OUTLOOK

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Credit conditions – Global

2025 Outlook – Transitioning to a new normal in a fragile and changing landscape

Summary

As we look ahead to next year, four key trends, reflecting both short and longer-term structural shifts, will influence credit quality. Here we outline our baseline expectations for these trends and which sectors and geographies are most likely to be affected and why.

» **Finding macro normal**. The global economy has seen significant shocks in recent years, including the COVID-19 pandemic, war in Europe and a massive surge in inflation. If President-elect Trump enacts all of the policies he talked about while campaigning, further disruption is likely in 2025. But even if that happens, the effects of past shocks will fade; and if US (Aaa negative) policies are not as disruptive as feared, we will see some normalisation in the global economy. That will be most evident in rate cuts aided by lower inflation, which will help with issuers' refinancing needs, boost cash flows and reduce asset quality risks.

» **Geopolitical tensions**. Efforts by governments and businesses to diversify their supply chains have strengthened their resilience to US-China (A1 negative) tensions and ongoing military conflicts. But the unpredictable nature of geopolitical developments will lead to further shocks which businesses and policymakers will need to respond to, adding costs.

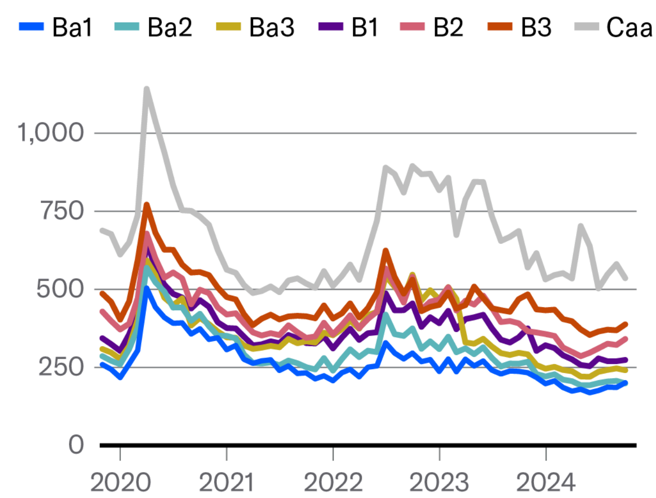
» **Digitization and disruption.** Transformational technologies like artificial intelligence (AI) and blockchain will continue to attract substantial levels of investment next year. But excluding select firms, profits are still hard to come by and some companies might use up resources without significant benefits, at least in the near term. Other disruption comes from the rapidly growing private credit market, which is vying to become a one-stop financial shop but is less regulated and is raising concerns about transparency. Increasing union activity, changing government policies and regulatory intervention are other challenges businesses will need to deal with next year.

» **Global transitions**. Despite an expected shift the direction of US climate policy, cost reductions in clean technologies, geopolitical competition in new areas and the growing costs of extreme weather events will continue to drive investment into climate mitigation and adaptation next year, especially from China. But the spending needed to close the climate financing gap is huge and returns are uncertain. Companies and governments will also need to manage the growing fiscal and economic costs of ageing; and sociopolitical conditions in advanced economies suggest that immigration cannot be counted on to offset the effects.

Finding macro normal

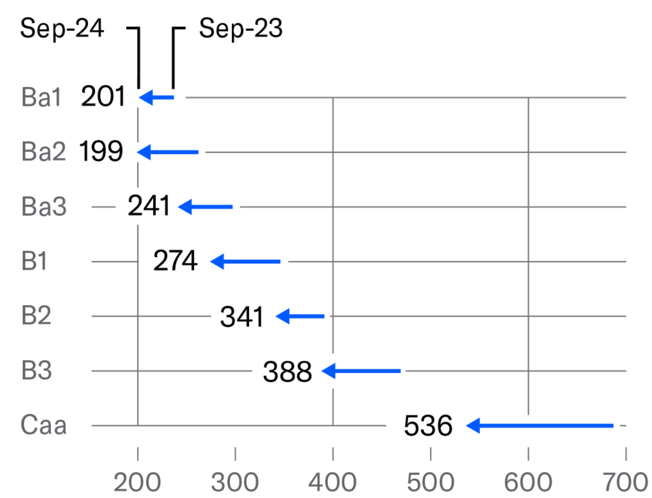
After a series of major shocks in recent years, global growth is starting to normalise as those disturbances fade. And with inflation in most markets at or approaching central bank targets, we are entering a synchronised cycle of monetary easing which should reduce uncertainty and help contain financial market volatility. Expectations of more stable macro conditions are also improving market confidence, with the difference between company and government bond yields at its narrowest in two decades (Exhibits 1 and 2).

Exhibit 1
The gap between higher and lower-rated speculative-grade credit spreads has narrowed (in basis points)



Credit spreads represented as median bond yields over seven-year US Treasurys for Moody's rated debt.
Source: Moody's

Exhibit 2
Credit spreads tightened across the board from a year ago (in basis points)



Credit spreads represented as median bond yields over seven-year US Treasurys for Moody's rated debt. Year-to-date average investment-grade credit spreads as of September 2024 tightened by roughly 33 basis points compared with the 2023 average.
Source: Moody's

Many borrowers will still have to refinance maturing debt at much higher rates than at issuance or loan origination, but lower funding costs will lower refinancing risk and free up cash flow. Lower inflation will ease pressure to raise wages, which tend to adjust more slowly than prices. Consumers will benefit from lower mortgage costs as well as more affordable loans that could benefit retail and durable goods sectors. Overall, improving macro conditions are a key reason why only one of the 17 nonfinancial corporate industry sector outlooks we assign globally is now negative.[1]

And where economic growth picks up next year, that will give governments more opportunity to stabilize or even reduce debt slightly. The easing cycle could also support a rebound in issuance and a broader revival of capital flows to emerging markets (EMs).

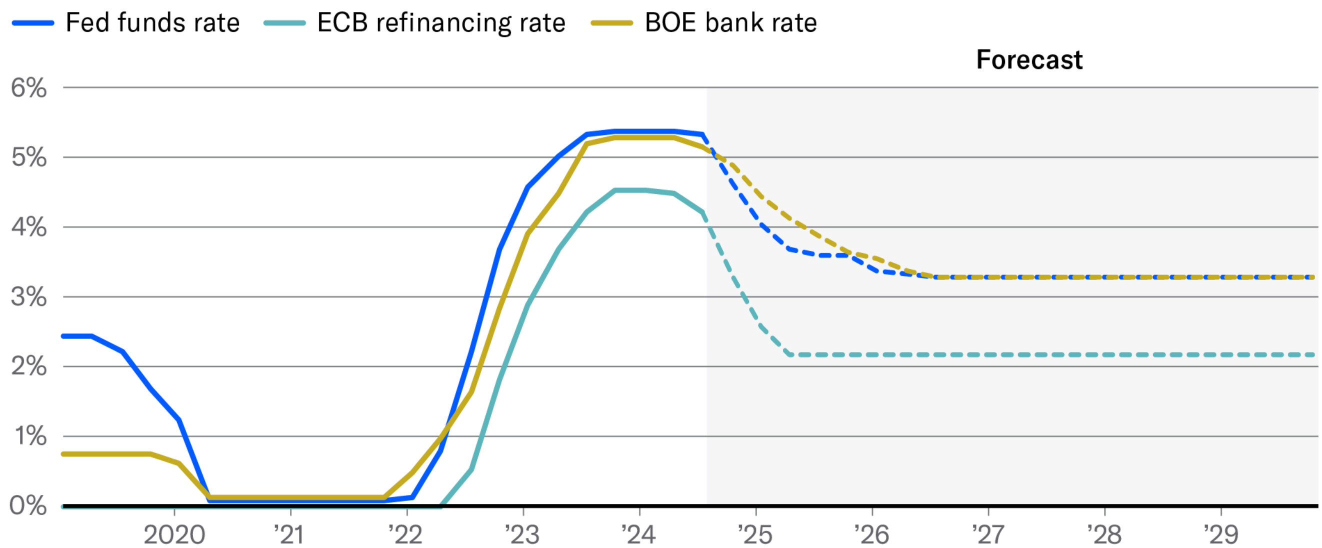
But there is considerable uncertainty about what "normal" now looks like for the global economy. Our baseline view is that **trend economic growth** will be lower in many countries than simple backward-looking averages would suggest. This reflects structural factors like weak investment, high debt levels, population ageing, weak productivity growth and institutional constraints in some countries, particularly some major EMs.

We should get greater clarity over what trend growth rates actually now are during the course of 2025. For example, recent data on jobs, disinflation and growth indicate a soft landing for the US economy, but we do not yet know the exact timing and scope of the policy measures President-elect Trump's administration will adopt when it takes power in January 2025. If large tariffs and mass deportations are implemented as described during the election campaign, they could weaken growth in the US and globally.

Similarly, we should have a better assessment of the impact of the stimulus the Chinese government is willing to provide, including its effects on domestic demand. In Europe, we will learn if relative economic decline will continue, or whether the European Commission – and more importantly member states – are willing to implement the recommendations of Draghi's recent competitiveness report. Policymakers in South Africa (Ba2 stable) and Turkiye (B1 positive) for example will either implement reforms to boost growth or let the structural constraints continue.

The same is true of policy rates. While it is clear that rates are not going back to 0%, it is unclear when central banks will stop cutting rates; or in other words, where the **neutral policy rate** is, where monetary policy neither boosts nor hinders growth. Our best guess is that this neutral rate is around 3% for the US fed funds rate, and around 2% for the European Central Bank's (ECB) main refinancing rate (see Exhibit 3).

Exhibit 3
Major policy rates will fall back in 2025, but there is uncertainty over the longer-term neutral level



Source: Moody's Ratings

But there are considerable uncertainties here as well, and policy rates could settle at higher levels. If so, the reason why will matter. If interest rates are higher because of an increase in risk premia — and there is no corresponding increase in growth — then fiscal sustainability will become even more difficult. But if higher rates reflect higher trend growth, that will be credit positive. As ever, the source of the shock matters.

As the effects of previous surprises wash out of the global flows, and we get visibility on the answers to some of these questions, that should reduce some of the market volatility of recent years and give us a clearer picture of global and regional credit conditions.

Geopolitical tensions

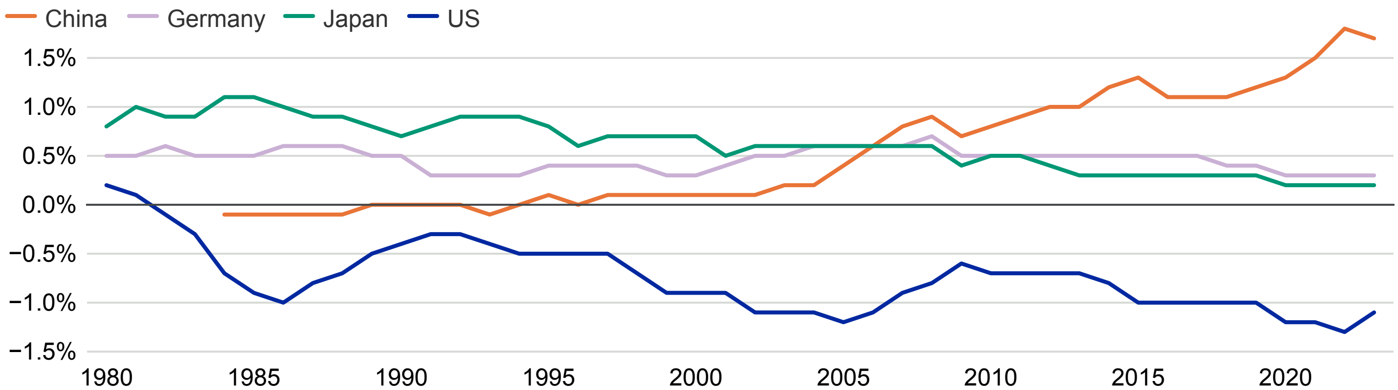
Geopolitics has emerged as the key threat to global credit conditions. Governments and businesses are already working to build resilience to the related uncertainty by diversifying supply chains, but the unpredictable nature of geopolitical developments will lead to further shocks that both will need to respond to.

For example, economic relations between the US and China have deteriorated since President-elect Donald Trump raised tariffs and trade barriers against China during his first term in 2019. So far, the impact on aggregate trade balances has been negligible, reflecting the targeted and staggered implementation of tariffs, as well as global trade and financial flows finding ways around the barriers. But new tariffs proposed by President-elect Trump would be much more disruptive depending on how they are implemented. For example, we estimate blanket tariffs would knock between 0.9% and 2.5% off China's growth in the first year they are implemented. The risk of additional trade restrictions has risen as a result of China's growing trade surplus and resulting imbalances with the US (see Exhibit 4).

Exhibit 4

China's growing trade surplus since the pandemic will stoke further trade tensions with the US

Manufactured goods trade surplus, % of global GDP



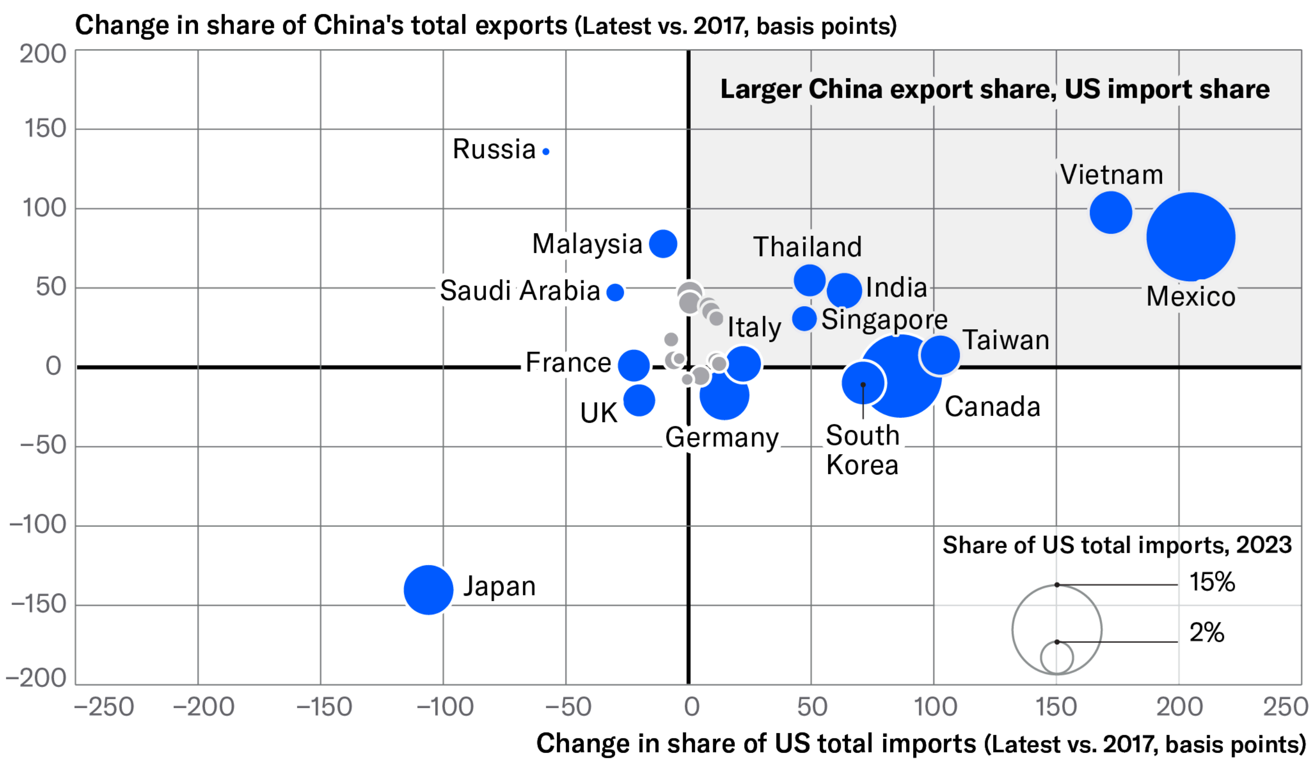
Manufactured goods surplus based on the Standard International Trade Classification (SITC) system, using categories 5 through 9.

Sources: UN Comtrade, IMF and Moody's Ratings

In addition to tariffs, we expect even stricter investment restrictions and rules of origin beyond those already in place. This could affect regions and sectors with strong trade links to China like Latin America and Asia-Pacific, particularly those that have acted as connector countries in recent years (see Exhibit 5). For Taiwan, it could accelerate ongoing efforts by major economies to diversify chip production, threatening its long-term economic competitiveness. And for Asia more broadly, these trade tensions could worsen geopolitical divisions, particularly in the Taiwan Strait, Korean Peninsula and South China Sea.

Exhibit 5

Connector countries are vulnerable to tighter rules of origin



Sources: IMF and Moody's Rating

The disruption to global trade would be magnified if President-elect Trump chooses to impose tariffs against a broader range of countries or to renegotiate existing trade agreements, especially if it leads to retaliation. US companies in strategic sectors could benefit from incentives to build new manufacturing capacity domestically. But trade wars are generally lose-lose outcomes, especially for open, trading economies in Europe, Latin America and Asia-Pacific, and for companies plugged into global supply chains. Companies with single-source suppliers are most exposed until they diversify.

There are other effects as well. For example, tensions could also lead to different product standards across regions, increasing costs for exporters and curbing information sharing crucial for high-tech manufacturing. Because China leads in processing and mining essential raw materials for green tech, these tensions could slow the global green supply chain, delaying the transition to new, green technologies.

Geopolitical risks have also crystallized in the form of sustained, outright conflict. In the past few weeks, the long-standing but mostly contained conflict in the **Middle East** has escalated into open conflict between Israel and Hezbollah in Lebanon. And while diplomatic efforts, military deterrence and the high cost make a full-scale conflict in the Middle East less likely, each exchange of fire raises the risk of a conflict between Iran and Israel that pulls in the US and other allies.

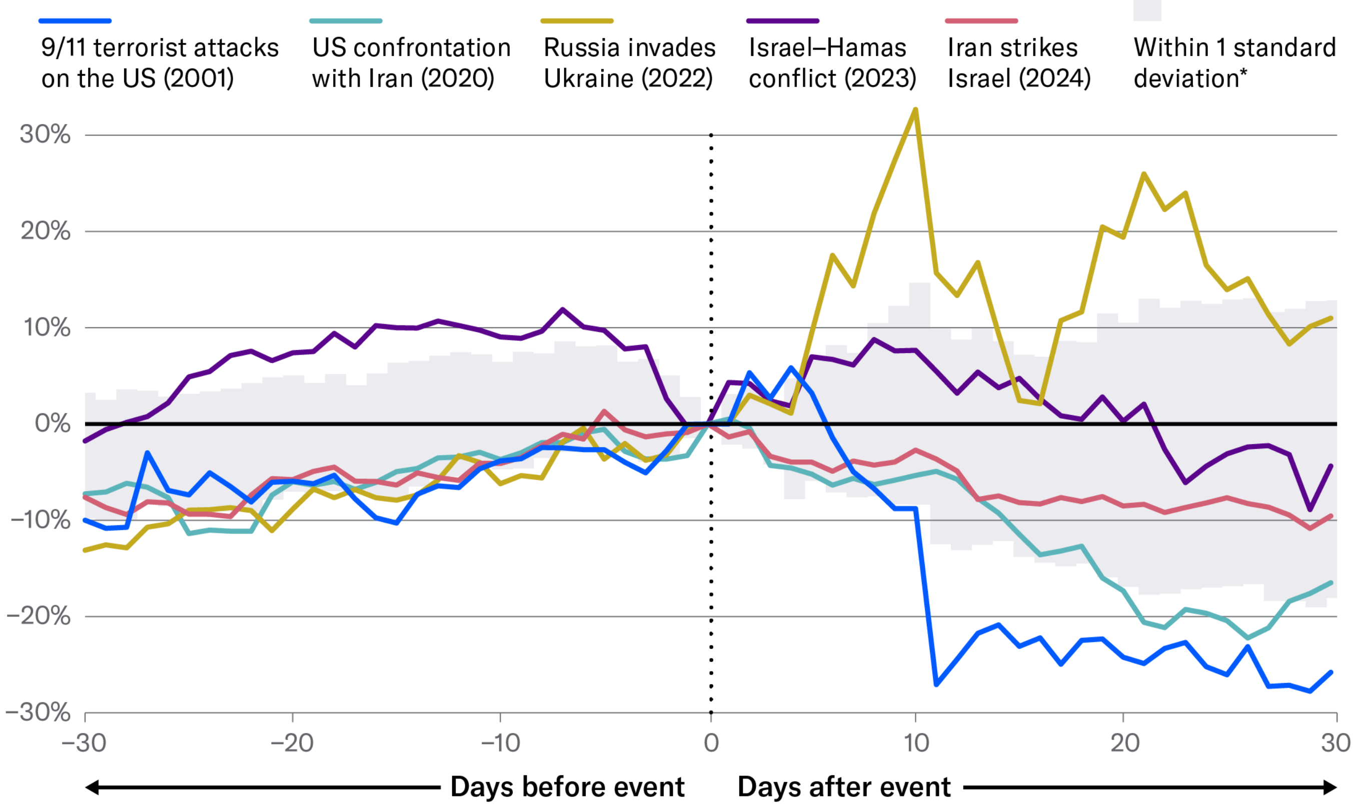
The credit effects of this would be significant for some Middle Eastern sovereigns. And if shipping through the Strait of Hormuz is disrupted or if Iran were to attack other countries in the Gulf region, this would have global effects through energy prices, supply chain disruption, financial market volatility and weaker economic and financial sentiment. However, even in this scenario these global effects could still be smaller than the post-COVID inflation shock.

The **Russia-Ukraine war** also grinds on at the cost of many lives. With any popular dissent in Russia squashed, much will depend on public support for the conflict among Ukrainians. With the near-stalemate at present, most companies have adapted to the disruption. But the future course of the war is uncertain, especially because President-elect Trump has promised to end it quickly. It is unclear how he plans to do this, but the US's decision on supporting Ukraine will affect Europe's finances and security.

Both within and beyond Ukraine, the human and financial costs of cyberattacks and sabotage will also continue to rise in line with the increasing digitization of critical infrastructure. This can undermine the creditworthiness of companies, organisations and governments, hitting revenues and increasing costs. By contrast, some central Asian economies are likely to benefit from diverted trade flows and financial transfers because of Western sanctions against Russia.

Geopolitical events will therefore continue to affect credit in 2025, and we will continue to examine financial, economic and credit indicators to gauge the transmission channels and impact of these events. The oil price is still an important indicator, even though its role in production has decreased (see Exhibit 6).

Exhibit 6
The oil price is a key transmission channel of geopolitical shocks, but effects vary
Cumulative change in Brent crude oil price 30 days before and 30 days after major geopolitical events



*These events are when the Geopolitical Risk (GPR) Index by Caldara, Dario, and Iacoviello rose significantly between 2001 and 2024. The GPR index is based on the proportion of newspaper articles covering adverse geopolitical events in each month as a share of the total news articles.
Sources: The US Energy Information Administration, Haver Analytics and Moody's Ratings

Digitalisation and disruption

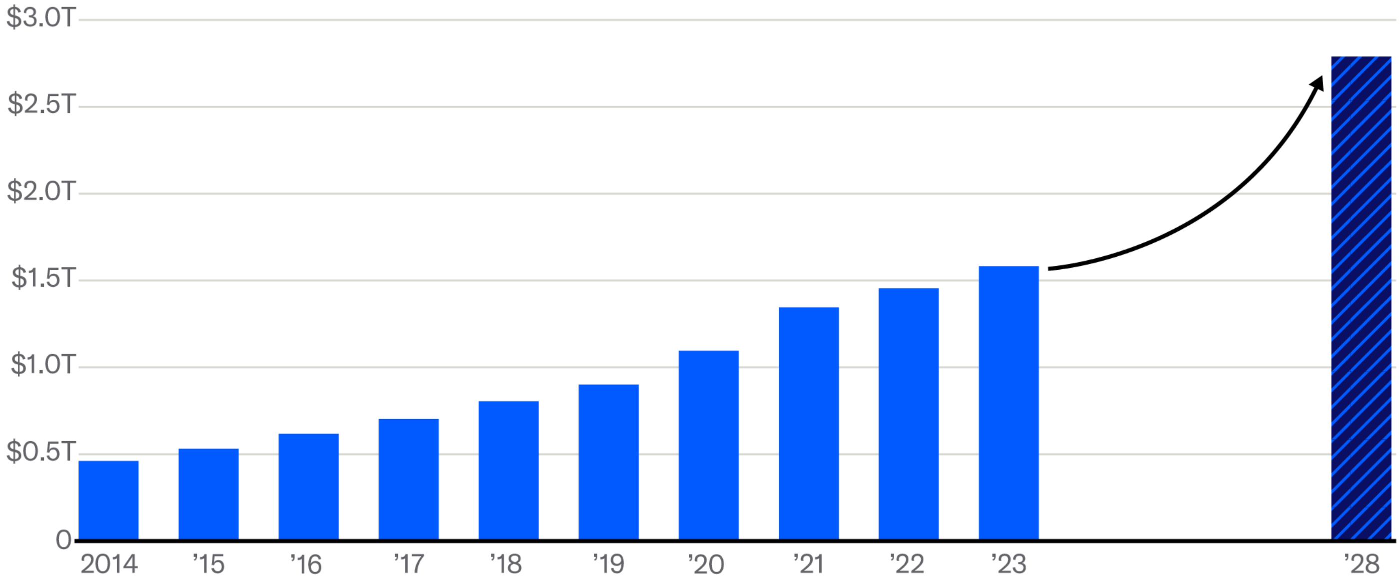
The adoption of new technologies is starting to be felt across businesses and organisations. **Artificial intelligence** (AI) is gradually improving the productivity of white-collar workers and transforming customer services. It will also start to feature in consumer goods, including new generations of personal computers and mobile virtual assistants like Apple's Siri and Google's Gemini. **Blockchain** is already being tested in sectors and activities ranging from financial market infrastructure to supply chains and we expect slow but steady progress addressing the hurdles to wider digital ledger technology (DLT) adoption.

Businesses will continue to invest billions next year as they seek solutions that secure their competitive advantage, particularly in AI. But profits remain elusive and some companies may end up using scarce resources that could have boosted balance sheets or liquidity positions without recouping any substantial benefits. Companies and governments will also need to grapple with a myriad of the associated risks.[2] The risk-reward trade-off will probably favour large companies and banks given their greater financial resources, larger data sets and ability to attract talent. Sectors with high barriers to entry stand to gain more than others.

Another byproduct of the associated greater demand for data will be investment in data centre capacity, which we estimate will hit $2 trillion in the next five years. This will present revenue opportunities for a range of sectors like tech companies, utilities, telecommunications, real estate and for lenders. For example, strong data center demand and good profitability for related products are some of the main drivers of our stable outlook for the global manufacturing sector. But these huge investments are not without risks for lenders and spenders, especially if breakthroughs in computer chip power and design greatly enhance energy efficiency.

Another source of continued disruption next year will be the **private credit (PC) market,** which has grown rapidly in recent years and has become a widely accepted go-to market for ever larger deals once done more exclusively by the broadly syndicated loan market (BSL). With policy rates declining, BSL activity is likely to provide more competition to PC lenders, even as banks' lending capacity is constrained by the finalisation of Basel III. However, we still expect private credit to grow rapidly, reaching $2.7 trillion by 2028 (see Exhibit 7).

Exhibit 7
Private credit's capital spending power will continue to grow



Assuming AUM grows at a cumulative average growth rate of 12%
Sources: Preqin and Moody's Ratings

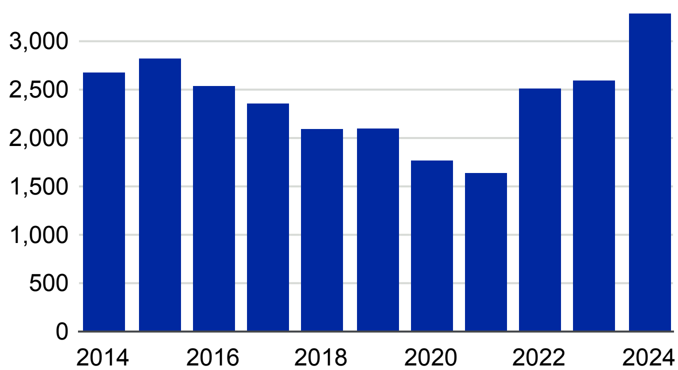
Part of the reason for this growth is that private credit is also evolving rapidly. With traditional returns under pressure, asset managers are expanding into new sectors such as the asset-based finance (ABF) market, which Apollo estimates at $40 trillion. And to get greater access to capital and deals, asset managers and private capital firms are also entering into partnerships with Wall Street banks, which is bringing in retail investors through private credit exchange-traded fund (ETFs). This rapidly growing ecosystem suggests private credit could become a more mainstream form of finance. In the near term, this could boost companies' liquidity by providing an additional source of funding.

But the recent rise in the number of payment in kind (PIK) loans – essentially a form of IOU – suggests some companies are struggling, particularly those heavily leveraged by their private equity owners when rates were low.[3] And as assets under management increase, there is a growing risk non-bank lending will be increasingly concentrated in the largest institutions. There are also risks in selling illiquid and hard-to-value products to less experienced retail investors who are used to having easy access to their money, and may not be used to "gating" processes used to manage fund outflows.[4]

Over the longer term, the impact of private credit on the broader financial system will depend on potential spillovers like its impact on credit standards, behaviours and liquidity in other parts of the financial system. Regulators will get more involved as the private credit market targets retail investors.

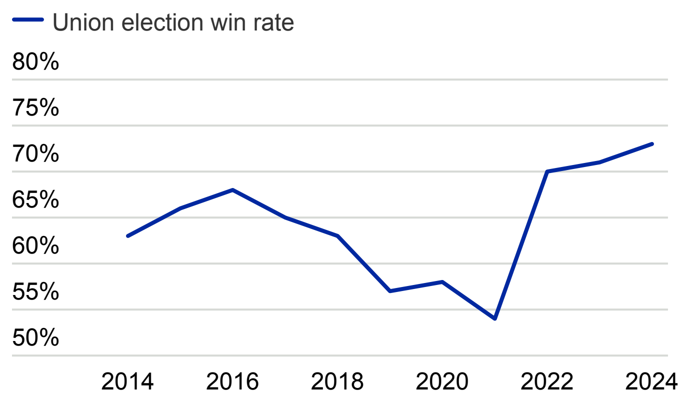
Disruption will also come from people and governments. For example, there was more **strike action** last year in the US and UK than in more than two decades. Industrial action at Canadian railways and Indian ports earlier this year worsened trade problems before Christmas. Dockworker strikes shut down major US ports, risking huge revenue losses and credit issues for many sectors. In September, we reviewed The Boeing Company's ratings for downgrade amid strike fears affecting cash flows. Strikes at Samsung Electronics (Aa2 stable) shows how they can raise labour costs, reducing earnings and weakening credit. Similarly, a potential strike by Air Canada pilots was expected to disrupt operations and consume cash, hurting credit. In some cases, strikes can speed up restructuring plans, as happened with Tata Steel (Baa3 stable). Workers' leverage may ease as labour markets cool, but a series of high-profile union victories, coupled with the strongest public support for unions in nearly 60 years in the US, will likely embolden unionised and union-curious workers in 2025 (see Exhibits 8 and 9).

Exhibit 8
Union organising activity and worker interest in union representation have grown in the last year
Petitions for union elections



Fiscal year data ending on 30 September.
Sources: National Labor Relations Board and Moody's Ratings

Exhibit 9
And unions are winning elections at the highest rate for over a decade
Union election win rate, %



Fiscal year data ending on 30 September.
Sources: National Labor Relations Board and Moody's Ratings

At the same time, **governments are likely to continue to intervene** to level the playing field against rivals accused of engaging in unfair trade practices. President-elect Trump has proposed imposing tariffs on many countries, but they are also popular elsewhere.[5] Intense price competition and excess capacity in some sectors like steel, semiconductors, electric vehicles, solar cells, wind turbines and hydrogen mean they will remain key battlegrounds, particularly for tariffs.[6] And weak global trading oversight heightens protectionism risks. Smaller economies will find it difficult to compete in an increasingly interventionist trade environment.

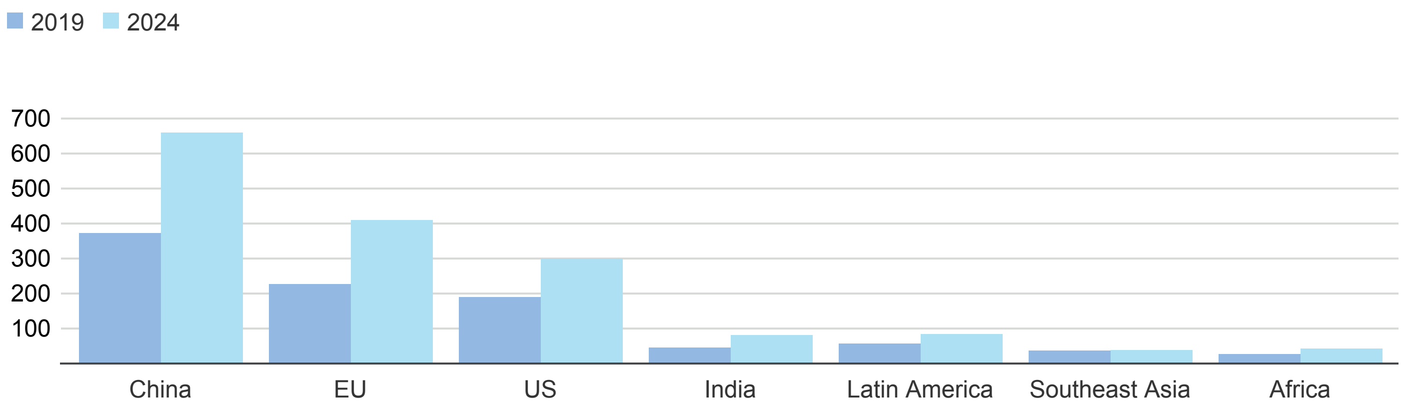
Regulatory action is another area to watch; recently competition authorities have flexed their muscles. This year, the US Justice Department and the Federal Trade Commission have taken an aggressive stance against what they view as monopolistic behaviour from a range of companies like Ticketmaster, Apple (Aaa stable), Alphabet (Aa2 stable) and Visa (Aa3 stable).[7] For most companies, these penalties are likely to hurt their bottom lines. But in some cases, proposed remedies could undermine business models, even for tech giants which have a lot of money and various businesses that protect them. The adverse credit effects here could be substantial; but President-elect Trump is likely to adopt a pro-business stance that could limit the impact, even before likely legal challenges to any regulatory action. Any lack of regulatory clarity after the US elections will present risks for the tech industry, but so would the costs of major regulatory changes, especially if they differ by state.

Global transitions

President Trump's victory in the 2024 US elections will shift the direction of US **climate policy**, raising risks to green investment, slowing the pace of US carbon transition and potentially dampening momentum on global climate action. We expect it to lead to lower funding for clean energy and green technologies, looser environmental regulations and renewed support for the fossil fuel industry in the US. The Trump administration will also probably withdraw from the Paris Agreement again and reverse US commitments to meet net zero greenhouse gas emissions by 2050. Higher barriers to trade could make green investments more expensive for US consumers and companies.

Despite these policy headwinds, we expect private sector commitments, state-level regulations and incentives, evolving consumer trends and cost reductions in clean energy technology to continue to support green investments in the US. We also expect other countries, including China, which accounts for a large share of global clean energy investment, to carry on with their own climate agendas (see Exhibit 10). But the policy environment will likely curtail a potential rebound in US sustainable debt volumes following several years of decline.

Exhibit 10
China accounted for the lion's share of clean energy investment in 2024
Annual investment in clean energy by selected country and region, $US billion



[1] Includes renewable power, power grids and storage, nuclear and other clean power, energy efficiency and end use and low-emissions fuels.
Sources: International Energy Agency and Moody's Ratings

And we expect climate mitigation and adaptation will remain a focus for other countries next year for a number of reasons. Interim 2030 targets for reducing carbon emissions are rapidly approaching, which includes a pledge to triple renewable energy capacity made at COP28. Governments will need to set even more ambitious emission reduction goals before COP30 in Brazil in late 2025. New sustainability disclosure rules imposed by securities regulators will put pressure on companies to do more. And the growing economic, fiscal and human costs of extreme weather events will push climate action up the policy agenda.[8]

Collectively, this momentum will create opportunities for new revenue streams and over time bring economic and social benefits. But the size of the investment needed is huge, returns are uncertain and the associated spending can still weigh on balance sheets even with policy support and when the competitive landscape demands it. These financial pressures could intensify if elections or social pressures lead to a pullback in industrial green policies elsewhere.

Among the sectors we believe are most exposed to the **carbon transition**, electric utilities remain best positioned because of favourable regulations and growing demand from the electrification of transport and industrial processes. But even here, progress has been bumpy and the future is uncertain. In the US, for example, growing electricity demand from data centers has put pressure on utilities to delay retiring fossil fuel assets. Although utilities can recover capital investment through rate adjustments, consumers may resist higher electricity bills. Despite progress in major EMs like China and India, additional coal capacity needed to meet growing energy demand means fossil fuels will continue to play a large role in power generation in the years to come.

Other highly exposed sectors like oil and gas companies, auto manufacturers, airlines and steel-makers will also look at ways to decarbonise their operations. However, the global shipping industry's experience shows how the path to decarbonisation over the next decade is fraught with economic, logistical and technological hurdles. Through this transition the management of credit strength is key, whether its finding windows of supportive industry conditions to reduce debt and leverage or to enhance resiliency to commodity price volatility.

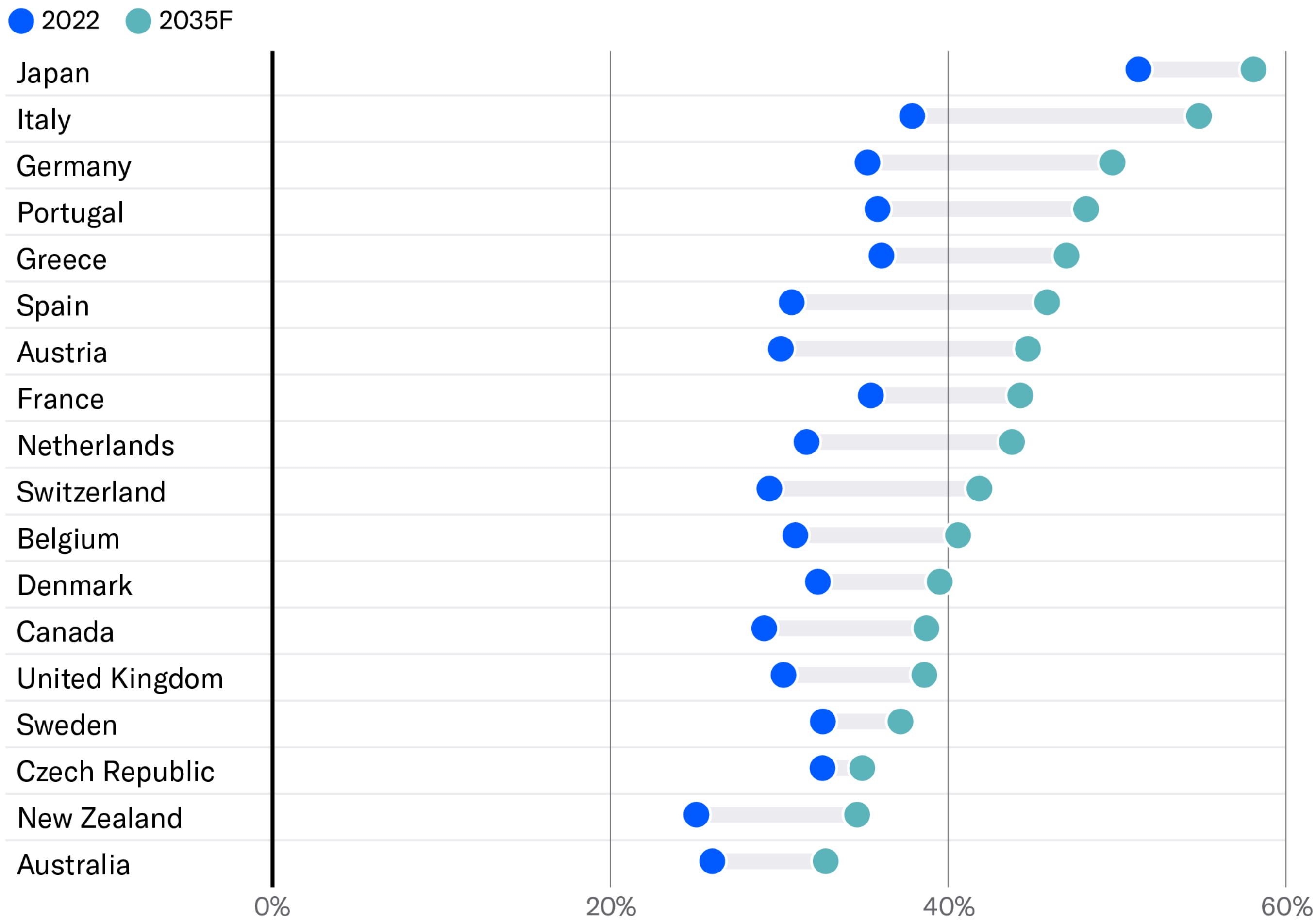
Technology offers solutions. Companies are looking to AI-powered solutions to facilitate emissions accounting and disclosures and improve energy efficiency but other use cases are likely to emerge. Other tech like green hydrogen, small modular nuclear reactors and carbon capture has the potential to accelerate the transition but have yet to scale because of cost, infrastructure and regulatory barriers. As Big Tech companies seek to secure access to clean power to meet their net zero targets, their investments could help reduce costs and speed up adoption.

In the meantime, the economic, financial and human costs of **climate events** like hurricanes, droughts, wildfires and floods will continue to grow and put pressure on sovereigns, local governments, companies and insurers. For example, many primary insurance companies in the US and Europe are raising premiums and in some cases withdrawing services altogether in response to growing catastrophe losses and rising reinsurance costs. In EMs, where private insurance coverage is less prevalent, the credit implications for governments and private sector issuers will rise without more investment in adaptation.

Businesses and governments will also need to adapt to **ageing**, which is accelerating as people live longer and birth rates fall, especially in parts of Asia, Europe and North America, limiting how much countries can produce and grow (see Exhibit 11). Governments are making policy changes to address the related revenue, spending and economic pressures.

But another remedy, **immigration**, is becoming a hot-button topic in advanced economies, making it harder to address this growing demographic deficit. The direction of US postelection immigration policy in particular will have an important bearing on the future growth of the US economy[9] and public finances. It could also have a big impact on a number of others in Latin America reliant on the associated remittances.

Exhibit 11
Population ageing will accelerate in advanced economies during the next decade
Old-age dependency ratio (OADR), 2022 vs 2035



OADR = ratio of the population aged 65 and over to the working-age population (15-64)
Sources: UN and Moody's Ratings

Conversely, other parts of the world like Sub-Saharan Africa and in South Asia, are set to reap a demographic dividend. But without a strong economy to provide jobs, more working-age people can lead to underemployment and social instability. Good education and quality infrastructure will be essential to reap the associated benefits.

Exposure to carbon transition risk varies by sector

We find that 16 sectors with nearly $5 trillion in Moody's rated debt face high credit exposure to policy, technology and market risks associated with the transition to a low-carbon economy. According to our proprietary carbon transition indicator (CTI) scores, electric utilities are the best positioned for a rapid transition to a low-carbon economy, while independent exploration and production (E&P), refining and marketing, and integrated oil companies are the most weakly positioned. The shift will also have wide-ranging effects on sovereigns' economic and fiscal strength.

Endnotes

1 We changed the outlook on the global auto industry's outlook from stable to negative in October because we expect lower light vehicle sales, especially in China, Europe and the US.

2 These risks include data-related risks, including safeguarding privacy, data accuracy and data protection; regulatory risks, operational risks, technology risks, governance risks and social risks like job losses arising from automation.

3 In April, we changed our outlook to negative from stable for three publicly traded business development companies (BDCs), which are already at the lowest investment grade rung, in large part reflecting potential losses on loans.

4 In December 2022, Blackstone was forced to put a limit on withdrawals from its Real Estate Income Trust (BREIT) after withdrawals breached monthly limits.

5 In Europe, producers are calling for new set of comprehensive tariffs to restrict the flow of subsidised, below-cost steel exports from markets like China. This follows a US decision to level a 25% duty on any steel coming from Mexico that had not been melted and poured in North America. India recently indicated that it was in talks to tackle rising steel imports.

6 Hydrogen producers want "made in Europe" criteria to protect the home industry as equipment from Chinese manufacturers costs less than half the price of those from domestic companies.

7 The Department of Justice (DOJ) said Visa prevented smaller rivals from gaining market share by using pricing structures like volume discounts and banning the use of competing networks. Visa also made agreements with companies like PayPal and Square that allegedly block their ability to compete and UnitedHealthcare.

8 In 2023, there were 28 individual disasters in the US that caused at least $1 billion in damage, compared to just 33 throughout the entire decade of the 1980s. According to Swiss Re, thunderstorms in the US last year cost a record $34 billion in insured losses in the first of the year.

9 Stricter immigration policies and fewer immigrants are likely to raise labour costs in sectors like construction and worsen labour shortages in other growing industries as baby boomers retire.

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