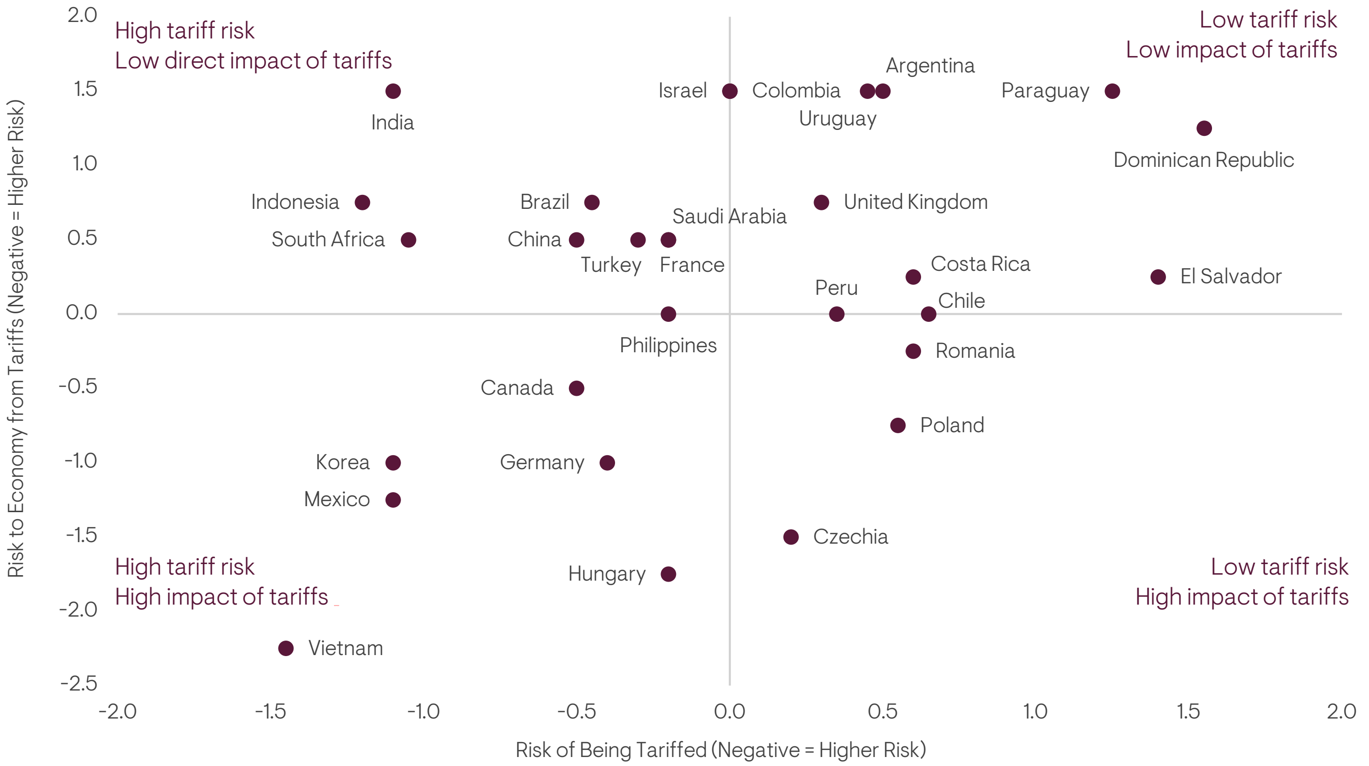
This framework does not provide a crystal ball in terms of how, on whom, and when Trump will use tariffs. That would be a fool's errand, given these tariff considerations are likely to be dynamic and attempting to achieve several objectives. Rather than seeking to just balance global trade and diminish the role of China (which would make the potential focus of tariffs more predictable), the US administration's recent rhetoric suggests that the goal is to enforce its views across various dimensions, including but not limited to: raising fiscal revenue through the establishment of an external revenue service; enforcing geostrategic ambitions (as evidenced in Panama and Greenland); and, finally, enforcing domestic policy objectives such as immigration control and deportation in the case of Colombia. Although these shifting considerations could make any simple weighting scheme of tariff vulnerability ineffective, the ability to identify areas of risk in an objective and transparent manner could still be valuable to investors, particularly if we consider recent communications. US Treasury Secretary, Scott Bessent, and Chair of the Council of Economic Advisers, Stephen Miran, have spoken about having a "traffic light" system for determining the scaling of tariffs, which is likely to encapsulate several trade and non-trade factors.

The framework we have developed allows us to transparently assess the risks each economy faces across the various dimensions the US administration has – in its communications – highlighted as issues that matter to it (x-axis). It also assesses the direct impact of such scenarios on each economy (y-axis). The interplay between these two factors will be important for investors; behind the noise of tariff announcements, investors should not lose sight of the fact that in a world of tariffs and trade disruptions, not all countries will be equally impacted, and the potential impact on sentiment means this noise could create investment opportunities.

## Findings

The figure below plots a selection of markets in the emerging market debt universe according to their scores in our tariff vulnerability assessment.

**Tariff vulnerability snapshot**




Source: Ninety One. For illustrative purposes only. Not all countries in the EM debt universe are shown to make the chart legible.

Considering the four broad categories (chart quadrants) in turn, here are the key observations of our tariff vulnerability assessment:

- **High risk and high impact of tariffs (bottom left)**: Unsurprisingly, risks here are focused on Asia, Europe, and Mexico. These are countries where investors will need to carefully monitor the timing, size, and scope of tariffs and are likely to remain most sensitive to US tariff policy pronouncements. In the case of Mexico and Canada, we have already seen this begin to play out.
- **High risk but low direct impact of tariffs (top left)**: These are countries that might find themselves on the wrong side of the US across trade or non-trade dimensions, but outside of souring of market sentiment towards these markets, the fundamental impact of tariffs is more limited. These countries include India, Indonesia and South Africa.

- **Low risk but high impact of tariffs (bottom right)**: These are large open economies which, despite possibly aligning with the US across several factors, will still be vulnerable to second-round impacts of any trade war. European economies such as Poland, Romania and Czechia fit this bill.
- **Low risk and low impact of tariffs (top right)**: This category is dominated by select frontier economies (e.g., Paraguay, Dominican Republic, Argentina) in Latin America, which outside of some risks related to immigration are unlikely to be in the eye of the Trump tariff storm.

# Methodology

All factors are scored on a scale of +3 to -3. Each country is scored based on the factors listed below. For each indicator we use a variety of third-party data sources to supplement our qualitative analysis; further information is available on request. We have weighted these factors according to our view of the relative importance of each factor to US government policy priorities.

### Risk of tariffs

Here, we try to give an idea of which countries exhibit features that the current US administration would frown upon, meaning that it would consider imposing tariffs if it felt it served US interests. This is scored using 14 factors across five broad categories, namely:

- **Trade and market access vulnerability:** this attempts to assess whether the country runs an imbalanced relationship with the US through the lens of trade balances and whether it allows US firms sufficient market access through reduced tariff and non-tariff barriers. It considers the level and trend of:
  - US dollar trade balance with the US.
  - Trade balance with the US as a percentage of the country's GDP.
  - Non-tariff barriers, as per the Fraser Institute.
  - Weighted mean of tariffs the country charges across imported goods.
  - Percentage of export lines charged at the highest rate (i.e., tariffs used as a protectionist measure).
- **Relationship with adversaries**: this attempts to assess whether the country has significant trading or investment relationships with countries such as China, Russia and Iran, which raises the risk of tariffs being used to encourage alignment with US positioning towards these countries. It considers the level and trend of:
  - FDI from China in US$ billions.
  - FDI from China as a percentage of the country's GDP.
  - Imports from Russia/Iran in US$ billions.
  - Imports from Russia/Iran as a percentage of the country's GDP.
- **Political and military alignment**
  - Ideological and political alignment (how conservative/liberal the country is).
  - How the country has voted relative to the US in UN General Assembly Resolutions.
  - For NATO countries, how far away the country is from Trump's proposed spending target of 5% of GDP and how spending has evolved over recent history.
- **Immigration**
  - Number of illegal immigrants from that country in the US.
- **Geostrategic considerations**
  - Reflects the risk of tariffs for geostrategic actions already announced by the Trump administration (such as on Panama, Greenland and possible Middle East considerations).

### Vulnerability to tariffs

Here, we look at the actual vulnerability of the country's economy to the direct impact of US tariffs. The four factors considered focus on assessing:

- Exports (excluding energy exports) of the country to the US as a percentage of GDP.
- How open or closed the economy is (total imports + total exports as a percentage of GDP).
- How reliant the economy is on goods trade relative to services as a measure of sensitivity to declining goods exports (current account minus goods trade balance as a percentage of GDP).
- How entrenched the economy is within global value chains (percentage of trade related to global value chain).

## In summary

For investors grappling with significant uncertainty around tariffs under the new Trump administration, this simple framework can provide a structure and a starting point for further analysis to assist in the investment decision-making process.

The knee-jerk market response to any announcements relating to tariffs on specific countries is likely to over/underestimate the longer-term economic risks. What really matters over the long term is how any tariffs impact the country in question – as our analysis shows, the economic vulnerability to tariffs varies greatly across countries. Market volatility may well present opportunities for the focused investor.

**General risks:** The value of investments, and any income generated from them, can fall as well as rise. **Specific risks:** Emerging markets: These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems.





MACS18576