



Which countries appear to be on a positive debt trajectory?

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Kaspar Hense
BlueBay Senior
Portfolio Manager,
Investment Grade team

Published November 2023

“Greece has been one of the success stories of the last decade, achieving huge deleveraging.”

A falling debt to GDP ratio is a useful indicator of creditworthiness, and a number of countries appear to be moving in the right direction.

Interest rates are higher than they have been for a long time, and we don't see them beginning to fall for another 12 months or so. This represents a fundamental change – after a long spell when low refinancing rates encouraged countries to increase their leverage, the opposite is now true.

As sovereign debt investors, we're looking for countries that are managing this deleveraging process effectively, and one of the metrics we can look at is a country's overall debt to GDP ratio. It's not perfect and there can be caveats, but it is a useful guide.

In the current environment, we see levels of 150-200% as a conservative number. Germany already sits in the bracket, but what other countries are in a good position to get there? Here are three countries which we think are currently on a positive trajectory.

Greece – a debt success story

Greece has been one of the success stories of the last decade, achieving huge deleveraging. Their tradable (ex-EU loans) debt is now down to just 90%, having been 40 percentage points higher in 2020. And the trend continues, we foresee government debt levels to fall another 20 percentage points.

Within the next six months, we expect Greek sovereign debt to be reclassified as investment grade and, when that happens, passive funds could buy up to USD 20bn. This is close to a quarter of Greece's total tradable debt, which we believe will tighten the country's spreads to Bunds quite substantially.

The wider economic and political picture is also supportive of further progress. The green transition is working well for Greece, with solar power acting as the country's sole provider of electricity for more than a month this summer. And the current centre-right government was re-elected in June, confirming our view that Greece will continue its efforts to reduce government debt in the coming years.

Sweden – a lesson learnt

Sweden has learnt its lesson from a housing and debt crisis in the 1990s. As a result, they've come into this crisis with very low government debt (gross debt at 30%), and the private sector – which has been quite leveraged – has brought its overall debt ratio quickly down from 180% to 160% in less than a year. Overall debt levels have fallen from 300% to 275% now.

Furthermore, they've managed to do this without too much pain. That's in large part because net assets are high – although housing assets are fairly illiquid, corporates and even households have had enough assets in stock markets and other liquid assets to help pay down their debts.

Sweden's true situation is also probably better than its debt to GDP figure would suggest. Household debt is only 85% of GDP, which is very manageable. And while corporate debt is higher, Swedish companies are very international in nature, so they're not as levered as a ratio which Sweden's GDP would suggest.

United States – anticipating a soft landing

Deleveraging is ultimately a healthy process to go through, but it can lead to disruptions, which is where we start to think about hard and soft landings.

The US is currently engaging in some deleveraging, going from 260% to 250% in recent times. This is positive, as is the fact that now they own more of this debt themselves – foreign ownership of the US government debt market has fallen from 40% to 30% over the last five years.

Forward rates are rising rapidly but from very low levels, so overall we are still in the soft-landing camp. However, quickly rising government debt is a problem in the US. With 8% budget deficits and gross government debt levels alone rising from 120 to 150% in the foreseeable future, even the Federal Reserve chair, Jerome Powell, mentioned that the US is not on a sustainable path. We need to see a major reshuffle away from high cash balances and high stock ratios among private households in order to absorb net new Treasury issuance over the coming years.

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Published November 2023



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