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# Perspectives on the impact of recent US tariffs across financial markets



**July 2025**

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**Impact of US tariffs on markets**


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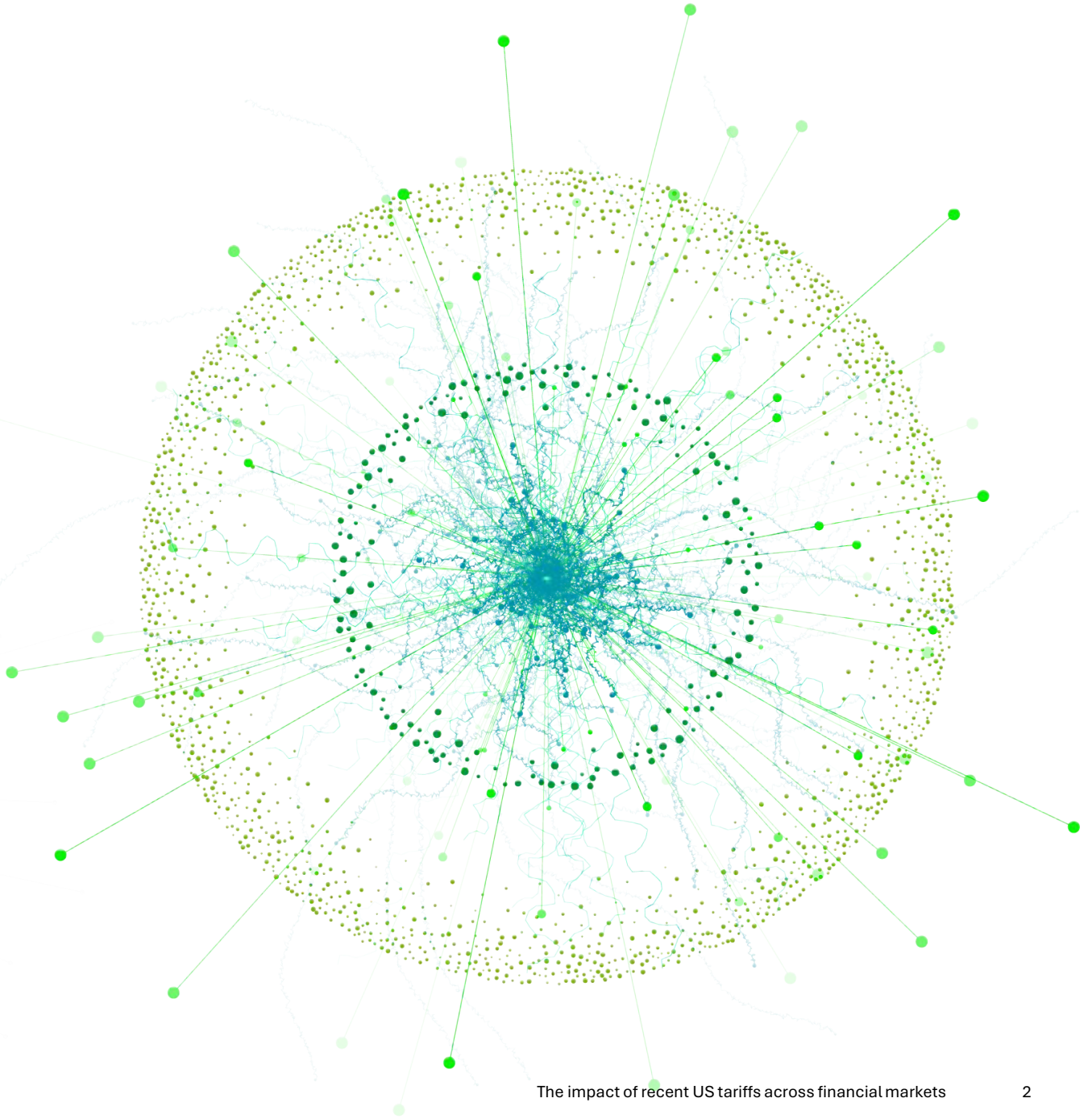

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# Impact on financial markets – Volatility and Derivatives

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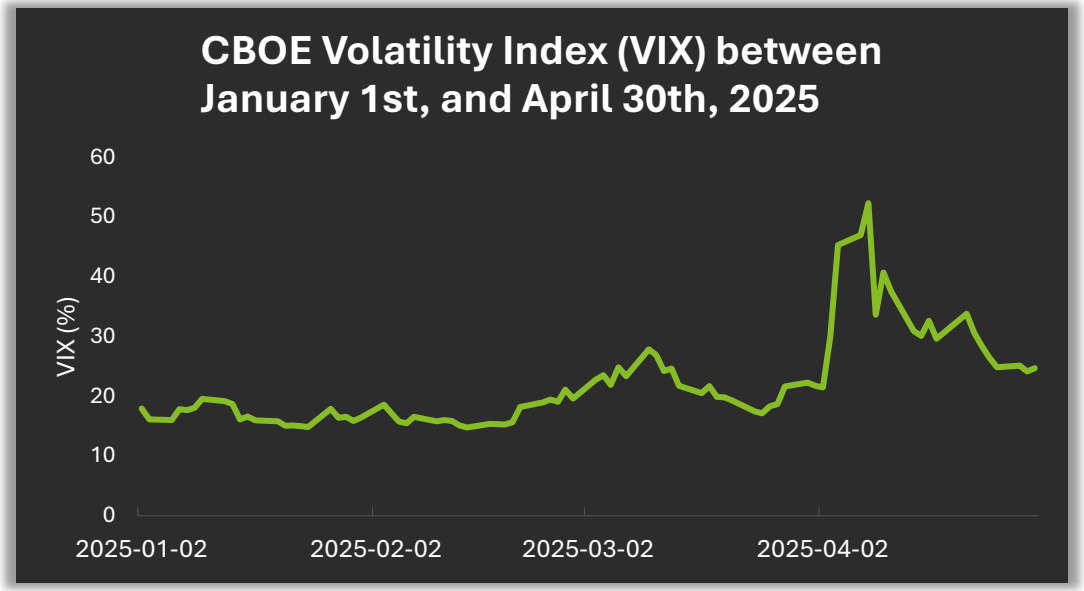
# Market Reaction to Trump's April Tariffs Announcement: Volatility Surge and S&P500 Decline

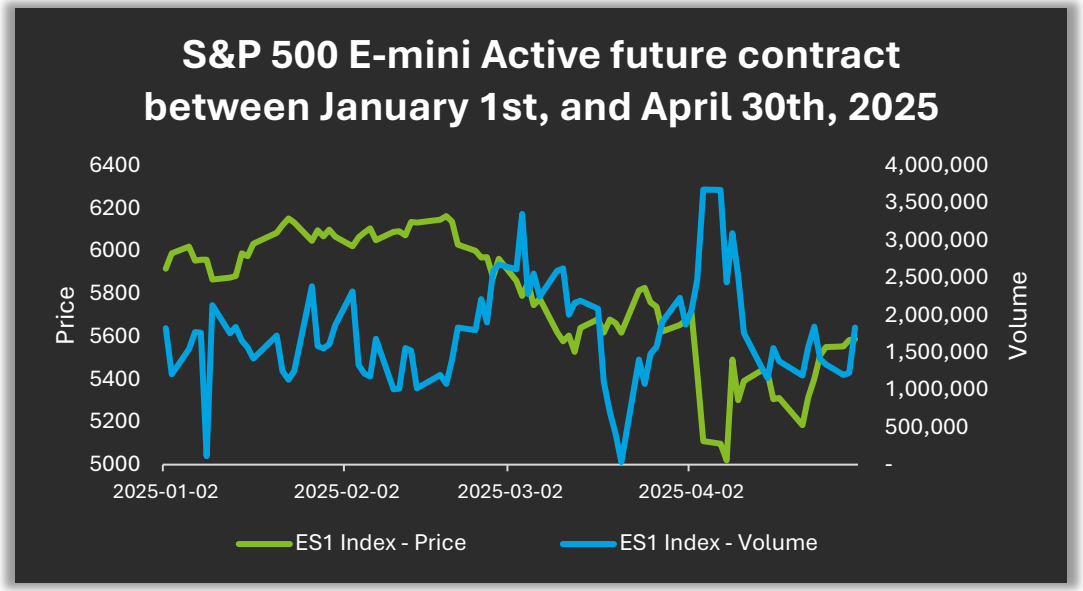
Following President Trump's April 2nd tariffs speech, market sentiment took a sharp turn, with the VIX spiking significantly and S&P 500 futures experiencing a notable decline, reflecting heightened uncertainty and investor concerns over potential trade disruptions.




Source: Deloitte analysis, Bloomberg

The sharp rise in the VIX, which nearly tripled between April 2nd and April 8th, signals a dramatic increase in market uncertainty and fear. It reflects heightened concerns among investors about potential economic disruptions from trade tensions.

For global equity markets, it often leads to a correction or a pullback in stock prices, as uncertainty about future economic conditions undermines investor confidence. The spike in the VIX could also suggest that global equities might experience heightened instability in the near term.




Source: Deloitte analysis, Bloomberg

S&P 500 e-mini futures decreased by more than 12% in a week following Trump's announcement, from 5,712 on April 2nd, to 5,020 on April 8th. This decline reflected fears of slowdown of global trade, and most importantly of a recession that would have spill over effects on global equity markets.

The volume of trading spiked right after the speech, as investors were adjusting their positions and signaling their concerns about the ongoing events.

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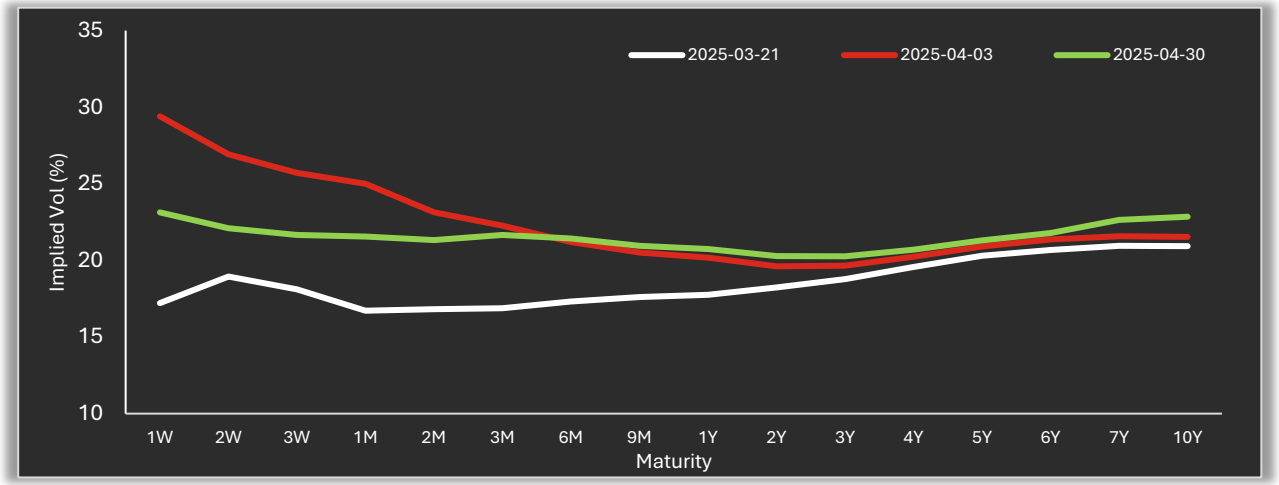
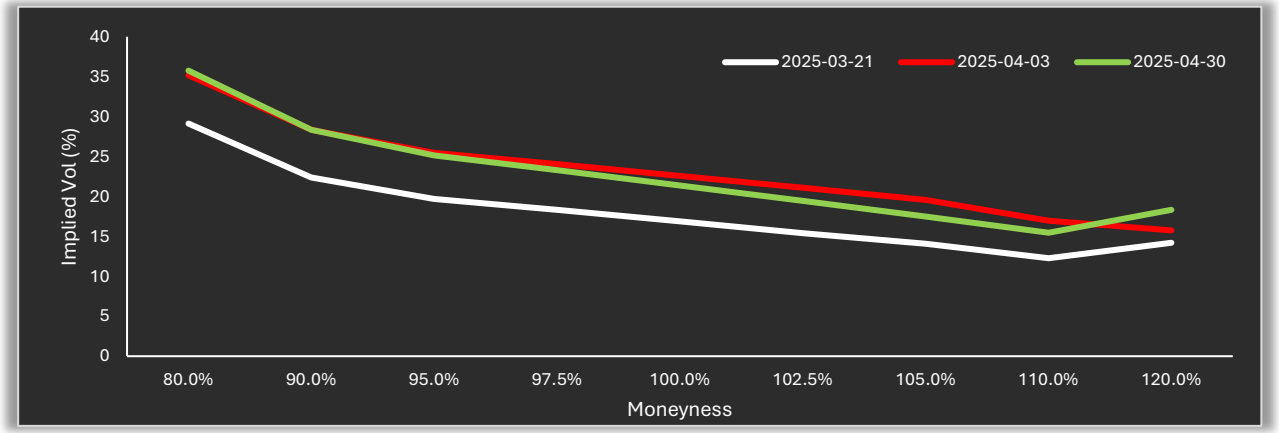
# Market Reaction to Trump's April Tariffs Announcement: Term Structure and Volatility Smile Analysis

In the wake of President Trump's April 2nd tariffs announcement, significant changes in the term structure of implied volatility and the volatility smile of S&P 500 options emerged, indicating increased investor apprehension and heightened fears of market disruptions.




Sources: Deloitte analysis, Bloomberg

## Term structure of the Implied Volatility on March 21st, April 3rd, and April 30th

Prior to the tariffs announcement, the term structure of implied volatility for ATM options on the S&P 500 was in contango, indicating that the market expected volatility to increase over time. However, following the announcement, the term structure shifted to backwardation, reflecting a sharp rise in short-term uncertainty as investors anticipated immediate market disruptions. As of April 30th, the term structure remains in backwardation, suggesting that elevated levels of uncertainty persist, with investors still wary of the potential for continued volatility in the near term.

## Volatility smile on March 21st, April 3rd, and April 30th

The volatility smile observed in option pricing experienced an upward shift, with implied volatility for ITM options rising significantly. On March 21st, the volatility smile bottomed at 10%, but by April 2nd, it had surged to nearly 25%. This increase across all strike prices made options more expensive, As a result, the cost of protection or hedging also rose, as investors priced in the likelihood of increased market volatility and potential disruptions.

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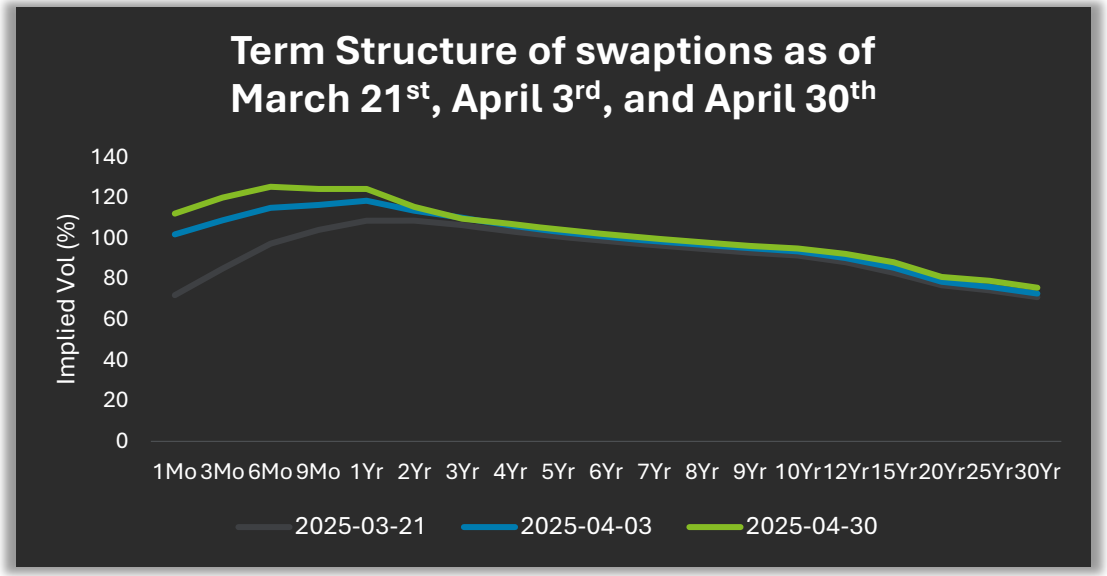
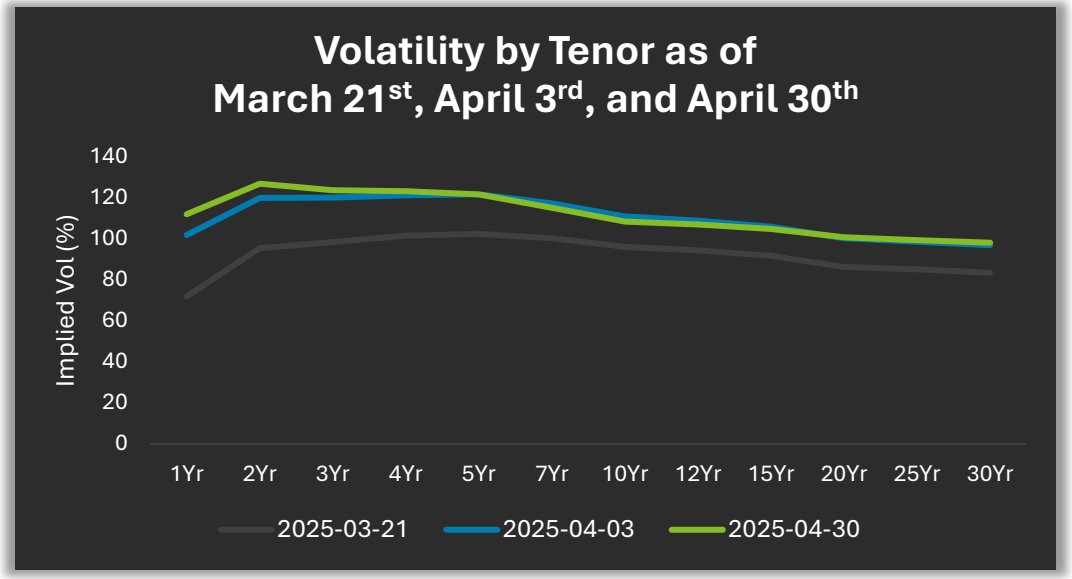
# Market Reaction to Trump's April Tariffs Announcement: Interest rate swaptions volatility analysis

The volatility of interest rate swaptions saw a significant increase. This shift highlights how the tariffs announcement raised expectations of potential changes in interest rate movements and economic conditions.




Source: Deloitte analysis, Bloomberg




Source: Deloitte analysis, Bloomberg

Following President Trump's tariffs, the term structure of implied volatility for interest rate swaptions experienced a significant upward shift, reflecting growing uncertainty in the markets. This increase in volatility indicates that investors are now expecting more immediate and broader economic impacts, which are likely to affect global fixed income markets.

With heightened uncertainty, market participants are pricing in the possibility of more aggressive or reactive actions from central banks, such as interest rate cuts or adjustments to monetary policy, in response to potential trade disruptions.

For global fixed income markets, this increased volatility means higher costs for hedging and protection, as investors seek to navigate a more uncertain environment. As central banks remain under pressure to respond to these shifting economic conditions, the market's response to any future policy changes will likely be more pronounced, further adding to volatility across global bond markets.

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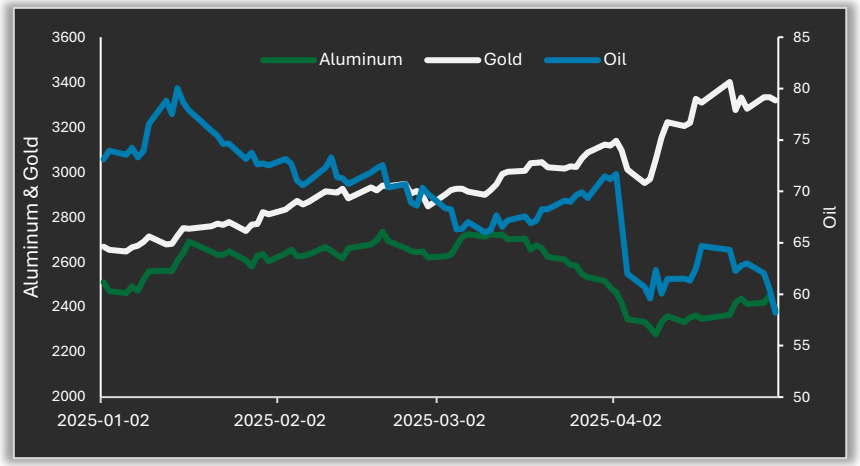
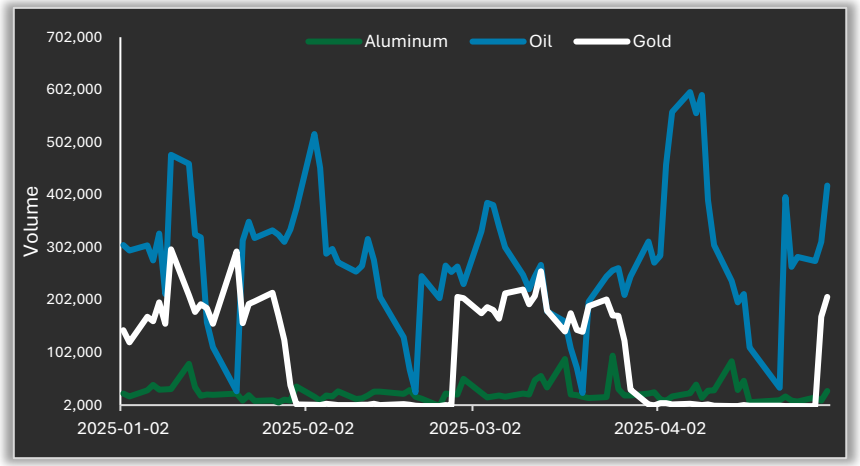
# Market Reaction to Trump's April Tariffs Announcement: Commodity Price/Volume analysis

The tariffs announcement by Trump led to a decline in commodity prices, accompanied by a surge in trading volumes as market participants adjusted to the anticipated economic impact




**Aluminum, Gold, and Oil <u>prices</u> between January 1st, and April 30th, 2025**

Prices of WTI Oil, Gold and Aluminum sharply declined following the announcement as investors adjusted to the changes in supply and demand, shifting their expectations and leading some to unwind their positions, triggering a sell-off and deeper price decline. Gold prices quickly bounced back as it is seen as a store of value in times of market stress.




**Aluminum, Gold, and Oil <u>volumes</u> between January 1st, and April 30th, 2025**

The volume in each commodity was relatively low prior to April 2nd, as investors were waiting on the news. As the tariffs were announcement, volume significantly increased as investors were adjusting their portfolio for rebalancing or hedging reasons for example.

The imposition of tariffs on key commodities often leads to sharp price movements, increasing overall market volatility. This volatility is further amplified when tariffs have the potential disrupt global supply chains or alter demand forecasts. As a result, hedging becomes more complex, with traditional strategies becoming less effective due to unpredictable, non-linear price behavior. Commodity producers and consumers have to restructure their hedging portfolios to adapt to these new risk dynamics.

Tariffs can also distort normal market functioning, leading to pricing discrepancies such as a widening basis between spot and futures prices, driven by inefficiencies and shifts in supply and demand.

Sources: Deloitte analysis, Bloomberg

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# Impact on financial markets – Private debts

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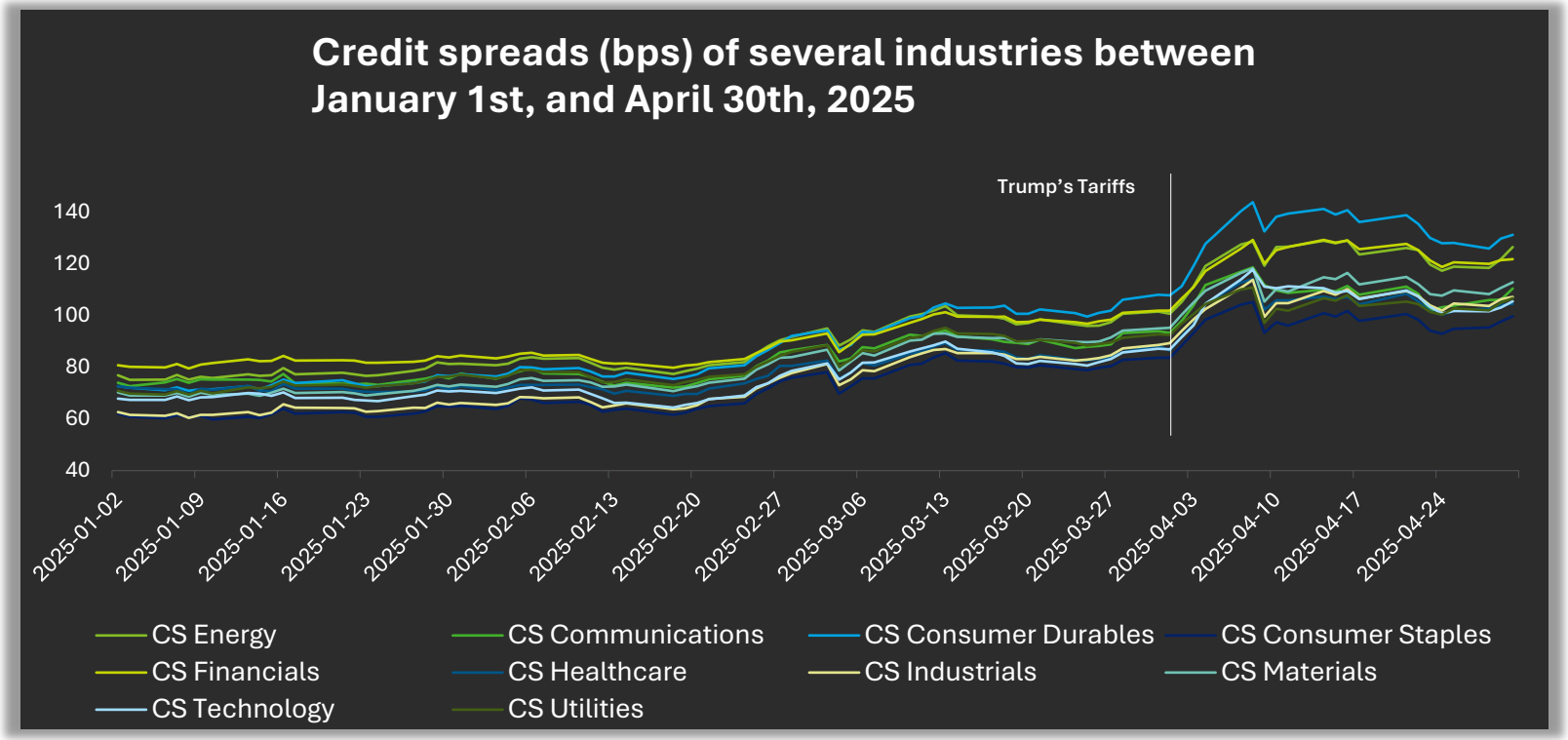
# Impact of Trump's April Tariffs Announcement: Private debts

The tariffs raised concerns about global trade tensions, leading to a reassessment of the creditworthiness of companies, particularly those heavily reliant on international trade.




Source: Deloitte analysis, Bloomberg

Following Trump's announcement, the credit spread of most sectors significantly went up, increasing by more than 50% for some. Industries with international supply chains (automotive, electronics) are the most impacted by tariffs, as they are facing increasing input costs and reduced revenue, leading to higher perceived credit risk from lenders, therefore increasing borrowing costs, and therefore reduced margins.

In turn, reduced margins could cause some covenant breaches, leading to technical defaults on some debt and triggering renegotiation of debt terms, higher interest rates on new borrowings, or more stringent covenant requirements in subsequent loan agreements.

In addition, reduced margins would increase debt restructuring – or even bankruptcy – for companies operating with high-leverage or with already thin margins. Therefore, an increase in debt buybacks at discounted prices, and pre-packaged bankruptcies where debt holders exchange debt for equity can be expected.

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# Case Study: Impact of Trump's Tariffs against China during his first term

During his first term, Trump imposed a series of tariffs starting in March 2018, with 25% on steel and 10% on aluminum on all countries. Following series of tariffs were targeted at China, raising tariffs on billions of dollars of imported goods.

## Compagnies default statistics in the US between 2001 and 2019

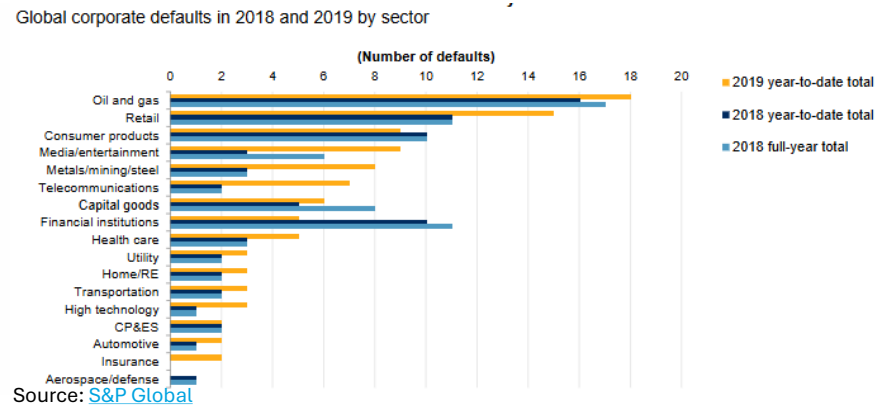
**U.S. Corporate Default Summary**

| | Total defaults* | Investment-grade defaults | Speculative-grade defaults | Default rate (%) | Investment-grade default rate (%) | Speculative-grade default rate (%) | Total debt defaulting (Bil. $) |
|---|---|---|---|---|---|---|---|
| 2001 | 172 | 6 | 134 | 4.59 | 0.34 | 10.63 | 100.91 |
| 2002 | 134 | 10 | 82 | 3.18 | 0.57 | 7.25 | 188.14 |
| 2003 | 89 | 0 | 65 | 2.32 | 0.00 | 5.60 | 42.68 |
| 2004 | 45 | 1 | 29 | 1.09 | 0.06 | 2.44 | 18.68 |
| 2005 | 33 | 1 | 26 | 0.95 | 0.06 | 2.02 | 42.04 |
| 2006 | 22 | 0 | 19 | 0.65 | 0.00 | 1.38 | 6.97 |
| 2007 | 18 | 0 | 15 | 0.50 | 0.00 | 1.02 | 7.02 |
| 2008 | 95 | 11 | 66 | 2.56 | 0.75 | 4.31 | 334.34 |
| 2009 | 195 | 5 | 166 | 6.01 | 0.35 | 11.81 | 516.08 |
| 2010 | 58 | 0 | 45 | 1.69 | 0.00 | 3.47 | 79.45 |
| 2011 | 39 | 1 | 30 | 1.12 | 0.07 | 2.16 | 74.30 |
| 2012 | 46 | 0 | 39 | 1.37 | 0.00 | 2.66 | 39.00 |
| 2013 | 45 | 0 | 34 | 1.16 | 0.00 | 2.19 | 64.85 |
| 2014 | 33 | 0 | 27 | 0.87 | 0.00 | 1.61 | 81.98 |
| 2015 | 66 | 0 | 52 | 1.58 | 0.00 | 2.86 | 85.90 |
| 2016 | 106 | 0 | 92 | 2.85 | 0.00 | 5.22 | 166.77 |
| 2017 | 64 | 0 | 54 | 1.70 | 0.00 | 3.09 | 70.70 |
| 2018 | 47 | 0 | 43 | 1.35 | 0.00 | 2.42 | 101.55 |
| 2019 | 78 | 2 | 59 | 1.85 | 0.14 | 3.11 | 147.88 |

Source: S&P Global

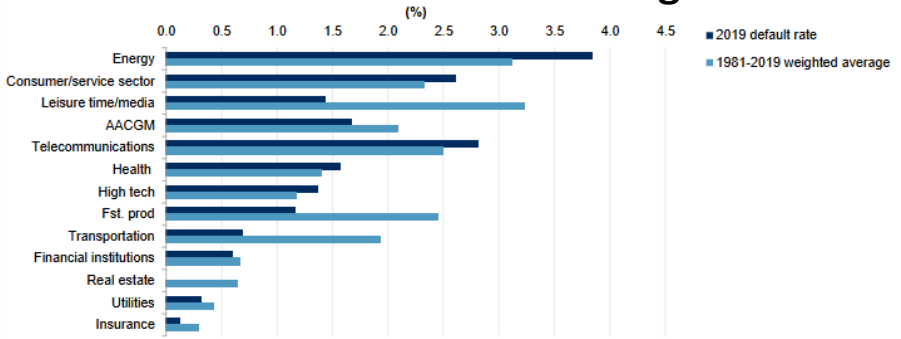
The number of defaults in 2019 reached the second highest level since the Great Financial Crisis of 2008-2009 because of the tariffs imposed by Donald Trump, triggering the first defaults of IG issuers since the crisis, and increasing the HY default rate by almost 30% YoY.

## Compagnies default statistics by sector in the US between 2018 and 2019




Source: S&P Global

## Global Corporate Default rates by Industry in 2019 vs 1981-2019 average




Source: S&P Global

Tariffs impact different sectors asymmetrically, with import/export intensive sectors being the most impacted by tariffs, as well as sectors with international supply chains. In 2019, the oil and gas was the most impacted as its default rate was more than 25% above its long-term average.

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# Impact on financial markets – Risk Management

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# Implications of Trump’s tariffs on risk management and portfolio construction

**Tariffs create another layer of geopolitical risk as firms have to navigate a more uncertain environment. A more in-depth analysis of country risk and of possible further tariff escalation is needed and has implications when it comes to portfolio construction.**

Tariffs are integrated into adverse macro scenarios, such as trade wars and supply chain disruptions, impacting key variables like GDP growth, inflation, interest rates, unemployment, and exchange rates. These variables feed into models for IFRS 9, CCAR, stress testing, and VaR frameworks.

The impact of tariffs can affect loan values, as changes in economic conditions influence borrowers' repayment capacity. Counterparty exposures may rise due to shifting credit risks. Margin and collateral requirements may also adjust to reflect the heightened risks.

Funds holding significant non-investment grade loans need to adjust their risk models and restructure portfolios to reduce exposure to potentially distressed borrowers, particularly those in sectors vulnerable to tariff impacts. As tariffs can strain companies with thin profit margins or heavy reliance on international trade, portfolio managers will reassess their credit exposure. Credit funds would be shifting away from export-oriented or low-margin sectors and increasing allocations to domestic, tariff-insulated industries. This diversification and sector rotation help mitigate risks and position portfolios for more stable returns amid tariff-related disruptions.

Dynamic asset allocation funds employ flexible, quantitative models that track changes in tariff policies and broader trade conditions in real time. These models analyze the potential impact of tariffs on various asset classes and markets, adjusting the portfolio’s exposure accordingly. By constantly evaluating the evolving economic landscape, the fund dynamically reallocates assets to manage risk and optimize returns. The fund’s allocations shift based on real-time data, responding to economic shifts and trade policy changes, ensuring that the portfolio remains aligned with evolving market risks and opportunities.

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# Conclusions

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## Indirect Impact on Terms and Valuation

Tariffs do not directly alter the contractual terms of derivatives or private debt, but they significantly reshape the environment in which these instruments are priced, valued, and traded.

## Macro and Credit Effects

By influencing macro-economic conditions and credit dynamics, tariffs can affect borrower fundamentals, increase credit risk, and shift key inputs in pricing and risk models.

## Increased Volatility and Uncertainty

Tariffs contribute to market volatility and financial instability, creating second-order effects that complicate hedging strategies and risk assessments for both derivatives and private debt.

## Access to Capital and Market Behavior

The broader financial impact of tariffs can restrict access to capital and alter investor behavior, indirectly affecting the demand, pricing, and structure of financial instruments.

**Our Financial Engineering & Modeling team can help**

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# Our field of play offers a 360 vision: we cover the full cycle of a model life

## Model Development

- Identification and selection of modeling methodology
- Design of implementation algorithm and code in developmental environment
- Testing and outcome analysis
- Benchmarking to alternative methodologies
- Creation of technical documents for model development to comply with requirements set by regulators as well as internal policies and guidelines

## Model Validation

- End-to-end model validation using leading industry best practices
- Validation procedures including assessment of data, model conceptual soundness, development testing and model performance testing, outcome analysis, independent benchmark, implementation testing and ongoing model monitoring

## Model Governance

- Develop and enhance enterprise model risk management framework, policies, standards, processes and procedures, model inventory systems, reporting and governance control
- Perform gap analysis on the model risk management framework
- Maintain and update model inventory

## Model Audit and Review

- Review of model development and validation documents
- Assessment of compliance to regulatory requirements and internal model risk management governance
- Production of review document including details of review process and findings/observations/ recommendations

## Valuation and Financial Modeling

- Independent valuation and advisory services for different types of financial instruments including structured products, loans, plain vanilla, and exotic derivatives
- Managed valuation services

## Investment Performance

- Advisory and verification services to help companies comply with the requirements of the Global Investment Performance Standards (GIPS)
- Evaluating their current state of readiness with the Standards, identifying where gaps exist and providing recommendations
- Assisting with performance-based compensation, investment benchmarks and investment performance systems implementation and controls testing

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# Our field of play offers a 360 vision: we cover a wide spectrum of risks

| | |
|---|---|
| **Financial Engineering** | Financial Instrument Pricing Model Advisory \| Managed Valuation Services for Financial Investments<br>Financial Reporting Assistance \| Pricing Model Assessment & Regulatory Standards Compliance<br>Advanced Financial Model Advisory \| Financial Modeling Automation \| Financial Instruments Valuation |
| **AI/ML Modeling** | Insurance Underwriting \| Responsible AI Guidance \| Model Benchmarking \| Performance Testing and Monitoring |
| Credit Risk | Regulatory Capital Models \| Stress-Testing, IFRS 9, ECL Models \| Retail Business Decision Making Models (incl. AI/ML) |
| Market Risk | Derivative Products Modeling \| Risk Measurement Models \| Regulatory Capital Models |
| Corporate Treasury | Regulatory Requirements \| Performance Management & Governance Oversight \| Business Opportunities & Strategic Analytics |
| Financial Crime Modeling | Sanction Screening Models \| Fraud Detection Models \| AML/AFT Models (Transaction Monitoring, Client Risk Rating) |
| Insurance Modeling | Pricing Models \| Valuation (Reserve) Models \| Asset Models \| IFRS17 Models \| Capital models |
| **GIPS** | GIPS Advisory \| GIPS Verification \| Performance Measurement \| Investment Benchmark \| Performance Based Compensation |

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