

Sovereigns | Can The Books Be Balanced Without Toppling Growth?

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As governments seek a delicate balance between growth and fiscal rebalancing, there is a risk that inflation and higher commodity prices could throw a wrench in the recovery.

How this will shape 2022

Economic recovery is still uneven and highly correlated with the pace of vaccination and the size of the fiscal and monetary stimulus available. While strongly under way in developed sovereigns, recovery is lagging in Latin America, Africa, and to a lesser extent in South East Asia.

Fiscal consolidation will take longer. While most economies expect to return to pre-COVID output levels by the end of 2021 or in 2022, we forecast that, in 2023, average general government deficits to GDP in 2023 will still be above the 2015-2019 average in nearly all regions (see chart 32). 2022 is likely to be a year of transition in terms of fiscal rebalancing. While sovereigns will unlikely be able to implement serious revenue-increasing measures or reforms, the overall fiscal picture should continue improving, primarily from the recovery of revenue--as economies reopen--and from the end of temporary expenditures/subsidies measures that will not be extended.

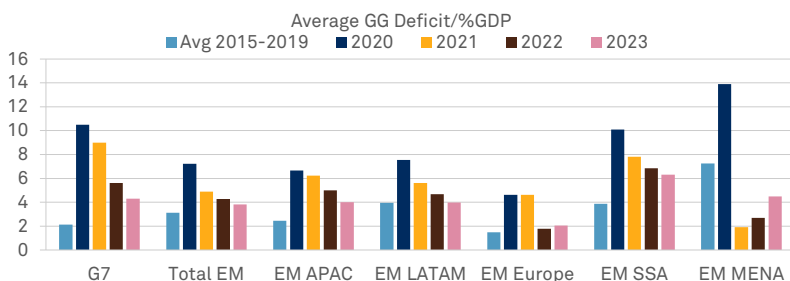
Sovereigns that cannot stabilize or improve their fiscal position could see negative rating pressure

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Chart 32

Most Regions' Deficits In 2023 Will Still Be Above The 2015-2019 Average

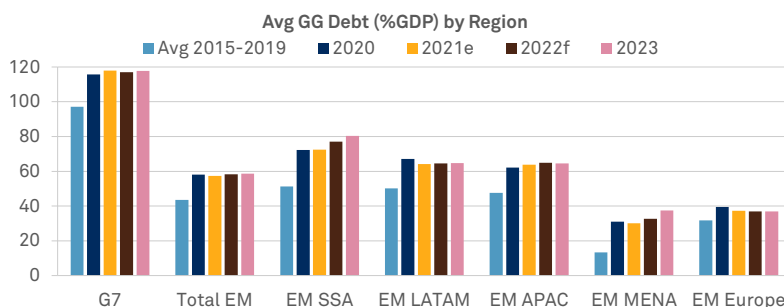


Source: S&P Global Ratings

All sovereigns are entering 2022 in a weaker fiscal position than before the pandemic (see chart 33). Some have used up a large share of their fiscal buffers and were able to sustain ratings levels. Others had little to no room for fiscal deterioration and their pre-pandemic creditworthiness was not able to withstand the crisis. The larger share, however, is somewhere in the middle of these two groups. Between January 2020 and September 2021, approximately 25% of our sovereign portfolio had at least one downgrade, and seven sovereigns defaulted.

Chart 33

Sovereigns' Fiscal Positions Are Weaker Than Before The Pandemic



Source: S&P Global Ratings

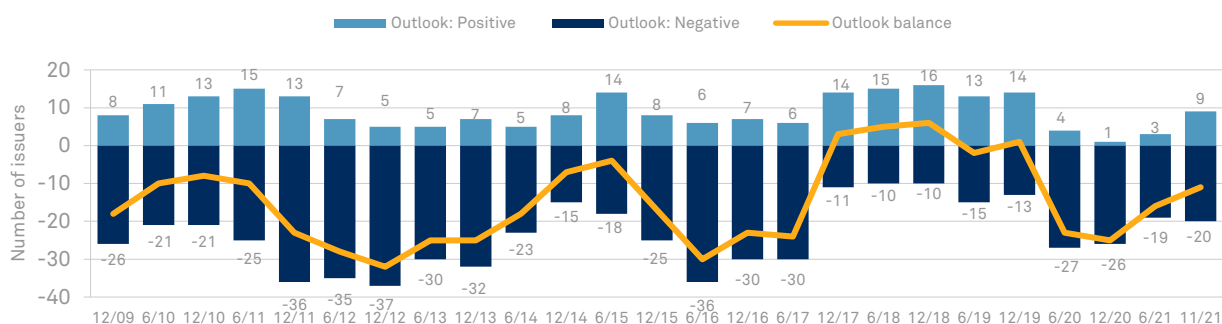
Global Credit Outlook 2022: Aftershocks, Future Shocks, And Transitions

What we think and why

Governments face the delicate task of withdrawing fiscal stimulus without hurting growth in a more fragile social context after the damage left by COVID-19. In Peru, for example, the pandemic contributed to a very fragmented congress that could make it harder to manage the political challenges of fiscal consolidation and, in turn, hurt growth. We revised our outlook on Peru to negative in October. Sustaining growth rates that could aid fiscal consolidation will be difficult once the temporary fiscal stimulus phases out. In this context, both the EU and the U.S. have designed longer term programs to recover from the pandemic, such as the EU Recovery and Resilience and the U.S. Build Back Better. Such large-scale programs are less feasible for emerging markets and we expect those struggling before the pandemic in terms of economic growth, mainly in Latin America and Sub-Saharan Africa, will go back to those dynamics in 2022. The costs that sovereigns had to incur to counter the pandemic since early 2020 will be around for years to come.

Sovereigns that cannot stabilize or improve their fiscal position will likely see negative pressures on their credit ratings over the next 12 to 18 months. This was the case for Colombia and Chile, which we downgraded earlier this year, as well as for Spain, Malaysia, and Indonesia, which saw the rating outlooks revised to negative. Currently, 20 sovereigns have negative outlooks, versus nine with positive outlooks. All but one of the negative outlooks (Spain) are in emerging or frontier market economies (see chart 34).

Chart 34
Global Sovereign Ratings Outlook Balance As of Nov. 12, 2021



Source: S&P Global Ratings

What could go wrong

Monetary tightening and rising interest rates could complicate governments' attempts to balance growth and fiscal rebalancing. Inflationary pressures are mounting. A combination of supply-chain bottlenecks, labor dislocations, and production facilities that are still not operating or are doing so at reduced capacity are pushing wages and prices higher. Commodities reached their highest prices of the past five years. In response, monetary authorities have started to reduce the massive stimulus put in place to fight the pandemic. This indicates that interest rates in advanced economies will start to rise in 2022, while the rates hike has already started in emerging markets.

The combination of inflation, higher commodity prices--especially energy--and measures to counterbalance them, could throw a wrench in the recovery. In particular, emerging markets that are net importers of oil could see their current account deficits widen because of higher import bills at a time when foreign currency funding will be more expensive and difficult to access. In addition, persistently higher energy prices will likely mean that some of the temporary fiscal measures put in place during the pandemic, instead of being phased out, could be extended, or replaced by new ones. This would likely push growth downward and extend the timing of fiscal rebalancing further to future years, negatively impacting creditworthiness and ratings.

This report is an extract from "[Global Credit Outlook 2022: Aftershocks, Future Shocks, And Transitions](#)", Dec. 1, 2021.

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