Emerging market debt outlook for 2025: Ready for Trump 2.0?

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Looking ahead to 2025, the macro environment, in theory, sets the stage for a friendly backdrop in EM, especially given continued disinflation, which should allow most major central banks to ease rates throughout the year. However, the incoming US administration poses several risks to EMs.

President-elect Trump has made four key economic policy proposals: increasing tariffs (a threatened 60% on China and 10-20% on the rest of the world), reducing or reversing immigration, decreasing taxes (an extension of the 2017 tax cuts and a reduction in corporate tax are likely), and reducing regulation (mainly in energy and financial industries).

These policies present headwinds to EMs. US policy is now highly unpredictable, however, and the reality might not be as strong as outlined during the campaign, especially on tariffs. During Trump's first term in 2016, for example, the focus was initially on fiscal rather than trade policy and if this were to be the case again, it could be more positive than negative for certain EMs.

Global and local interest rates

Expansionary US fiscal policy and tariffs could both put upward pressure on US inflation. Cutting taxes without a reduction in expenditure boosts overall demand in the economy, which will generally raise prices (unless supply also increases) and can also lead to higher wages.

Tariffs, meanwhile, directly lead to a rise in domestic inflation in the US by raising the cost of imported goods. These tariffs may also reduce foreign competition, giving domestic producers more runway to raise prices themselves, exacerbating inflation pressures. Whether this translates into sustained inflation depends on the Fed's response to this price level shock.

In the case of a hawkish Fed, this might put pressure on some EM central banks to maintain higher interest rates domestically.

These risks are highest in EM countries with greater vulnerabilities, particularly those with high or persistent inflation and low external stability. Central banks in these countries might cut rates less or even hike them, depending on the extent of exchange rate movements. Brazil, for example, has already been forced to start hiking rates in response to currency weakness and market concerns about its fiscal position.

In the fundamentally stronger EM countries, including many in Asia, central banks have become more confident in moving ahead of the Fed due to the absence of systemic pressure on financial systems and with the development of deeper and more liquid local markets. These central banks may prioritise mitigating the growth impact of tariffs by embracing exchange rate weakness and implementing rate cuts. This is more likely to be the case if China ends up reducing export prices to keep its export share. One important takeaway from 2018/19 is that tariffs had minimal effect on EM inflation.

The dollar and EM currencies

The dollar should strengthen, at least initially, should the US impose additional tariffs and fiscal policy become more expansionary. Tariffs will tend to reduce US demand for imported goods due to their rising cost, directly shrinking demand for those foreign currencies, which will likely weaken. Moreover, this impact tends to grow as consumers have more time to find substitutes and adjust their consumption habits.

Over the longer term, however, tariffs might reduce growth prospects in the US, which would tend to weaken the dollar. Similarly, an expansionary fiscal policy agenda could increase US growth expectations and attract capital flows into the US, thereby boosting the dollar, but in the long term, a higher US debt-to-GDP could pressure the dollar the other way. Note that a more erratic and unpredictable economic policy will likely have opposing effects on the dollar.

For example, Trump has remarked publicly that the US has a "big currency problem" and that the dollar's strength has harmed American competitiveness.

The impact of tariffs would also likely vary by country. During the first Trump administration, the most material increases in US tariffs were on China. While this led to a significant reduction in the share of US imports directly sourced from China, the diversion of trade flows away from China benefited some countries, notably Mexico and Vietnam, which saw their share of US imports increase.

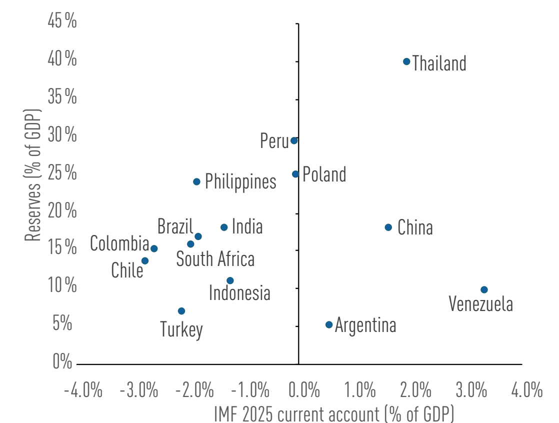
Similarly, countries such as Brazil were able to gain market share in China after it imposed retaliatory tariffs, targeted mainly on agricultural products, on imports from the US. Whether or not we see the same pattern under a second administration will depend on whether China is again the primary focus of new tariffs, or they are applied more broadly, including to countries with which the US is running significant bilateral trade deficits such as Mexico and Vietnam. Mexico is also vulnerable to how US policy may change on immigration issues. Any negative effects on remittances would harm growth, the current account, and thus the currency.

EM fundamentals

EMs have proven resilient since the previous Trump presidency, enduring two regional wars and a pandemic. External balances are generally strong outside of some frontier markets, while inflation has moderated substantially from 2022 peaks and is generally on a downward trend amid continued restrictive monetary policy stances.

Fiscal indicators are generally the weak spots, but most of the major EMs have lengthened the maturity profile of their debt and are issuing more now in local currency. Many EM countries also have room to ease rates and support growth if needed. China, in particular might deliver more fiscal easing, offsetting some of the headwinds from higher tariffs.

EM external positions look relatively healthy



As at October 2024. Source: IMF forecasts

Similarly, EM corporate fundamentals are in good shape, especially when compared to developed market corporates. As a result of enduring the pandemic relatively effectively, they are generally in a better position than for most of the past decade. The high default rates observed in EM corporates in recent years were primarily concentrated in specific areas, such as the Chinese property sector and companies affected by the Russia/Ukraine war.

Overall, while the election of Trump could represent a potential headwind for emerging markets, strong fundamentals, controlled inflation and the potential for the dollar to weaken in the long-term, all paint a favourable picture for emerging market debt investors.

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