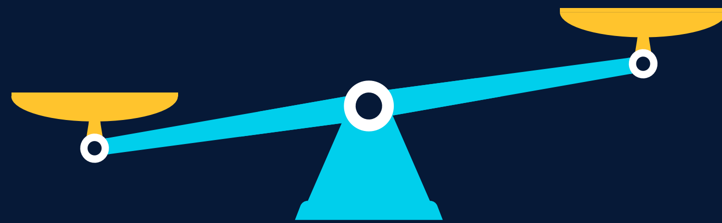
T.RowePrice

Tariffs create uneven outcomes, but they can also present opportunities



In the Loop

Key Insights

- Tariffs create uneven outcomes. Economically, more U.S. consumers and corporations are likely to be negatively impacted compared with the beneficiaries.
- Policy changes present opportunities for active managers. In fixed income markets, we see advantages in a globally diversified approach.
- We like shorter-duration bonds and cash over intermediate-term bonds and believe there are more opportunities in actively managed sub-investment-grade markets, both private and public. In private and public credit, we tend to favor larger companies with strong pricing power.

Jeff Helsing
Institutional Fixed Income Strategist

Blerina Uruçi
Chief U.S. Economist, TRPA

Cindy Huang
Public Credit Analyst, TRPA

Izzy Goncalves
Private Credit Product Specialist, OHA

Tariffs are taxes imposed by the federal government on imported goods and services and are paid by the domestic company or individual importing the goods. They are used to increase the relative cost of foreign goods and services and serve various purposes: generating revenue for the government, protecting domestic industries from foreign competition, and influencing trade policies.

In this Q&A—to better understand how tariffs create uneven outcomes in the U.S. fixed income markets—Institutional Fixed Income Strategist Jeff Helsing converses with Chief U.S. Economist Blerina Uruçi, Public Credit Analyst Cindy Huang, and Oak Hill Advisors L.P. (OHA) Private Credit Product Specialist Izzy Goncalves.

Jeff: Blerina, since 2020, we've observed a significant rise in the prices of goods and services. While tariffs increased to approximately 3% in 2018, primarily affecting Chinese imports, do you think the tariff policy announced on April 2—estimated to impact 15% to 20% of imports[1]—will result in higher inflation?

Blerina: Jeff, this is a question many clients are asking, and as I discussed in more detail in a previously published report, it depends. By definition, inflation is a persistent increase in the pace at which prices are adjusted. In contrast, a tariff is a one-time increase in the price level—not a sustained shift in the rate of inflation. After reviewing the proposed

[1] Source: The Budget Lab at Yale, as of 15 April, 2025. Estimate based on tariffs after the 90-day pause, inclusive of the 10% baseline. Estimates are for illustrative purposes only and actual outcomes may differ materially.

> … economic uncertainty associated with this substantial rise in tariff policy, among other considerations, is likely to raise the equity risk premium and steepen curves in U.S. Treasury markets.

– Blerina Uruçi
Chief U.S. Economist, TRPA

reciprocal tariffs, we estimate the net effect of tariffs is likely to be negative for the U.S. economy. Although the federal government and U.S. producers in protected industries stand to benefit from tariffs, U.S. companies and consumers are likely to pay the price. Exporting countries such as those in Asia, Europe, Mexico, and Canada may also see a decline in demand, which may result in lower interest rates and currency values. The resulting increase in economic uncertainty associated with this substantial rise in tariff policy, among other considerations, is likely to raise the equity risk premium and steepen curves in U.S. Treasury markets.

Jeff: Thanks, Blerina. In Q1 2025, there was a 4% decline in the S&P 500 and nearly a 10% decline in small-caps as represented by the Russell 2000 ahead of the April 2 tariff announcements. In addition, the U.S. dollar index declined by 4%, and the 10-year and two-year U.S. Treasury yields declined by roughly 36 basis points to 4.2% and 3.9%, respectively. While tariff policy isn't the only consideration, risk premiums and uncertainty rose, as your publication suggested. Izzy, price movements in private markets are slower and typically less pronounced. What are you and OHA's team of over 120 investment professionals globally seeing in private credit?

Izzy: Jeff, as you know, our process is driven by bottom-up opportunities and rigorous credit selection. Changes in government policies that create uneven outcomes can expand the opportunity to provide bespoke financing solutions to great companies facing balance sheet strains. As Blerina said, the rising uncertainty that impacted the equity risk premium typically makes the financing cost and complexity rise for the most leveraged companies. For example, if a leveraged buyout of a company was originally financed at a loan to value (LTV) of 50%, and the equity valuation multiple of the company declined by 25% near the time to refinance the debt, the current LTV would be closer to 67%, all else equal. Lenders may not be willing to refinance the company at the higher LTV. Other borrowers with capital structures created before the Fed started hiking rates in 2022 may

> Changes in government policies that create uneven outcomes can expand the opportunity to provide bespoke financing solutions to great companies facing balance sheet strains.

– Izzy Goncalves
Private Credit Product Specialist, OHA

have difficulty sustaining debt service if interest rates remain elevated. Well-positioned lenders can participate in restructurings of existing debt or liability management exercises that improve liquidity and/or reduce leverage for these borrowers and may generate premium spreads for investors.

At OHA, we focus on the upper end of middle market—or large-cap—borrowers. Policy changes that create uneven outcomes can expand alpha-generation opportunities in these segments.

Jeff: Appreciate the big-picture perspective on how equity market valuations impact the loan to values and credit premiums in private credit, Izzy. Let's dive into even more detail on industry impact. Cindy, as a credit research analyst covering the automotive industry, you are well-positioned to share insights based on your analysis and access to management of auto manufacturers, otherwise known as original equipment manufacturers (OEMs). Please share some perspective on what's been discussed.

Cindy: Thanks, Jeff. For background, I'm on the T. Rowe Price Associates, Inc., (TRPA) Fixed Income team focused on credit research for European auto manufacturers, but I recently coordinated with our equity research and my teammates that cover U.S. OEMs and auto suppliers, among others, to share insight on tariff policy and its potential impacts. While I expect the net impact on credit will be negative in aggregate for the largest issuers, it really depends on how willing consumers are to pay higher prices and any potential mitigating action OEMs are able to take. However, we expect lower margins for the sector from both the direct impact of the tariffs and second-order effects such as increased competition in Europe, as Asia-produced vehicles originally bound for the U.S. market are redirected into the European market. We also see volume risk for the sector. The latest S&P Mobility forecasts[2] point to flat global light vehicle production for 2025, but we see downside risk to these estimates following tariff announcements. A higher risk of global recession also raises volume risk in both the short and medium term.

> “While I expect the net impact on credit will be negative in aggregate for the largest issuers, it really depends on how willing consumers are to pay higher prices and any potential mitigating action OEMs are able to take.
>
> – Cindy Huang
> Public Credit Analyst, TRPA

The potential impacts by individual credits can vary greatly, but we view manufacturers with North America assembly and high North American content on vehicles sold into the U.S. as better positioned than those who assemble vehicles abroad or import significant parts. As such, we believe that the impact on the Detroit, Michigan-based manufacturers collectively, while negative, should be manageable, while Asian manufacturers will be worse hit.

[2] As of April 2, 2025.

On the other hand, there are some companies that supply parts where the higher relative cost of imported goods makes their products more competitive, so as you said, it creates uneven outcomes, and this is why independent bottom-up analysis can be additive for making investment decisions. While as lenders we don't expect this will meaningfully impact the ability for the companies to pay timely interest or make principal payments, it's helpful to have the insight from equity analysts because as long-term valuations of the company change, it can impact the costs of refinancing debt—which is important to credit analysts.

Jeff: It appears that the uneven impact of tariff policy tends to be more negative for issuers on average. However, increased clarity on tariffs could help reduce the uncertainty premium. As Blerina mentioned, a significant one-time increase in tariffs is unlikely to lead to a sustained shift in the rate of inflation. Nevertheless, the size and scope of the announcement on April 2 heighten the risk of a more substantial decline in investment and spending as private sector confidence wanes. Policy changes, including tariffs, underscore the potential need for a diversified and actively managed approach to global fixed income, equity markets, and private credit. The TRPA and OHA Fixed Income investment teams anticipate that intermediate- and longer-maturity yields will rise relative to shorter maturities in the U.S. They also see more opportunities in sub-investment-grade markets, both public and private, particularly in larger companies with pricing power over those that may struggle to pass on higher costs.

For definitions of financial terms refer to: https://www.troweprice.com/en/us/glossary

INVEST WITH CONFIDENCE®

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

This document reflects the views of the respective associates of T. Rowe Price Associates, Inc. (TRPA) and its investment advisory affiliate Oak Hill Advisors, L.P. (OHA). The views expressed in this material may differ from the views of other associates and/or T. Rowe Price group companies. TRPA and OHA have separate research platforms and make investment decisions independently. OHA, an alternative credit manager, is a T. Rowe Price company. TRPA and OHA are affiliated companies.

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are those of the authors as of April 16, 2025, and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation concerning investments, investment strategies, or account types, advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Please consider your own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. **Actual future outcomes may differ materially from any estimates or forward-looking statements provided.**

Past performance is not a guarantee or a reliable indicator of future results. All investments are subject to market risk, including the possible loss of principal. **International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. These risks are generally greater for investments in emerging markets. Fixed-income securities are subject to credit risk, liquidity risk, call risk, and interest-rate risk. As interest rates rise, bond prices generally fall.** All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc., distributor. T. Rowe Price Associates, Inc., investment adviser. T. Rowe Price Investment Services, Inc., and T. Rowe Price Associates, Inc., are affiliated companies.

ID0008113
202504-4407155