

Fitch Ratings 2019 Outlook: Global Sovereigns

Stable Outlook but Rising Risks

Fitch's Sector Outlook: Stable

Common themes that have driven sovereign ratings in the last few years will dominate again in 2019, including commodity price fluctuations, reductions in imbalances following the eurozone and global financial crises, political and geopolitical developments, and changes in sovereign financing conditions. Slowing economic growth in some countries may bring fiscal concerns back to the fore depending on policy responses and governments' starting public finance positions.

Rating Outlook: Stable

For the first time since the mid-2000s, Outlooks for both developed- and emerging-market sovereigns are roughly balanced between Positive and Negative, providing no clear directional indication of rating changes in the coming 12-18 months. Sovereigns with a Stable Outlook entering 2019 account for 75% of the portfolio, in line with the 10-year average. 2018 had the fewest rating actions since 2007, at less than 20, but we would expect to see a return to a more normal range of 20-30 actions in 2019, assuming there are no unforeseen shocks.

Rating Distribution: Dominated by the 'B' Category

The fall in commodity prices in 2014 and continued growth in the number of newly rated sovereigns in Sub-Saharan Africa have led to a marked expansion of the 'B' category. Nearly 30% of sovereigns are rated in this lowest category, and Outlooks in place do not signal a meaningful change in the category distribution of ratings in 2019. With Austria (AA+) and Finland (AA+) on Positive Outlook, the 'AAA' category is likely to expand from its all-time low of 11. These would be the first two sovereigns to regain 'AAA' after having been downgraded.

What to Watch

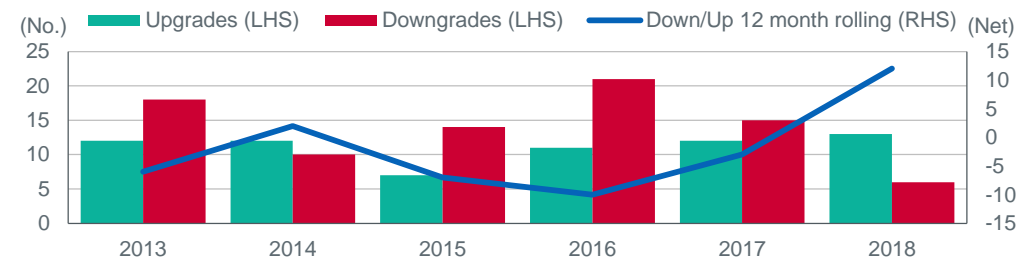
- A further tightening of global financial conditions will be evident in 2019 as the largest central banks move collectively to quantitative tightening for the first time
- US policy uncertainty persists, centred on trade policy, but including the use of sanctions and other initiatives that could diminish the role of the US dollar over the medium term
- Political and geopolitical issues may disrupt markets and elicit immediate policy responses, displacing other government objectives and sovereign credit considerations

James McCormack, Managing Director

Sovereign risks in 2019 centre on the tightening of global financial conditions, potential changes in trade policies that increase impediments to the flows of goods and services across borders, and heightened, or unexpected, political and geopolitical risks that quickly dominate the policymaking environment and market conditions.

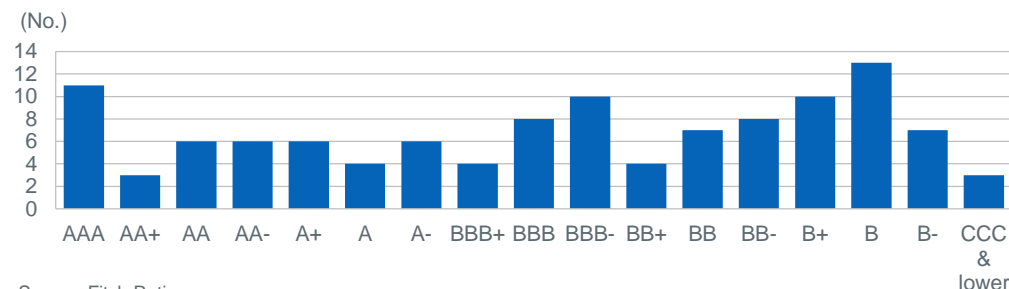


Global - Rating Changes



Source: Fitch Ratings

Global - Rating Distribution



Source: Fitch Ratings



Tightening Global Financial Conditions

The removal of accommodative monetary conditions in developed markets will reach an important milestone in 2019 with the summed balance sheets of central banks in the US, eurozone, UK and Japan expected to contract for the first time since quantitative easing began. The transition to a modest collective quantitative tightening at the same time as continued increases in US policy interest rates and a further strengthening of the US dollar if exchange rate trends persist will represent a meaningful change in global financial conditions.

From a sovereign credit perspective, the most immediate and potentially severe impacts of developed-market policy tightening will be in emerging markets. Higher funding costs can be expected for all sovereigns with globally integrated financial sectors, but emerging markets are more likely to face disruptions and heightened volatility with respect to international capital flows. Greater stresses are probable where macroeconomic imbalances are larger or where markets question the suitability or sustainability of macro policy frameworks.

Global Implications of US Policy Uncertainty

The US is unique in the global reach of its economic policy decisions, most obviously in the context of the dollar's dominance of payment systems for world trade, as the numeraire in commodity prices, the most important reserve currency, and the currency in which most external borrowing is denominated. More recently, however, an increased number of US policies have been explicitly intended to have international consequences that are dependent on the continued supremacy of the dollar, a strategy that could, over time, undermine its own foundations.

The Risk to Developed-Market Public Finances

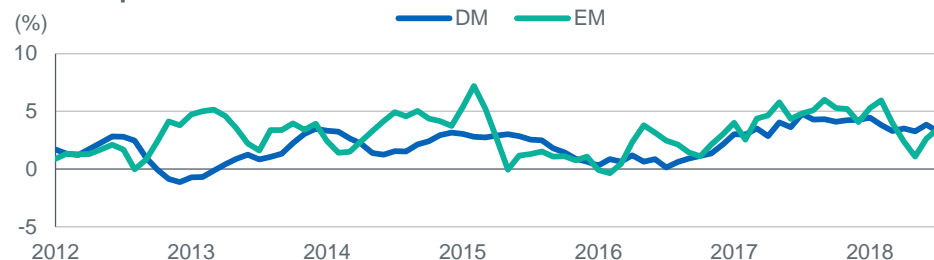
With elevated government debt levels in several developed markets even after long periods of economic expansion, public finances look exposed to the next downturn, with likely negative rating implications for some sovereigns. Looking at developed-market recessions since 1980, we find the median fall in GDP to have been 4.4%, the median deterioration in the general government balance was 4.3%, and the median increase in debt was equivalent to 16% of GDP. Fitch sees limited tolerance to absorb significant deteriorations in public finances at current rating levels for those sovereigns with relatively high public debt or weak track records of fiscal consolidation.

Nominal Effective Exchange Rate



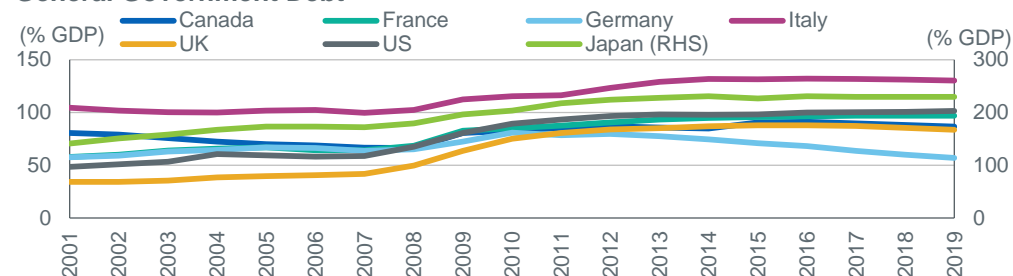
Source: Federal Reserve Bank of St Louis

Global Export Growth



Source: Netherlands Bureau of Economic Policy Analysis

General Government Debt



Source: Fitch Ratings



A more urgent US policy initiative with global implications is the active use of trade policy, and specifically the tariffs on imports from China. With no end in sight to the mounting trade tensions, the direct economic effects in terms of interruptions to trade and investment as well as higher prices and squeezed profit margins are at risk of growing larger. We believe there are no third-country “winners” in this dispute, as any benefits from displaced trade or investment must be considered in the context of slower global growth and a less integrated global economy.

With growth in China already on a mild downward trajectory, the trade dispute presents another challenge to policymakers attempting to balance the risks associated with a more meaningful slowdown against those that have typically accompanied the excesses and imbalances following previous stimulus policies. The US is of foremost importance in terms of the global impact of its policies, but China is surely second to no others. A number of commodity markets and countries’ export performances depend on Chinese policies continuing to deliver robust growth.

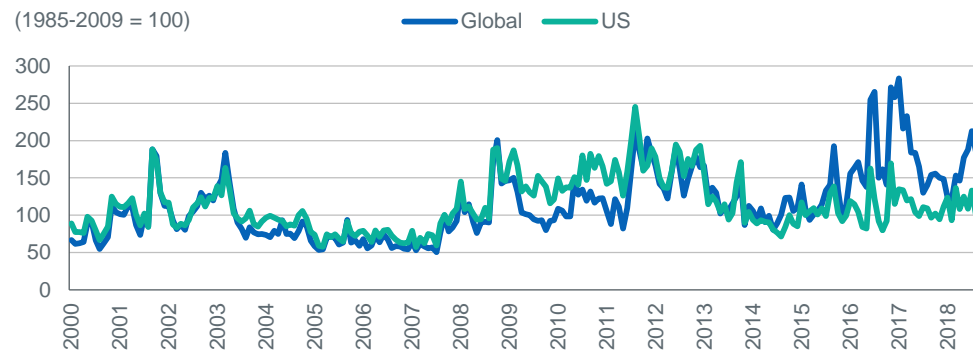
Politics and Geopolitics – the Capacity to Surprise and Overwhelm

On the experiences of the last few years, it should now be taken as given that politics can deliver abrupt and unexpected change, even in previously staid and predictable environments. Such change can be positive or negative for sovereign creditworthiness, and sometimes both, depending on the timeframe considered. Several elections in 2019 warrant investors’ attention, including those in Argentina, India, Indonesia, Nigeria, Poland and South Africa.

European Parliament elections in 2019 are also noteworthy, not least because they are a focus of Italy’s coalition government, which has some non-traditional views on various European institutions and their roles. The “European Project” is still a work in progress. Brexit will reach a conclusion of sorts next year with the end of the formal negotiating period, but it is far from clear what comes next.

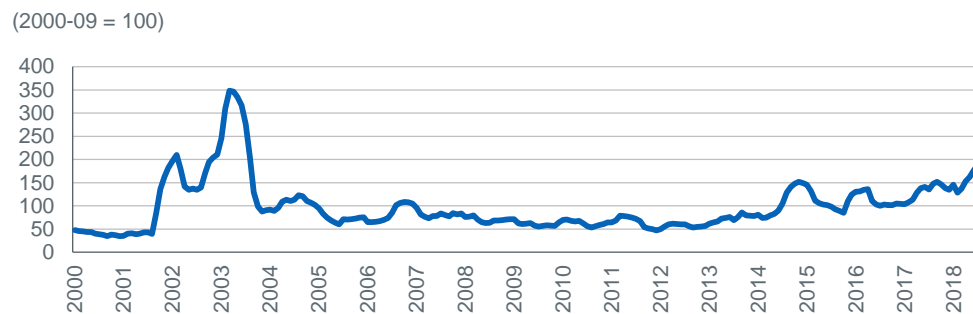
Geopolitically, the international order is as difficult to assess as ever. Oil prices remain beholden to the fact that several of the world’s larger exporting countries could be swept up in affairs that threaten production or otherwise affect their ability to supply the market. More broadly, there appear to be a growing number of countries accusing others of meddling in their internal affairs. This unsettling trend speaks to the possibility of several latent risks coming to the fore or, more dramatically, a breach of international security.

Policy Uncertainty



Source: www.policyuncertainty.com

Geopolitical Risk Index



Source: “Measuring Geopolitical Risk” by Dario Caldara and Matteo Iacoviello at <https://www2.bc.edu/matteo-iacoviello/gpr.html>



Outlooks and Related Research

2019 Outlooks

[Global Economic Outlook \(September 2018\)](#)

[Public Finances at Risk When Next Recession Strikes \(October 2018\)](#)

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