

Commentary

Supply Chain Is the Largest Source of Tariff Exposure for Middle Market Borrowers

Morningstar DBRS

June 19, 2025

Key Highlights

- We conclude that 63% of consumer or industrial issuers faces either moderate or high exposure to supply chain disruptions or inflation.
- On a regional basis, we observe that European issuers appear to have lower exposure to supply chain risk but slightly higher exposure to risk related to customer proximity.
- Our data indicate that 34% of issuers appear to face some degree of cyclical demand exposure, and another 19% are focused on products with discretionary demand.

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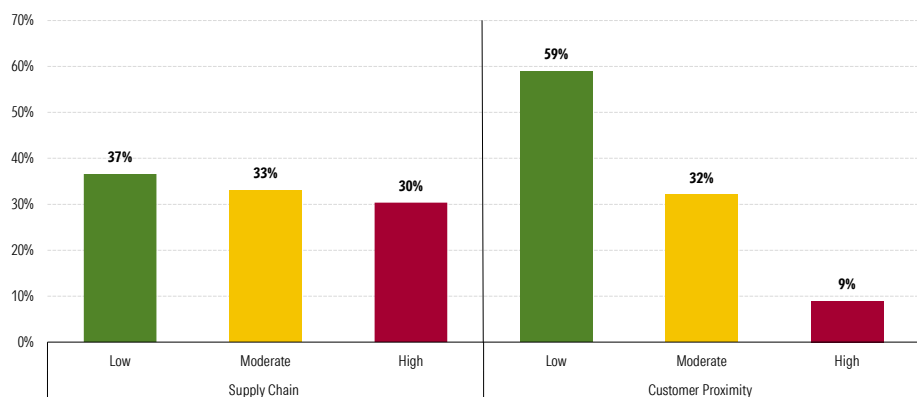
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Expanded Analysis Confirms Highest Exposure to Supply Chain Disruption

In the May 2025 edition of our *Leveraged Finance Spotlight*, we included an examination of the exposure of a group of lower-rated industrial and consumer sector middle-market issuers (holding ratings of B (low) or lower) to risk vectors driven by economic tariffs or other headwinds to global trade. In this commentary, we report the results of an expanded analysis, including an additional 72 consumer/industrial products issuers rated B or stronger to complement the original set of 40 lower-rated issuers. The combined group represents about 27% of all actively rated private issuers. We did not include service providers in this analysis as they are likely to be less directly affected by tariffs and trade policy.

We conclude that 63% of consumer or industrial issuers faces either moderate or high exposure to supply chain disruptions or inflation. Meanwhile, on the demand side, we observe 41% of the group as having moderate or high exposure to customer proximity risk (Exhibit 1).

Exhibit 1 Risk Skews Toward Supply Chain for Middle-Market Issuers



Source: Morningstar DBRS.

Our analysis is based on a qualitative assessment of each issuer to determine the level of exposure to two primary direct sources of tariffs and trade frictions: (1) the risk of price increases or volume disruption in supply chains for key materials and (2) disruption in customer demand or pricing patterns driven by higher structural costs of moving finished product across geographical boundaries for delivery to end customers (customer proximity). We believe the ultimate impact on demand will depend on a company's ability to pass on supply-side price increases to customers and on the elasticity of

How We Classify Our Private Credit Ratings

We provide different types of credit rating products to the private credit market, which we reference in our research. Our fundamental corporate credit ratings, which we provide for more than 425 middle-market issuers, are reviewed and refreshed at least once a year until the credit ratings are discontinued. We also provide point-in-time quantitative credit estimates for 1,500 entities, which serve as inputs into our analysis of collateralized loan obligations (CLOs). Credit estimates must be renewed annually by the end user. Finally, we also rate notes issued by CLOs and other corporate credit transaction structures. All methodologies and related criteria used to provide the products described above are available at <https://dbrs.morningstar.com>.

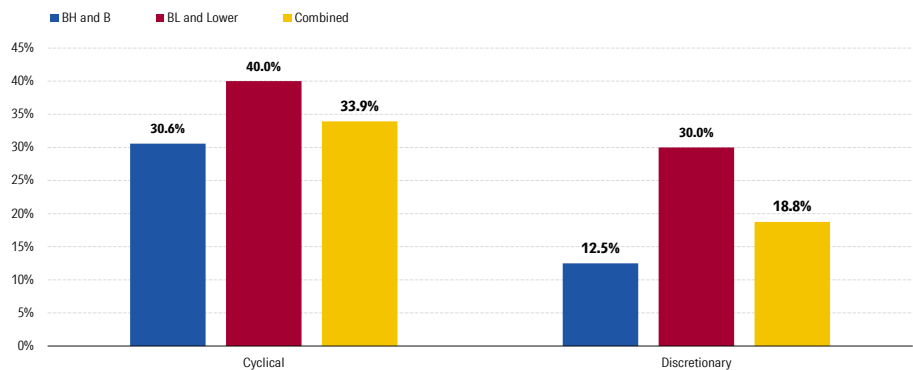
customer demand in response to changing macroeconomic conditions. To the latter, we also report on the mix of exposure to indirect risks on customer demand arising from cyclical or discretionary spending characteristics.

Our analysis indicates that supply chain risk is roughly balanced between the moderate and high categories (left side of Exhibit 1) across the group. The data also point to a generally higher mix of supply risk from China and greater southeast Asia. In contrast, only 9% of surveyed issuers indicate high risk with respect to the geographic proximity of production facilities to delivery locations for end-customer sales with another 32% that we assess as moderate (right side of Exhibit 1). We attribute the lower impact of this risk factor to the smaller size of middle-market issuers compared with global-footprint firms. An example of high risk for customer proximity would be a Eurozone manufacturer with a large proportion of sales volume from U.S. customers, which would be subject to tariffs. Conversely, U.S. manufacturers selling primarily to other U.S. companies would have lower risk to this factor by not having to ship finished products outside of the trade zone.

Europe Indicates Lower Supply Chain Risk but Higher Customer Proximity Risk

On a regional basis, we observe that European issuers appear to have lower exposure to supply chain risk but slightly higher exposure to risk related to customer proximity compared with the group of U.S. and Canadian issuers (Exhibit 2). We attribute higher European proximity risk to a higher proportion of issuers with a more diversified regional mix of sales, which may increase their exposure to cross-border trade frictions. For example, a European issuer with 80% of revenue coming from European customers and 20% from outside of Europe will be scored higher risk than a European issuer only selling to customers within the Eurozone.

Exhibit 2 Issuers With Moderate or High Risk Exposure by Region



Source: Morningstar DBRS.

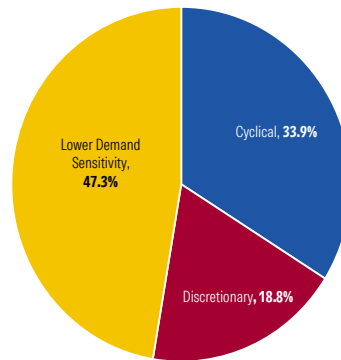
Trade Frictions May Also Indirectly Affect Customer Demand

In the previous section, we outlined risk profiles for direct sources of trade risk for middle market companies. However, we recognize that higher trade restrictions may create knock-on effects, contributing to an overall slowdown in macroeconomic conditions. This, in turn, may drive a reduction

in demand for issuers with either cyclical or discretionary customer demand characteristics. Our data indicate that 34% of surveyed issuers appear to face some degree of cyclical demand exposure (Exhibit 3). Cyclical demand for certain sectors rises and falls with economic strength, including automotive, construction, semiconductors, and electronics or industrial products.

Meanwhile, we observe another 19% of surveyed issuers are focused on products with discretionary demand (e.g., producing goods which are “nice-to-have,” but not “need to have”). Demand for discretionary products may be influenced by a propensity toward substitution (for luxury or premium products) or end-users deferring purchases of nonessential products.

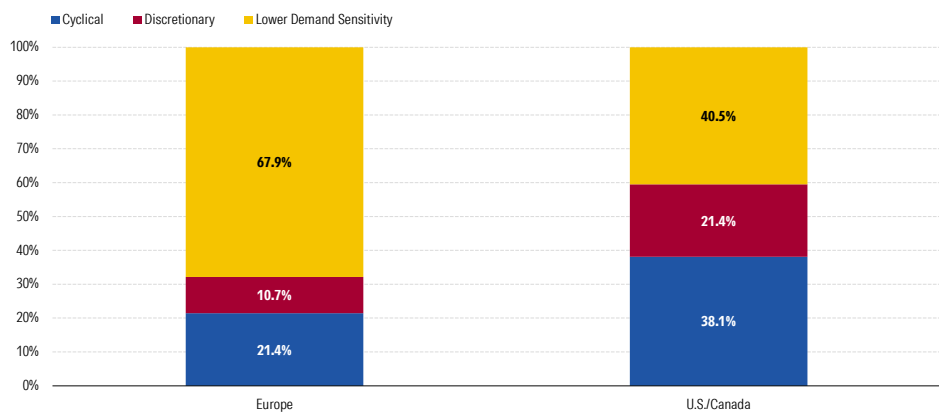
Exhibit 3 Many Issuers Are Also Exposed to Indirect Risk From an Economic Downturn



Source: Morningstar DBRS.

In Exhibit 4, we decompose the Exhibit 3 demand sensitivity data by geographic region. The data indicate a lower demand sensitivity for European issuers to either cyclical or discretionary effects when compared with the U.S./Canada. We attribute this to Europe’s higher mix of sectors with more stable demand, such as specialty engineered products, food processing, and staple consumer products.

Exhibit 4 Lower European Skew Toward Cyclical or Discretionary Exposure vs. U.S./Canada



Source: Morningstar DBRS.

Recent Morningstar DBRS Research Publications

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- [Quarterly Middle Market Credit Ratings Update: Downgrades Accelerate as Weak Borrowers Confront Challenges](#), May 6, 2025.
- [Trade Tariffs Will Weigh on European Structured Finance](#), April 8, 2025.
- [Prolonged U.S. Tariffs May Amplify Divergence in Middle Market Credit Quality](#), February 28, 2025.
- [Credit Estimate Snapshot: New Issue and Refreshed Credit Estimates in Q4 2024 Shatter Three-Year Record High](#), January 24, 2025.
- [Private Credit Outlook: Pace of Downgrades May Slow in 2025](#), December 12, 2024
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- [Morningstar DBRS Credit Estimate Snapshot: Q2 2024 Financial Metrics Deteriorate Modestly](#), August 23, 2024
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- [Credit Estimate Snapshot: Q1 2024 Credit Quality Holds, New Activity Rebounds Some](#), June 18, 2024
- [A Closer Look at Private Credit Covenant Relief](#), June 17, 2024.
- [First Quarter Private Credit Rating Activity Shows Diverging Trends](#), April 25, 2024
- [Private Credit 2024 Outlook: Negative Rating Actions Likely to Outpace Positive Actions](#), December 11, 2023

Leveraged Finance Spotlight

- [Leveraged Finance Spotlight: Corporate Outlook Still Cloudy Despite China - U.S. Trade Settlement](#), May 19, 2025.
- [Leveraged Finance Spotlight: Erratic Trade Policy Messaging Puts Markets on Edge](#), March 26, 2025.
- [Leveraged Finance Spotlight: Credit Risk Heavily Dependent on Economic Stability in 2025](#), January 30, 2025.

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