

Public Finance 2018 Outlook

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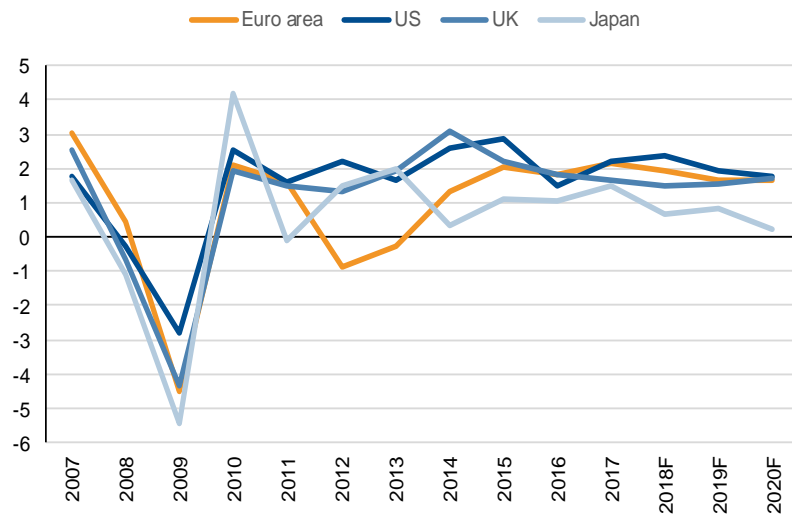
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- World economy escaping 5 year low growth period
- Robust, broad-based and synchronised economic growth
- Closing output gap for most advanced economies

Real GDP growth

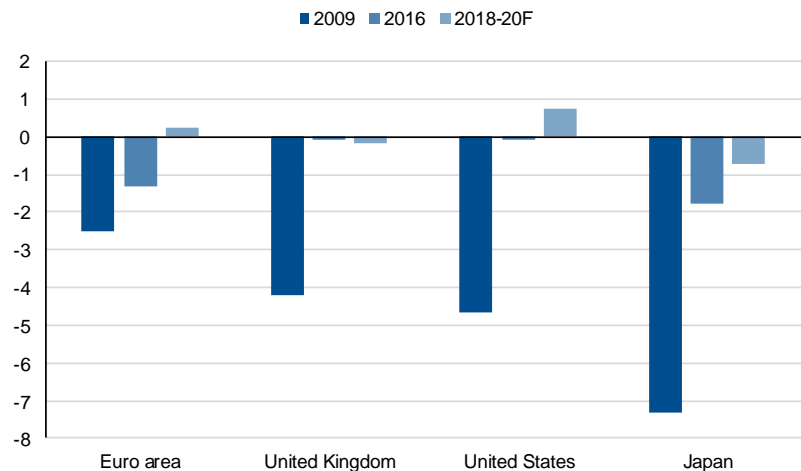
%



Source: IMF, Scope Ratings AG calculations

Output gap

% of potential GDP



Source: IMF, Scope Ratings AG calculations

Key upside potential

- European reform
 - A new German government supports ambitions for important institutional reform in the euro area
- Avoiding the worst-case
 - Risks from Brexit, China's leverage, US policy uncertainty and higher global rates are manageable

Key downside potential

- Risk of no Brexit deal increases
 - Potential for a cliff-edge exit rises
- End of the 'Central Bank Put'
 - Faster than anticipated monetary tightening results in repricing of global risk
- Crystallisation of international risks
 - China's economic adjustment, US political risks, geopolitical tensions
- Rising protectionism
 - US policy stance on trade remains uncertain

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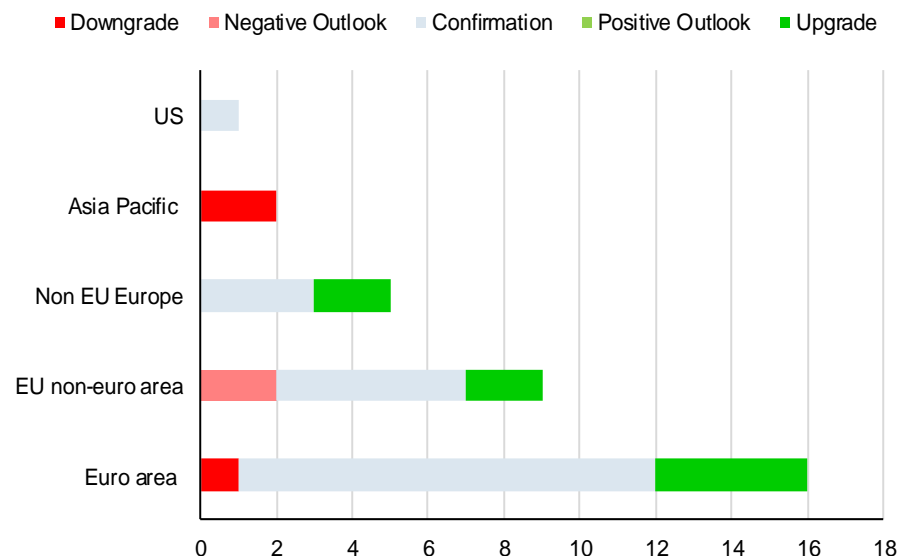
➤ United States (AA/Stable) and China (A+/Stable)

➤ Geopolitical tail-risks

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- **Since June 2017**, Scope started publishing long-term and short-term foreign and local currency issuer and debt ratings
- Scope has since published ratings on **33 countries** including **European sovereigns** as well as in the rest of the world, including **China, Japan, Russia, Turkey and the US**
- The European sovereigns carrying a Scope rating represent **around 99% of total EU sovereign issuance**
- Aggregate amount of all sovereigns' long-term and short-term debt rated by Scope now exceeds **EUR 34 trillion**

Rating actions



Source: Scope Ratings AG



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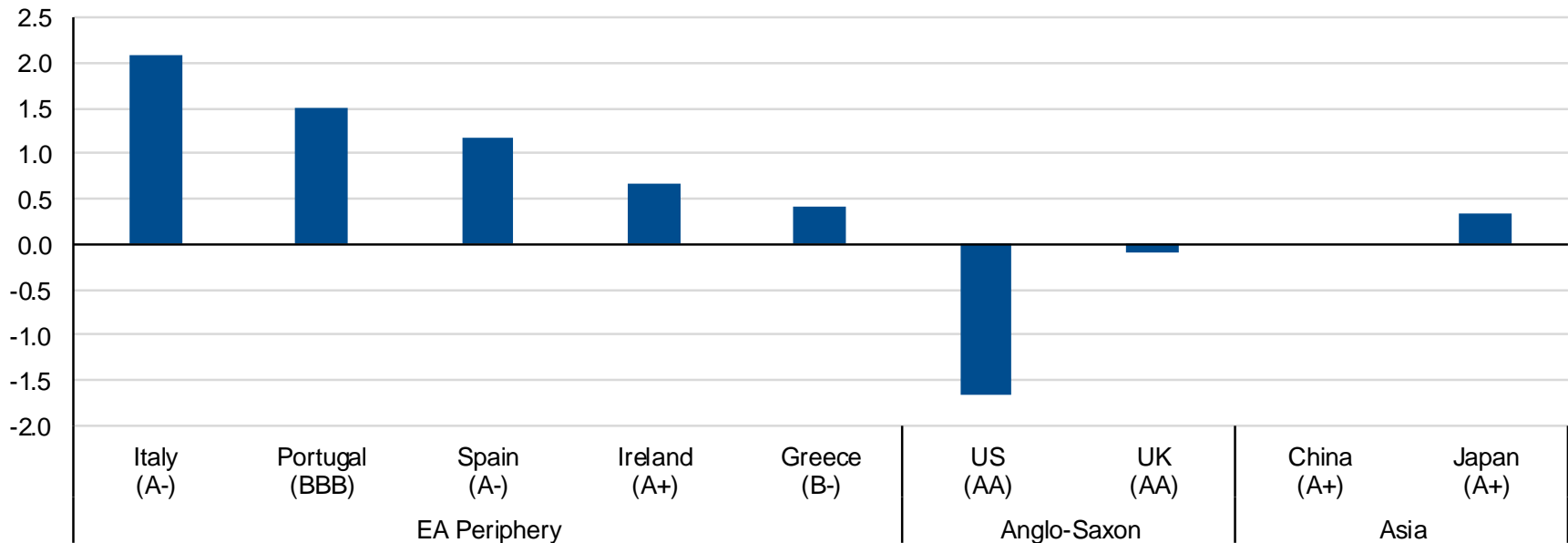
Scope's 2017 rating actions

➤ Scope's ratings differentiate from those of the US agencies

- Constructive view on Europe, ahead of the curve on the euro area periphery
- More conservative view on the US and the UK, and about in-line on major Asian sovereigns

Scope ratings vs. US agencies

Notch differences, November 2017



Source: Scope Ratings AG
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 +/-0.25 adjustment.

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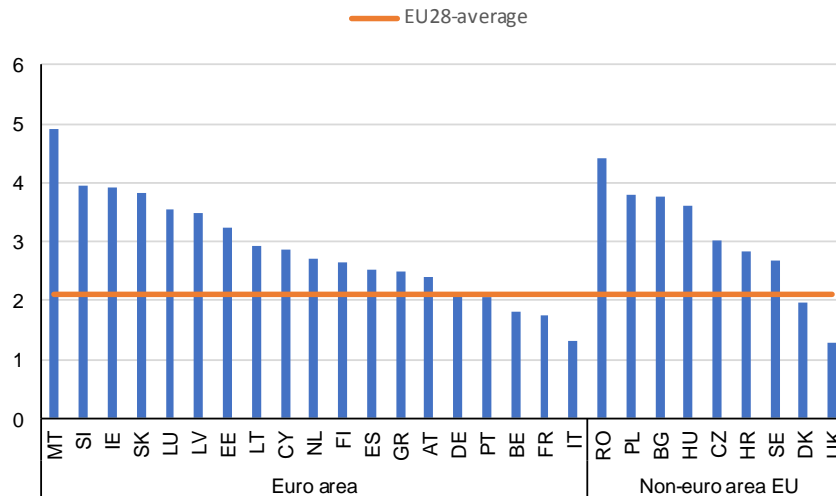
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➤ Enhanced resilience driven by national and European reforms since the crisis

- All EU members to experience positive GDP growth in 2018
- Most EU members' public debt level will fall in 2018
- Most euro area members' fiscal deficits will be falling or are already below 1% (with France an exception)

GDP growth, 2018 forecasts

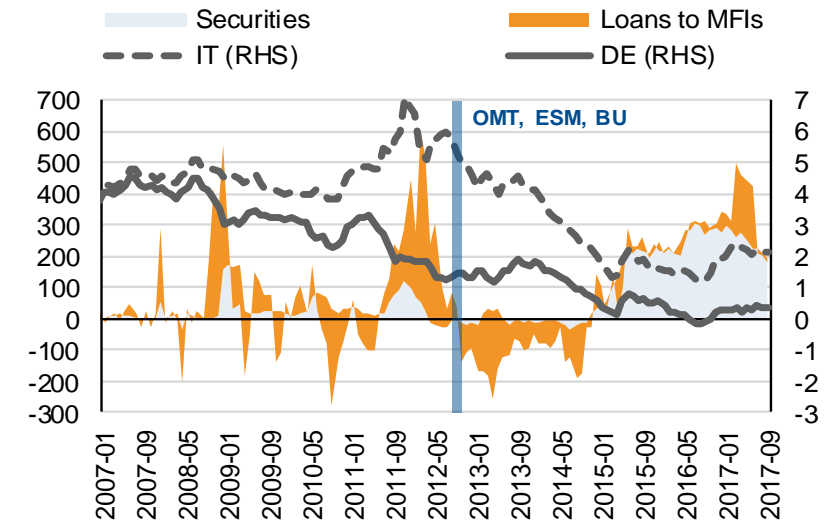
YoY % change



Source: EC

ECB asset purchases & loans; LT-yields

EUR mn (lhs), % (rhs)



Source: ECB

European reform agenda

- Push from French President Macron
- Potential German resistance

Credit-relevant reforms

- Lender of last resort (OMT+ESM)
- Banking Union
- Limits / risk-weights sov. exposures
- Capital Markets Union
- Fiscal capacity

Tail-risks

- German political vacuum
 - German government talks drag or even result in fresh elections

Timing

- First half of 2018
- End of 2018
 - Brexit negotiations intensify
 - EU-budget negotiations
- European Parliament elections in June 2019

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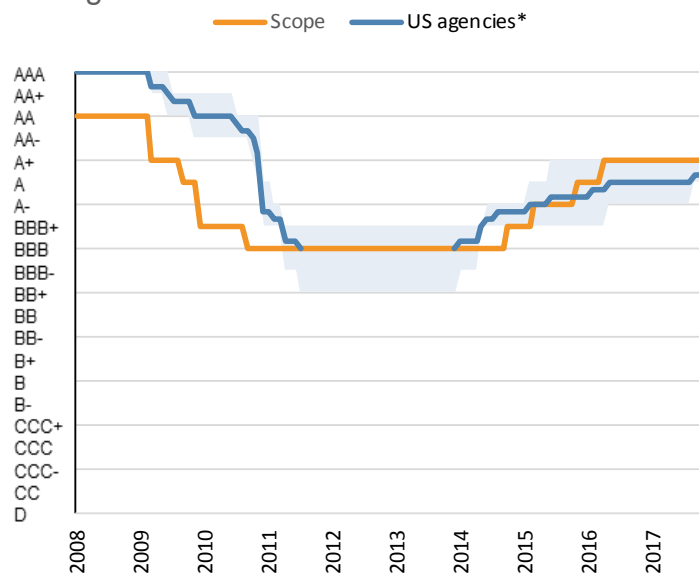
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➤ Emerging research consensus supports Scope's view

- National and European reforms have enhanced resilience of EMU and sovereigns, incl. periphery ratings

Ireland rating history

Scope ratings vs. average US agencies rating & range of ratings

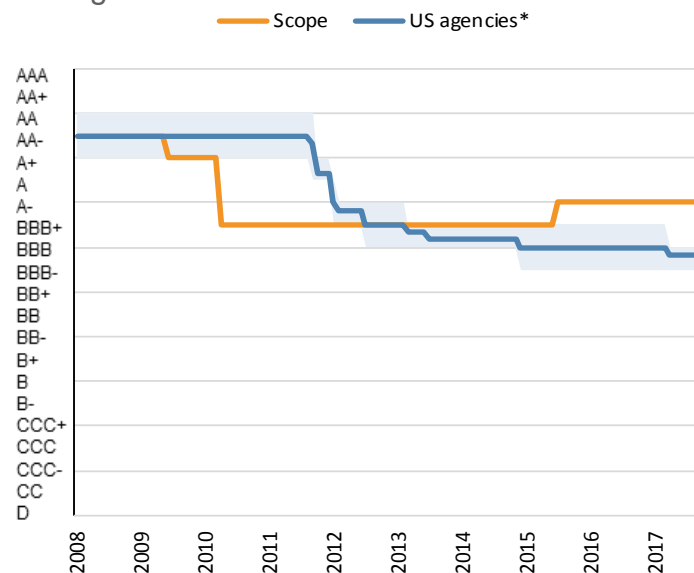


Source: Scope Ratings AG

*Refers to the average rating of Fitch, Moody's and S&P; the grey shaded area refers to the rating-range between the three agencies

Italy rating history

Scope ratings vs. average US agencies rating & range of ratings

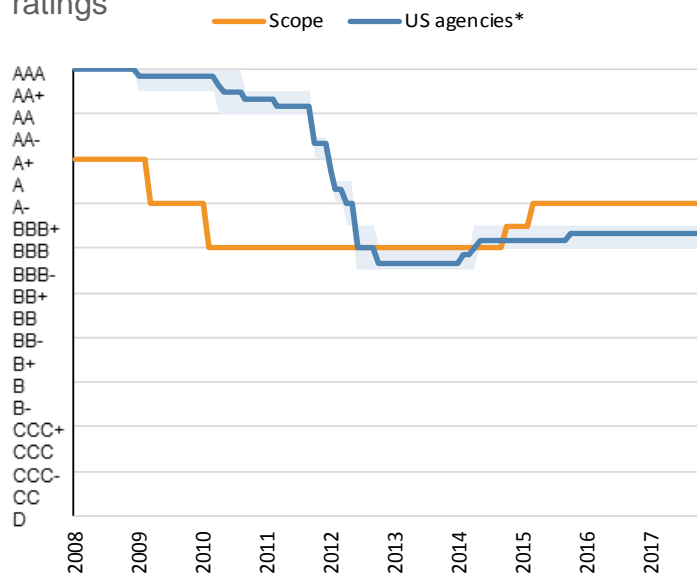


Source: Scope Ratings AG

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Spain rating history

Scope ratings vs. average US agencies rating & range of ratings

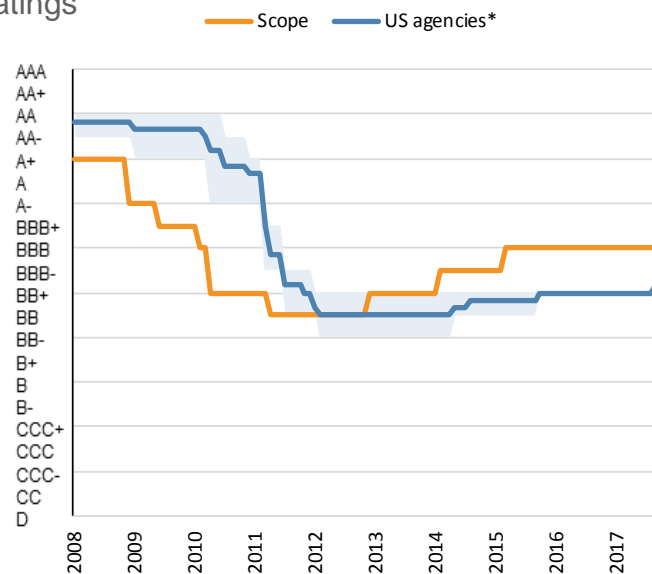


Source: Scope Ratings AG

*Refers to the average rating of Fitch, Moody's and S&P; the grey shaded area refers to the rating-range between the three agencies

Portugal rating history

Scope ratings vs. average US agencies rating & range of ratings



Source: Scope Ratings AG

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➤ Rating constraints in the crisis' legacy

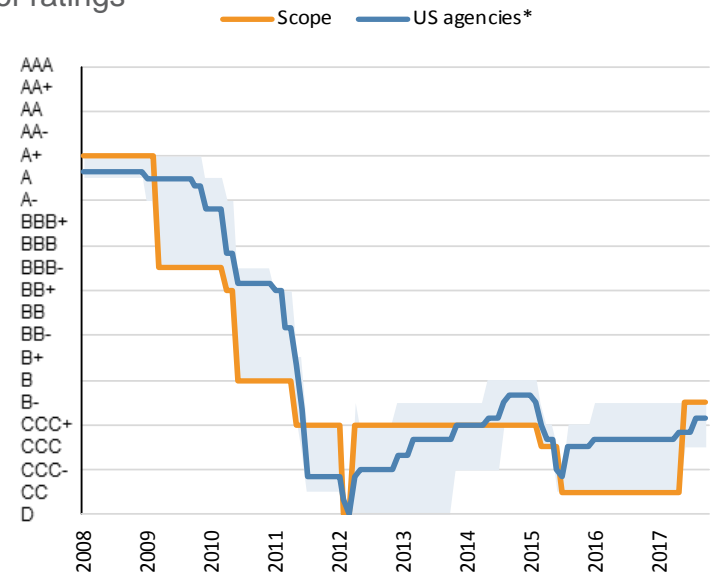
- High public & private debt
- Banking sector weaknesses

➤ End of Greek programme: uncertainty on debt relief, financing and ECB eligibility

- The third ESM programme ends on 20 August 2018
- Greece's market access under institutions' vigilance
- Scope expects EU oversight on Greece to continue after the conclusion of the current programme, possibly linked to additional debt measures, further financial assistance, and/or QE eligibility

Greece (B-/Stable) rating history

Scope ratings vs. average US agencies rating & range of ratings



Source: Scope Ratings AG

*Refers to the average rating of Fitch, Moody's and S&P; the grey shaded area refers to the rating-range between the three agencies

➤ Scope expects no change to Spain's A- rating on the basis of Cataluña crisis

- Next step is regional elections on 21 December 2017 following the removal of the local government
- Scope's baseline remains a negotiated solution, including greater fiscal and/or political autonomy

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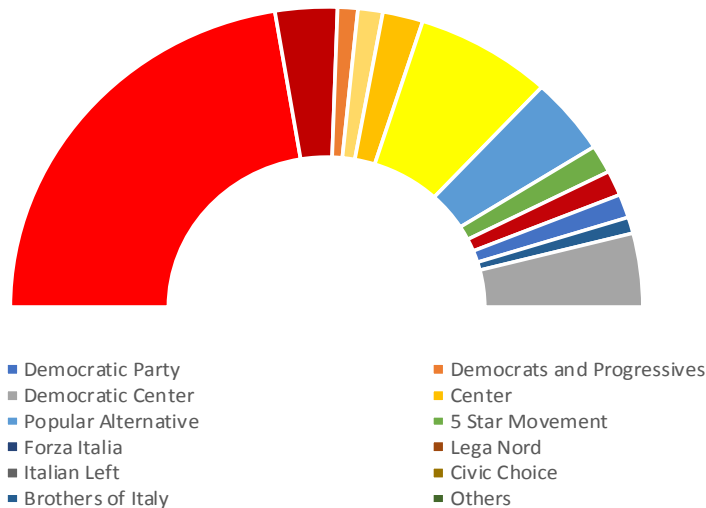
Uncertain election outlook in Italy poses some downside risks

➤ 2018 election outlook

- New electoral law aims to reduce political fragmentation, but risks of inconclusive election remain
- Equal support for the centre-left (PD), the centre-right (FI, LN, FdI) and anti-establishment M5S
- Historically, higher electoral volatility in Italy compared to other EU members reduces predictability of polls

Italian Chamber of Deputies

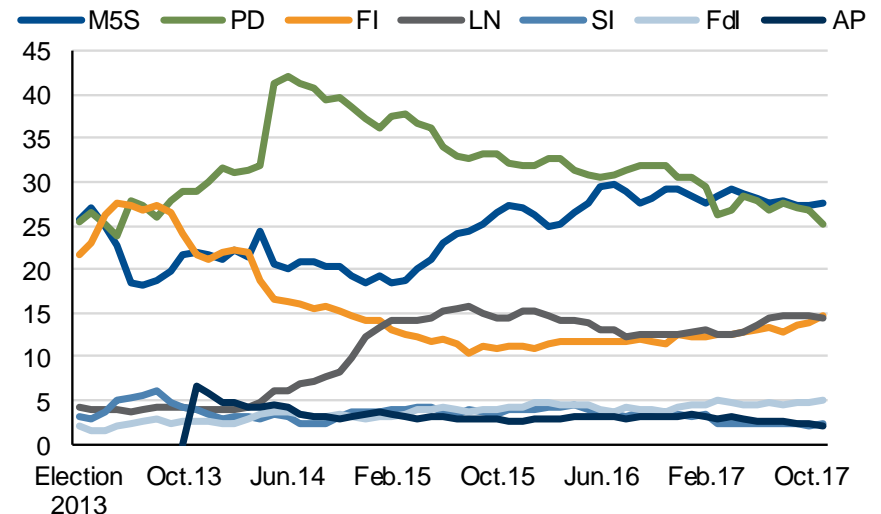
Seats distribution



Source: Italian Parliament

Voting intentions

% of answers, poll of polls



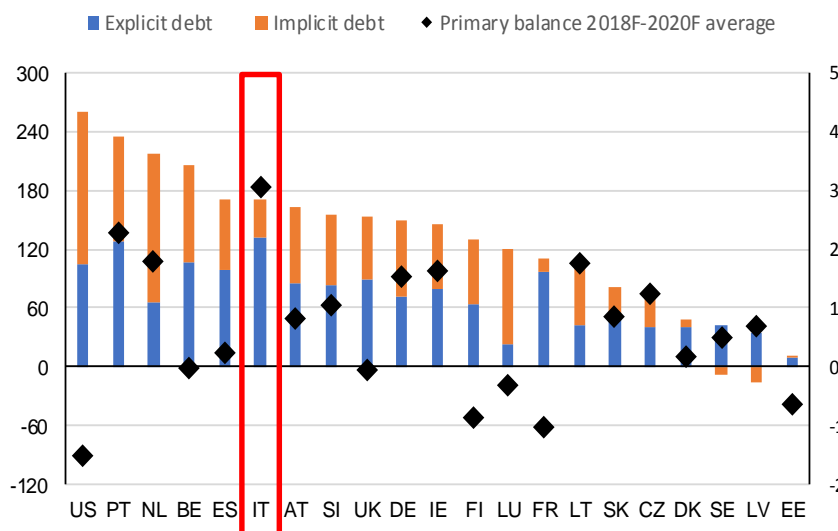
Source: Various polls, Scope Ratings AG calculations

➤ High debt is not the full story...

- Fiscal consolidation efforts have resulted in consistent primary surpluses
- Elevated level of NPLs is substantially provisioned for
- Once pension- and healthcare-related liabilities are included, Italy's debt level is in line with EU, below US

Explicit vs. implicit debt

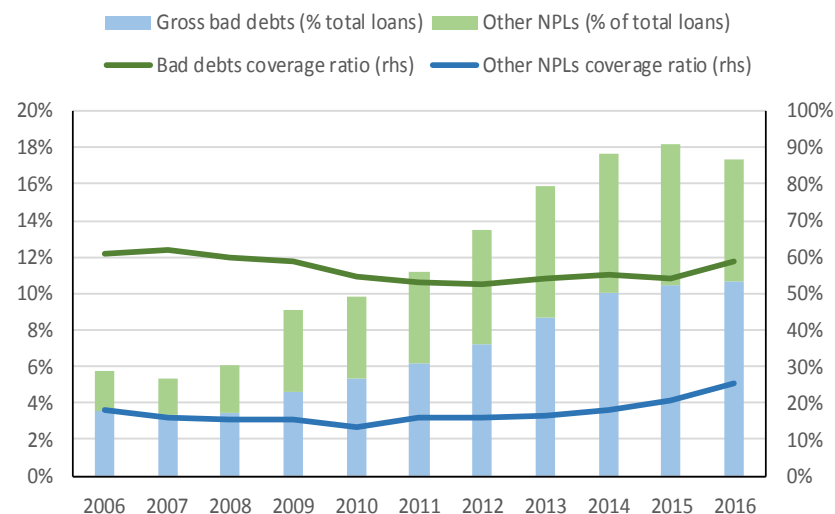
% of GDP



Source: IMF

NPLs and coverage ratios

In % of total loans (lhs), in % of equity (rhs)



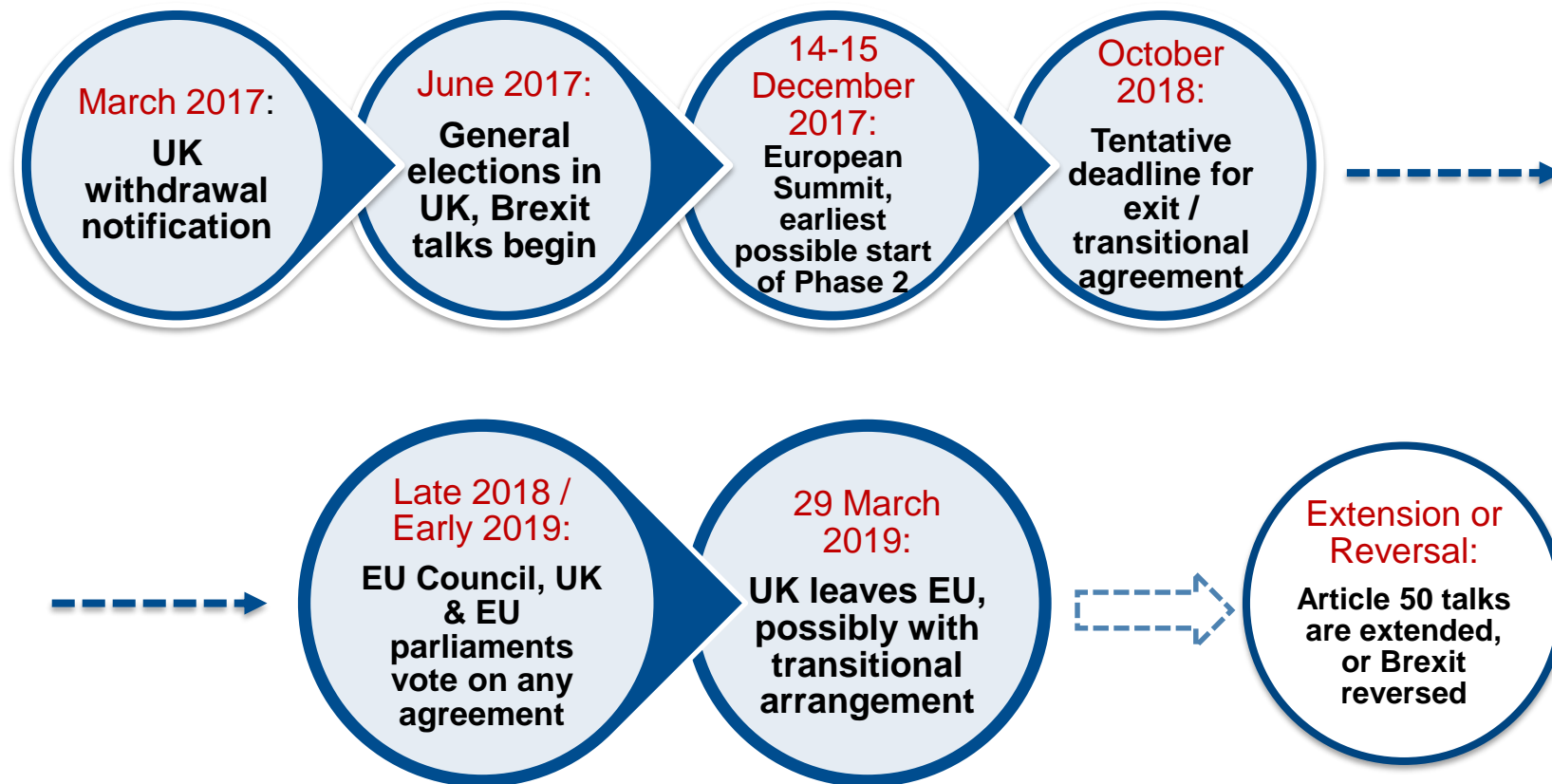
Source: Banca d'Italia

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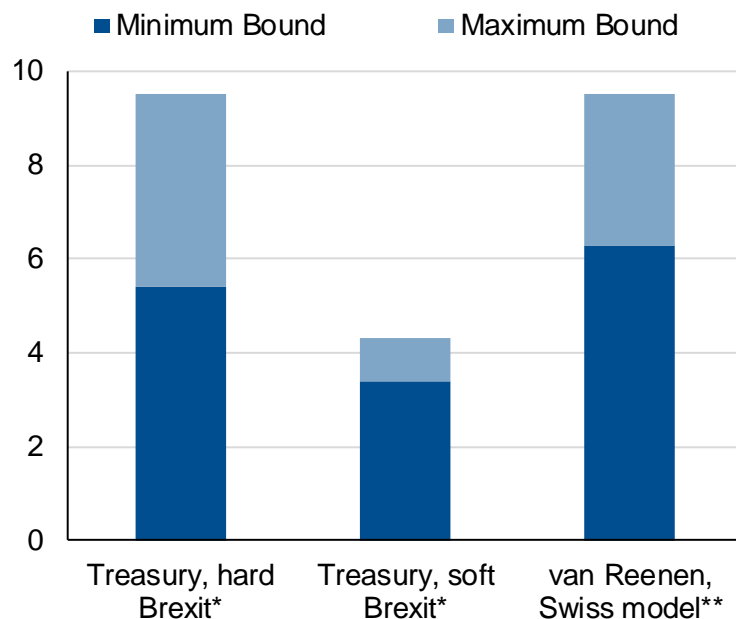
Brexit negotiations before March 2019 scheduled departure



➤ A hard Brexit could pose very significant costs on the UK outlook

Aggregate impact of Brexit on UK GDP/Income, HM Treasury and MIT research

%



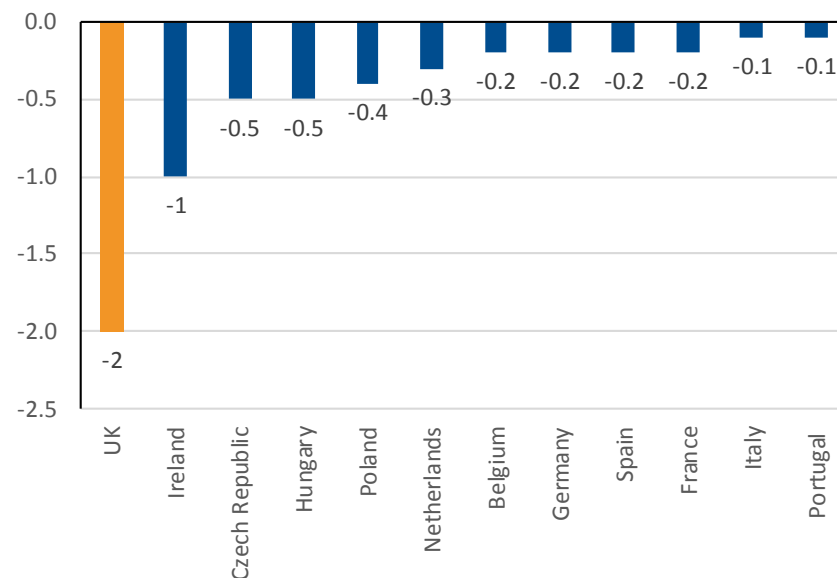
*Impact of Brexit on UK GDP after 15 years relative to baseline of remaining in the EU. Hard Brexit represents scenario of WTO membership without an agreement with the EU. Soft Brexit represents a Norwegian model post-exit.

**Impact of Brexit with Swiss model post-exit on UK incomes

Source: HM Treasury, Brookings Institution

Impact on GDP by 2020 of hard Brexit relative to scenario of no exit

% of GDP



Source: Oxford Economics

Scenario	Favourable rating drivers	Negative rating drivers
Soft Brexit (Scope's baseline)	<ul style="list-style-type: none"> ➤ Norway model ➤ Reduced uncertainty ➤ Solid policy framework 	<ul style="list-style-type: none"> ➤ Swiss or Turkish models ➤ High uncertainty ➤ Policy regression
No Brexit (second most probable)	<ul style="list-style-type: none"> ➤ Breversal ➤ Reduced uncertainty ➤ Resilient policy framework 	<ul style="list-style-type: none"> ➤ Weakened policy framework ➤ Continued uncertainty
Hard Brexit	<ul style="list-style-type: none"> ➤ Policies that soften shock, including transitional arrangements 	<ul style="list-style-type: none"> ➤ Cliff-edge hard Brexit ➤ Exit from single market and customs union

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Russia's IG rating versus Turkey's constraints

Russia (BBB-/Stable)

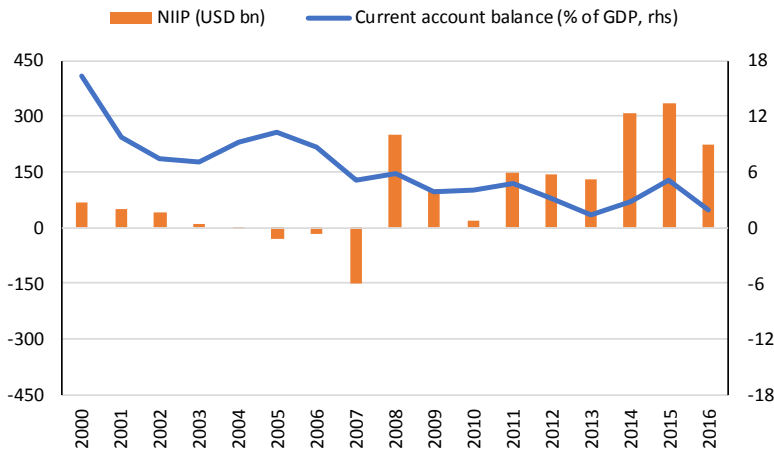
- Investment-grade rating supported by strengthened macroeconomic stability and resilience
- Political continuity after March elections

Turkey (BB+/Stable)

- Non-investment grade rating driven by elevated vulnerability to domestic, external and financial risks
- Political risks and policy variability

Current account vs. NIIP

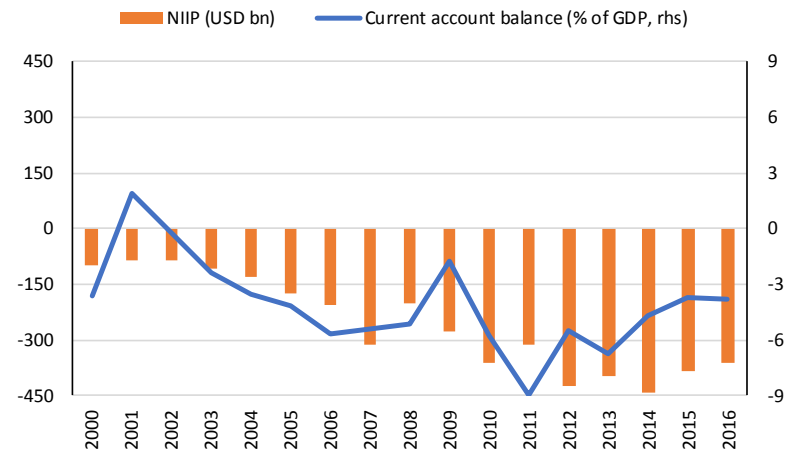
USD bn (lhs), % of GDP (rhs)



Source: Russian Federation Treasury

Current account vs. NIIP

USD bn (lhs), % of GDP (rhs)



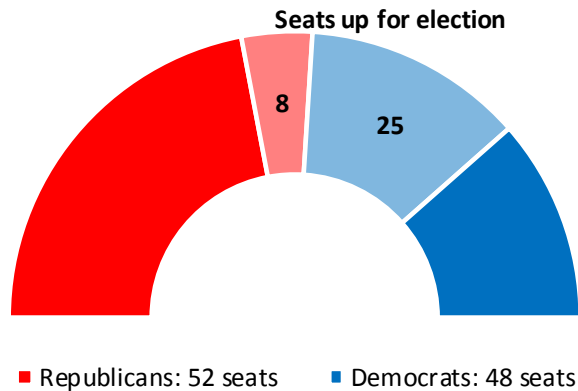
Source: Central Bank of the Republic of Turkey

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Congressional elections

Senate seats

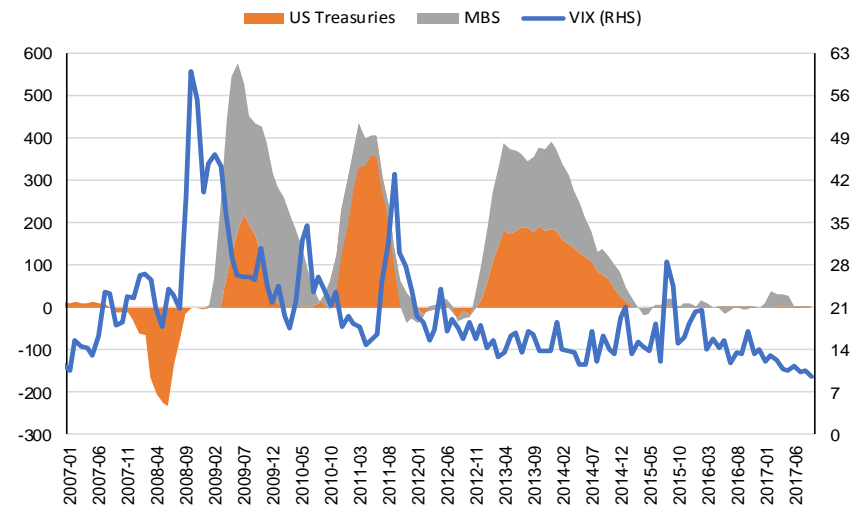


Source: US Senate

- Divided and uncertain politics
 - House and Senate elections unlikely to lead to new bipartisan spirit
 - Uncertain trade policies

Federal Reserve flows & VIX

USD mn (lhs)

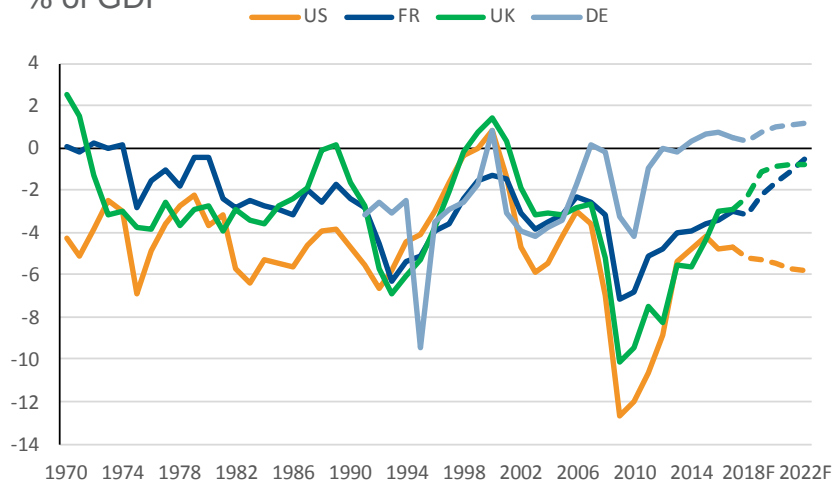


Source: Federal Reserve, WSJ

- End of the 'Central Bank Put'
 - Risk of asset repricing due to QE-unwind abated with J. Powell
 - However, *volatility paradox* exists

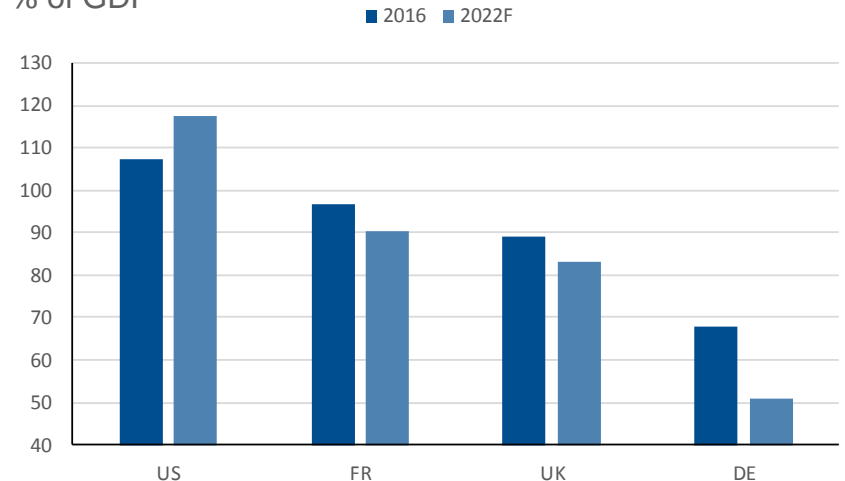
Fiscal balances

% of GDP



General government debt

% of GDP



➤ US budget reform

- Tax reform plan in final stages, expected to be completed by Congress by end year/early 2018
- Scope's baseline remains deficit-enhancing budget (tax cuts not offset by cuts in discretionary spending)

➤ US debt ceiling

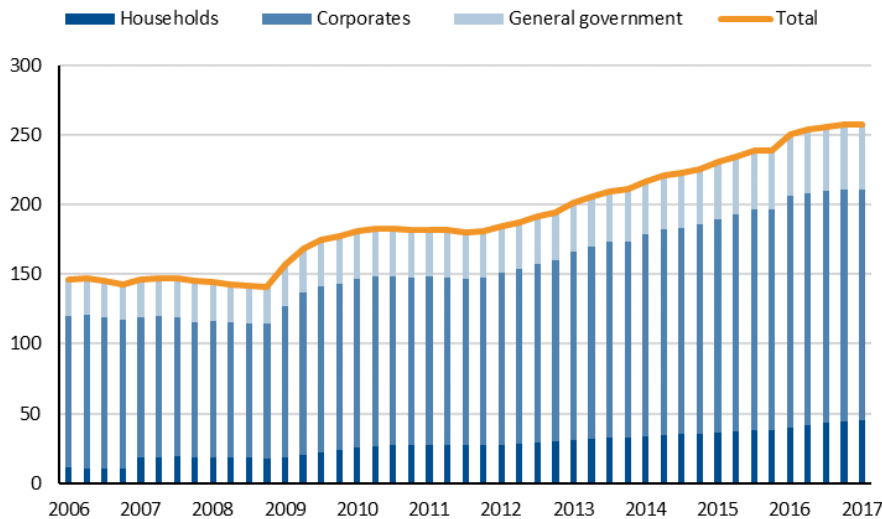
- The deadline of 8 December for debt ceiling represents an immediate risk
- Scope's baseline remains an agreement pushing debt limit issue forward, possibly to sometime in 2018
- Central issue of ensuring fiscal discipline while avoiding political brinkmanship unlikely to be resolved

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China's sovereign ratings (A+/Stable) hinge on deleveraging initiatives

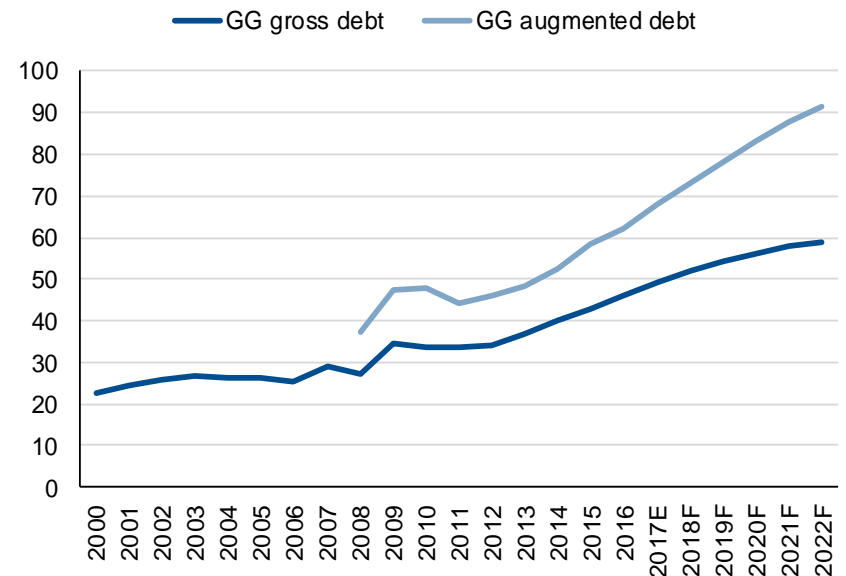
➤ The risk to the global economy from China's debt buildup is not resolved

NFS¹ debt by sectoral contribution % of GDP



Source: BIS, Scope Ratings AG calculations
¹NFS = Non-financial sector

GG debt & IMF augmented definition % of GDP



Source: IMF (incl. Article IV forecasts to 2022)

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Geopolitical Risk (GPR) Index



Source: Matteo Iacoviello

➤ North Korea crisis

- Heated rhetoric between US and North Korea escalates
- Destabilising tensions accounted for in Scope's forward-looking assessment (China, Japan)

➤ Middle East & North Africa regional tensions

➤ Russian interventionism

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➤ Macro-economic Outlook 2018-2020

Region	Real GDP growth (%)		Headline inflation (%)		Fiscal balances (% GDP)		Debt level (% of GDP)		Current account (% of GDP)	
	2015-17E	2018-20F	Target	2018F*	2015-17E	2018-20F	2017E	2020F	2015-17E	2018-20F
Euro area	2.0	1.8	2.0	1.4	-1.6	-0.7	87.4	81.1	3.2	2.9
Germany	1.8	1.6	2.0	1.5	0.7	1.0	65.0	55.7	8.3	7.5
France	1.3	1.9	2.0	1.2	-3.3	-2.7	96.8	95.6	-0.9	-0.5
Italy	1.1	1.0	2.0	1.2	-2.5	-0.6	133.0	125.8	2.2	2.0
Spain	3.2	2.1	2.0	1.4	-4.3	-2.2	98.7	94.5	1.7	2.0
Netherlands	2.5	2.1	2.0	1.5	-0.3	1.2	57.4	48.4	9.0	9.8
United Kingdom	1.9	1.6	2.0	2.6	-3.4	-1.6	89.5	87.6	-4.1	-3.0
Russia	-0.4	1.5	4.0	3.9	-3.1	-1.0	17.4	18.2	3.3	3.5
Turkey	4.8	3.5	5.0	9.1	-2.3	-2.3	27.9	27.2	-4.0	-4.4
United States	2.2	2.0	2.0	2.0	-4.1	-3.9	108.1	108.3	-2.4	-2.7
China	6.8	6.3		2.3	-3.4	-3.9	47.6	57.0	1.9	0.9
Japan	1.2	0.6	2.0	0.6	-4.0	-2.8	240.3	237.2	3.5	3.7

* 2018 average inflation rate forecast

Source: IMF, ECB, EC, BoE, CNBS, ROSSTAT, TRSTAT, BOJ

➤ Scope Ratings AG's Public Finance 2017 rating actions

Euro area		
Germany	AAA stable	Confirmed
France	AA stable	Confirmed
Italy	A- stable	Confirmed
Netherlands	AAA stable	Confirmed
Belgium	AA stable	Confirmed
Spain	A- stable	Confirmed
Portugal	BBB stable	Confirmed
Ireland	A+ stable	Confirmed
Austria	AAA stable	Confirmed
Finland	AA+ stable	Downgraded from AAA to AA+
Greece	B- stable	Upgraded from CC to B-
Slovakia	A+ stable	Confirmed
Slovenia	A- stable	Upgraded from BBB to A-
Estonia	A+ stable	Upgraded from A to A+
Latvia	A- stable	Confirmed
Lithuania	A- stable	Upgraded from BBB+ to A-

Non-Euro area EU		
U.K.	AA negative	Confirmed
Denmark	AAA stable	Confirmed
Sweden	AAA stable	Confirmed
Czech Republic	AA stable	Confirmed
Hungary	BBB stable	Upgraded from BB+ to BBB
Poland	A+ stable	Upgraded from A to A+
Romania	BBB negative	Confirmed
Bulgaria	BBB stable	Confirmed
Croatia	BB stable	Confirmed
Non-Europe		
China	A+ stable	Downgraded from AA- to A+
Japan	A+ stable	Downgraded from AA- to A+
Georgia	BB stable	Confirmed
Russia	BBB- stable	Upgraded from BB- to BBB-
Turkey	BB+ stable	Upgraded from BB to BB+
US	AA stable	Confirmed

EFTA		
Norway	AAA stable	Confirmed
Switzerland	AAA stable	Confirmed



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