Questions That Matter

Sovereigns | Are More Defaults Inevitable?

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More defaults are likely among low- and middle-income sovereigns as the pandemic forces them to prioritize social needs of the population at a time when their capacity to continue servicing their debt is even more diminished.

How this will shape 2021

COVID-19 has highlighted the fragile positions of lower-income sovereigns. In addition to the loss in human lives, the pandemic has led to large drops in tax revenues from shutdowns, while creating spending pressures on health and social programs. As a consequence, fiscal imbalances are intensifying in the 46 sovereigns we rate with income per capita of $6,000 and below.

Fiscal limitations. Social and political tensions are likely to increase as the pandemic hits some households and economic sectors harder than others. Few of them will be able to afford the fiscal stimulus currently being administered by wealthy advanced countries, where spending is being backstopped by central banks.

In 2020, there have already been six sovereign defaults—in Argentina, Belize, Lebanon, Ecuador, Suriname, and Zambia. The long-term foreign currency issuer ratings on Lebanon, Suriname, and Zambia remain on selective default.

Governments, official lenders, and the private sector will need to make some tough decisions to increase the capacity of these countries to access more resources to boost economic activity toward a sustainable path that in turn will improve their creditworthiness

What we think and why

The vast majority (70%) of low and lower middle-income sovereigns carry ratings in the low 'B' and 'CCC' categories, highlighting overall weak creditworthiness. The low ratings of these sovereigns reflect a combination of weak public finances, high debt, high interest burdens, and often narrow economic bases, alongside limited monetary flexibility. 35% of them have interest payments higher than 20% of general government revenues, with some extreme cases like Sri Lanka, Ghana, and Egypt, where this ratio is of 68%; 52%, and 45%, respectively. The willingness and ability of EM central banks to monetize the fiscal cost of COVID is constrained in several cases by high dollarization and less developed domestic capital markets, which constrains the capacity to reverse the increase in their borrowing costs.

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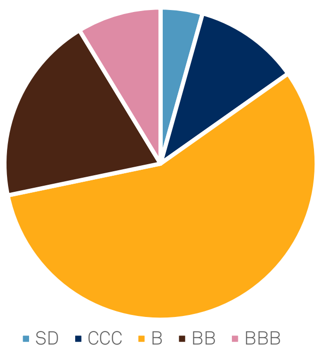
Credit FAQ: COVID-19 And Implications Of Temporary Debt Moratoriums For Rated African Sovereigns, Apr. 29, 2020

G20 Sovereign Debt Suspension: To Apply, Or Not To Apply, Dec. 2, 2020

Chart 20

Most Lower-Income Sovereign Are Rated 'B'

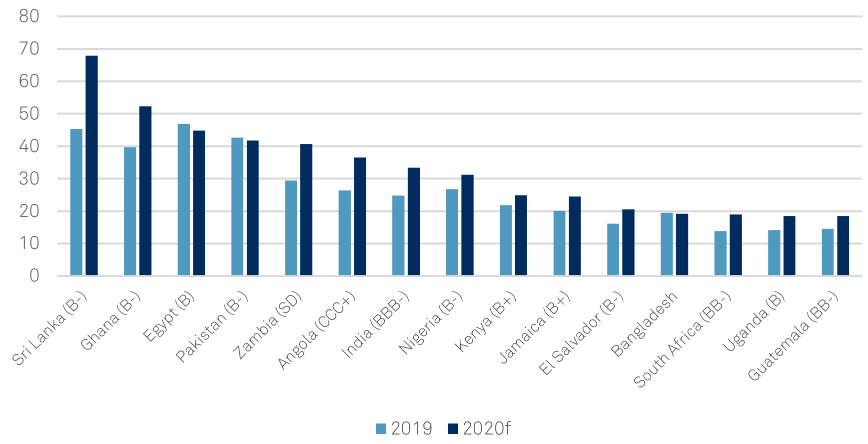


Source: S&P Global Ratings

Most of these economies are highly concentrated in one key industry, mostly commodities. They were already running fairly large fiscal deficits prior to the pandemic and are highly dependent on external borrowings denominated in foreign currency to finance their deficits, as their weak local capital markets cannot provide sufficient funding at competitive costs.

Chart 21

General Government Interest Payments / General Government Revenues (%)



Source: S&P Global Ratings

Debt relief programs such as the World Bank and IMF Heavily Indebted Poor Country Initiative could be less effective today. One key difference from the past is the composition of sovereign debt now compared to the 1990s. Today, a larger share of debt is held by private sector market participants (bondholders) rather than by bilateral or multilaterals. Hence, any potential debt relief plan, to be effective, would have a bigger impact on private sector creditors. Back in April, the G20 nations sponsored the "Debt Service Suspension Initiative". This aimed to provide relief in the context of the COVID-19 pandemic to a group of 73 low-income nations so that resources could be allocated to fight the disease. It included mostly bilateral (country to country) debt. However, according to World Bank data as of late October, about 40% of the sovereigns eligible for this debt relief have not participated in the initiative. A few reasons have been identified so far as to why this has been the case, but the one that continues to surface is the rather diverse composition of debt holders, which now includes a larger share of private holders than ever before.

What could go wrong

The road to recovery looks steep. Governments, official lenders, and the private sector will need to make some tough decisions on measures that, for example, increase the capacity of these countries to obtain more resources and to use them in a productive way to boost economic activity in a more prolonged and sustainable path that, in turn, could improve their creditworthiness. This is usually a difficult process. In the aftermath of a global pandemic, with a social environment of high tensions, it is going to prove even harder.

This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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