



Subnational Debt 2024

Global LRGs can handle rising interest expenses

S&P Global
Ratings

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This report does not constitute a rating action

Key Takeaways

- We generally see interest expenses putting increasing pressure on the budgets of local and regional governments (LRGs) worldwide. This pressure will only ease if rates decline faster than we expect, or if LRGs reduce their deficits.
- For now, the pressure seems manageable for most LRG sectors worldwide. However, expanding deficits or higher-for-longer rates would quickly ramp the pressure up even further and limit budgetary flexibility, especially where debt stocks are high or debt repricing is fast due to a reliance on variable-rate or relatively short-term debt.
- We see most pressure in countries that need to increase investments materially (like New Zealand, Canada, and Australia), or where LRGs must help sustain economic growth (China).
- Countries that rely on short-term debt (Nordics) or variable-rate debt (Central and Eastern Europe) will see faster repricing and moderate pressure.
- Western Europe seems to have a fair amount of protection thanks to the predominance of long-dated, fixed-rate debt, still benign funding conditions, and moderating deficits. That said, within each LRG sector, meaningful differences between entities affect risk significantly.
- Indian LRGs face a very high interest burden, but we expect their interest ratios to improve slightly thanks to fast revenue expansion. Japanese LRGs should continue to benefit from very low borrowing costs.

Interest Burdens Across Global LRGs Are Set To Follow Different Paths

Deficits, the existing debt stock, credit conditions, and the speed of debt repricing will drive the evolution

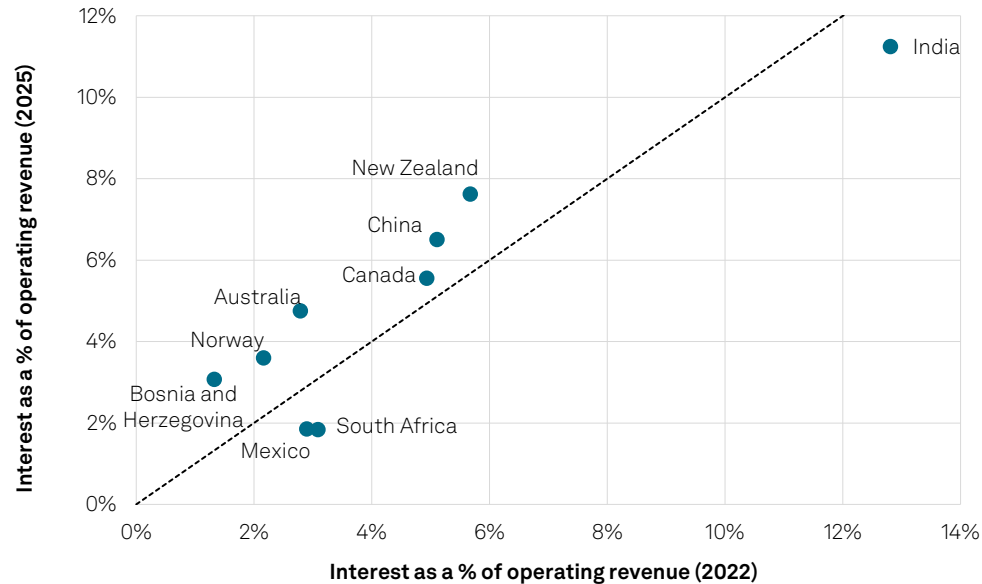
	Trend (2022-2025)		
Interest as a % of operating revenue (2022)	Worsening	Stable	Improving
Very high (above 6%)			India
High (4%-6%)	Canada, China, New Zealand		
Medium (2%-4%)	Australia, Norway, U.K.	Morocco	Mexico, South Africa, Turkiye
Low (1%-2%)	Belgium, Bosnia and Herzegovina, Brazil, France, Germany, Latvia, Poland, Spain, Sweden	Argentina, Colombia, Italy	Netherlands
Very low (0%-1%)	Austria, Denmark, Finland, Japan, Sweden	Croatia, Indonesia, North Macedonia, Romania, Switzerland, Vietnam	Czech Republic

LRGs In New Zealand, China, Norway, And Australia Will See The Largest Interest Burden Hikes

European LRGs will see interest expenditure rise, but only moderately

Indian LRGs face the highest interest rate pressure, but with a slightly improving trend

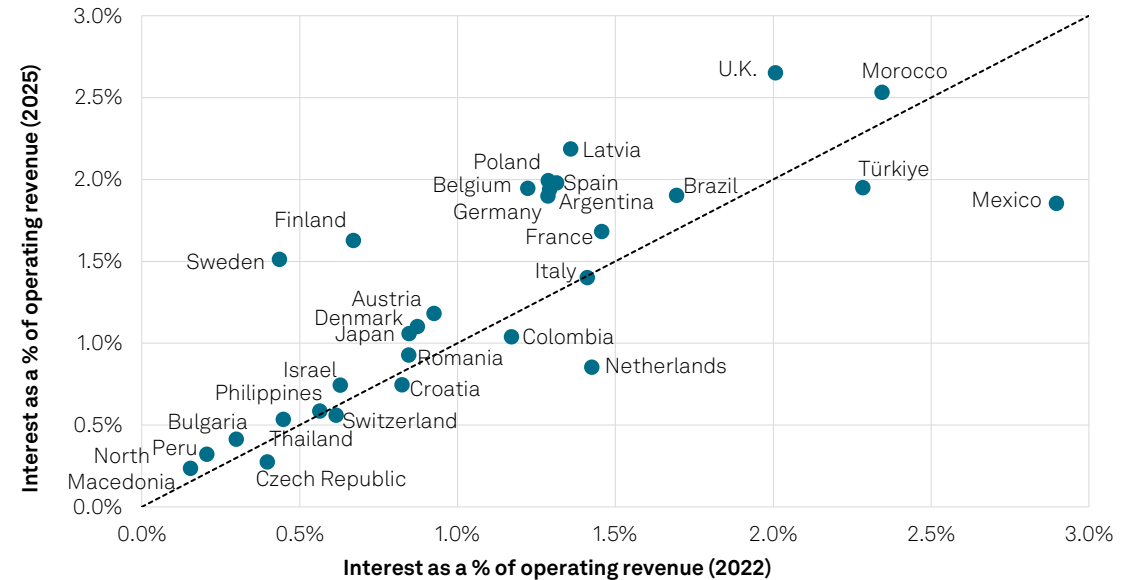
Expected change in interest expenditures as a % of operating revenue



Source: S&P Global Ratings.

European LRGs will see moderately rising interest burdens

Expected change in interest expenditures as a % of operating revenue



Source: S&P Global Ratings.

The Key Drivers Of The Evolution In Interest Burdens Vary Across Countries

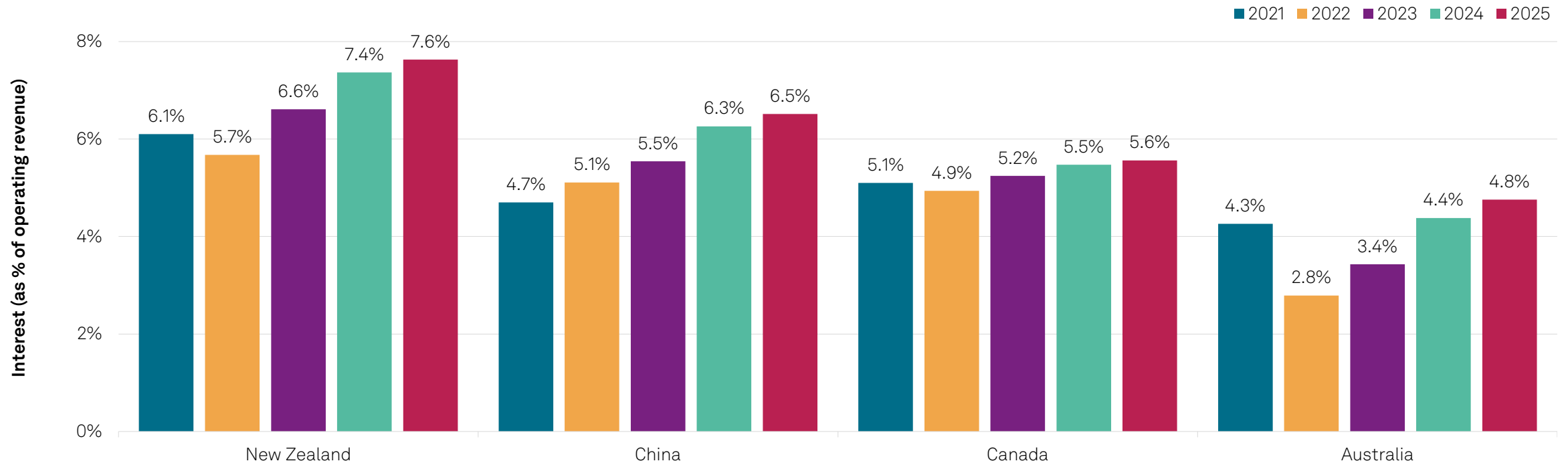
Large debt stocks and deficits create vulnerability, as does reliance on short-dated, variable-rate debt

Key risk factors

	Expected deficits	Debt stock	Debt structure (fixed versus variable)	Refinancing / average life of debt
New Zealand	Green	Green	Green	Green
China	Green	Green	Grey	Grey
Canada	Green	Green	Grey	Grey
Australia	Green	Green	Grey	Grey
Norway	Green	Green	Green	Green
Sweden	Grey	Grey	Green	Green
Finland	Green	Grey	Green	Grey

We Expect The Steepest Interest-Burden Increases At LRGs In New Zealand, China, Canada, And Australia

The interest burden is set to rise particularly strongly in New Zealand

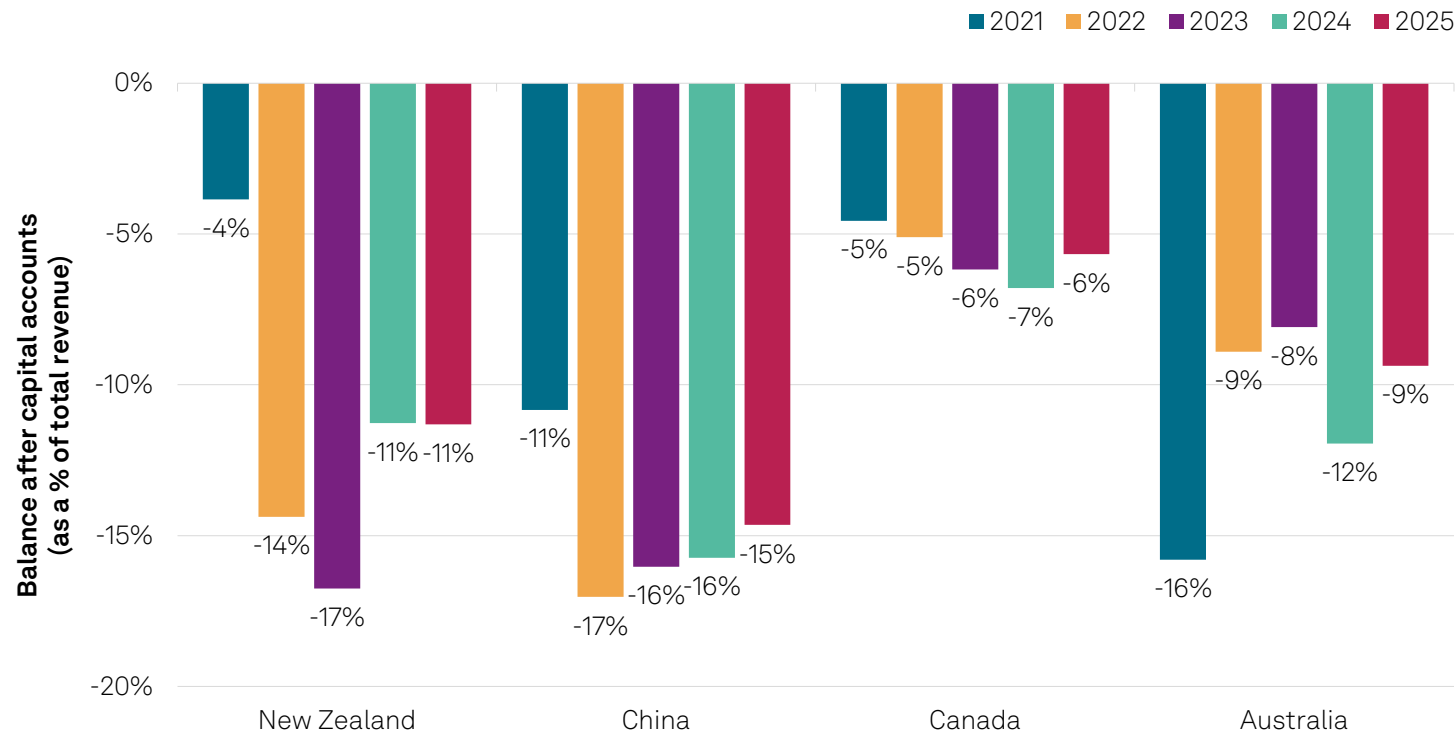


Source: S&P Global Ratings.

Large Deficits Will Only Add To Already High Debt Stocks...

New Zealand and Australian LRGs are embarking on large infrastructure projects

Large deficits in China, New Zealand, and Australia will drive borrowing needs and add to interest rate pressures



- Chinese LRGs will continue to post very large deficits as they seek to boost economic growth, albeit with a slightly improving trend.
- New Zealand councils are running large deficits to finance infrastructure projects amid tighter national standards for water quality and earthquake management, as well as reconstruction following recent flooding.
- Australian states will run high deficits to invest in infrastructure, particularly road and rail, as well as in the energy transition.
- Canadian deficits are relatively large, but more moderate than those of peers.

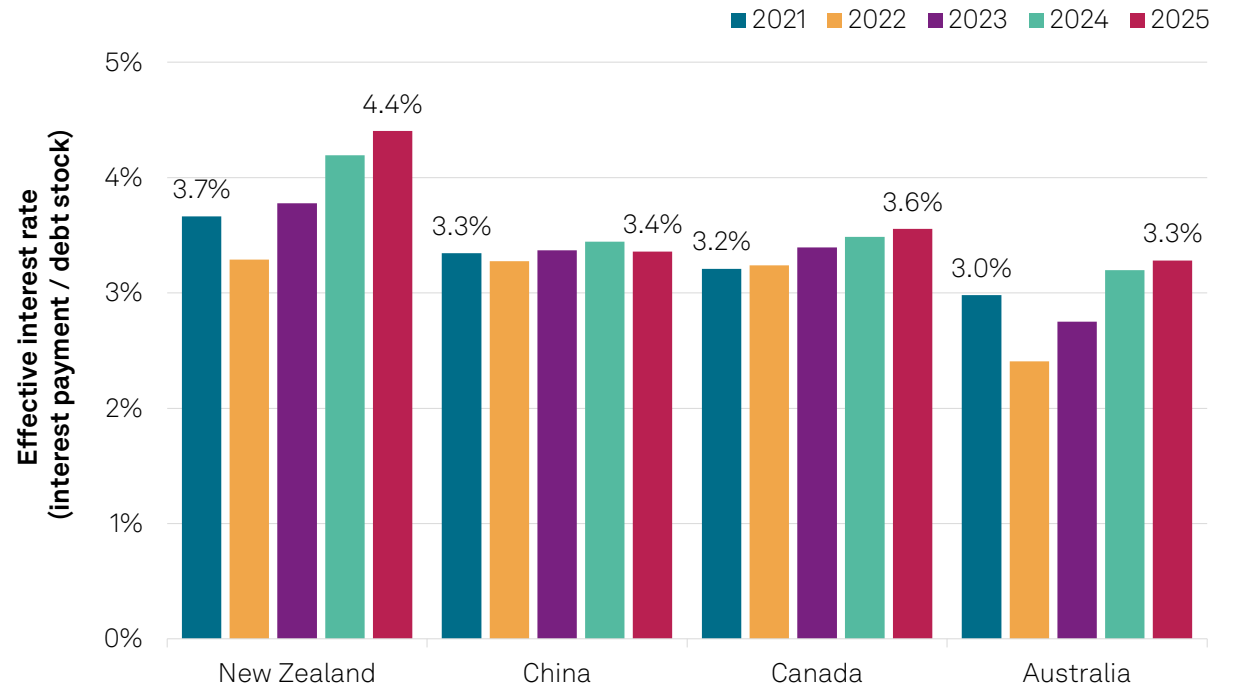
Source: S&P Global Ratings.

...While Average Funding Costs Will Rise Materially In New Zealand And Australia

Average funding costs are set to remain fairly stable in China and Canada

- Chinese LRGs' funding costs are set to remain fairly stable, or even decline slightly, as determined by the country's monetary policy.
- New Zealand councils will see a steep increase in their funding costs, partly due to the short-term nature of their issues. The average term for councils borrowing from the New Zealand Local Government Funding Agency Ltd., the main lender to councils, stands at around five years.
- Furthermore, the Reserve Bank of New Zealand has been relatively hawkish, hiking its policy rate earlier and faster than most peer central banks in developing markets. A high share of variable-rate debt also affects repricing.
- Australian states will likely see an increase in average funding costs, adding to the pressure, albeit without it reaching levels in New Zealand.
- The effective interest rate in Canada will rise moderately, since about 11% of provincial debt is exposed to variable rates, and about 10%-12% is refinanced annually. However, interest rates that remain higher for longer would add to the pressure on Canadian LRGs.

Effective interest rates are set to rise in New Zealand and Australia

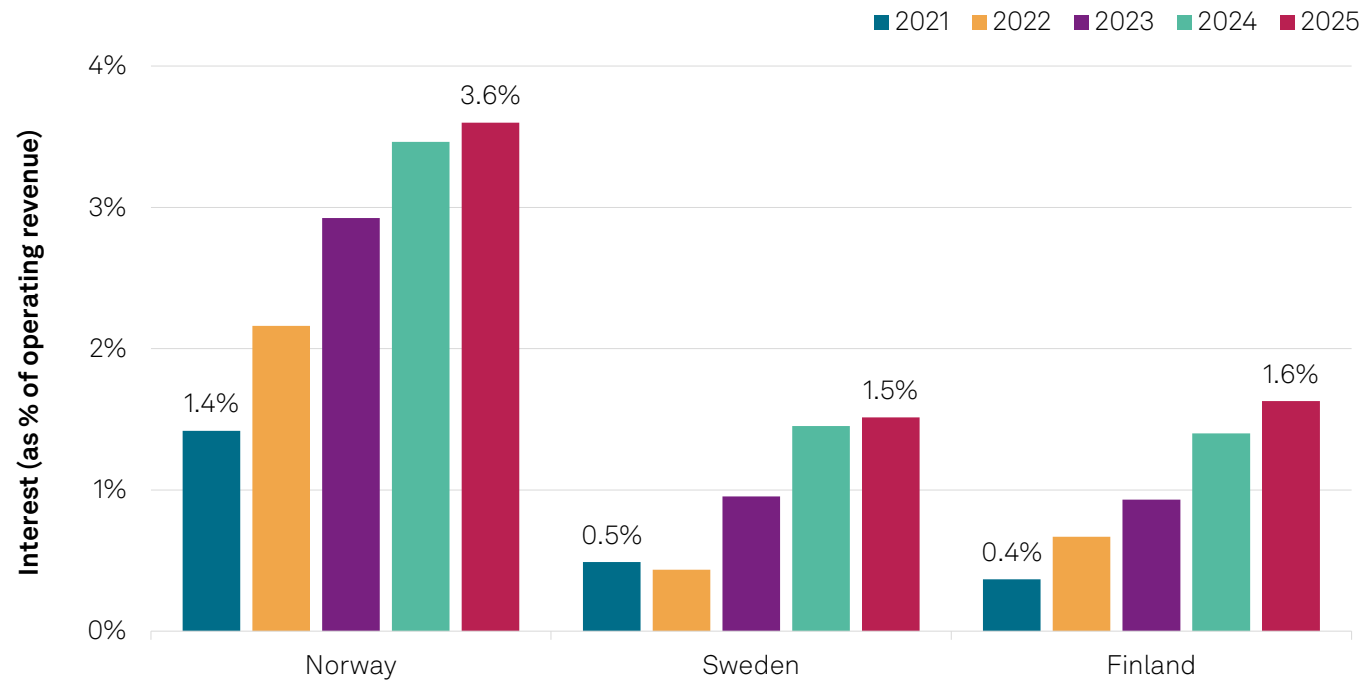


Source: S&P Global Ratings.

Nordic LRGs Will See Their Interest Burdens Rise, Albeit From A Strong Starting Point

Sweden and Norway are exposed to short-term debt, while Norwegian and Finnish LRGs' deficits will require new interest-bearing debt

The interest burden is set to worsen more in Norway than in other Nordics



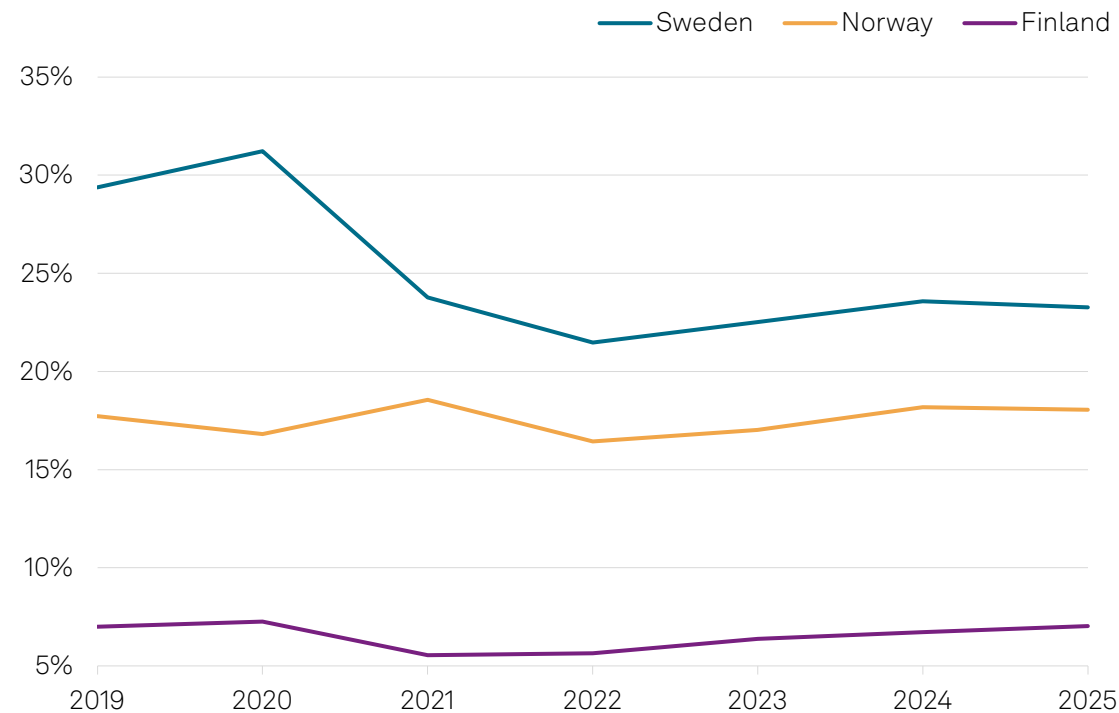
Norway is set to experience the fastest increase in interest, but pressure should remain manageable. Source: S&P Global Ratings.

- Norwegian LRGs will see a steep increase in their interest burdens due to likely high deficits. LRGs in Norway are having to increase their investments to accommodate increasing public service needs arising from an aging population. Despite this tension, we view the Norwegian central government as supportive, having both the willingness and the means to intervene if necessary.
- Finnish LRGs are feeling the impact of increasing investment needs to improve public services, though to a lesser degree than in Norway. Finnish LRGs are also less exposed than other Nordics to refinancing risk.
- In Sweden, the key driver of deterioration is exposure to short-term debt, which leads to a fast repricing of debt portfolios. However, deficits are set to remain moderate, and risks are mitigated by access to centralized funding sources (like Kommuninvest), as well as on-lending to self-supporting GREs that shoulder the weight of the added interest.

Rapid Short-Term Debt Refinancing Raises Nordic LRGs' Effective Interest Rates

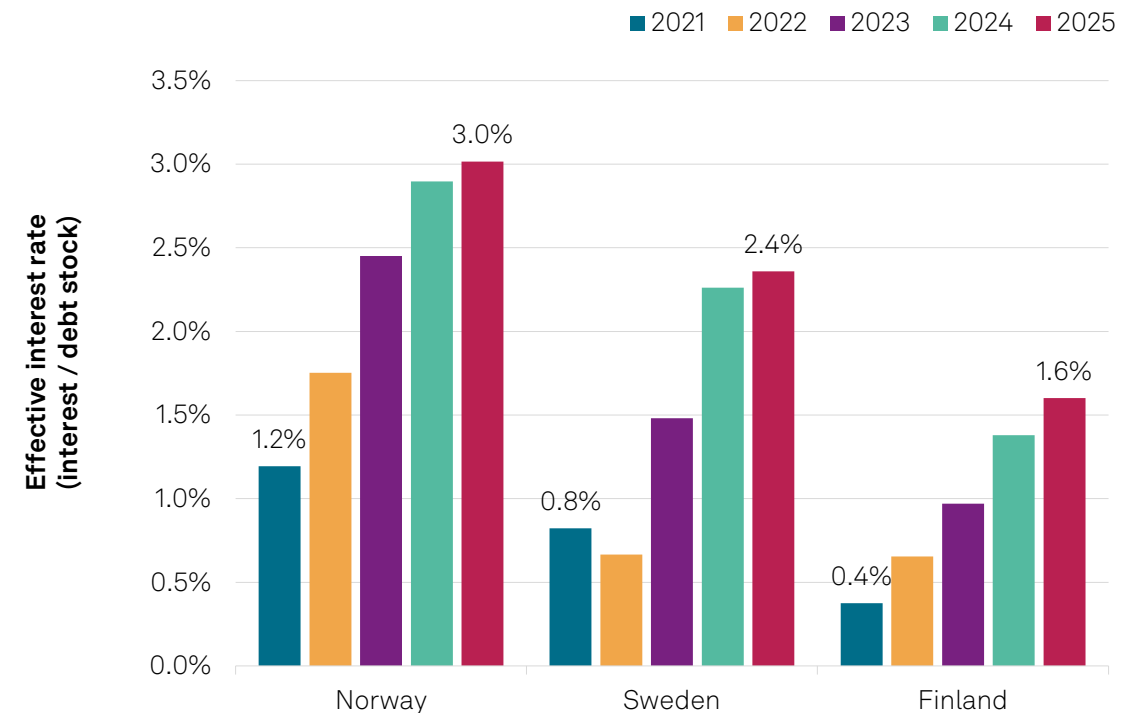
Swedish and Norwegian LRGs refinance a large proportion of debt each year

Finnish LRGs are less exposed



Source: S&P Global Ratings.

Effective interest rates will rise more markedly in Norway

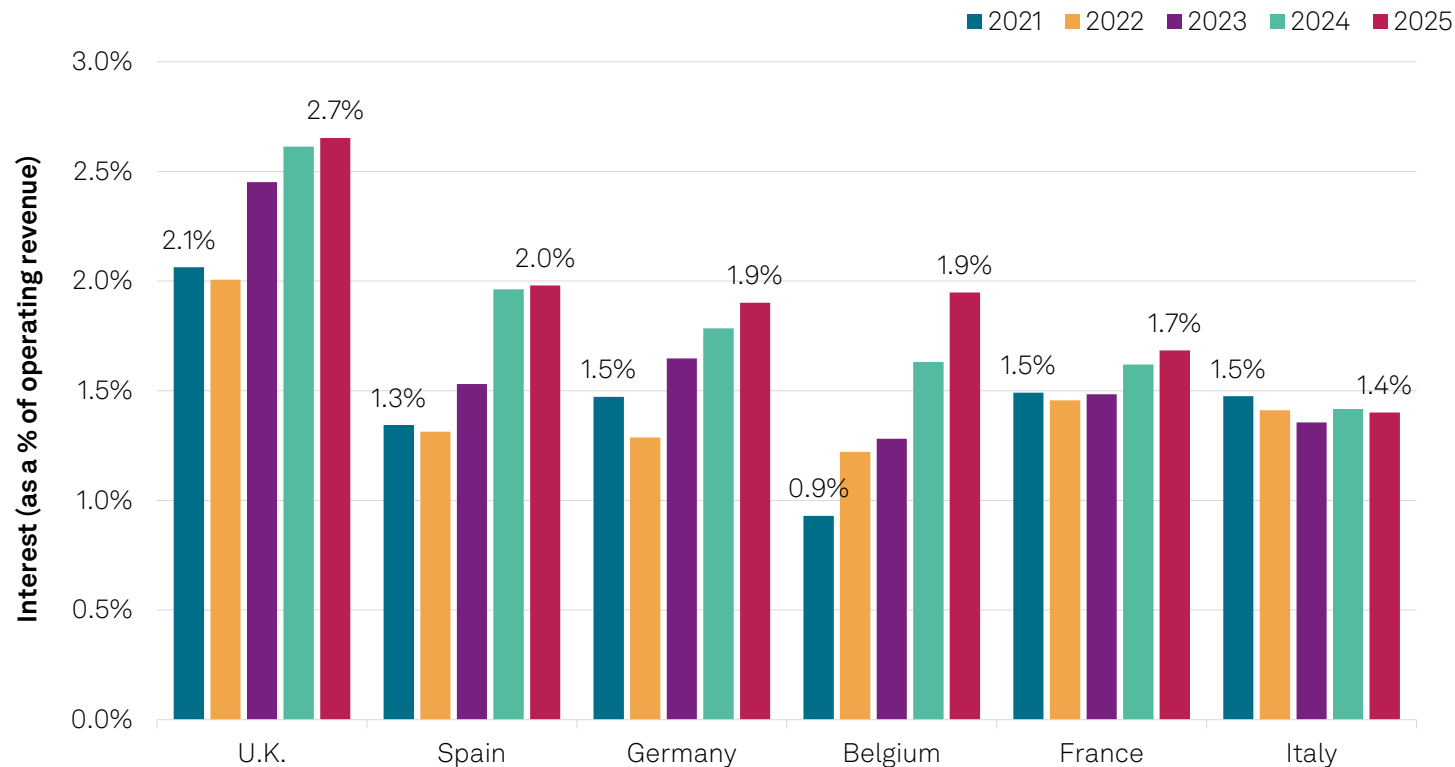


Source: S&P Global Ratings.

Large Western European Countries Will Only See Moderate Rises In Interest

U.K. LRGs are set to experience the largest increase in interest burden

LRGs in Spain, Germany, and Belgium will also face some pressure



Source: S&P Global Ratings.

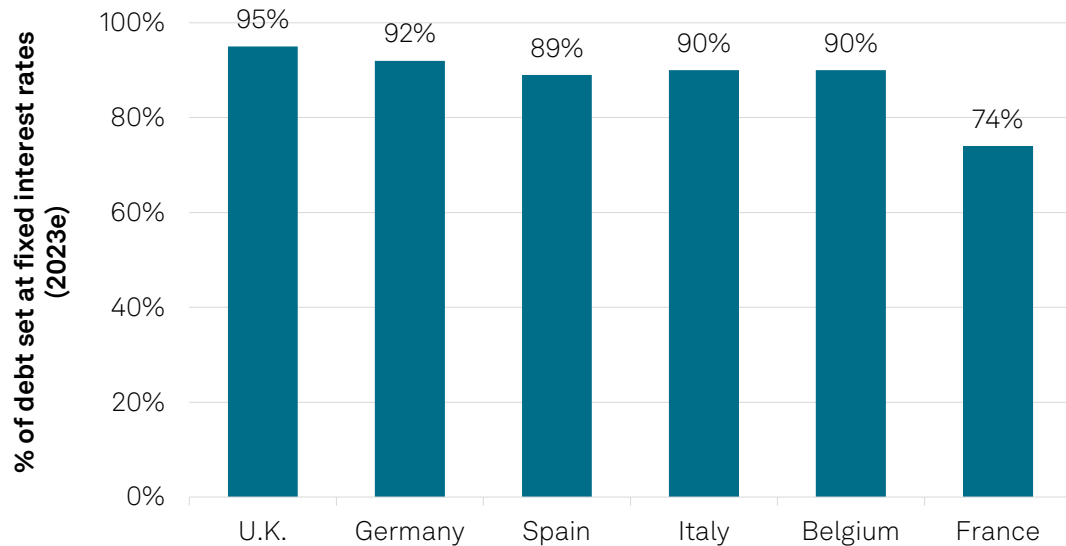
- Interest rate pressure on budgets is most acute for LRGs in the U.K., mostly due to the high average deficit we expect of about 6% of total revenues between 2023 and 2025.
- Interest rate pressure is also set to increase in Germany, Spain, and Belgium, but thanks to long-dated, fixed-rate debt, such pressure will remain manageable, as debt repricing takes a long time, giving LRGs time to adjust.
- In France and Italy, we expect low deficits or balanced budgets. Despite having lower debt ratios than their French counterparts, Italian LRGs' funding costs are higher on average. Overall, however, we expect a fairly stable situation in both countries.

A High Proportion Of Fixed-Rate Debt And Slow Refinancing Mitigate The Risk

German and Spanish LRGs are slightly more exposed to refinancing risk than peers

Western European LRGs have largely fixed-rated debt portfolios

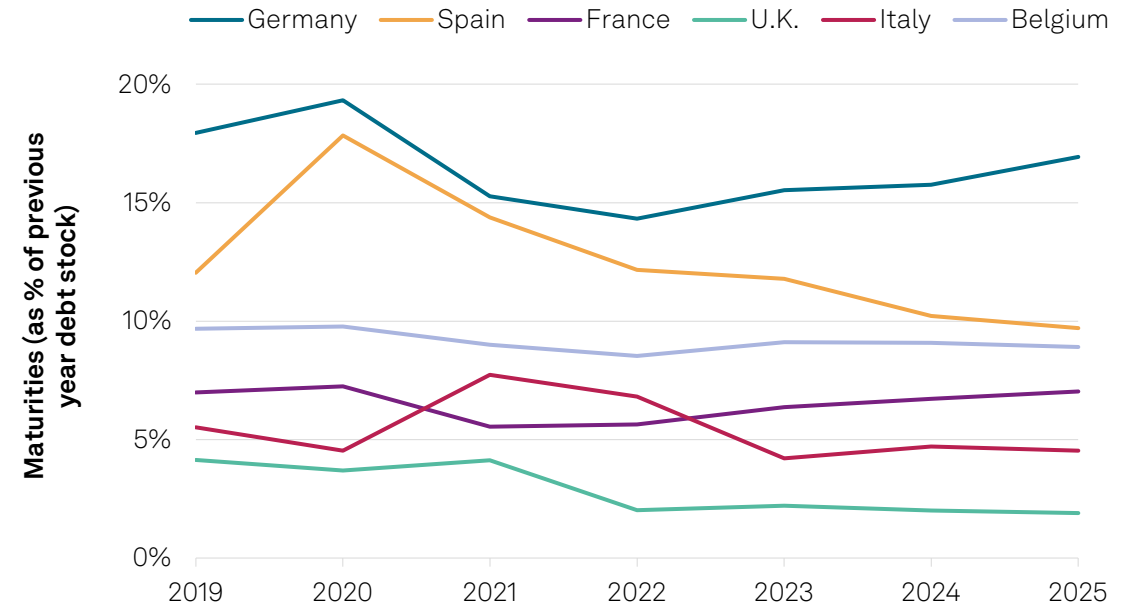
This shields them from a fast repricing of their debt



e--Estimate. Source: S&P Global Ratings.

German LRGs are the most exposed to refinancing in the years ahead

Spanish LRGs' refinanced CG loans in 2020 and 2021 to take advantage of low rates



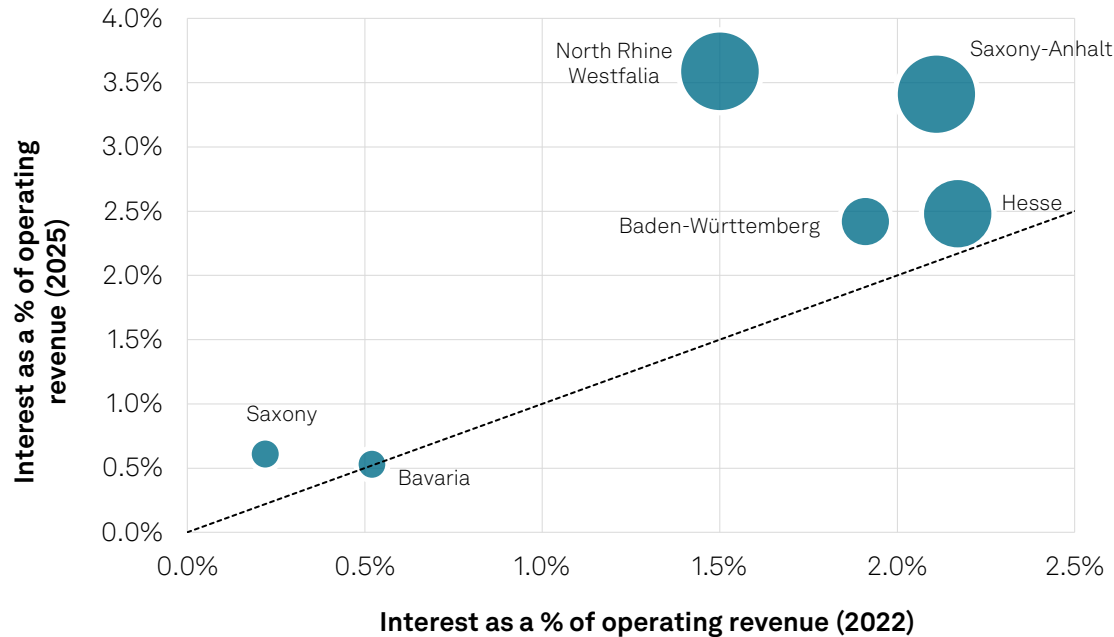
CG--Central government. Source: S&P Global Ratings.

The Most Highly Indebted LRGs in Germany And Spain Are More Exposed

In Spain, access to central government funding mitigates the risk

Highly indebted states will see a greater impact, driven by relatively fast repricing

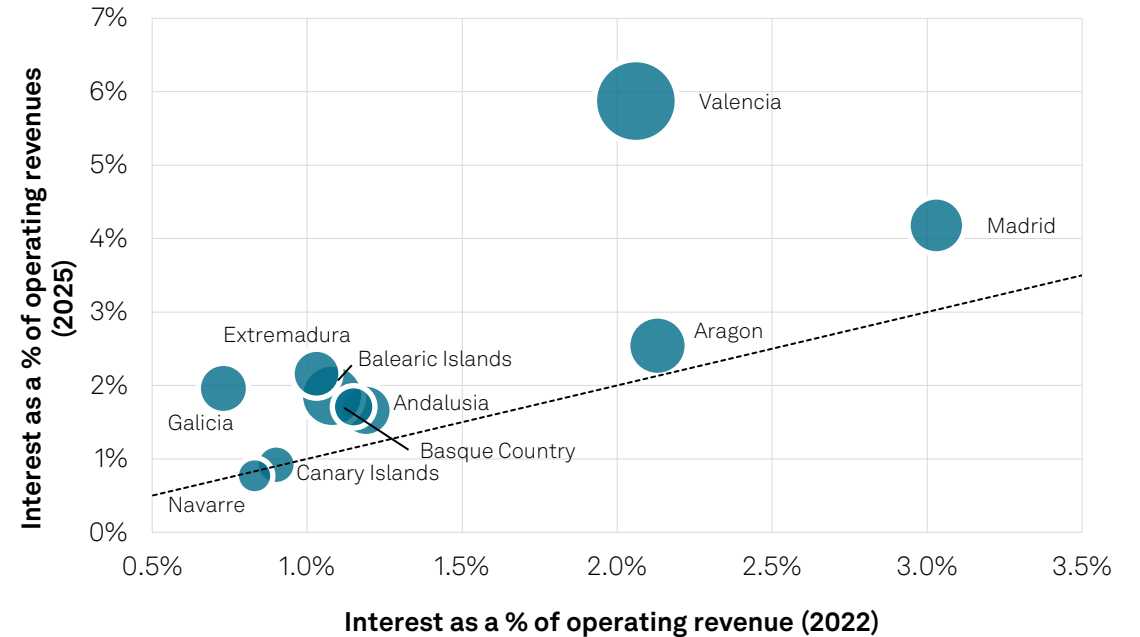
Saxony and Bavaria are almost immune thanks to their very low debt burdens



Bubble size represents tax-supported debt as a % of consolidated operating revenue. S&P Global Ratings-rated entities only. Source: S&P Global Ratings.

Highly indebted regions will see a greater impact, moderated by subsidized funding from the central government

Madrid's cost increase reflects a policy of market-based, long-maturity debt issues



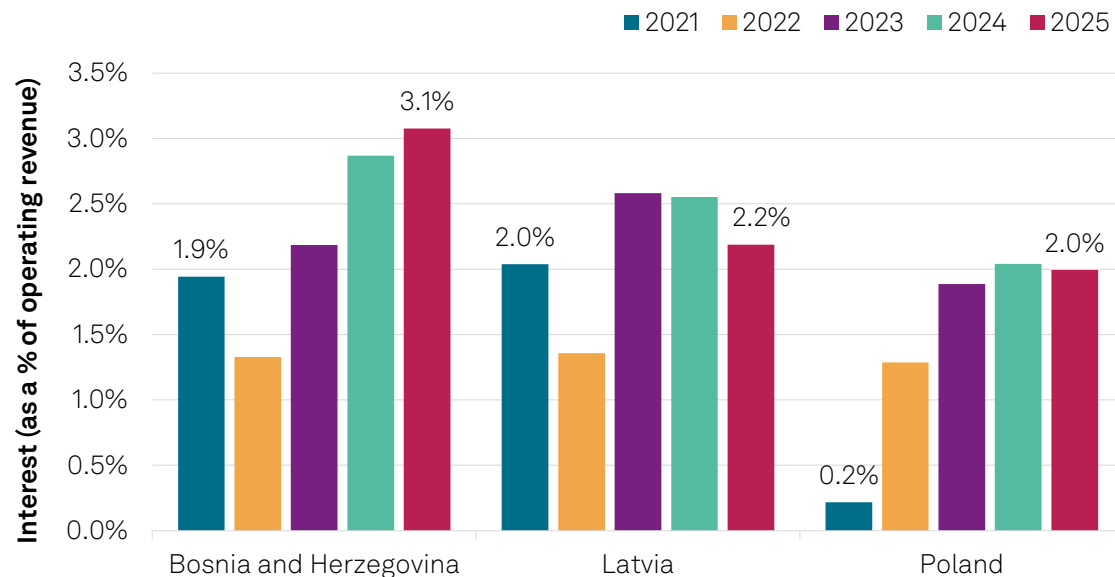
Bubble size represents tax-supported debt as a % of consolidated operating revenue. S&P Global Ratings-rated entities only. Source: S&P Global Ratings.

In Central And Eastern Europe, Bosnia, Latvia, And Poland Are Most Exposed

Exposure to variable-rate debt is a key vulnerability in these countries. Bosnian LRGs also have higher levels of debt

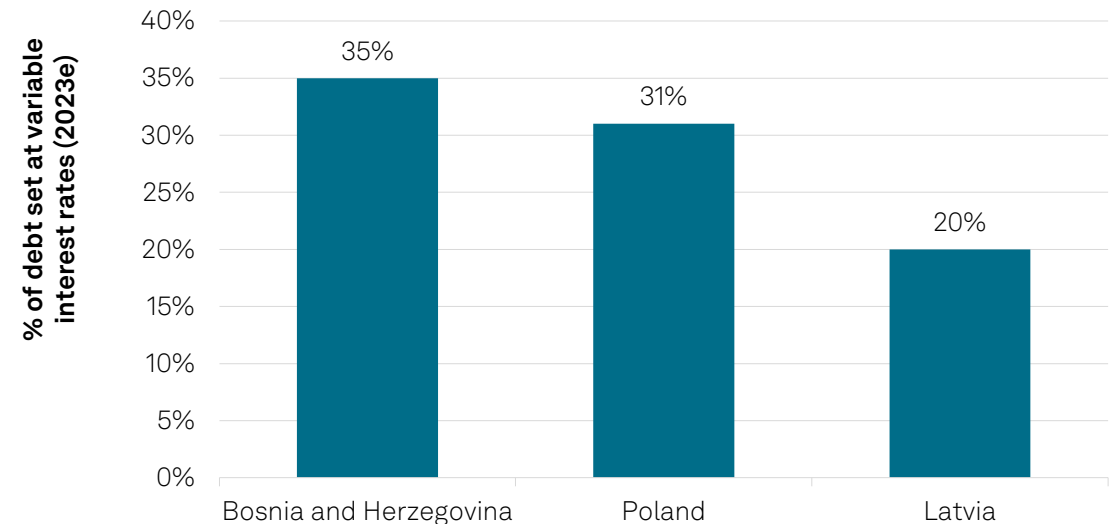
Among CEE countries, Bosnia, Latvia, and Poland may experience additional pressure

Variable-rate debt is more prevalent in these countries than in others in CEE or Western Europe



Poland, Bosnia, and Latvia will see more pressure. Other countries show great stability. CEE--Central and Eastern Europe. Source: S&P Global Ratings.

Variable-rate debt is relatively prevalent in these countries
This has led to a rapid repricing of the portfolio in recent years



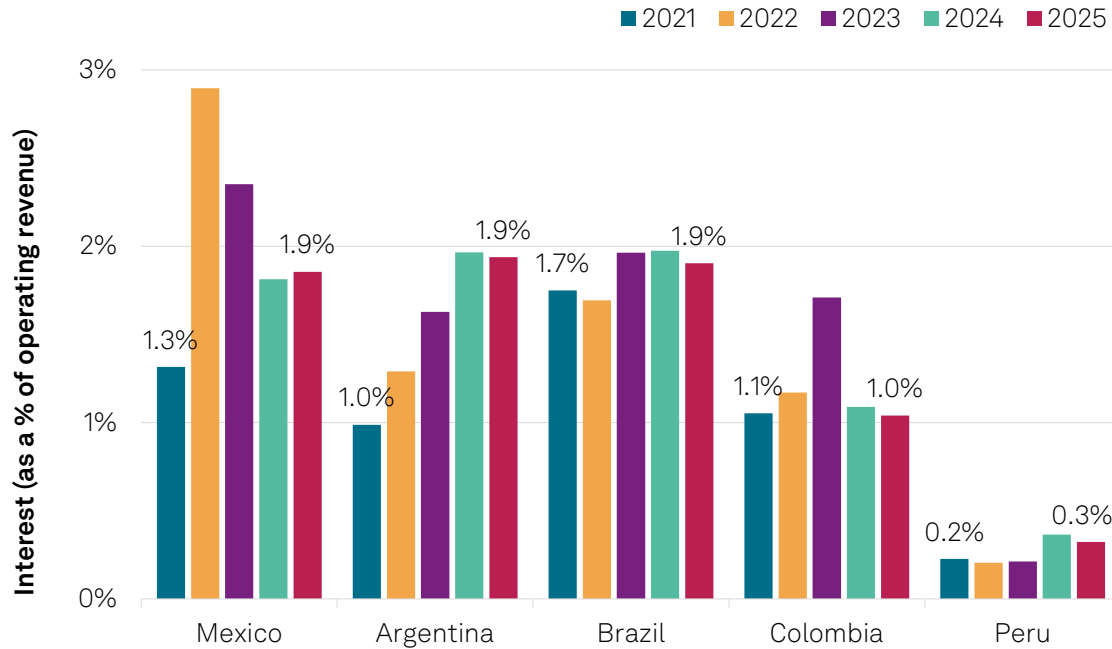
e--Estimate. Source: S&P Global Ratings.

Latin American LRGs Are Mostly Protected Thanks To Low Debt Burdens

Brazilian LRGs benefit from low funding costs of below 4% on average. Risks to Argentine LRGs' interest burden will stem from currency movements on US\$-denominated debt, as market access is restricted.

Latin American LRGs see moderate pressure on their budgets thanks to low levels of debt

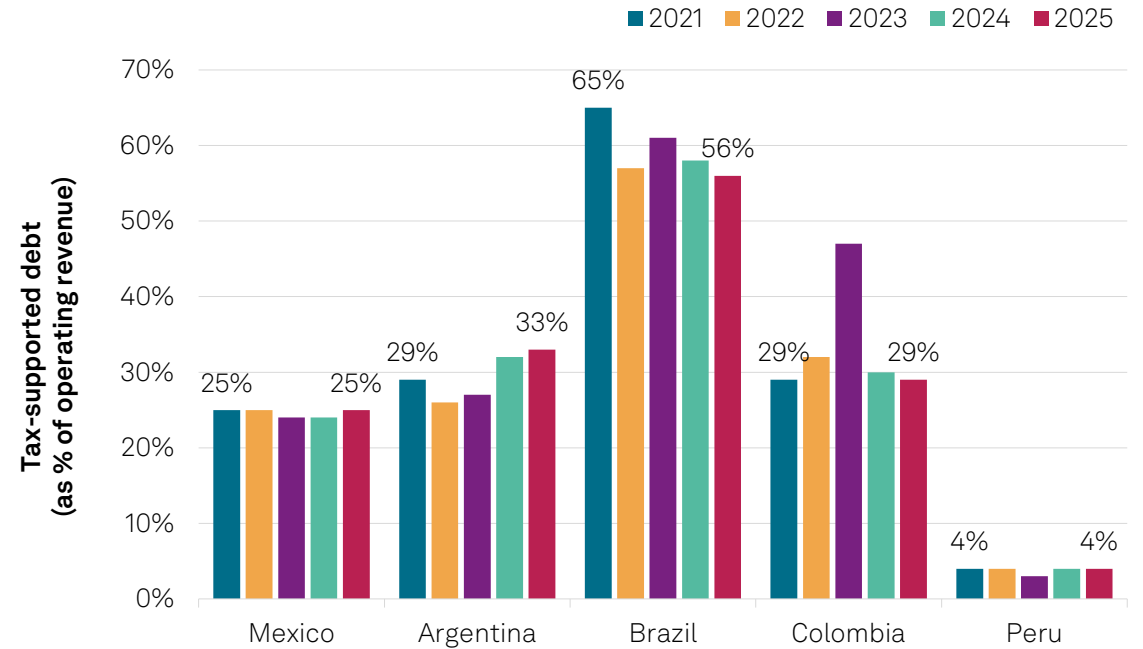
Mexican LRGs benefit from stable debt and expanding revenue



Source: S&P Global Ratings.

Debt ratios in Latin America are low and largely stable

Brazilian LRGs have the highest debt ratios, but they are declining



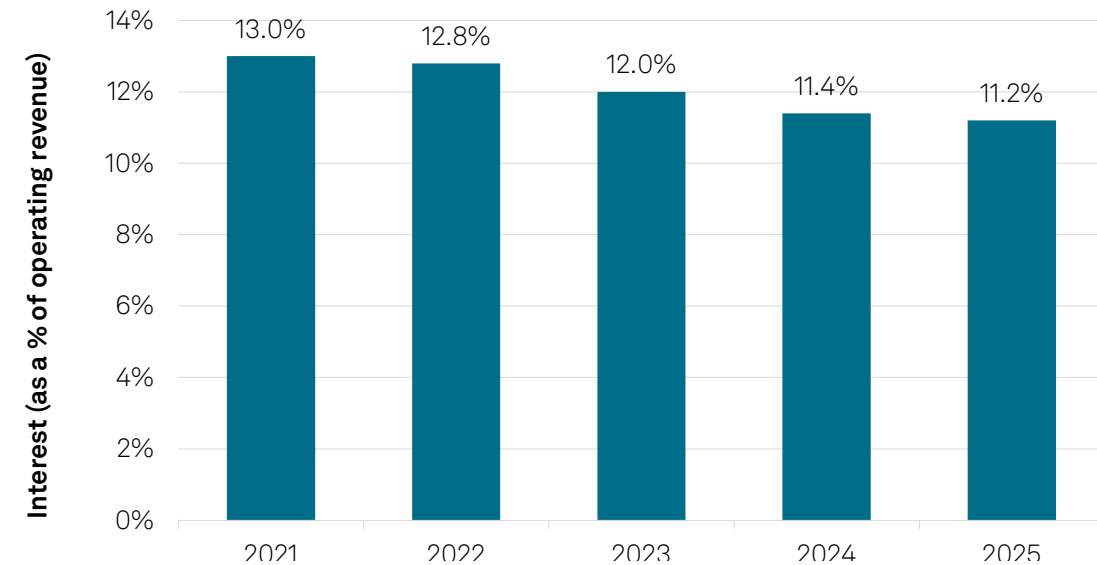
Source: S&P Global Ratings.

India: Improvement Thanks To Strong Revenue Growth, But Pressure Remains High

Effective interest rates will come down slightly, but the main source of resilience is economic growth

Indian LRGs' interest burden is very high, but set to moderately decline

Revenue expansion explains the trend



Source: S&P Global Ratings.

Indian LRGs' revenues are growing fast, which shields their budgets from interest rate pressure

This is despite large debt stocks and likely large deficits



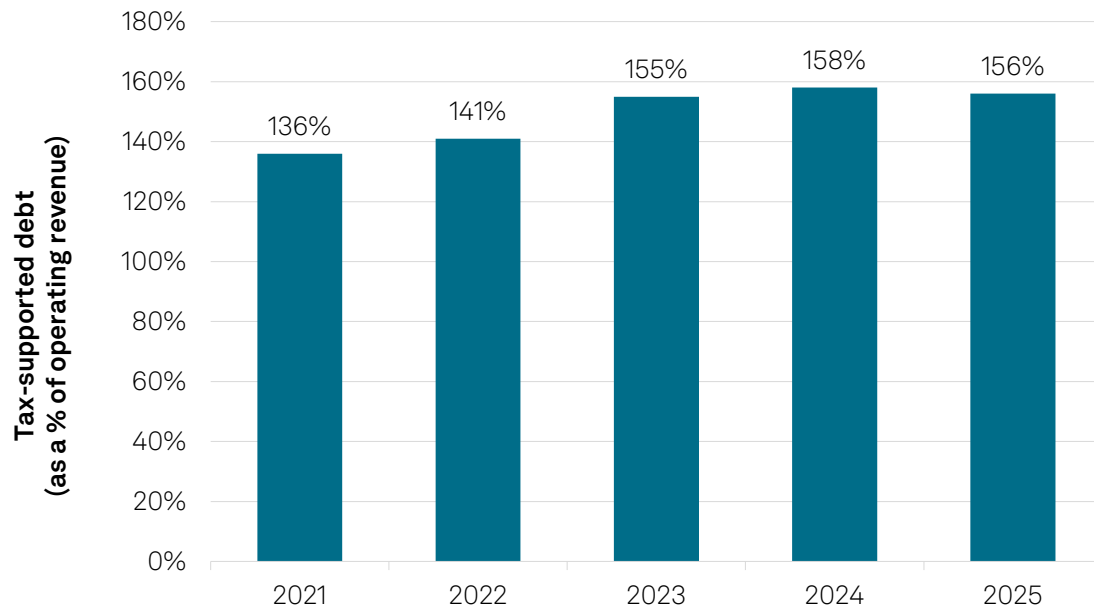
Source: S&P Global Ratings.

Japan: Ultra-Low Funding Costs Are Set To Stay, Mitigating The Impact Of High Debt

We expect an average effective rate of only about 0.7% between 2023 and 2025

Japanese LRG debt remains high in an international comparison

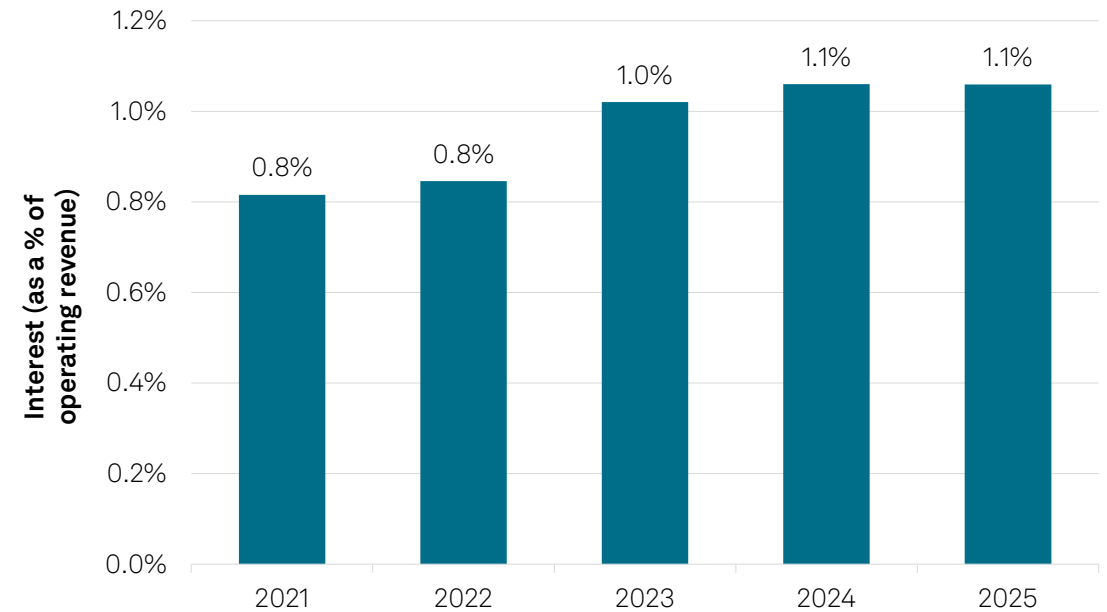
However, we see signs of stabilization



Source: S&P Global Ratings.

Japanese LRGs' interest burden as a % of operating revenue will remain very low

Funding costs are set to remain low in Japan



Source: S&P Global Ratings.

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