Global Sovereign Rating Trends Midyear 2020: Outlook Bias Turns Negative As Governments Pile On Debt To Face COVID-19

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Key Takeaways

- In response to the substantial drop in economic activity--as a result of measures put in place to slow the spread of coronavirus--governments globally have embarked on massive fiscal and monetary stimulus, which has resulted in a large accumulation of sovereign debt and expansion of central banks' balance sheets.
- While we expect the economic recovery will start in first-quarter 2021, the debt load on government balance sheets will remain high for several years to come.
- Since March 10, 2020, we have reviewed 117 sovereign ratings, or 87% of the total sovereigns we rate. We have affirmed ratings on almost 60% of the sovereigns we have reviewed, downgraded 18%, and revised outlooks to negative on 15%.
- Over the next six months, the global outlook balance for sovereign ratings is stable with a negative bias, with the number of expected downgrades surpassing expected upgrades by 24.

Rating Outlook And Trends

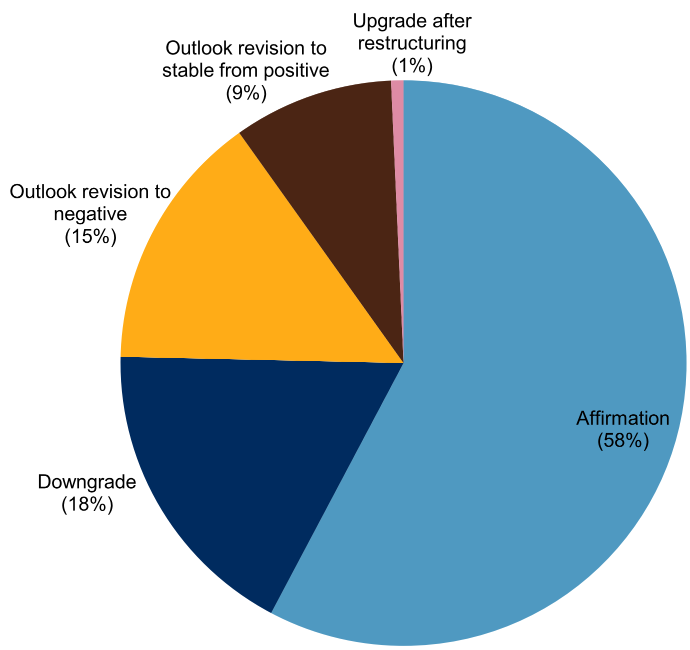
Since our last sovereign rating trends report, COVID-19 became a global pandemic that led to widespread stay-at-home orders in an effort to curb the spread of the virus. As businesses shut down, economic activity plummeted and unemployment started to soar to unprecedented levels. We expect the global economy will contract by 4% in 2020 before it starts recovering in 2021.

In response, governments globally have embarked on fiscal and monetary stimulus of unprecedented size that has helped mitigate the situation. However, it has also resulted in an even larger accumulation of sovereign debt and expansion of central banks' balance sheets to provide a financial bridge to the private sector. While we expect economic recovery will start in first-quarter 2021, the debt load on government balance sheets will remain high for several years to come. The sustainability of higher debt burdens will largely depend on the pace of the recovery and the level of real interest rates, which we expect will remain low.

Since March 10, 2020, we have reviewed 117 sovereign ratings, or 87% of our global portfolio. We affirmed ratings on almost 60% of the sovereigns we have reviewed, downgraded 18%, and revised outlooks to negative on 15% (see chart 1).

Chart 1

Sovereign Rating Actions Since March 10
Percent of total reviews



Source: S&P Global Ratings.

The most severe initial impact of the pandemic was in emerging markets, in countries with heavy reliance on one industry or commodity producers. In addition, they typically have a more limited capacity to exercise the countercyclical macroeconomic policies that many sovereigns in the developed world were able to implement.

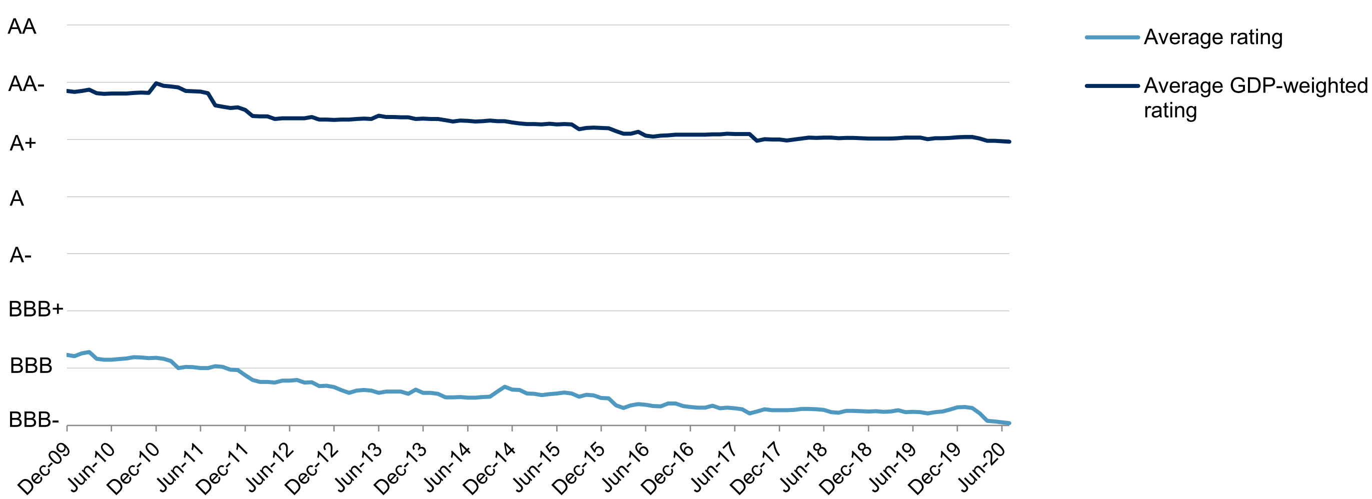
The future, however, could be different. In the developed world, as economies come out of lockdowns, we will be able to see more clearly whether some of the damage to economic structures is temporary or longer term. If the recovery for developed economies were to require a longer and larger-than-expected fiscal stimulus to continue supporting GDP growth, there could be downward pressure on some of those sovereign ratings. Conversely, emerging markets could benefit from a growing flow of funds searching for yield, as interest rates in the developed world will likely remain very low or even negative for a longer period.

Sovereign Ratings Outlook Second-Half 2020: Downgrades Are Expected To Surpass Upgrades

S&P Global Ratings rates 135 sovereigns globally (see charts 2 and 3). Looking into the next six months, the global outlook balance for sovereign ratings is stable with a negative bias, with the number of expected downgrades surpassing expected upgrades by 24 (see chart 4).

Chart 2

Global Sovereign Rating History*



*Updated to July 28, 2020.

Chart 3

Global Sovereign Ratings Distribution

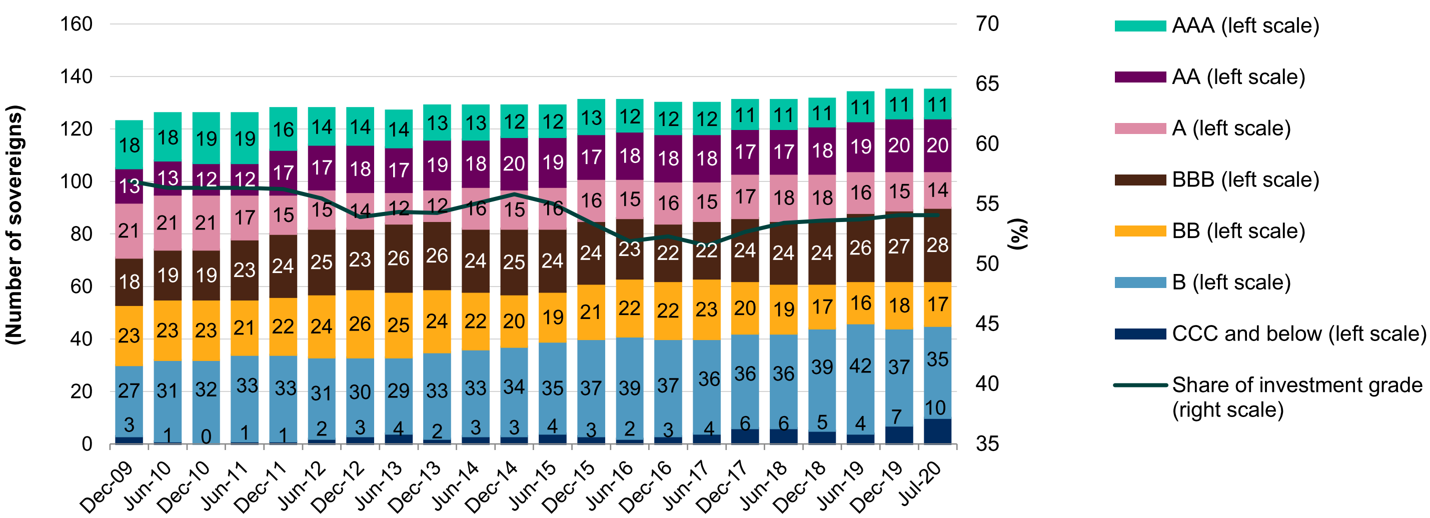
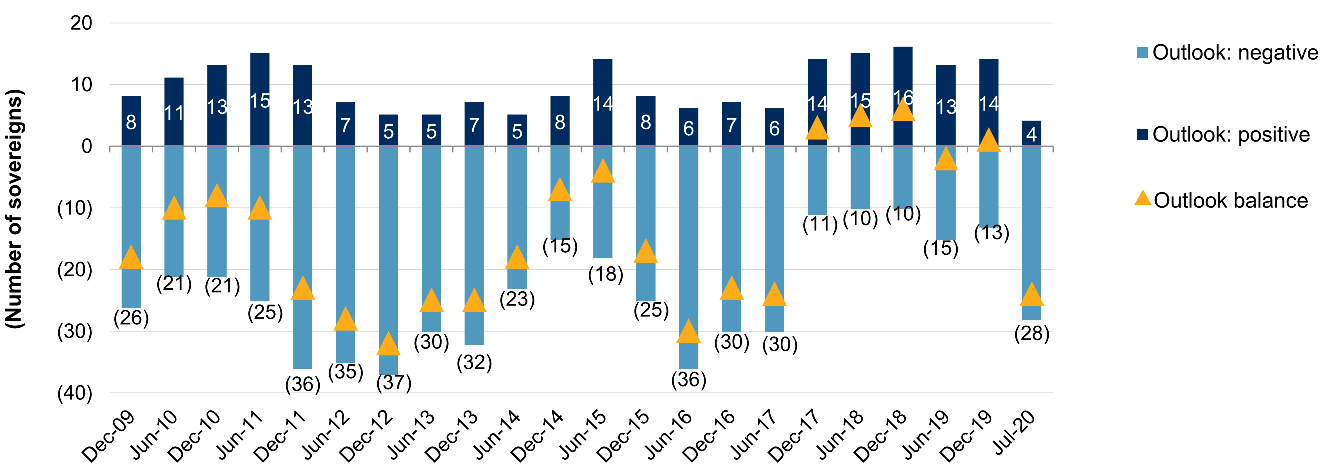


Chart 4

Global Sovereign Ratings Outlook Balance



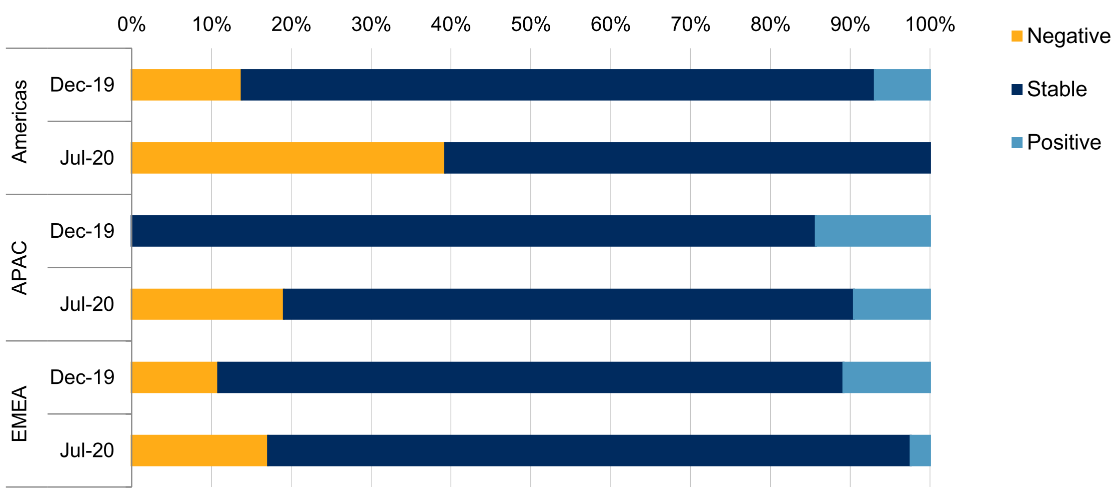
Over the next six months, and as the pandemic continues forcing economies to come in and out of lockdowns, negative pressures will remain high. Lower-rated sovereigns and economies that were already struggling to grow before the pandemic will remain at risk. And so will the economies where lockdowns will have more permanent effects, like those heavily dependent on tourism or other types of retail services.

Regional Outlooks

- Regionally (see chart 5), trends among sovereigns in Latin America, Africa, and the Middle East suggest that pressures to the downside will remain during the next six to eight months.
- Ratings on the eurozone's sovereigns remain mostly stable on the back of the extraordinary support provided by the ECB and, going forward, on the recently agreed upon EU recovery fund.
- In Asia-Pacific, the majority of the sovereign ratings have stable outlooks, though the number of negative outlooks has increased to four from none at the beginning of the year.

Chart 5

Outlooks And CreditWatches By Region



Source: S&P Global Ratings.

Sovereigns With Positive Or Negative Outlooks Or CreditWatch Placement July 28, 2020

Positive	Negative
EMEA	
Congo (DRC)	Congo-Brazzaville
Estonia	Ethiopia
	Ghana
	Italy
	Kenya
	Kuwait

Sovereigns With Positive Or Negative Outlooks Or CreditWatch Placement July 28, 2020 (cont.)

Positive	Negative
	Montenegro
	Oman
	Ras Al Khaimah
	Romania
	Slovakia
	Sharjah
	Uzbekistan
	Zambia
Americas	
	Aruba
	Bahamas
	Belize*
	Chile
	Colombia
	Costa Rica
	Curacao
	Dominican Republic
	Jamaica
	Mexico
	Panama
Asia-Pacific	
Cook Islands	Australia
New Zealand	Fiji
	Indonesia
	Malaysia

*Belize currently is on CreditWatch negative.

Europe, the Middle East, and Africa (EMEA)

Developed Europe

Most of the outlooks on the 30 European developed sovereigns we rate are stable, with just one positive outlook (Estonia) and one negative outlook (Italy).

We think that these governments' willingness and ability to service their debt on time and in full depends more on their monetary flexibility, external positions, and economic resilience than it does on their public debt-to-GDP ratios at any particular point in time. We also think it is too early to determine what the pandemic implies for economies' post-pandemic productive capacity, and the willingness of elected authorities to introduce growth-enhancing reforms.

Sovereign creditworthiness in the region now depends on the pace of economic recovery, which, in turn, depends on the evolution of the pandemic. Also key will be governments' ability to gradually repair their balance sheets in tandem with the policy decisions of monetary authorities. Monetary authorities' actions have so far been fundamental in providing a potent response to the economic shock and have prevented an erosion in sovereign creditworthiness, particularly for sovereigns with high amounts of government debt.

If, as we expect, governments are able to channel their resources such that economic activity picks up and recovers the ground it will lose this year, we should see many of our ratings remain at the current levels in 2021-2022. Conversely, if the pandemic persists, demanding additional stimulus amid lower-for-longer economic growth, we could see the pressure on sovereign creditworthiness mount.

Emerging EMEA

For emerging market EMEA sovereigns, negative outlooks exceed positive outlooks by nine, versus year-end 2019, when negative outlooks exceeded positive by one. Also, we have downgraded four sub-Saharan African sovereigns earlier this year, leading to changes in their negative outlooks to stable (Angola and Nigeria in March, and Cameroon and South Africa in April), alongside the downgrade of Lebanon to 'SD' in March.

Sub-Saharan Africa is the region with the lowest median sovereign rating globally. It came into 2020 with, on average, high public debt, weak tax administration, concentrated economies, commodity exposures, open foreign currency positions, and elevated interest rate burdens (as a percentage of tax receipts). In light of these challenges, one-quarter of rated sovereigns in sub-Saharan Africa had negative outlooks as early as February of this year. This highlights their vulnerability to the COVID-19 shock and the downside risk on the sovereign ratings in the region that we expect to remain over the next six to eight months.

In the Middle East and North Africa (MENA) region, this year's steep drop in oil prices once again highlighted the overwhelming fiscal, GDP, and external dependency of the Mideast on oil receipts, alongside the social challenges to managing populations' economic expectations accordingly. Offsetting high liabilities, the Gulf sovereigns continued to manage the world's largest stock of fiscal reserve assets via their sovereign wealth funds. Nevertheless, at current oil prices, no major GCC (Gulf Cooperation Council) energy producer would run a budgetary surplus (excluding investment income), though Qatar comes close. Only the UAE still run current account surpluses at prices of around $42, according to IMF estimates.

During the first half of 2020, the net balance of negative outlooks in MENA declined from negative one to negative three (Oman continues to have a negative outlook, and the outlooks on two Emirates, Ras Al Khaimah and Sharjah, were revised to negative). We also lowered the ratings on Kuwait, Lebanon, Oman, and Sharjah.

Central and Eastern Europe and the Commonwealth of Independent States (CEE/CIS) faced the pandemic from a stronger position than the average emerging market economy. Over the last few years before COVID-19 hit, this region saw a period of strong economic growth that contributed to private-sector deleveraging as well as fiscal and external rebalancing. Over the next six to eight months, we expect the ratings in the region to remain fairly stable.

Asia-Pacific

The outlook balance for Asia-Pacific (APAC) heading into the second half of 2020 has turned negative on the back of the economic shock the pandemic has generated. As of July 15, 2020, there are four governments with negative outlooks (Australia, Fiji, Indonesia, and Malaysia), 15 Asia-Pacific sovereign ratings with stable outlooks, and two with positive outlooks (New Zealand and Cook Islands).

Like for most of the sovereigns we rate, COVID-19 continues to be the key uncertainty for APAC sovereign ratings over the next few months. After large increases in 2020, we see general government deficits across APAC sovereigns shrinking markedly in 2021. However, improvements may be significantly less than we expect in countries that continue to struggle with high infection rates well into 2021.

China. China's economic recovery is holding up, after real GDP growth rebounded above 3% in the second quarter, sparking optimism in Chinese asset markets, with real estate and stock prices rebounding.

That said, the geopolitical environment continues to complicate Chinese efforts to balance risk and growth. Most analysts expect U.S.-China relations to remain tense in the foreseeable future. The U.S. government is expected to show a tough stance against China--especially in the run-up to the U.S. presidential election in November. We do not expect potential U.S. measures to seriously affect the Chinese economy. The risk, however, is that the Chinese government may react in a forceful manner that could derail investor confidence and hurt its growth prospects.

Hong Kong. The situation in Hong Kong remains unpredictable in 2020. It is here that the U.S.-China tensions are playing out. Implementing economic sanctions on Hong Kong is a highly visible way for the U.S. to show firm actions against China. Yet, it avoids the risks of triggering a military conflict that a more aggressive stance in the South China Sea could bring. Going forward, we will continue to closely monitor the performance of the economy in Hong Kong.

Americas

U.S. and Canada. We expect continuity in recent economic measures in the U.S. aimed at mitigating the effects of the pandemic, regardless of the election outcome. The U.S. dollar's status as the world's premier reserve currency, and the size and depth of the U.S. financial market, should sustain policy flexibility, giving scope for the government to manage its recently higher debt burden.

We expect a deterioration in fiscal and debt metrics in Canada because of the size of the government's unprecedented stimulus policy. However, Canada's public finances were well-positioned entering the pandemic to enable a strong policy response to contain the negative impact without deteriorating sovereign creditworthiness, despite a substantial rise in the government's debt burden.

Latin America and the Caribbean. We have taken more negative sovereign rating actions in this region than in the world as a whole since the outbreak of the global pandemic, demonstrating the comparatively bigger impact of the downturn in Latin America and the Caribbean.

The majority of our recent negative rating actions on a global basis have been on speculative-grade sovereigns, and mainly in emerging markets. Most sovereigns in Latin America and the Caribbean fit into those two categories. However, the recent sovereign defaults in the region have not all been caused by the pandemic. Both Venezuela and Argentina had defaulted before the outbreak of the pandemic, and Ecuador and Suriname had very low ratings prior to the pandemic.

Related Research

- What The EU Recovery Fund Breakthrough Could Mean For Eurozone Sovereign Ratings, July 22, 2020
- Sovereign Risk Indicators, July 14, 2020 (https://www.spratings.com/sri/)
- Sovereign Ratings Score Snapshot, July 7, 2020
- The G20 External Interest Payments Moratorium Will Partly Ease African Sovereign Debt Service Burdens, June 24, 2020
- IMF Lending And Sovereign Ratings, May 28, 2020
- COVID-19 And Implications Of Temporary Debt Moratoriums For Rated African Sovereigns April 29, 2020
- Sovereign Ratings And The Effects Of The COVID-19 Pandemic, April 16, 2020
- Global Sovereign Rating Trends 2020: Sovereign Debt Buildup Continues, Jan. 29, 2020

This report does not constitute a rating action.

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