SCOPE Scope Ratings

June 2021 Sovereign Interim Outlook

A robust yet uneven global recovery continues, with diverging sovereign ratings implications

Sovereign and Public Sector, Scope Ratings GmbH, 17 June 2021

info@scoperatings.com | www.scoperatings.com

Executive summary

The global economy is expected to grow by **around 6%** in 2021, modestly stronger than the **5.4%** growth in our December 2020 projections. We see **4.4%** global growth in 2022. However, even as the crisis slowly recedes over 2021-22, the impact of the pandemic leaves behind much higher government debt and deficits with diverging ratings implications. We summarise projections for major economies in **Figure 1**, with full forecasts on the **next page**.

Economic assumptions (global baseline scenario):

The economic rebound continues after gaining strength in the spring. Accommodative monetary and fiscal policy is supporting growth as is the roll-out of vaccines that has accelerated across many countries – which should present greater sustainability to economic reopenings. However, unequal vaccine availability means noticeable gaps are retained between sustainability of recovery of advanced versus emerging economies. Even in the developed world, full economic normalisation remains vulnerable to setbacks as some segments of the population stay unvaccinated, while more transmissible virus variants present risks of increases in cases. Governments' plans to phase out extraordinary support could lay bare the problems of unemployment and corporate insolvencies. Fresh re-introduction of targeted economic restriction is likely as cases re-rise with reopening, although we do not anticipate the same scale of restriction moving ahead compared with lockdowns of 2020. Output in the US returns to 2019 levels in 2021, with the UK and EU aggregate achieving this by 2022.

A central risk to Scope's economic baseline is a further substantive tightening of global financial conditions, in the form of higher long-term treasury yields, a significant correction in bubbly global equity markets and/or depreciation of exchange rates. This could be a result of a more significant "taper tantrum" in which inflation returns more dramatically or for longer than currently foreseen by global central banks, forcing behind-the-curve adjustments in policy setting and signalling. Such an adverse scenario could test economies, particularly in emerging markets, which have accrued debt and are struggling with fragile recoveries.

Sovereign rating outlook:

Even as the recovery gains traction, the legacy of the Covid-19 crisis includes much higher government debt and structurally wider budget deficits reflecting the shift in fiscal orthodoxy as governments have turned their backs on austerity, which was the default to differing degrees after the Global Financial Crisis. While structurally weakened government balance sheets are credit negative, intervention by central banks – especially the G4 central banks – have supported continued low rates and enhanced lender of last resort functions. In Europe, the crisis has seen further institutional advancement via EU Recovery Fund and joint EU debt issuance. In emerging economies, the crisis has held greater net negative consequences for sovereign risk as governments' balance sheets have weakened without domestic central banks being able to provide commensurate monetary support. Since the crisis started, Scope has downgraded two sovereign issuers of the 36 credits it rates (Turkey, Belgium), while upgrading two (Lithuania, Ireland) (**Annex II**). Meanwhile, eight issuers are on Negative Outlook (three EU member states, and five non-EU) with one issuer on Positive Outlook (Greece). Scope's scheduled sovereign review dates for the remainder of 2021 are summarised under **Annex III**.

Figure 1: Scope's growth forecasts, summary, as of 17 June 2021

Country/region	Real GDP growth (%)				
	Baseline scenario				Medium-run potential
	2020	2021F	Diff. from Dec.*	2022F	
Euro area	(6.7)	4.7	↓ 0.9	4.2	1.4
Germany	(5.1)	3.5	↓ 0.6	4.6	1.1
France	(8.0)	5.0	↓ 2.0	4.0	1.4
Italy	(8.9)	5.6	-	3.8	0.7
Spain	(10.8)	6.0	-	5.0	1.5
United Kingdom	(9.8)	6.6	-	5.4	1.5
Russia	(3.0)	3.0	↑ 0.5	2.7	1.5-2.0
Turkey	1.8	8.0	↑ 1.8	4.0	3.9
United States	(3.5)	6.2	↑ 2.2	4.8	1.9
China	2.3	9.3	↓ 0.6	5.4	5.0
Japan	(4.7)	3.0	-	2.1	0.5
World	(3.3)	6.0	↑ 0.6	4.4	2.9

*Changes compared with December 2020's 2021 Sovereign Outlook forecasts.
Negative growth rates presented in parentheses. Source: Scope Ratings GmbH forecasts, regional and national statistical offices, IMF.

Global macro-economic outlook, 2021-22

Country/region	Real GDP growth (annual average, %)						Policy rates (EOP, %)			
	2019	2020E	2021F	Diff. from Dec.[1]	2022F	Medium-run potential	End-2019	End-2020	End-2021	End-2022
Euro area[2]	1.3	(6.7)	4.7	↓ 0.9	4.2	1.4	(0.5)	(0.5)	(0.5)	(0.5)
Germany	0.6	(5.1)	3.5	↓ 0.6	4.6	1.1				
France	1.8	(8.0)	5.0	↓ 2.0	4.0	1.4				
Italy	0.3	(8.9)	5.6	-	3.8	0.7				
Spain	2.0	(10.8)	6.0	-	5.0	1.5				
Netherlands	1.6	(3.7)	4.0	↑ 0.8	3.1	1.4				
Belgium	1.8	(6.3)	4.1	↓ 1.4	3.5	1.3				
Austria	1.4	(6.4)	4.5	-	4.2	1.6				
Ireland	5.9	2.5	9.0	n/a	4.0	4.0				
Finland	1.3	(2.7)	2.5	n/a	2.5	1.2				
Portugal	2.5	(7.6)	3.8	↓ 1.2	5.0	1.5				
Greece	1.7	(7.8)	6.5	↑ 2.0	3.6	1.0				
Western Europe ex-euro area										
United Kingdom	1.4	(9.8)	6.6	-	5.4	1.5	0.75	0.10	0.10	0.25
Switzerland	1.1	(2.7)	3.5	-	2.5	1.3	(0.75)	(0.75)	(0.75)	(0.75)
Sweden	2.0	(2.9)	3.0	n/a	2.7	1.8	(0.25)	0.00	0.00	0.25
Norway	0.9	(1.3)	3.6	n/a	3.5	1.5-2.0	1.50	0.00	0.25	1.00
Denmark	2.8	(2.7)	2.1	n/a	3.8	1.2	(0.75)	(0.60)	(0.50)	(0.50)
Central and eastern Europe										
Poland	4.8	(2.7)	4.9	↑ 1.4	4.5	2.5	1.50	0.10	0.10	0.50
Russia	2.0	(3.0)	3.0	↑ 0.5	2.7	1.5-2.0	6.25	4.25	6.00	5.50
Turkey	0.9	1.8	8.0	↑ 1.8	4.0	3.9	12.0	17.0	16.0	14.0
Rest of World										
United States	2.2	(3.5)	6.2	↑ 2.2	4.8	1.9	1.50-1.75	0-0.25	0-0.25	0-0.25
China[3]	6.0	2.3	9.3	↓ 0.6	5.4	5.0	4.15	3.85	3.95	4.05
Japan[4]	0.0	(4.7)	3.0	-	2.1	0.5	(0.1)	(0.1)	(0.1)	(0.1)
World	2.8	(3.3)	6.0	↑ 0.6	4.4	2.9				

Country/region	Unemployment rate[5] (annual average, %)				General government balance (% of GDP)				Public debt level (% of GDP)			
	2019	2020E	2021F	2022F	2019	2020E	2021F	2022F	2019	2020E	2021F	2026F
Euro area	7.6	8.0	8.3	7.7	(0.6)	(7.2)	(7.9)	(4.4)	86	100	101	98
Germany	3.1	4.2	3.9	3.1	1.5	(4.2)	(7.0)	(2.5)	60	70	72	63
France	8.5	8.1	9.1	9.2	(3.1)	(9.2)	(9.0)	(5.5)	98	116	118	121
Italy	10.0	9.3	10.8	9.3	(1.6)	(9.5)	(11.7)	(7.1)	135	156	158	162
Spain	14.1	15.6	16.0	15.0	(2.9)	(11.0)	(8.5)	(6.0)	96	120	121	120
Netherlands	3.4	3.8	3.4	3.6	1.8	(4.3)	(5.0)	(2.7)	49	55	56	53
Belgium	5.4	5.6	6.8	6.6	(1.9)	(9.4)	(7.6)	(4.8)	98	114	116	120
Austria	4.5	5.3	5.5	5.0	0.6	(8.9)	(7.6)	(4.4)	71	84	88	79
Ireland	5.0	5.6	5.6	5.0	0.5	(5.0)	(5.4)	(2.8)	57	60	60	49
Finland	6.7	7.8	8.5	8.0	(0.9)	(5.4)	(4.5)	(3.4)	60	69	71	76
Portugal	6.7	7.1	7.3	6.8	0.1	(5.7)	(4.8)	(3.5)	117	134	132	115
Greece	17.3	16.5	16.1	16.1	1.1	(9.7)	(8.9)	(5.0)	181	206	208	188
Western Europe ex-euro area												
United Kingdom	3.9	4.6	4.6	4.0	(2.3)	(13.4)	(11.4)	(6.1)	85	104	106	112
Switzerland	2.3	3.2	5.1	5.4	1.4	(2.6)	(3.4)	(0.7)	40	43	45	41
Sweden	6.8	8.3	8.7	8.4	0.6	(3.1)	(4.3)	(1.0)	35	40	42	35
Norway	3.7	4.6	4.0	3.7	6.6	(3.4)	0.7	1.4	40	46	41	40
Denmark	5.0	5.6	5.6	5.5	3.8	(1.1)	(3.3)	(1.0)	33	42	43	45
Central and eastern Europe												
Poland	3.3	3.2	3.4	3.6	(0.7)	(7.0)	(4.5)	(3.4)	46	58	56	57
Russia	4.6	5.9	5.4	4.9	1.9	(4.0)	(2.5)	(1.5)	14	19	20	20
Turkey	13.7	13.2	13.6	13.5	(5.6)	(5.4)	(6.5)	(6.0)	33	37	39	59
Rest of World												
United States	3.7	8.1	5.7	4.2	(5.7)	(15.8)	(15.4)	(7.1)	108	127	133	134
China[6]	5.1	5.6	5.2	5.1	(6.3)	(11.4)	(9.5)	(8.6)	57	67	69	87
Japan	2.4	2.8	2.7	2.5	(3.1)	(12.6)	(9.2)	(4.5)	235	256	257	260
World												

Negative values shown in parentheses

Source: Scope Ratings forecasts, Macrobond, IMF

[1] Changes compared with Scope December 2020's 2021 Sovereign Outlook forecasts ("n/a" reflects countries not forecasted as of the December 2020 Sovereign Outlook)

[2] Shown for the euro area policy rate is the ECB deposit facility rate

[3] Shown for China's policy rate is the bank prime loan rate

[4] Shown for Japan's policy rate is the deposit rate on current account balances

[5] Unemployment rate data source is Eurostat for EU states; national series otherwise

[6] Unemployment is survey-based urban unemployment rate

Contents

Executive summary **2**
Global macro-economic outlook, 2021-22 .... **3**
Global Outlook: June 2021 .... **5**
Regional Views **6**
Core Europe 6
Italy, Spain and Portugal 6
Greece, Cyprus and Malta 7
UK and Ireland 7
EU central and eastern Europe (CEE-11) 8
Turkey, Russia and Georgia 8
United States 9
China and Japan 9
Annex II: Scope's sovereign ratings and recent rating actions **11**
Annex III: Scope Rating Publication Calendar (Rest of 2021) **13**

Scope Sovereign and Public Sector Ratings Group

Giacomo Barisone
Managing Director, Head of Sovereign and Public Sector
g.barisone@scoperatings.com

Alvise Lennkh
Executive Director, Deputy Head
a.lennkh@scoperatings.com

Dennis Shen
Director
d.shen@scoperatings.com

Jakob Suwalski
Director
j.suwalski@scoperatings.com

Eiko Sievert
Director
e.sievert@scoperatings.com

Levon Kameryan
Senior Analyst
l.kameryan@scoperatings.com

Thibault Vasse
Senior Analyst
t.vasse@scoperatings.com

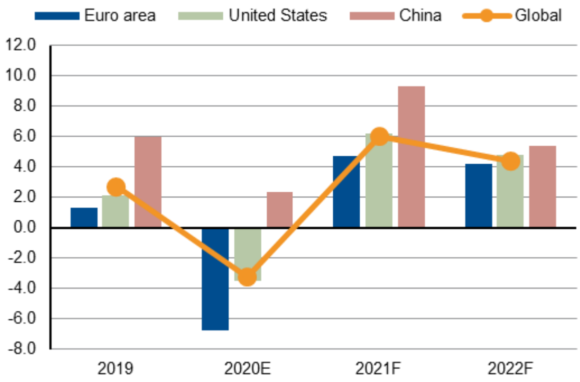
Giulia Branz
Analyst
g.branz@scoperatings.com

Julian Zimmermann
Analyst
j.zimmermann@scoperatings.com

Global Outlook: June 2021

We project a modestly stronger global recovery in 2021. In our mid-year outlook, we revise up the global forecast for this year to an elevated 6% (**Figure 2**), from 5.4% in our December 2020 projections. The global economy should grow by 4.4% next year, remaining above an estimated medium-run potential growth of 2.9%. In line with our earlier expectations, recoveries have gained traction since spring amid staggered economic reopening. However, unequal vaccine availability means noticeable gaps remain between sustainability of recoveries of advanced versus those of emerging economies. Even in the developed world, full economic normalisation remains vulnerable to setbacks as some segments of the population stay unvaccinated, while more transmissible virus variants present risks of increases in cases. Governments' plans to phase out extraordinary support could lay bare the problems of unemployment and corporate insolvencies.

Figure 2. Global growth, 2019-2022F, %, baseline

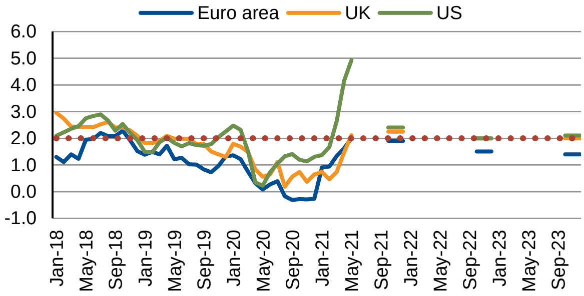


Source: Macrobond, Scope Ratings GmbH forecasts

Fresh re-introduction of targeted economic restriction is possible if not likely as cases re-rise in the future after reopening, although we do not anticipate the same scale of economic restriction nor GDP consequences of restriction moving ahead compared with those of 2020-21 as vaccination advances and countries increasingly adapt to new ways of doing business. Output in the US returns to 2019 levels in 2021, with the UK and the EU aggregate achieving this by 2022, supported by sizeable fiscal and monetary stimulus.

The slight upward revision to Scope's 2021 global GDP forecast stems mostly from a revised outlook for the US (+2.2pps to 6.2%) **(Figure 1)** compared with six months ago. In contrast, we revised down euro area growth by 0.9pps to 4.7% and revised down China's by 0.6pps to 9.3%, with forecasts for the UK and Japan unchanged at 6.6% and 3.0%. The impact of the pandemic on labour markets remains comparatively benign due to ongoing government intervention, with unemployment rates averaging 8.3% in the euro area this year, 5.7% in the US and 4.6% in the UK. In the developing world, we revise up 2021 growth in Turkey by 1.8pps to 8.0% and in Russia by 0.5pps to 3.0%.

Figure 3. CPI %YoY rate with central bank forecasts

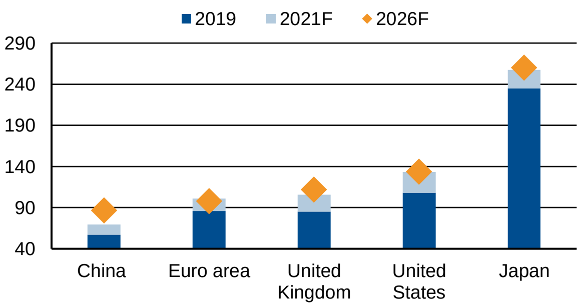


Source: Macrobond, central bank forecasts

A central risk to Scope's economic baseline is a further significant tightening of global financial conditions, in the form of higher long-term treasury yields, a significant correction in bubbly global equity markets and/or depreciation of exchange rates. This could be a result of a more significant "taper tantrum" in which inflation returns more dramatically or for longer than currently foreseen by global central banks **(Figure 3)**, forcing behind-the-curve adjustments of policy setting and signalling. This risk is evidenced as central banks start advancing projections of interest rate increases.

Even as the world's economies regain their footing, the legacy of the crisis includes much higher government debt (**Figure 4**) and structurally wider budget deficits as fiscal orthodoxy has shifted away from austerity – the default to one degree or another after the Global Financial Crisis – to growth-driven fiscal consolidation. Structurally weakened government balance sheets are credit negative, but ultra-loose monetary policy – particularly from the Federal Reserve, ECB, Bank of England and Bank of Japan – has been compensating by ensuring continued low interest rates. The G4 central banks have enhanced roles as lenders of last resort. In Europe, important institutional reform with agreement on the EU Recovery Fund and joint EU debt issuance is another credit positive development brought about in response to the pandemic. In emerging economies, the crisis has held greater net negative consequences for sovereign risk as governments' balance sheets have weakened without domestic central banks being able to provide commensurate monetary support. Eight sovereign issuers are presently rated on Negative Outlook (three EU member states, and five non-EU) with one sovereign issuer on Positive Outlook (Greece).

Figure 4. General government debt, % of GDP



Source: IMF, Eurostat, Scope Ratings GmbH forecasts

Regional Views

Core Europe

The credit outlook of **Germany** (AAA/Stable) remains stable as the number of Covid cases has sharply decreased and large parts of the economy are starting to reopen as vaccination accelerates. We expect real GDP to rebound in 2021, growing 3.5%, followed by 4.6% in 2022. Strong budgetary stimulus is supporting reopening of the economy as private sector consumption increases and investment picks up with improving business sentiment. The labour market is recovering gradually with employees relying less upon "Kurzarbeit" support. Wages are starting to rise. The outlook for 2021 reflects expectation of continued recovery given sizeable fiscal stimulus financed through an expected fiscal deficit of around 7% of GDP. We expect public debt to rise to around 72% of GDP in 2021 before starting to decline as of 2022.

France (AA/Stable) experienced a sharp contraction in output of 8.0% last year, deeper than recessions of most euro area nations. The economy is expected to rebound in 2021 with 5% growth, revised down 2pps compared with our December 2020 projections, anchored by the government's EUR 100bn recovery plan (France Relance). We put 2022 growth at 4%. Public debt will edge higher to 121% of GDP by 2026, from 98% pre-crisis, highlighting the importance of the government's willingness and capacity to adopt structural reforms in raising growth potential and a credible budget consolidation once output exceeds pre-pandemic levels. High public debt levels and labour market challenges remain structural credit weaknesses. Here, the pace of reform in exiting this crisis – as well as the outcome of 2022 elections – will prove pivotal to the trajectory of France's credit ratings.

The **Netherlands** (AAA/Stable) will record growth of around 4% this year, reversing economic losses in 2020, before expanding 3.1% in 2022. The increase in public debt to 56% of GDP in 2021 (from 49% in 2019) is moderate and expected to reverse starting in 2024.

We downgraded **Belgium**'s credit ratings one notch to AA-/Stable on the 28th of May. The Covid-19 crisis resulted in an economic contraction of 6.3% and a marked increase in public debt to 114% of GDP in 2020. These adverse credit developments came on top of pre-existing structural fiscal and economic bottlenecks including increases in ageing-related expenditure and limited productivity growth. While challenges could be addressed via ambitious acceleration of structural reform, we expect political fragmentation and regional divides to constrain decisive policy making in Belgium. In **Luxembourg** (AAA/Stable), the economy will recover quickly, reflecting in part its strong growth potential, estimated at around 2.5%. Real growth is forecast at 4.1% in 2021 and 3.6% in 2022 with debt stabilising at around 27% of GDP.

In **Austria** (AAA/Stable), dependence on winter tourism as well as effects of renewed lockdown led to double-dip recession over Q4 2020 and Q1 2021. Starting from Q2 2021, we expect a robust recovery, with 4.5% growth during 2021, unchanged from December 2020 forecasts. Austria's budget balance will be -7.6% of GDP in 2021 with public debt increasing to 88% of GDP, by far the highest among AAA-rated sovereigns, up from 71% at end-2019.

Italy, Spain and Portugal

After a severe 8.9% economic contraction in 2020, we expect **Italy**'s economy to recover in 2021, with an above-consensus estimate of 5.6% growth, unchanged on December 2020 projections, followed by 3.8% growth next year, as vaccination advances and the economy reopens. The government led by Prime Minister Mario Draghi enjoys a strong parliamentary majority, underpinning expectation of greater reform momentum. Nevertheless, the expansionary budget policy, including increased investment spending in complementing EUR 192bn in Next Generation EU (NGEU) funds allocated to Italy, should translate into higher growth and wider budget deficits (the latter of 11.7% of GDP in 2021 before 7.1% in 2022. Public debt remains on the rise medium term, surpassing 160% of GDP in the coming period, challenging debt sustainability. Here, extraordinary support via ECB asset purchases continues to anchor Italy's funding and debt profile – presenting offsetting factors that support the outlook for BBB+/Negative ratings of Italy.

Spain's A-/Negative credit ratings capture enduring effects on the economy and fiscal position from the crisis. We expect a robust economic rebound over 2021 and 2022: 6% and 5% growth, respectively. The recovery, while uneven across sectors, is accelerating, helped by the gradual reopening of the economy. Public debt will remain elevated, at around 120% of GDP over the next five years, compared with 96% pre-crisis. Fiscal support has been critical in buffering the economy and Spanish labour market, with the ERTE furlough scheme prolonged through Q3 2021, helping contain increases in the unemployment rate, though still elevated at above 15%. The EUR 140bn of NGEU funds allocated to Spain are a prime opportunity to address structural economic and fiscal bottlenecks, although Spain's poor record in absorbing EU funds and repeated political instability remain obstacles to reform. Our next review date of Spain's ratings is on 16 July.

We expect **Portugal** (BBB+/Stable) to grow 3.8% in 2021, driven by the manufacturing sector and recovering consumption as public-health-related restrictions are phased out. The absorption of EU funds will support strong investment, which should underscore real growth of 5.0% in 2022. However, extraordinary policy support, including moratoria on bank loans, will be curtailed in the second half of 2021, thereby increasing debt service within a highly levered economy and limiting investment capacity of the private sector medium term. We expect the Portuguese economy to, over time, converge to its moderate pre-crisis growth potential of around 1.5%, acknowledging structural challenges, such as a fragmentated labour market and an ageing population.

Greece, Cyprus and Malta

The Covid-19 shock proved particularly severe for **Greece** (BB/Positive) due the economy's significant dependence on tourism and high proportion of the self-employed. The government and local banks continue, however, to benefit from the policy support of European institutions, including the ECB's acceptance of Greek sovereign debt as collateral at least until June 2022 and as eligible securities for extraordinary pandemic purchases through at least March 2022. We do not rule out further extension(s) of ECB Covid-19 related monetary accommodations that support Greek debt markets even as the ECB transitions in direction of normalisation of monetary policies. Greece's share of NGEU funds in conjunction with measures adopted by the Greek government should similarly bolster the recovery. We have revised up growth 2pps to 6.5% growth in 2021, with GDP expanding 3.6% in 2022. This year's budget deficit will remain a sizeable 8.9% of GDP, with fiscal risk linked to a new wave of NPLs and potential guarantee calls under the state guarantee programme. Finally, Greece benefits from improving access to debt capital markets, with 10-year yield spreads of under 100bps at time of writing, the lowest since the start of the sovereign debt crisis. While access to capital markets importantly helps the diversification of government sources of funding, issuance involves the increase in the stock of Greek debt held by the private sector, the segment of debt rated by Scope.

Cyprus (BBB-/Stable)'s record of strong economic growth and budgetary performance was interrupted in 2020 by the pandemic. Following renewed lockdown in the H1, we expect a robust recovery from Q3. Output should return to pre-pandemic levels by 2022. For **Malta** (A+/Stable), we expect the economy to recover rapidly, with GDP projected to exceed pre-crisis levels as early as 2022, supported by the government's national recovery plan, as well as robust growth medium term, underpinned by strong growth potential of over 3.5%. This will support recovery in fiscal metrics and return public debt on a firm downward trajectory.

UK and Ireland

We expect a strong, but uneven, economic rebound in the **United Kingdom** (AA/Negative) in 2021 after severe 9.8% contraction last year. In line with our December forecasts, output is expected to grow 6.6% this year. This is seen being driven by increased consumption, particularly in services sectors, as pandemic-related restrictions are eased, and embeds, moreover, the recent announcement of a delay in remaining steps for economic reopening due to increasing Covid-19 cases. The UK labour market has been resilient over the crisis. Furlough schemes are being phased out, but any rise in unemployment should be contained as most furloughed workers are likely to remain in employment. The UK's budget balance will remain near -10% of GDP in 2021 as public debt is likely to rise to around 106% of GDP with public debt on a rising trajectory in the medium term – representing a challenge to the ratings outlook. Nonetheless, sterling's reserve-currency status and the Bank of England's large-scale purchases of gilts, a benign 15.3-year average securities maturity and independent monetary policy remain supporting factors for the ratings. Scope next reviews the UK's credit ratings on 25 June. While the UK and EU reached agreement on Britain's exit from the EU single market and customs union, economic uncertainties remain. The resulting higher barriers to trade, and differing views on the implementation of the Brexit deal, are likely to reduce investment and productivity growth medium term. Finally, the Bank of England is contending with a sharp rise in inflation to the central bank's 2% objective. We expect an unchanged base rate in 2021 but a small rate increase to 0.25% by end-2022.

We upgraded the sovereign credit rating of **Ireland** one notch to AA-/Stable in May 2021. Economic output has been resilient during the pandemic, increasing 2.5% last year. A strong export performance of the multinational enterprises drove this growth, while the underlying Irish economy shrank 5.4% driven by declines in private consumption. We expect output to increase a high 9% this year driven by strength in the multinational enterprises sector, the release of pent-up demand, strong policy support and the recoveries in Ireland's main trading partners. Ireland's budget deficit will remain elevated in 2021 at around 5.4% of GDP with public debt reaching 110% of modified GNI (60% of GDP). Public debt ratios will fall in subsequent years as economic recovery gains traction. Ireland is among countries that could see attenuated competitiveness from changes in global corporate tax policy; however, the scale of impact hinges on policies Ireland adopts in response to ease consequences for its comparative advantage.

Nordics and Switzerland

Denmark, **Norway**, **Sweden** (all rated AAA/Stable) and **Finland** (AA+/Stable) have pulled through the Covid-19 crisis to date relatively well in economic terms, with comparatively moderate output contractions of under 3% last year. The region's economies are set to rebound this year between 2.1% and 3.6%. Norges Bank is likely to hike its sight deposit rate 25bps in 2021 before another 75bps in 2022 while Riksbank is seen increasing the repo rate 25bps by end-2022 – both from current zero interest rate policies. In the case of Finland, public debt remains on an upward trajectory, reaching over 75% of GDP by 2025, representing a challenge for the sovereign ratings. Debt ratios in Sweden and Norway will stabilise at more moderate levels. Overall, increases in fiscal deficits and debt in the region have been modest compared with those of other advanced economies, with no significant deterioration in the sovereigns' creditworthiness.

Switzerland's withdrawal from negotiations over a new institutional framework agreement with the EU increases uncertainty around economic relations with its major trading partner, with potential consequences for medium-run growth. However, given mutual importance of trade and financial flows, it is not unlikely that negotiations with the EU could resume at a later stage. In 2021, we project output growth of 3.5%, after contraction of 2.7% in 2020. Switzerland's institutional, fiscal and economic strengths as well as long-standing reserve currency status of the Swiss franc underpin AAA/Stable ratings and support long-run growth.

EU central and eastern Europe (CEE-11)

Output across EU member states of CEE is expected to recover to pre-crisis levels by next year, but the speed of recovery will vary. Manufacturing production is running near pre-pandemic levels, but services have not fully recovered. CEE countries more reliant on services, such as **Croatia** (BBB-/Stable), lag, while countries with strong industrial sectors and diversified economies, such as **Poland** (A+/Stable), are leading.

Poland is expected to grow 4.9% in 2021 before 4.5% next year. **Hungary** (BBB+/Stable) and **Romania** (BBB-/Stable) should grow 4.5% and 4.8% this year, and 5.5% and 4.7%, respectively, in 2022, benefitting from sturdy growth potential. Romania's Outlook was revised to Stable (from Negative) in May 2021. The **Czech Republic** (AA/Stable) and **Slovakia** (A+/Negative) are seen growing 3.8% and 4.3% this year, and 4.5% and 4.7% in 2022, supported by recoveries in external demand. Current supply-chain bottlenecks in automotive sectors ought to be temporary. We expect **Slovenia** (A/Stable) to grow around 4.5% both years; **Bulgaria** (BBB+/Stable) is expected to grow 5.4% in 2021 before 4.7% in 2022 and Croatia is seen recovering 5% this year before 5.8% growth next year. Among the three Baltic states: **Estonia** (AA-/Stable), **Latvia** (A-/Stable) and **Lithuania** (A/Stable), after comparatively soft economic contractions last year, we expect average growth of 3.1% this year, before 4.5% next year.

We project headline budget deficits to remain elevated around 6% of GDP on average among EU CEE member states this year (moderating somewhat from about 7% of GDP last year), with fiscal policies remaining supportive of recovery, which, however, delays needed budget consolidation to 2022 and beyond. Elevated public debt accrued in the crisis increases fiscal vulnerabilities with a higher share of debt to be rolled over near term – gross government financing needs in 2021 are near or above 10% of GDP across most governments of the region, and 18% of GDP in case of Hungary.

Foreign-exchange reserves of regional central banks, such as that of Poland, the Czech Republic and Hungary, should remain adequate to address possible exchange rate volatility as global central banks ponder normalisation of crisis policies, supported by curtailed net external debt positions pre-crisis and enhanced resilience during periods of capital outflow. Our outlook for the CEE region will be discussed in more colour in our coming interim 2021 central and eastern Europe sovereign outlook.

Figure 5. 2020-22 real growth, %, CEE region

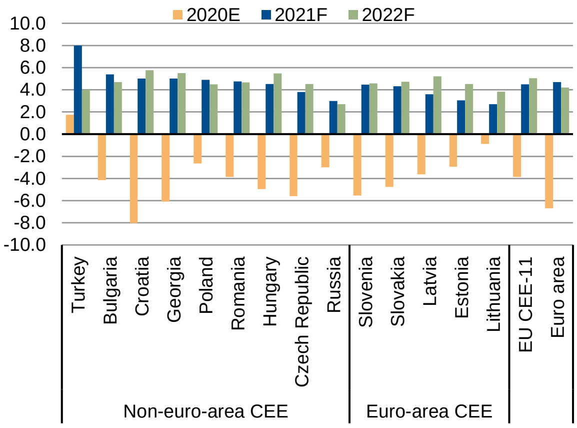


Diagram sorted by 2021 growth rates. Source: European Commission, national statistics agencies, IMF, Scope Ratings GmbH forecasts.

Turkey, Russia and Georgia

Political interference at the central bank, institutional risk before elections by 2023 and a confidence crisis in the Turkish lira continue to present risks to **Turkey**'s B/Negative (foreign-currency) and B+/Negative (local-currency) ratings. Underlying economic distortions are being made worse as President Recep Tayyip Erdoğan gives priority to supporting higher short-run growth, rather than seeking to correct existing economic imbalances and achieving sustainable longer-run growth. Any easing of Turkey's currently significant positive real benchmark interest rate of 2.1% could make the economy more vulnerable to capital outflow, lira depreciation and higher inflation. However, due to stronger-than-anticipated economic data and expectation of future monetary loosening, we revise up growth expectations to 8.0% for 2021 (from an already above-consensus estimate per our December 2020 projections of 6.2% for 2021, which has seen external forecasting organisations upgrading forecasts converging on this figure). However, credit-fuelled economic growth raises likelihood of adverse side-effects such as a weakening exchange rate, structurally higher inflation and risk of balance of payment crisis in future years. We see more moderate growth of 4.0% in 2022. Turkey's public finances have attenuated as a credit strength with general government debt increasing to 39% of GDP in 2021 (from 33% in 2019), before reaching nearly 60% of GDP by 2026. Turkey's external vulnerabilities, including net FX reserves of USD -54.3bn as of April 2021 alongside weakening in the current account, increase vulnerabilities under any scenario of renewed "risk-off" in market sentiment.

For the **Russian Federation** (BBB/Stable), we expect the economy to grow 3% in 2021, even as the city of Moscow adopts fresh Covid-19-linked restrictions, before 2.7% in 2022, and thereafter to converge towards potential growth of 1.5-2% medium term. Higher oil prices and higher oil production near term should translate to increased public investment. Volatility in oil markets remains a risk, however, for recovery in the economy. The central bank's tightening of the policy rate supports USD-RUB near term, with further rate hikes possible this year due to rising inflationary pressure. The reorientation of macroeconomic policies of recent years has resulted in sustainably increased government liquid assets and foreign-exchange reserves, which strengthen resilience against risk of western sanctions against Russian institutions. Gross government financing needs are increasingly met domestically, supported by liquidity offered by state-owned banks. Absent substantive structural reforms, including as related to addressing the state's dominant role in the economy, inadequate levels of competition, and weak governance, which leads to underinvestment, the medium-run growth outlook remains subdued and constitutes a key constraint on the sovereign rating.

In **Georgia** (BB/Negative), we foresee partial recovery from the Covid-19 crisis this year with growth of 5% (after -6.1% in 2020) as the tourism sector is recovering gradually. Extended political instability weighs on economic growth potential but should not derail a credible macroeconomic policy framework – the latter as reflected in recent EU-brokered agreement between the government and opposition, which foresees implementation of further electoral and judicial reform.

United States

Under the presidency of Joseph Biden, the **United States** seeks to repair damage done to domestic institutions and to its global leadership role over the previous four years. Nevertheless, former president Donald J. Trump remains a force within the opposition political party and retains likelihood of re-election in 2024 elections, meaning risks to governance, civil stability and the rule of law continue to be relevant to the outlook for the US medium term. Sizeable stimulus through the USD 1.9trn American Rescue Plan Act of 2021, 2020's USD 2.3trn CARES Act and negotiation around USD 1trn sought for infrastructure expenditure raise longer-term growth potential (estimated at 1.9%) but stress near- to medium-run US fiscal dynamics. We see a budget deficit of 15.4% of GDP in 2021, after last year's 15.8% of GDP shortfall, with an increase in government debt to 133% of GDP this year, from 108% pre-crisis and 65% as of 2007. At the same time, we revise up growth expectations 2.2pps for the US to 6.2% for this year, followed by 4.8% growth next year – abetted by continued budget and monetary stimulus, with the Federal Reserve expected to begin scaling back monthly minimum bond purchases of USD 120bn but hold the Federal Funds Rate unchanged through 2022, with rate hikes starting by 2023 – as the central bank targets firstly full employment. Unemployment is set to decline to 5.7% in 2021 before 4.2% in 2022. Higher inflation, with the CPI up 5% YoY in May, represents a core risk should price increases prove less transitory than the central bank anticipates. The national debt limit suspension set to expire on 31 July represents a near-term concern, putting the government on course for potentially another heated summer of negotiations though we expect talks to sidestep technical default. Finally, global FX reserves held in US dollar fell to 59% in Q4 2020 – reflecting slow attrition of the US dollar's unparalleled reserve currency status. These contrasting credit relevant forces remain balanced at our below-consensus AA credit rating.

China and Japan

We revise down the 2021 growth forecast for **China** by 0.6pps to 9.3% – still above consensus estimates (8.5%), which have been revised up 0.4pps since December 2020 – as China's V-shaped rebound resumes even as the pace of recovery has moderated (with Chinese output having already reached pre-crisis trend output levels by Q4 2020). China is seen accounting for nearly a third of growth globally in 2021. 2022 Chinese growth is forecast at 5.4%. The People's Bank of China has proactively started moderating the pace of credit growth as it seeks to normalise monetary policies. We project a 10bp increase in the one-year loan prime rate by end-2021 with another 10bp hike next year. As authorities seek to introduce greater financial-system discipline, transparency and market-based price setting, corporates have defaulted on onshore bonds at the fastest pace on record in 2021. These developments are credit positive and increase likelihood for a soft rather than hard landing to China's substantive debt accrual since the global financial crisis. Nevertheless, credit to the non-financial sector has increased, reaching a record of nearly 290% of GDP in Q4 2020, from 263% in Q4 2019 and compared with only 139% as of 2008. The general government deficit will remain sizeable (at 9.5% of GDP in 2021, before 8.6% of GDP in 2022) with public debt continuing to rise to 69% of GDP by end-2021 (and to 87% by 2026), from 57% in 2019. Our next review of China's A+/Negative credit rating is on 9 July.

In April 2020, we assigned a Negative Outlook to **Japan**'s A+ ratings, reflecting material and lasting damage of the Covid-19 crisis to underlying fiscal fundamentals, exacerbating longer-dated risks posed by very high government debt. The Japanese government appropriately responded to the crisis with large-scale budget support. This led, however, to widening of the budget deficit to 12.6% of GDP with public debt rising sharply to 256% of GDP last year. A meaningful reversal of this fiscal deterioration is unlikely given pressures adverse demographics will place on budget performance and very low growth potential (we estimate at 0.5%) as well as the government's mixed track record on fiscal consolidation. We forecast Japan's public debt ratio to rise steadily to over 260% of GDP by 2026, the highest in our rated sovereign universe and more than 20 percentage points above pre-crisis levels.

Annex I. Additional research

Western Europe

Belgium and France: Different reform momentum underpin rating divergence, 7 Jun

Ireland’s debt ratio could fall to pre-Covid levels after 2026 on deficit reduction, strong growth, 4 Jun

Nordic sovereigns: strong environmental policies, green bond issuance support credit ratings, 17 May

Italy’s debt: ECB creates room for budget expansion but fiscal space still has limits, 4 May

Italy: fiscal prudence requires attention even as Draghi investment plan critical to reviving growth, 27 Apr

Sovereign incentives to honour government guarantees and their structured finance implications, 23 Apr

France’s Stability Programme: large fiscal support followed by gradual path to fiscal consolidation, 22 Apr

Sovereign ESG financing: France’s second green OAT bond boosts lead in climate-resilient financing, 26 Mar

Euro-area economic outlook: taking stock of a sluggish rebound, ECB stimulus and public debt, 12 Mar

Sovereign ESG financing: Italy’s first green bond gets warm reception, helping ease funding risk, 8 Mar

Spain: reform momentum key for facilitating recovery after historic economic contraction, 10 Feb

A Draghi government would have longer-term implications not only for Italy but Europe at large, 9 Feb

Germany: fiscal response limits Covid-19 economic, financial costs; structural challenges loom, 21 Jan

Italy’s government crisis adds risk to outlook for economic recovery and public finances, 18 Jan

Brexit: trade agreement avoids no-deal, but “slow burn” of EU-exit costs weakens UK outlook, 7 Jan

Central and eastern Europe

Romania: government reduces near-term fiscal risk; longer-term sustainability, reform are challenges, 19 May

Poland: EU funds could help shift the economy towards a more sustainable growth path, 5 May

Greening central banks’ mandates: Hungary leads Czech Republic, Poland in tackling climate challenge, 4 Mar

Romania: political stability bodes well for fiscal discipline; rising debt limits policy flexibility, 18 Feb

Baltic states: economic resilience improves; addressing structural bottlenecks vital for recovery, 12 Feb

Global & rest of the world

Turkey: political interference at central bank, weak lira risk policy mistakes ahead of elections, 2 Jun

Sovereign ESG risk: direct and indirect environmental risks material for credit outlooks, 11 May

Sovereign ESG risk: Eastern Europe, CIS, Middle East most exposed to transition risks, 21 Apr

Russia: US sanctions on sovereign debt signal rising risk surrounding geopolitical tensions, 16 Apr

Southern Africa’s demographics make raising employment the priority for growth, public finances, 14 Apr

Africa’s solvency crisis: coordinated debt restructuring needed despite relief from DSSI extension, 13 Apr

Covid-19 sovereign impact: lasting on debt, mixed for growth and mostly transitory on unemployment, 9 Apr

Turkey: persistent challenges in monetary governance increase risk to macroeconomic stability, 22 Mar

US: Biden’s stimulus to raise growth prospects, tackling economic disparities at high fiscal cost, 12 Mar

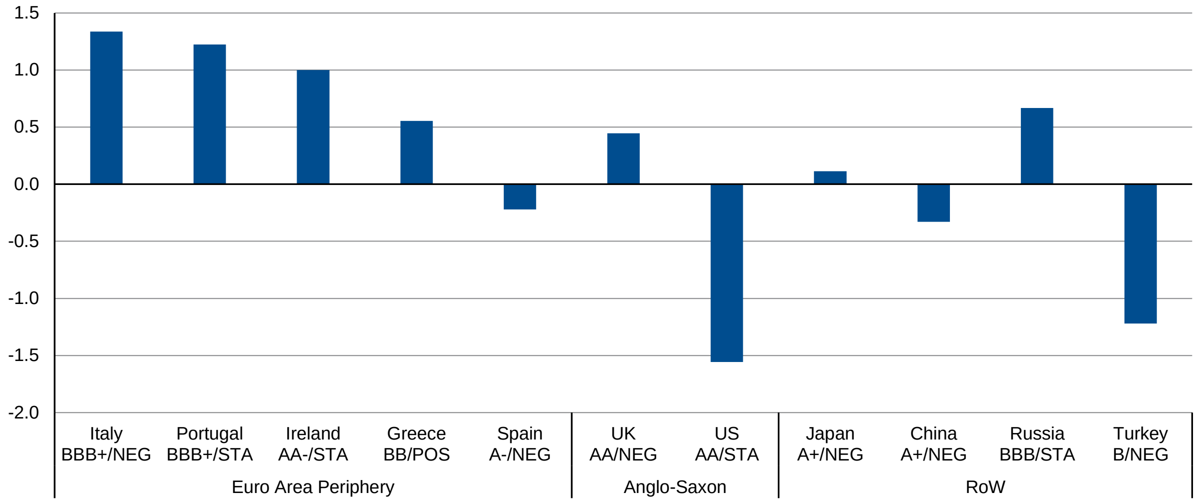
Annex II: Scope's sovereign ratings and recent rating actions

Figure 6. Scope's global long-term sovereign issuer ratings, as of 17 June 2021

Europe						Other Countries	
EU				EFTA			
Euro area		Non-euro area					
Austria	AAA/Stable	Bulgaria	BBB+/Stable	Norway	AAA/Stable	China	A+/Negative
Belgium	AA-/Stable	Croatia	BBB-/Stable	Switzerland	AAA/Stable	Georgia	BB/Negative
Cyprus	BBB-/Stable	Czech R.	AA/Stable			Japan	A/Stable
Estonia	AA-/Stable	Denmark	AAA/Stable			Russia	BBB/Stable
Finland	AA+/Stable	Hungary	BBB+/Stable			Turkey	B/Negative
France	AA/Stable	Poland	A+/Stable			USA	AA/Stable
Germany	AAA/Stable	Romania	BBB-/Stable				
Greece	BB/Positive	Sweden	AAA/Stable				
Ireland	AA-/Stable	UK	AA/Negative				
Italy	BBB+/Negative						
Latvia	A-/Stable						
Lithuania	A/Stable						
Luxembourg	AAA/Stable						
Malta	A+/Stable						
Netherlands	AAA/Stable						
Portugal	BBB+/Stable						
Slovakia	A+/Negative						
Slovenia	A/Stable						
Spain	A-/Negative						

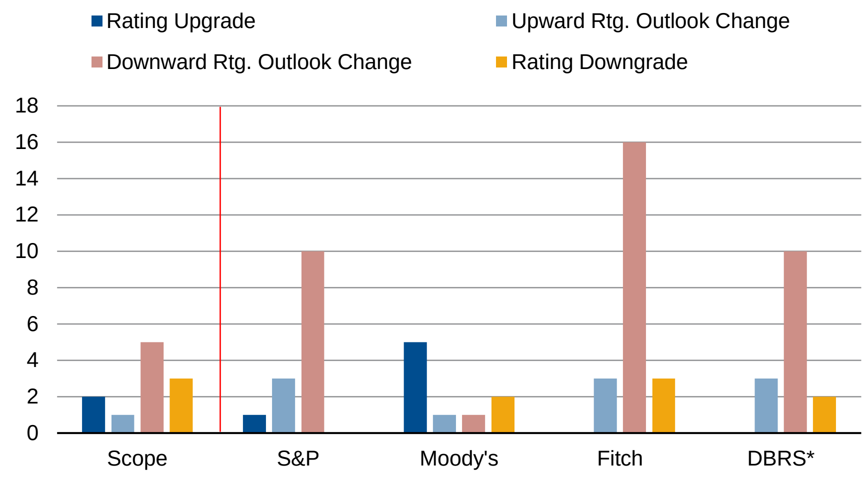
NB: only foreign-currency ratings are displayed.

Figure 7. Scope ratings vs US agencies', as of 17 June 2021 (rating notches)



NB: Calculated based on alpha-numeric conversion on a 20-point scale from AAA (20) to D (1). Positive/negative outlooks are treated with a +/-0.33 adjustment. Credit Watch positive/negative with a +/-0.67 adjustment. RoW = Rest of World.

Figure 8. Number of rating revisions since March 2020 (since crisis escalation)



NB. Rating revisions since March 2020 for the 36 countries that Scope rates. *Among countries that Scope rates, DBRS does not rate Bulgaria, Croatia, Hungary, Romania, Russia and Turkey (as such, the above is from a sample of 30 rated countries in the case of DBRS).

Figure 9. Scope's sovereign rating actions, 2021 YTD

Date	Sovereign	Rating action	Rating & Outlook
29 January	Lithuania	Upgrade/Outlook change	A/Stable
23 April	Malta	Affirmation	A+/Stable
14 May	Romania	Outlook change	BBB-/Stable
21 May	Ireland	Upgrade/Outlook change	AA-/Stable
28 May	Belgium	Downgrade/Outlook change	AA-/Stable

Annex III: Scope Rating Publication Calendar (Rest of 2021)

Month	Date	Entity
June	18-06-21	European Bank for Reconstruction and Development
	18-06-21	Republic of Bulgaria
	18-06-21	Japan
	25-06-21	United Kingdom
	25-06-21	Grand Duchy of Luxembourg
	25-06-21	Land of Berlin
	25-06-21	Slovak Republic
July	02-07-21	Federal Republic of Germany
	02-07-21	Republic of Estonia
	02-07-21	United States of America
	09-07-21	People's Republic of China
	09-07-21	Republic of Lithuania
	16-07-21	Kingdom of the Netherlands
	16-07-21	Kingdom of Spain
	16-07-21	Republic of Poland
	16-07-21	Hungary
	16-07-21	Republic of Cyprus
	23-07-21	Republic of Latvia
	30-07-21	German Länder
	30-07-21	Land of Baden-Wuerttemberg
	30-07-21	Czech Republic
	30-07-21	Spanish autonomous communities
August	06-08-21	European Stability Mechanism
	06-08-21	European Financial Stability Facility
	06-08-21	Republic of Croatia
	20-08-21	Italian Republic
	27-08-21	Swiss Confederation
September	03-09-21	Republic of Georgia
	03-09-21	Republic of Austria
	10-09-21	Hellenic Republic
	10-09-21	Italian sub-sovereign
	10-09-21	Republic of Slovenia
	10-09-21	Republic of Turkey
	10-09-21	City of Milan
	17-09-21	Council of Europe Development Bank
	17-09-21	European Investment Bank

October	01-10-21	European Union
	01-10-21	Communauté européenne de l'énergie atomique
	08-10-21	Black Sea Trade and Development Bank
	08-10-21	Swiss Cantons
	15-10-21	Republic of Malta
	15-10-21	Free State of Bavaria
	22-10-21	Romania
	29-10-21	Russian Federation
November	05-11-21	Republic of Finland
	05-11-21	Kingdom of Sweden
	05-11-21	Ireland
	05-11-21	French Republic
	12-11-21	Kingdom of Denmark
	12-11-21	Kingdom of Norway
	12-11-21	City of Milan
	19-11-21	Kingdom of Belgium
	19-11-21	Italian sub-sovereign
	26-11-21	Portuguese Republic
	26-11-21	Japan
	26-11-21	United States of America
December	03-12-21	European Bank for Reconstruction and Development
	03-12-21	Republic of Bulgaria
	03-12-21	Federal Republic of Germany
	03-12-21	Kingdom of Spain
	03-12-21	Slovak Republic
	10-12-21	United Kingdom
	10-12-21	Grand Duchy of Luxembourg
	10-12-21	People's Republic of China
	10-12-21	Land of Berlin
	10-12-21	Republic of Lithuania
	10-12-21	Hungary
	17-12-21	Republic of Estonia
	17-12-21	Kingdom of the Netherlands
	17-12-21	Spanish autonomous communities

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
23 Boulevard des Capucines
F-75002 Paris

Phone + 33 6 62 89 35 12

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid
Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 8295 8254

Scope Ratings UK Limited

London
111 Buckingham Palace Road
London SW1W 0SR

Phone +44 20 3457 0444

info@scoperatings.com
www.scoperatings.com

Disclaimer