Beyond Ratings
Sovereign Risk Matters

Beyond Ratings Weekly Digest n°151

Your briefing on augmented financial risk analysis ***28th June 2018***

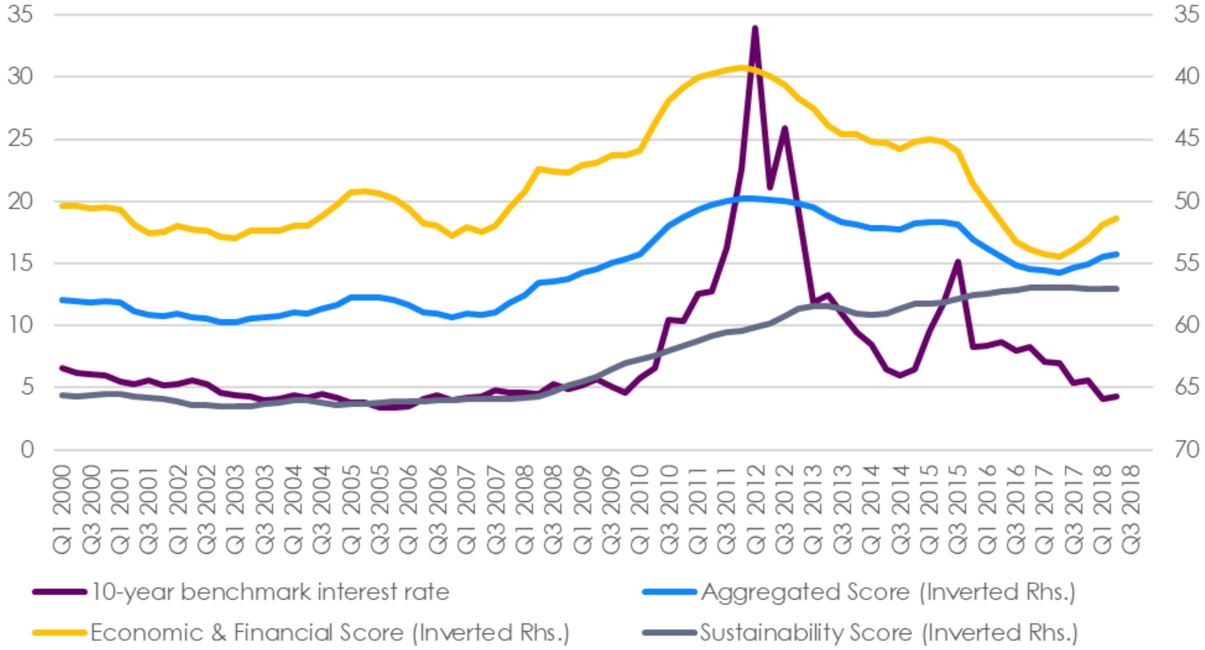
ANALYST INSIGHT

S&P upgrades Greece debt rating to B+

On Monday June 25th, the credit rating agency (CRA) Standard & Poor's (S&P) upgraded the long-term debt rating for Greece to B+ from B with a stable outlook. The CRA underlined that the debt relief announced by the Greek's Eurozone creditors on Thursday June 21st and the country's cash buffers "significantly" reduced debt servicing risks over the next years. This upgrade comes after a succession of upgrades since Athens was on the verge of default in June 2015 (S&P downgraded Greece debt rating to CCC- with a negative outlook on June 29th, one notch before default). Since then, the Greek rating has steadily improved, notch by notch, to reach B+.

Regarding last week's deal, the Eurozone ministers agreed to extend maturities by 10 years on significant parts of Greece's total debt obligations, with public debt peaking at around 180% of GDP. They also agreed to disburse EUR 15 billion to improve the country's safety cushion to face its next financial commitments. The CRA said the maturity extensions and the sizeable cash buffer would cover Greece's debt payments through 2021 and "partly cover repayments coming due in 2022", significantly reducing refinancing risks. However, S&P warned that "public and private debt remains high and the authorities' track record on attracting foreign direct investment is weak". The country's eight-year crisis toppled four governments and shrank the economy by 25%. Unemployment soared and still hovers over 20%, sending thousands of young educated Greeks abroad. The CRA said it was important for the country to resist rollback of economic reforms and continue with additional measures "to restore economic health and confidence in the banking sector as well as to attract foreign capital inflows to finance growth".

Beyond Ratings sovereign risk scores vs. 10-year bond yield



Turning to Greece bond market, the 10-year bond yield plummeted by more than 1,000 bps since the country was on the verge of default at the end of June 2015. Three years later, this same bond yield stands at 4.1%, its lowest point since mid-May. In the chart above, we show that, in the Greek case, our sovereign risk aggregated score is well anti-correlated to the 10-year bond yield (c. -75%). This aggregated score also has the quality of clearly anticipating periods of stress on the bond market, as not only do the economic and financial fundamentals but also sustainability trends deteriorate a few quarters before the stress episodes. Over the recent period, even if the scores have slightly deteriorated, it seems that relative stability is at work. However, we see that the sustainability score, which is composed of environmental, social and governance determinants (ESG), is tendentially deteriorating. This deterioration is mainly due to the negative contribution of the governance factors: though the Greek government under the leadership of Prime Minister Aléxis Tsípras, has been stable since 2015, the regulatory quality, the rule of law and the government effectiveness have negatively contributed to the overall governance quality.

All in all, with this rating upgrade, the Greek tragedy seems to be coming to an end, at least for a few years. However, with a public debt that has reached close to double the annual economic output, it will be difficult for the country to restore sufficient room for maneuver to avoid new periods of stress within 3 to 4 years.

To be continued…

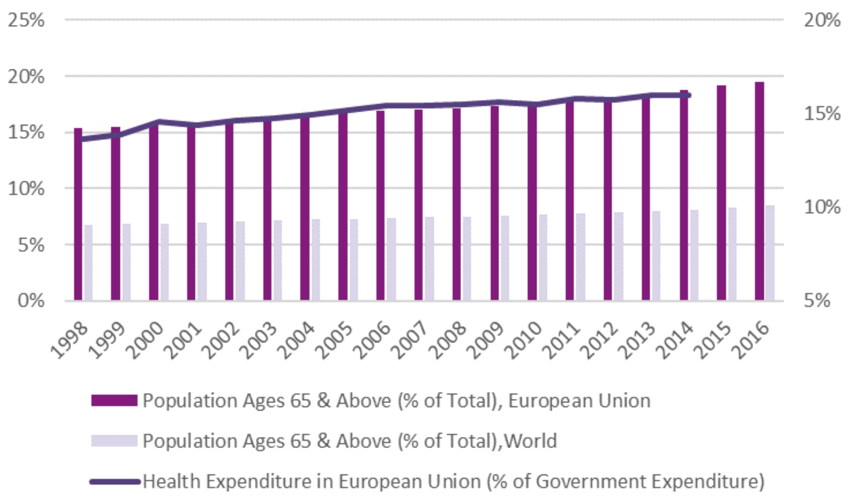
Julien Moussavi, Head of Economic Research *Source: Beyond Ratings*

WEEKLY FOOD FOR THOUGHT

Sovereign Risk

Demography in the European Union: a debt trap to come?

Evolution of demography and public health expenditure in the EU



Following the recent decisions of ECB to stop quantitative easing, the movement to future normalization of its monetary policy at a medium-term, the progressive return of Greece on the market and last elections results in Italy, some questions arise again about the European Union's perspectives and robustness. Another topic to add to the reflection could be how European countries could manage their aging populations and increasing public health expenditure.

In the face of this, and if demography and health expenditures follow the same trends in the future, EU countries have only three choices:

- Let public deficits increase, along with the debt-to-GDP ratio. This would cause higher long-term interest rates if the ECB continues on its normalizing path;
- Increase fiscal revenue in order to prevent higher deficit due to increasing public spending;
- Use monetary policy to maintain low interest rates and let the public deficit and debt-to-GDP ratio increase.

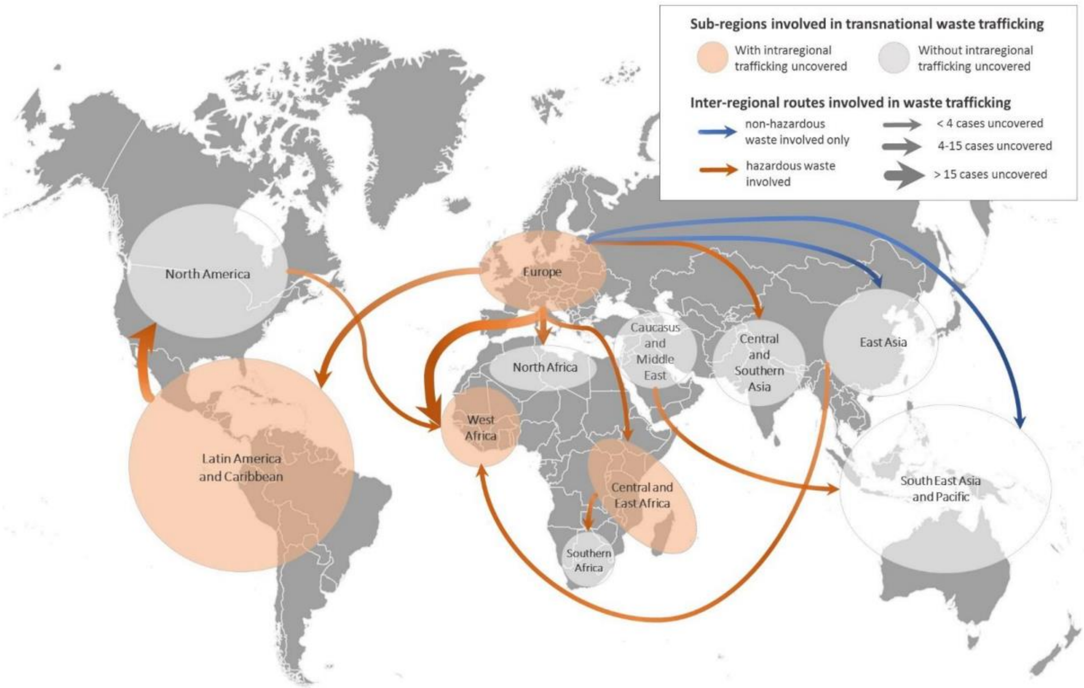
Each solution has potential negative effects. No matter the path European Union's countries will choose, there is still a lot of turmoil waiting for the ship that is European construction...

Thomas Lorans, Analyst *Sources: Beyond Ratings, World Bank*

ESG

The "Waste Road" is changing

Transcontinental waste trafficking routes detected during Operation 30 Days



China has recently banned on the import of most plastic waste from US and other industrialized countries, which means that about 7.3 million tons of plastic will need to find new ways to be recycled every year. This is a major signal that could indicate the beginning of the end of "pollution havens" for waste. As China's recent ban demonstrates, somedeveloping countries are more conscious of the environmental and health impacts of pollution of pollution's impact on environment and citizen's health and and are no longer content to be the dustbin of the world anymore. Their economy is mature and diversified enough to refuse industries with such negative externalities.

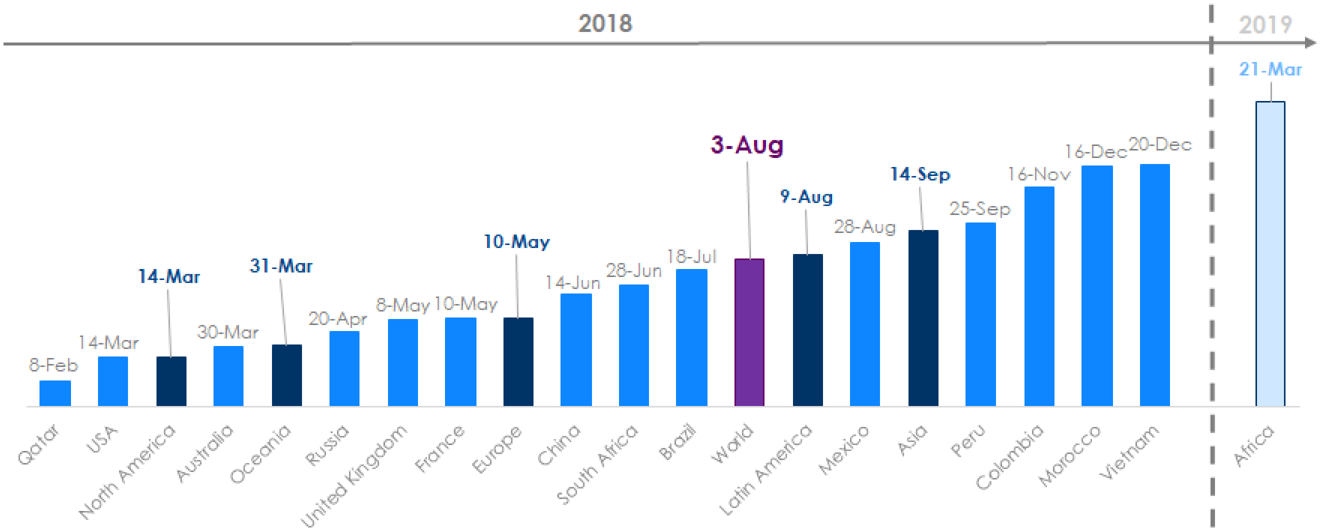
While some developing countries still continue to accept all our garbage because it is a necessary industry for them and a way to retrieve foreign currencies we can assume that local populations will put increasing pressure on their governments to limit the import of wastes in the near future. As the number of legal waste treatment options decrease, illegal waste trafficking is an increasingly lucrative activity. In order to prevent future pollution crises, we should increase punitive responses for environmental crimes to equal those for life-threatening ones and start dramatically reducing waste production to limit the economic interest of illegal waste trafficking.

Emeric Nicolas, Head of Statistics *Sources: Beyond Rating, **Interpol***

Carbon/Climate Change

It is mid-year and already 78 countries have reached their overshoot day

2018 overshoot days by country / continent



Note: With an 'overshoot day' estimated in 2019, Africa respects its ecological budget for the year

People consume the Earth's natural resources to produce what they need. However, there are only so many resources that the planet can renew and so much carbon it can absorb in one year. The "Earth Overshoot Day" represents the date when the planet's ecological footprint exceeds its biological capacity. Put more simply, it is the date when humanity has exhausted nature's budget for the year and starts depleting resource stocks and accumulating carbon dioxide in the atmosphere.

For countries, two distinct overshoot days can be estimated. The first option represents the date when the global ecological budget would be exceeded if the whole world was living as the selected country. For instance, France reached its 2018 "overshoot day" on May 10. The second alternative is more country-specific and marks the day when the country exceeds its own biological capacity to renew its resources. From this perspective, France's overshoot day comes a few months later, on July 29.

It is mid-year and, based on the first approach, 78 countries have already reached their overshoot day globally. The problem is not a small one. It is estimated that these countries will account for 40% of the world's population, 85% of GDP and two thirds of carbon emissions this year.

Whatever the approach, the human population is consuming more resources than what the Earth can replace and is emitting more carbon dioxide than what the Earth can absorb – the world's carbon footprint represents 60% of the world ecological footprint. As of today, we would need 1.7 Earths to subsist. We only have 1 Earth available to us, now would be the time to realize it.

Claire Hugo, Analyst *Sources: Beyond Ratings,* ***Global Footprint Network****,* ***Earth Overshoot day***

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