Positive Rating Momentum Continues
Since April 2018, there have been three rating upgrades (Andorra, Cyprus and Greece) and no downgrades. Three countries are on Positive Outlook (Austria, Cyprus and Finland). The United Kingdom and San Marino are on Negative Outlook. The UK’s Outlook reflects continued downside risks of a disruptive exit from the EU.

General Government Debt on a Downward Trajectory
Of the three countries that were upgraded, two – Cyprus and Greece – have each been upgraded by a total of five notches since mid-2015 as they have completed ESM programmes (Greece exited its latest programme on 20 August). More broadly, strong growth and improving public finances have underpinned improvements in Western European sovereign creditworthiness in recent quarters. General government deficits and debts are on a declining trend across most countries in the region. Near-term growth fundamentals remain solid, boosted by favourable financing conditions, robust employment growth and improving business profitability. Resilient domestic demand provides some offset to the drag from slowing global trade.

Politics to Remain an Important Rating Driver
The prospect of slower GDP growth and higher interest rates mean that further fiscal efforts may be required by highly indebted countries to place debt on a firm downward trajectory as politics becomes less conducive to tighter fiscal policies and structural reforms. The shifting political backdrop is seen in strong election results by parties that are critical of “austerity” and, more generally, the whole EU framework, most notably leading to the formation of a coalition government in Italy led by the Five Star Movement and the Lega. The electoral campaign for next year’s European Parliament elections due is likely to exacerbate divisions between pro and anti-EU parties. Rising political uncertainty could further undermine recent positive growth dynamics if falling business confidence led to weaker capex growth.

<table>
<thead>
<tr>
<th>Name</th>
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<th>Outlook</th>
<th>LT LC IDR</th>
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<tr>
<td>United Kingdom</td>
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Source: Fitch
Ratings Upgrade: The recent upgrade from 'BBB'/Positive to 'BBB+/Stable reflects falling public indebtedness, with the government debt/GDP ratio falling below 40% for the first time since 2011, and an increased pace in the economic recovery in Andorra. Andorra’s ratings and the Stable Outlook also reflect the country’s wealth and political stability balanced by the economy’s small size (estimated USD2.7 billion in 2017), the risks associated with a large banking sector, and weak economic data availability and frequency.

Key Developments
Public Indebtedness Falling: In 2017, public-sector indebtedness fell below 40% for the first time since 2011, reaching 37.6% of GDP (in line with the ‘BBB’ peer median). We expect the government debt ratio to fall further, reaching 35.0% of GDP by 2020. The sovereign balance sheet is enhanced by a large stock of liquid assets, mainly in the social security sector. The general government net asset position was around 17% of GDP at end-2017.

Government Surplus, Forecasts: Andorra recorded a small surplus of EUR9 million (0.3% of GDP) at the central government level in 2017. Surpluses among local governments and the social security fund supported a higher surplus in 2017 at the broader general government level of 3.3% of GDP, albeit lower than in 2016 (4.4%). Fitch expects a slightly higher deficit at the central government level compared with the government’s 2018 budget. At the general government level, we expect a surplus of 1.0% of GDP in 2018, declining to 0.7% by 2020.

Stronger Economic Recovery: Real GDP growth was 1.9% in 2017, with private-sector services (excluding finance) and construction the main drivers. With the pick-up in economic activity, unemployment fell to an average of 2.4% in 2017, from 3.5% in 2016. We expect the stabilisation of activity in the financial sector and positive growth dynamics in other sectors to translate to overall real GDP growth of 2.2% this year, and 2.0% in 2019 and 2020.

Positive Sensitivities
- Reduced risk of contingent liabilities from the banking sector materialising on the sovereign balance sheet
- Improvements in data availability and frequency, in particular for the external accounts
- Continued declines in the government debt/GDP ratio
- Improvements in medium-term growth prospects

Negative Sensitivities
- A deterioration in economic growth prospects, leading to rising government indebtedness
- A deterioration in the creditworthiness of the large Andorran banks, increasing the risk of contingent liabilities crystallising on the sovereign’s balance sheet

Latest Rating Review Date: 17 August 2018
Next Rating Review Date: By February 2019
**Strong Fundamentals, Declining Debt:** Austria has a rich, diversified, high value-added economy with strong political and social institutions. It benefits from low private-sector indebtedness and a high household savings rate. Gross general government debt (GGGD) is high relative to peers, but is on a firm downward trend.

**Key Developments**

**Outlook Revised to Positive from Stable:** The recent revision of the Outlook on Austria’s IDR reflects favourable debt dynamics, ongoing forecast fiscal consolidation and robust economic growth.

**Declining GGGD/GDP:** Debt dynamics are highly favourable as robust medium-term growth, ongoing primary balance surpluses, low effective interest rates and a long average debt maturity will maintain the GGGD/GDP ratio on a downward path.

**Fiscal Prudence:** The new Austrian coalition government remains strongly committed to the EU fiscal rules and targets a balanced budget by 2019 and a fiscal surplus in 2020 with the objective of frontloading the fiscal effort through a projected EUR2.5 billion in expenditure cuts (0.6% of GDP). Fitch expects the consolidation path to be slower than planned. The April Stability Programme Update outlines a structural reform package that entails a rationalisation of the social security system, a gradual decline in the tax/GDP ratio, and improvement of fiscal federal relations. Further planned tax relief could prolong the current positive economic cycle.

**Robust Medium-Term Growth:** Fitch forecasts the Austrian economy will grow by 2.8% in 2018, supported by domestic demand. A prolonged investment cycle, increased labour supply, and improved total factor productivity point to stronger potential growth. Fitch has revised its estimate for medium-term growth potential to 1.7% from 1.5%.

**Positive Sensitivities**

- A continued decline in the GGGD/GDP ratio
- Sustained economic growth and greater confidence in medium-term growth prospects, particularly if supported by the effective implementation of structural reforms

**Negative Sensitivities**

- Weaker nominal GDP growth or failure to place public debt on a downward trajectory over the medium term, for example because of significant slippage from fiscal consolidation targets
- Crystallisation of contingent liabilities, for example from the banking sector that worsens the government debt profile

**Latest Rating Review Date:** 20 July 2018

**Next Rating Review Date:** By January 2019
High Public Debt, External Creditor: Belgium’s ratings balance high public-sector indebtedness (with the government debt/GDP ratio more than double the ‘AA’ median) against high income per capita and macroeconomic stability, a still substantial net external creditor position, and strong governance indicators.

Key Developments

Lower Deficit, Debt Decline: Public finance outturns improved sharply in 2017. The general government deficit fell to 1.0% of GDP, from 2.5% in 2016. The improvement was driven by a continued decline in the spending/GDP ratio and particularly buoyant tax receipts. Lower interest payments accounted for around half of the decline in the spending share. Fitch expects a similar deficit this year, and a slightly higher deficit of 1.3% in 2019. Positive debt dynamics have brought about a substantial decline in the government debt/GDP ratio, to 103.4% at end-2017 from 106.0% in 2016 (with the sale of a quarter of the state’s stake in BNP Paribas accounting for 0.4pp). Our public finance projections are consistent with the debt ratio falling to 100.3% by 2019, and to below 100% in 2020.

Upturn in Growth, Employment: Economic growth picked up last year, in the context of marked labour market improvements. Real GDP growth rose to 1.7% in 2017 from 1.4% in 2016, with domestic demand contributing around two-thirds of the increase. Employment rose by 1.4% over 2017 and this helped push the unemployment rate down to 7.1% for the whole year (from 7.8% in 2016), and 6.0% by June this year.

High Inflation, Competitiveness: Consumer price inflation averaged 2.2% in 2017. Inflation fell back in the first few months of this year but has recently picked up, to 2.3% in May and 2.6% in June. The main risk from higher-than-expected inflation is the impact of higher prices, through wage indexation, on labour costs and firms’ competitiveness.

Current Account, External Position: Despite the positive contribution to net trade in 2017, the current account deteriorated last year to a modest deficit of 0.2% of GDP from a 0.1% surplus. We expect similar small deficits over the next two years. Belgium is a net external creditor, but the net creditor position has eroded in absolute terms and relative to peers. The net external debt (NXD)/GDP ratio has risen from -123% in 2010 to -15% at end-2017. If present trends were to continue, Belgium would be a net external debtor by 2019. On the other hand, the net international investment position remains strongly positive, at 59% of GDP.

Positive Sensitivities

• A sustained decline in the government debt/GDP ratio
• Strengthening medium-term growth prospects, particularly if related to improvements in competitiveness

Negative Sensitivities

• Larger fiscal deficits resulting in an increase in the public debt/GDP ratio
• Worsening of Belgium’s medium-term growth prospects and competitiveness

Latest Rating Review Date: 1 June 2018

Next Rating Review Date: 30 November 2018
Cyprus — BB+/Positive

**High Public Debt, Strong Structurals:** Cyprus’s ratings balance the exceptionally weak asset quality of the banking sector and high public indebtedness, with strong structural indicators including high income per capita and a skilled labour force.

**Key Developments**

**Ratings Upgrade:** Fitch upgraded Cyprus’s Long-Term IDRs to ‘BB+’ from ‘BB’ on 20 April 2018. The Outlook is Positive. The upgrade was based on the strong improvement in Cyprus’s external financing flexibility, revised external statistics, strong fiscal performances and favourable debt dynamics, supported by robust economic growth.

**External Financing, Adjusted Statistics:** Cyprus’s external financing flexibility has improved substantially since the country exited the macroeconomic adjustment programme in March 2016. Recently published data from the Central Bank of Cyprus indicates that external sector statistics are materially distorted by special-purpose entities (SPEs), including shipping and financial companies. NXD excluding SPEs would turn into a small net asset position compared with non-adjusted NXD of 164% of GDP.

**Progressing Deleveraging:** Deleveraging of the private sector is ongoing. Increased earnings, ongoing resolution of mortgage arrears, recovering house prices and legislative reforms enhancing the foreclosure and insolvency framework might foster further debt repayment. Non-performing exposures (NPEs) remain high and are still weighing on new lending, but we believe economic growth would be resilient to a possible acceleration in NPEs normalisation.

**Favourable Debt Dynamics, Strong Fiscal Performance:** Cyprus’s fiscal performance has benefited from a very strong cyclical economic recovery and prudent fiscal policy. We forecast the government will continue recording fiscal surpluses in 2018 and 2019. Medium-term debt dynamics point to a firm downward trend, which will provide Cyprus with some fiscal room to absorb any materialisation of contingent liabilities arising from the banking sector.

**Banking Sector Restructuring:** Hellenic Bank announced that it would acquire assets totalling EUR10.3 billion and customer deposits of EUR9.7 billion from Cyprus Cooperative Bank (CCB). CCB’s remaining assets will be held in a residual entity. The government will place an additional EUR840 million of deposits at CCB, on top of the EUR2.35 billion it deposited in April. This will increase GGDP/GDP to a forecast 110% in 2018 but will not derail debt dynamics. By retaining most of CCB’s NPEs in the residual entity, the transaction will reduce banking sector NPEs by EUR5.7 billion and bring the NPE ratio to 37% from 44%.

**Positive Sensitivities**

- Reduction in banking sector NPEs that materially reduces sovereign contingent liabilities
- Track record of a declining GGDP/GDP ratio
- Continued deleveraging of the private sector

**Negative Sensitivities**

- Failure to improve asset quality in the banking sector
- Deterioration of budget balances or materialisation of contingent liabilities resulting in a stalling in the decline in government debt/GDP

**Key Indicators**

<table>
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<th>Indicator</th>
<th>2016</th>
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<th>2018f</th>
<th>2019f</th>
<th>2020f</th>
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<tr>
<td>Real GDP (% change)</td>
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<td>3.9</td>
<td>3.6</td>
<td>3.1</td>
<td>3.1</td>
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<tr>
<td>Current account balance (% GDP)</td>
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<td>-6.7</td>
<td>-6.5</td>
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<td>-6.3</td>
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<tr>
<td>Net external debt (% GDP)</td>
<td>140.1</td>
<td>166.0</td>
<td>167.5</td>
<td>192.6</td>
<td>206.7</td>
</tr>
<tr>
<td>Government balance (% GDP)</td>
<td>0.3</td>
<td>1.8</td>
<td>1.1</td>
<td>1.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Government debt (% GDP)</td>
<td>106.6</td>
<td>97.5</td>
<td>110.2</td>
<td>104.8</td>
<td>99.0</td>
</tr>
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</table>

Source: Fitch

**Next Rating Review Date:** 20 April 2018

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**SPE Impact on External Debt**

- **House Prices** (2010 = 100)

  - **Decreasing Yields**
    - 3YR
    - 7YR

**2017 Public Debt -Composition**

- **Official loans** 62%
- **Domestic bonds** 7%
- **Foreign bonds** 24%
- **Retail securities** 3%
- **Treasury bills** 1%
- **Private loans** 3%

Source: Datastream

Source: Central Bank of Cyprus

Source: Cyprus Ministry of Finance

Source: Datastream

Source: Fitch
Advanced Economy, Strong Institutions: Denmark’s ratings reflect a wealthy, high value-added, open economy that is supported by low public debt, strong institutions and a track record of sound macroeconomic policy. External finance metrics are strong and the exchange rate peg functions well in the ERM2 regime. High household mortgage debt increases the economy’s vulnerability to macro-financial shocks, although the risks are somewhat mitigated by high net household wealth, including pension assets.

Key Developments

Healthy Economic Fundamentals: The economy is in a strong cyclical position as GDP grew by 2.2% in 2017, the strongest growth rate since the global financial crisis. Fitch forecasts economic growth to stabilise at close to 2% in 2018 and 2019 and to be driven primarily by domestic demand after a significant one-off boost from net exports in 2017. Despite record high employment, wage pressure remains subdued, with nominal wage growth well below the pre-crisis average, similar to many developed economies.

Sound Public Finances: The budget recorded a 1% of GDP surplus in 2017, boosted by one-off revenues from corporate and pension yield taxes. The underlying budget balance is also strong; the European Commission estimates a structural budget surplus each year over 2016-2019. The combination of a sound fiscal position and strong economic growth has put public debt on a declining trajectory. GGGD declined to 36% of GDP in 2017 from 44% in 2014.

Macro-Prudential Vulnerabilities: The gross debt level of households is high, at close to 110% of GDP. Fitch judges the high debt level to increase the vulnerability to macro-financial shocks. In particular, regional overheating risks have increased in the housing market, given the strong house price increases in Copenhagen and Aarhus and the very low interest rate environment. The authorities’ macro-prudential measures and property tax changes will help mitigate these risks over the medium term.

Strong External Position: The current account surplus was close to 8% of GDP in 2017, among the highest in the EU and well above the ‘AAA’ median. Large current account surpluses over the past 10 years have significantly improved the net external position. Denmark is a net external creditor (estimated around 10% of GDP in 2017), and the net international investment position reached 54.8% of GDP at end-2017.

Negative Sensitivities

- A severe macroeconomic shock – for example originating in the household sector – leading to a sharp deterioration in the public finances through higher deficits and lower GDP growth

Latest Rating Review Date: 15 June 2018

Next Rating Review Date: 14 December 2018
Outlook Revisited to Positive: On 3 August, Finland’s Long-Term IDRs were affirmed at ‘AA+’, with the Outlooks revised to Positive from Stable. The revision reflects its falling government debt/GDP trajectory, track record of fiscal consolidation, and improved competitiveness and medium-term potential growth since the ratings were last downgraded in March 2016.

Key Developments

Improved Public Debt Dynamics: Finland’s public debt dynamics have improved since its government debt/GDP ratio peaked at 63.5% in 2015, with Fitch forecasting the ratio to fall to 59.6% by 2027. Although debt/GDP is still higher than the historical ‘AA’ and ‘AAA’ medians, the downward trajectory represents a material improvement compared with our expectation at the time of the last rating downgrade in March 2016 of debt rising to 67.5% by 2020.

Fiscal Consolidation Narrows Deficits: Fiscal consolidation and the robust recovery in economic growth in 2016-2017 have led to a narrowing of the fiscal deficit to 0.7% of GDP in 2017 from a peak of 3.2% in 2014. Fitch forecasts the deficit to remain unchanged in 2018, before narrowing further towards balance by 2020.

Growth Outlook Improves: Medium-term potential growth has improved to 1.3%-1.5% per year, sustainably stronger than the 1.0%-1.2% we expected in our March 2016 review. Medium-term growth continues to be constrained by the ageing population, but could be boosted by the benefits of the 2017 competitiveness pact and pension reforms. Real GDP growth picked up to 2.5% in 2016 and 2.8% in 2017, driven by private consumption and investments, but also benefiting from favourable external demand.

Competitiveness Gap Narrowed: Wage freezes, lower social security contributions and reduced public-sector bonuses included in the competitiveness pact since 2017 have contributed to the narrowing of unit labour costs relative to Finland’s main trading partners, helping to boost Finnish exports during this upswing in the external environment. Recently concluded moderate wage agreements point to national wages rising by a relatively muted average 2.2% yoy in 2018-2019 against stronger wage growth in Germany and Sweden, suggesting gains will persist until at least 2019.

Positive Sensitivities

• Sustained downward trend in the government debt/GDP ratio towards the ‘AA’ and ‘AAA’ peer medians
• Evidence of further improvement in medium-term growth prospects and sustained gains in competitiveness

Negative Sensitivities

• Reversal of the downward trend in general government debt/GDP over the medium term, for example because of significant fiscal slippage or lower GDP growth
• Weaker medium-term growth prospects or deterioration in competitiveness

Latest Rating Review Date: 3 August 2018

Next Rating Review Date: By February 2019
Structural Strength, Fiscal Weakness: France's ratings are underpinned by a large, wealthy and diversified economy, strong and effective civil and social institutions, and a track record of macro-financial stability. Nevertheless, public finances, although gradually improving, remain a rating weakness relative to the ‘AA’ category.

Key Developments

Growth and Structural Reform: GDP growth is forecast to slow gradually from 2.0% in 2018 to 1.8% in 2019 and 1.6% in 2020. The estimate of the medium-term growth potential of the French economy remains around 1.2%. Implementation of President Macron’s ambitious structural reform agenda, launched shortly after the 2017 presidential and general elections, could significantly boost growth potential. However, at this early stage of reform implementation, quantification of the impact is highly uncertain.

Lower Budget Deficit, EDP Exit: Cyclical improvement of public finances has continued due to higher-than-expected tax revenues. The budget deficit declined to 2.6% of GDP in 2017, the lowest since 2007, and Fitch forecasts a 2.3% deficit in 2018. France exited the Excessive Deficit Procedure (EDP) in June 2018 based on the European Commission’s assessment that the budget deficit will remain below 3% of GDP over the medium term.

High Public Debt: GGGD remained very high at 97% of GDP at end-2017, compared with the ‘AA’ current median of 38%. GGGD probably peaked in 2017, but the decline will be slow over the medium term, partly due to the SNCF debt transfer, expected to reach EUR35 billion (1.6% of GDP) by 2022. GGGD will remain above 90% of GDP over the next decade under Fitch’s baseline debt dynamics scenario.

New Macro-Prudential Measures: The High Council for Financial Stability raised the counter-cyclical capital buffer from 0% to 0.25% in June 2018 in light of the continued acceleration of the financial cycle, as a positive output gap is opening up. This was a preventive measure; banks have 12 months from 1 July 2018 to comply.

Negative Sensitivities

• Reversal of GGGD’s downward trajectory
• Deterioration in competitiveness and weaker medium-term growth prospects

Positive Sensitivities

• Sustained smaller budget deficits, leading to a track record of a material decline in the public debt/GDP ratio
• Evidence of stronger medium-term growth prospects, particularly if underpinned by the implementation of effective structural reforms

Latest Rating Review Date: 20 July 2018
Next Rating Review Date: By 20 January 2019
High Value-Added Economy, Strong External Position, Financing Flexibility: Germany’s ‘AAA’ ratings reflect a diversified, high value-added economy, strong institutions and a history of sound public debt management. A large structural current account surplus, averaging 7.9% of GDP in 2013-2017, supports the country’s net external creditor position. Government debt, at 64.1% of GDP, is higher than the ‘AAA’ median of 41.7%, but is on a firmly downward path.

Key Developments

Above-Trend GDP Growth: Fitch forecasts domestic-demand driven GDP growth of 2.3% in 2018, taking the five-year average to 2.0%, close to the ‘AAA’ median of 2.3%. Investment is supported by favourable credit conditions, high capacity utilisation and solid profit growth, while private consumption is helped by positive labour market dynamics and strong house price growth, of 6.2% in July. Fitch forecasts a cooling of GDP growth to 1.6% in 2019 and 1.4% in 2020, close to our assessment of Germany’s trend rate of growth.

Further Budget Surpluses: Fitch forecasts general government surpluses of 1.4% in 2018 and 0.9% in 2019, which incorporate announced budget measures to increase investment and cut taxes totalling 0.4% of GDP in 2019, and a further reduction to 0.6% of GDP in 2020, which assumes some additional moderately expansionary budget measures in line with the government’s high-level commitment to use fiscal space relative to a balanced headline budget.

Favourable Debt Dynamics: Strong political commitment to the “black-zero” balanced budget provides a strong fiscal anchor. Under our debt sensitivity projections, which assume a gradual decline in the primary surplus from 2.4% of GDP in 2018 to 1.0% of GDP in 2022, debt falls to 44.2% of GDP in 2027, from 64.1% in 2017 (and 74.7% in 2014). There is a relatively high degree of cross-party consensus on macroeconomic policy, which reduces potential impacts on credit fundamentals of the somewhat weaker cohesion of the current coalition government.

Strong External Position: Underlying competitiveness is helped by the positive investment cycle, and export market share has been maintained in the face of higher wage growth and last year’s euro appreciation. Fitch forecasts a 0.3pp reduction in the current account surplus this year to 7.8% of GDP, partly due to the higher oil price, and to 7.1% in 2020 as unit labour costs pick up further and external demand moderates. Current account surpluses drove a 14pp improvement in 2014-2017 in Germany’s net external creditor position to 22.3% of GDP.

Negative Sensitivities

- A marked rise in the GGGD/GDP ratio
- Further state support for the banking sector or for other eurozone countries

Latest Rating Review Date: 3 August 2018

Next Rating Review Date: TBC
Ratings Upgraded to ‘BB−’: On 10 August, Fitch upgraded Greece’s Long-Term IDR by two notches to ‘BB−’ from ‘B’. The Outlook is Stable. The upgrade reflects improved public debt sustainability, underpinned by the debt relief measures agreed by the European creditors, a track record of general government primary surpluses, our expectation of sustained GDP growth, additional fiscal measures legislated to take effect through 2020 and somewhat reduced political risks.

Key Developments
Credible Debt Relief: The debt relief measures agreed at the 21 June Eurogroup are substantial. The agreement envisages an upfront (not subject to policy conditionality) deferral on interest and maturity payments on EUR96.4 billion of EFSF loans. The average maturity of Greek debt is already among the longest across all Fitch-rated sovereigns. The extension is set to lengthen average maturity further.

Sizeable Deposit Buffer: Greece is set to exit the ESM programme with a deposit buffer of EUR24.1 billion (13% of GDP). Our estimates indicate that Greece could be fully funded until 2022, providing a significant backstop against any financing risks for a prolonged period. This should in turn support market confidence and post-programme market access.

Solid Fiscal Performance: In 2017, Greece posted a headline budget surplus of 0.8% of GDP, up from 0.6% a year earlier, and the primary surplus was 4% of GDP. This was a significant fiscal outperformance. We expect fiscal performance to remain sound over the post-programme period. We forecast continued primary surpluses averaging 2.7% of GDP over 2018-2030.

Banking Sector Remains Impaired: Tackling NPEs, which remain high at 48.5% of total exposures in March, remains a key challenge, and further provisions are likely to be needed before they can be written off. Greek banks have committed to ambitious plans to reduce NPEs to around 35% by end-2019 and have achieved their interim targets. None of the four Greek systemically important banks were required to submit a capital plan as a result of the ECB stress tests in May 2018. The banks’ liquidity position continues to improve.

Positive Sensitivities
- Track record of achieving further primary surpluses and greater confidence that the economic recovery will be sustained over time
- Policy continuity after Greece’s exit from the ESM programme and lower risk of crystallisation of banking sector risks on the sovereign balance sheet

Negative Sensitivities
- A loosening of fiscal policy and/or a reversal of the policies legislated under the ESM programme
- Adverse developments in the banking sector or re-emergence of sustained current account deficits

Latest Rating Review Date: 10 August 2018
Next Rating Review Date: By February 2019
Strong Structural, Weak Externals: Iceland’s ‘A’ ratings balance very high income per capita and strong performance on governance, human development and doing business indicators against high commodity export dependence, vulnerability to external shocks and experience of macroeconomic and financial volatility.

Key Developments

Tourism Slowdown Moderates Growth: Real GDP growth in Iceland peaked at 7.5% in 2016 and slowed to 3.6% in 2017 as the positive output gap narrowed. Fitch forecasts growth to slow further to 3.3% in 2018 and 2.8% by 2020, driven by moderating tourism demand. Robust growth in tourism receipts caused a strong appreciation of the krona and is cooling the overheated sector. Slowing tourism has also cooled the overheated housing market, which saw house price growth moderate to 6.2% yoy in July 2018 from its 22.5% yoy peak in May 2017.

Wage Pressures Building: Current wage agreements agreed in 2015 expire in 2018. Vociferous demands by new trade union leaders are putting pressure on the government to improve real disposable incomes, benefits for lower earners and housing affordability in the lead-up to wage talks at end-2018. This is despite robust wage and real disposable income growth in recent years.

Public Debt Reduction Stabilising: Public debt/GDP is set to fall to 38.8% in 2018 and should reach 35.2% at end-2019. Plans to establish a sovereign wealth fund and to maintain government debt issuance could lead to gross government debt stabilising at roughly 30% of GDP beyond 2024, government assets accumulating, and a resulting fall in net debt. Foreign holdings of government debt have increased since capital controls were lifted.

Slight Easing in Fiscal Path: The government’s April 2018 fiscal plan targets a fiscal surplus of 1.4% of GDP in 2018, gradually narrowing to 1.0% by 2021-2022 owing to fiscal consolidation at the central government level. Expenditures are expected to grow in line with GDP, rising faster in 2019-2021 due to higher transport, education and healthcare investments. Revenues are expected to fall as a share of GDP due to proposed reforms to lower the tax burden.

Positive Sensitivities

- Continued falls in the public debt ratio, supported by prudent fiscal policy
- Sustained improvement in the external balance sheet and resilience of the economy to external shocks

Negative Sensitivities

- Evidence of overheating in the domestic economy, for example through wage-price spirals, inflation overshoots, and adverse effects on household and corporate balance sheets
- Excessive capital outflows leading to external imbalances and pressures on the exchange rate

Latest Rating Review Date: 8 June 2018

Next Rating Review Date: 7 December 2018

Key Indicators

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Source: Fitch
Wealthy Economy, Strong Institutions, Debt: Ireland’s sovereign ratings are supported by strong institutions and a wealthy, flexible economy with income per capita among the highest in the ‘A’ category. These factors are balanced by still elevated levels of public and private debt, and external vulnerabilities. The Stable Outlook balances strong underlying economic growth prospects and sizeable external risks such as the uncertainty surrounding the impact of Brexit, and the impact of potential shifts in global policies on corporate taxation and trade liberalisation.

Key Developments

Strong Underlying Growth: Methodological changes to headline national accounts and external accounts data since 2015 take greater account of the activities of multinational enterprises. Real GDP growth was 7.8% in 2017. Abstracting from this volatility, Irish economic activity expanded at a robust pace last year. Private consumption rose by almost 2%, while investment in buildings and machinery and equipment rose by 5.7%. Assuming some degree of carry-over from the strength of 2017, we have revised up our forecast of real GDP growth for this year to 4.8%. We then expect growth to slow to 3.5% in 2019 and 3.0% in 2020, assuming that the more volatile components of the national accounts develop in line with the underlying strength of the economy.

Stable Deficits, Falling Debt Ratio: Last year saw a further modest improvement in public finances, with the government deficit falling back to 0.3% of GDP from 0.5% in 2016. Despite robust economic activity, we do not expect the deficit to narrow at a rapid pace. Spending commitments for both current and capital spending will ensure that the deficit falls back only marginally to 0.2% this year before reaching a budget balance by 2019. Our public finance projections would be consistent with the government debt ratio falling to just over 62% by 2020. Government debt as a share of revenues remains much higher than the peer medians.

Private Sector Deleveraging: Private-sector debt remains high, but the deleveraging process in the private sector continues at a substantial pace. The household debt/disposable income ratio fell from 147.5% in 4Q16 to 136.9% at end-2017. At the same time, it remains the fourth-highest in the EU. Despite the strong pace of growth of economic activity, overall credit growth remains muted, highlighting the deleveraging process still under way in the Irish private sector.

Positive Sensitivities

• A continued reduction in government indebtedness
• A continued improvement in private-sector balance sheets and evidence that the economy is resilient to the impact of Brexit and other external shocks

Negative Sensitivities

• A reversal of the downward trend in government indebtedness
• A weaker economic performance, eg triggered by external shocks
• Adverse developments in the banking sector affecting asset quality and capitalisation

Latest Rating Review Date: 15 June 2018
Next Rating Review Date: 14 December 2018
High Government Debt, Weak Growth Outlook: Italy’s creditworthiness is supported by a large, diversified and high value-added economy, with GNI per capita and governance much stronger than the peer group medians, moderate private-sector indebtedness and a sustainable pension system. Set against these are the extremely high level of public debt, relatively high NXD, low trend GDP growth, weak banking sector asset quality, and political risk.

Key Developments

Policy Uncertainty: Ideological and policy differences between MS5 and Lega are likely to put increasing strains on the cohesion of the coalition. We do not expect this government to see out a full term, and we see an increasing possibility of early elections from 2019. There is a high degree of uncertainty over the policy agenda, and inconsistencies between the cost of new fiscal measures and the stated objective to reduce public debt. We expect the government’s antipathy towards EU/euro membership to focus on a push-back against the EU fiscal rules.

Fiscal Loosening Expected: Our current view is that a rise in the 2019 general government deficit to around 2.2% of GDP is more likely than the much higher deficits implied by a fuller implementation of the measures in the coalition programme. We expect the deficit to rise further in 2020, but with the 3% of GDP threshold of the EU EDTP together with financial market pressures providing some anchor for fiscal expansion.

Moderate Growth: Fitch forecasts GDP growth will moderate to 1.2% in 2018 from 1.5% the year before. This partly reflects weaker growth in Q418 in line with wider euro-area trends but also a recent softening in confidence indicators, and we have halved our forecast for investment growth to 2.7% in 2018 largely due to political uncertainty. We see GDP growth dropping to 0.9% in 2020, towards a trend growth rate of around 0.6%.

Banking Sector Challenge: The reduction in the relatively high non-performing loan (NPL) ratio in the Italian banking sector (around 14%, compared to the EU average of 4%) has gathered pace since mid-2017; gross “sofferenze”, the worst category of impaired loans, fell from their April 2017 peak of EUR203 billion to EUR132 billion in June 2018. However, the coalition’s proposals to revise bank bail-in rules, its intention to interrupt ongoing reform of cooperative and mutual banks, and less emphasis on reducing NPLs could have a significant adverse effect on Italy’s banking sector.

Positive Sensitivities

• A track record of falling GGGD/GDP; a stronger economic recovery and greater confidence in medium-term growth prospects; and reduction in banking sector risks

Negative Sensitivities

• Political developments negatively affecting economic and fiscal policies and/or outturns; a rise in GGGD/GDP; and adverse developments in the banking sector increasing risks to the real economy or public finances

Latest Rating Review Date: 16 March 2018

Next Rating Review Date: 31 August 2018
Wealthy, Ultra-Open Economy: Luxembourg’s rating reflects its high income per capita, strong governance indicators, high growth potential and sound public finances, balanced against higher macroeconomic volatility partly due to heavy reliance on the financial services sector.

Key Developments

Low Public Debt: Gross public debt is the lowest among ‘AAA’ rated sovereigns, at below 23% of GDP in 2017. The very low interest rate environment, locked in for many years ahead, will help debt dynamics over the medium term. Furthermore, social security reserves exceed the debt level. Luxembourg faces significant ageing challenges over the longer term, posing a risk to public finance sustainability beyond the rating horizon.

Persistent Budget Surpluses: The general government balance has been in surplus since 2011. Following the 1.6% of GDP surplus in 2016, fiscal easing measures were implemented in 2017, primarily through tax cuts, and the revenues from e-VAT continued to decline. Nevertheless, the budget recorded a 1.3% surplus, due to higher-than-expected corporate income tax receipts. Fitch forecasts the budget to remain in surplus until 2019.

Slower Growth in 2017: GDP growth slowed to 2.3% in 2017 from 3.1% in 2016. GDP growth in Luxembourg has constantly outperformed eurozone growth over the last decade; 2017 was the first year when the GDP growth rate was slightly weaker than the eurozone’s 2.4%. Nevertheless, domestic fundamentals remain strong, underpinned by strong job creation, and external developments are also broadly favourable, including the eurozone’s buoyant cyclical recovery.

Strong External Position: Luxembourg has a strong external balance sheet, although its gross debt and asset position is volatile as it is inflated by the financial sector. Its net international investment position was 32% of GDP in 2016. The current account has been in surplus for more than two decades, at 4%-5% of GDP over the past five years.

Negative Sensitivities

• A severe sudden contraction of financial sector activity in Luxembourg with adverse consequences for the real economy, negatively impacting labour market conditions and public finances

Latest Rating Review Date: 13 April 2018

Next Rating Review Date: 28 September 2018
Fast-Growing Economy, Large External Creditor Position: Malta’s ratings reflect its high national income per head compared with the ‘A’ median, robust economic growth, large net external creditor position, and strong governance indicators. Malta’s ratings are constrained by the small and highly open nature of its economy, which makes it vulnerable to external shocks, and its high, albeit declining, contingent liabilities and outsized banking sector relative to GDP.

Key Developments

Prudent Fiscal Policy, Fast Declining Public Debt: Fitch forecasts Malta will maintain a fiscal surplus of 1% of GDP in 2018. We expect fiscal policy to remain prudent. The government revised its fiscal surplus targets upwards in the April Stability Programme Update and aims at achieving fiscal savings net of IIP proceeds over the forecast horizon. Public debt dynamics are very favourable, with low interest payments, strong nominal growth and primary surpluses.

Strong Economic Growth, Moderate Price Pressures: Real GDP growth is set to remain robust at 5.6% in 2018, supported by strong growth in public and private consumption and recovery in investment. Fitch estimates Malta’s medium-term potential growth at 3%, as we expect pressures on the infrastructure and rising labour shortages to constrain the expansion of the economy in the medium term. Price pressures are increasing given the tightening labour market, but we expect inflation to remain contained. Property prices rose 5.3% yoy in 2017, but increasing housing supply should help curb the rise in property prices.

Sound Banking Sector: The banking sector remains sound, although highly concentrated. Capitalisation remained strong and asset quality is improving. Risks to the sector stem from the high and rising exposure to the housing market, although mitigating factors to correction in house prices are strong.

Structural Developments: World Bank governance indicators exceed the ‘A’ median and are comparable with the ‘AA’ median, although the “rule of law” subcomponent of the governance indicators is on a declining trend. Malta’s Ease of Doing Business is also weaker than the ‘A’ median, ranking 84th out of 190 in 2018.

Positive Sensitivities
- Further fiscal consolidation leading to a sustained and sharp decline in government debt/GDP
- Convergence of GDP per capita with that of higher-rated sovereigns and progress in addressing key weaknesses in the business environment

Negative Sensitivities
- Significant fiscal slippages leading to deteriorating public debt dynamics
- Crystallisation of material contingent liabilities or a shock to the banking sector that requires fiscal support

Latest Rating Review Date: 3 August 2018
Next Rating Review Date: By February 2019
Structural Strengths: The ratings primarily reflect the Netherlands’ high value-added and diversified economy, effective institutions, and strong net international investment position, supported by large current account surpluses. GGGD, at 56.5% of GDP in 2017, is significantly higher than the ‘AAA’ median but on a firmly downward trend, and the Netherlands benefits from a high degree of financing flexibility as a core eurozone issuer with deep capital markets.

Key Developments

Strong Cyclical GDP Growth: The Netherlands’ strong, broad-based upswing continues. Fitch forecasts GDP growth of 2.9% in 2018 (with private consumption boosted by real wage increases and fiscal stimulus, offsetting some cooling in the contribution from net trade and investment growth). We expect growth to moderate to 2.5% in 2019 and 1.9% in 2020, partly due to slower growth in employment and external demand.

Modest Fiscal Stimulus: The boost to public finances from above-trend GDP growth is expected to offset the impact of moderately expansionary fiscal policy. The 2017 fiscal surplus increased to 1.1% of GDP, from 0.4% in 2016, and Fitch forecasts similar surpluses of 0.9% of GDP in 2018 and 1.0% in 2019, slightly above the current Stability Programme targets, helped by a further 0.3pp fall in debt interest costs. Implementation of the government’s phased, pro-cyclical, fiscal package will subtract an estimated 1.2% of GDP from the fiscal balance in 2021.

Falling Public Debt: The Netherlands’ debt dynamics continue to be favourable. Stronger nominal GDP, deficit reduction, and debt-reducing stock-flow transactions totalling 5.5% of GDP in 2015-2017 have driven general government debt down by 10.6pp since end-2014, to 56.5% of GDP at end-2017. Fitch forecasts a further reduction to 45.8% at end-2020, incorporating debt-reducing financial transactions totalling 1.5% of GDP in 2018-2020; this level is still above the current ‘AAA’ median of 41.2%.

Strengthening External Position: Exports grew 5.3% in 2017 in the face of a 1.4% real effective exchange rate appreciation, while the current account surplus widened to 10.2% of GDP from 8.4% in 2016, taking the five-year average to 9.1%. This has driven a 24.1pp fall in NXD since 2012, to 21.5% of GDP in 2017, and on a total IIP measure, the Netherlands has a net creditor position of 73.5% of GDP. We forecast a moderate narrowing of the current account surplus to 8.2% of GDP in 2020, still well above the ‘AAA’ median of 5.5%.

Negative Sensitivities

- A severe macroeconomic shock, potentially originating in the housing sector, and/or sharp fiscal loosening that reverses the downward trajectory in public debt
- Crystallisation of sizeable contingent liabilities, for example from the national mortgage guarantee scheme, or eurozone bailout packages

Latest Rating Review Date: 27 April 2018
Next Rating Review Date: 26 October 2018
Strong Institutional Framework, Large Buffers: Norway’s ratings reflect its strong sovereign balance sheet, large persistent current account surpluses, significant net external creditor position, strong performance on governance and human development indicators, and high income per capita metrics. A robust macroeconomic policy framework and strong buffers afford the authorities significant flexibility to respond to oil price shocks with accommodative fiscal and monetary policy measures.

Key Developments

Private Investments Drive Growth: Fitch forecasts mainland GDP growth to accelerate to 2.6% in 2018 (2017: 2.0%) and to moderate to 1.7% by 2020. Growth is expected to be driven in particular by private investments in equipment, which are expected to replace robust housing investments in recent years. Economic growth is expected to benefit from spillovers from the recovery of petroleum investments in Norway, supported by a mild recovery in oil prices.

Inflation Accelerates, Faster Rate Rises: Harmonised inflation picked up to 3.5% yoy in July 2018, driven primarily by stronger energy prices. Core inflation ticked up slightly to an average of 1.3% in H118, driven by stronger domestic demand, but Fitch expects Norges Bank to raise rates slightly faster than previously anticipated, due to the government’s recent lowering of the inflation target to 2.0% from 2.5%.

Fiscal Stimulus to be Unwound: The government’s medium-term fiscal strategy aims to unwind fiscal stimulus to the economy to prevent a premature tightening of monetary policy that would hurt non-oil exports. In 2018, the rise in the budgeted structural non-oil fiscal deficit has slowed to a 0.1pp increase (2017: 0.4pp rise), to 7.7% of trend mainland GDP.

House Price Correction: House price growth across Norway fell to a recent low of -1.1% yoy in Q118, and to -4.9% yoy in the Oslo area. However, house price growth recovered slightly in Q218 to 1.7% and 0.4% yoy respectively. Monthly house price data indicate that the price falls are moderating, and the fall in housing starts and investments in 2017 should lend some support to the outlook for Norwegian house prices in 2018.

Household Indebtedness Moderating: Household credit growth has been rising as low interest rates and the economic recovery have incentivised households to borrow for residential purchases. However, total credit to households has slowed slightly to 6.4% yoy from 7.0% yoy in May 2017.

Negative Sensitivities

- Risks to financial stability deriving from a severe macroeconomic shock, which would be amplified by excessive credit growth or household indebtedness
- A substantial erosion of Norway’s sovereign and external balance sheet strengths over the medium term

Key Indicators

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Source: Fitch

Next Rating Review Date: 21 September 2018

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**Growth Rebounds from Oil Shock; In Line with ‘AAA’ Median Growth**

Real GDP growth (%)

**Household Credit Rising, but at a Slower Pace**

Credit to households (% yoy)

**House Price Correction**

(% chg yoy)

**Oil Investments Recovery to Boost Growth**

pp of growth

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**Key Indicators**

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**Norway (AAA/Stable)**

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Improving Macroeconomic and Fiscal Performance: The ‘BBB’ rating balances Portugal's institutional strengths (human development, governance and income per capita indicators are all above ‘BBB’ rated peers) and improving macroeconomic and fiscal indicators with very high public and external debt levels and vulnerabilities in the financial sector.

Key Developments

Declining Debt Trajectory: The GGGD/GDP ratio was 125.7% at end-2017, compared with 129.9% at end-2016. The recent macroeconomic and fiscal developments have buttressed Fitch’s assessment that the debt trajectory is on a firm downward trend and the decline in the GGGD ratio will continue over the medium term. 

Buoyant Cyclical Recovery: The cyclical economic recovery reached its peak in 2017 when GDP grew by 2.7%. Fitch forecasts a gradual slowdown to 2.2% in 2018 and 1.8% in 2019, broadly in line with aggregate eurozone growth. Improving labour market conditions underpin the underlying growth momentum, as the unemployment rate fell to 7.5%.

External Adjustment: Improved competitiveness has helped the economy to maintain a modest current account surplus despite the buoyant recovery in domestic demand, and import-sensitivity investment in particular during 2017. The external deleveraging of the heavily indebted economy will continue over the medium term, driven by a sustained, albeit small, current account surplus of around 0.5% of GDP.

Banks Risks Declining: Banking sector vulnerabilities continue to reflect the crisis legacy. The NPL ratio is still high, although it declined to 13.3% at end-2017, and profitability prospects are weak in the very low interest rate environment. Furthermore, the banking sector recapitalisation costs continue to have a significant impact on the headline budget balance.

Positive Sensitivities

- Track record of further substantial decline in the GGGD/GDP ratio
- Evidence of significantly stronger potential growth over the medium term, exceeding 2% without jeopardising the necessary external adjustment
- Continued strong export growth that leads to widening current account surpluses and a rapid decline in NXD

Negative Sensitivities

- Reversal of the decline in the GGGD/GDP ratio
- Renewed stress in the financial sector that requires significant additional public-sector support and/or affects financial stability and growth outlook

Latest Rating Review Date: 1 June 2018
Next Rating Review Date: 30 November 2018
High Income, Low Debt, Banking Sector Risk: San Marino’s governance indicators, income per capita, and level of public debt compare favourably with ‘BBB’ medians, and the country is a net external creditor. However, it is exposed to a large banking sector with very weak asset quality, there are gaps in economic, fiscal and external data, and resilience to shocks is curtailed by its small size, limited economic diversification and high dependence on Italy.

Key Developments

Negative Outlook: The revision in June of the Outlook on San Marino’s ‘BBB−’ rating to Negative from Stable reflected further banking sector weakness, limited progress in bank restructuring and reform, and expectations of a larger public injection into banks in 2018-2021 than at our previous review. San Marino’s debt tolerance is, in our view, reduced by its lack of a track record of external borrowing, the limited “lender of last resort” capability for its banking sector, and the steady erosion of its fiscal reserves.

Ongoing Banking Sector Challenges: The sector made another loss in 2017 of 3.3% of GDP, and faces the challenges of low interest rates and adapting the business model in line with the greater bank transparency. Asset quality remains very weak, with the gross NPL ratio increasing by 5.5pp in 2017 to 48.9% (and net of provisions by 3.5pp to 29.9%). Bank liquidity stabilised in Q1T8 and is adequate, but has weakened since last year.

Increasing Net Debt: Fiscal reserves have fallen to below 2% of GDP, from 10.4% at end-2011, reducing fiscal flexibility. Fitch expects small fiscal surpluses (excluding bank recapitalisations) of 0.2% of GDP in 2018, helped by a one-off health tax, and 0.5% in 2019, supported by departmental spending cuts and a moderate income tax increase. Our public debt forecast incorporates further bank injections (largely into San Marino’s largest bank, CRSM) totalling EUR450 million in 2018-2021, taking public debt to 50% of GDP in 2021.

Shallow Economic Recovery: Available data indicate some moderation in GDP growth in 2017 to 1.5% from 2.2% the year before, amid ongoing bank deleveraging. Fitch forecasts economic growth of 1.4% in 2018 and 1.3% in 2019, which would leave real GDP around 18% below the 2008 peak. Domestic demand is supported by mildly positive labour dynamics and planned investment projects.

Positive Sensitivities

• Strengthening of the banking sector
• An improvement in public debt dynamics or rebuilding of fiscal buffers over time

Negative Sensitivities

• Further banking sector weakness that increases the risk of additional contingent liabilities appearing on the sovereign balance sheet
• Deteriorating fiscal balances resulting in a greater increase in public debt/GDP

Latest Rating Review Date: 1 June 2018

Next Rating Review Date: 30 November 2018
High Income, High Debt: Spain’s ‘A−’ rating reflects its diversified, high value-added economy, low government debt yields, negligible share of foreign-currency debt, broad-based economic recovery and steady reduction in macroeconomic balances. This is set against very high public and external debt, weak structural fiscal adjustment, still high unemployment and political risk.

Key Developments

Broad Policy Continuity: The Socialist Party administration, which took office in June following a no-confidence vote, commands just 84 of the 350 parliamentary seats, limiting its ability to implement new reform. It is unclear whether the government will see out the rest of the term to July 2020. The new cabinet has a generally moderate and pro-EU composition, and has signalled broad continuity in macroeconomic policy.

Cyclical Deficit Reduction: Fitch forecasts a moderation in GDP growth from 3.1% in 2017 to 2.7% this year, 2.3% in 2019 and 1.9% in 2020, as economic slack is steadily absorbed, the low savings rate dampens private consumption growth, and investment growth cools from 5.0% in 2017. The 2017 fiscal deficit hit the 3.1% of GDP target, and we forecast a further cyclically driven fall to 1.8% of GDP in 2020, and a gradual reduction in general government debt, from 98.3% of GDP in 2017 to 95.2% in 2020, which compares with the ‘A’ median of 50.6%.

High External Leverage: Solid export performance is underpinning moderate current account surpluses and gradual reduction in external vulnerabilities. Fitch forecasts the current account surplus will reduce by 0.3pp in 2018 to 1.6% of GDP, partly due to a higher oil price, and will average 1.7% in 2019-2020, helped by earlier unit labour cost adjustment and the greater number of Spanish firms that regularly export. Nevertheless, NXD remains very high at 90% of GDP at end-2017, and compares with the ‘A’ median of 12.4%.

Underlying Political Risk: Tensions between the central and Catalonia regional governments have abated this year, but Fitch does not see progress in developing policies that could form the basis of an agreement. Our central assumption remains that there will ultimately be a settlement on regional financial reform and greater autonomy for Catalonia on the basis of an agreement. Our central assumption remains that there will ultimately be a settlement on regional financial reform and greater autonomy for Catalonia within Spain, but that this will be a long-drawn-out process, with the potential to escalate from time to time.

Positive Sensitivities

• Lower risk of disorderly resolution of tensions between the central and Catalonia regional governments, further progress in reducing the budget deficit, improvement in the external balance sheet or increased confidence in stronger economic growth

Negative Sensitivities

• An increase in GGGD/GDP, sustained heightened tensions between the Catalonia regional and Spanish central governments or the emergence of a current account deficit

Latest Rating Review Date: 13 July 2018

Next Rating Review Date: By January 2019
**Strong Fiscal Position and Institutions:** Sweden’s ‘AAA’ rating reflects its high per-capita income, persistent budget surpluses and declining public debt, strong governance and human development indicators, and a track record of sound economic policy.

**Key Developments**

**Strong Economic Growth:** Economic growth is stronger than at rating peers. GDP grew by 2.4% in 2017 and the five-year average growth is 3.1%, compared with the ‘AAA’ median of 2.2%. The 2018 GDP forecast is 2.6%, followed by a gradual moderation to 2.2% in 2019 and 2.1% in 2020, in line with Sweden’s estimated growth potential around 2%.

**Budget Surplus, Declining Debt:** The budget recorded a surplus of 1.3% of GDP in 2017, slightly exceeding the target of a cyclically adjusted 1% surplus and the 2016 outturn of 1.2%. Public indebtedness is on a firm downward path due to sound economic growth and budget surpluses, underpinned by low and declining interest expenditure.

**Political Uncertainty:** Political uncertainty is unusually high before the 9 September general election, given the strength of the Sweden Democrats party in recent polls and the weakness of the Social Democrats and the Moderate Party, the two main traditional parties. Nevertheless, there is a broad political consensus on prudent fiscal policy and Fitch expects that any new government will comply with the fiscal target of a 0.3% of GDP budget surplus.

**Loose Monetary Conditions, Subdued Inflation:** The monetary policy stance is expansionary, the policy rate (-0.5%) is one of the lowest among advanced economies, and the Riksbank is reinvesting the full amount of redemptions and coupon payments from its SEK300 billion (6.5% of GDP) government bond portfolio. Underlying inflation pressure remains subdued, and wage growth is expected to pick up only gradually, despite the tighter labour market and strong cyclical position of the economy.

**Macro-Prudential Policy, Housing Market:** Macro-prudential policy is a key element of the Swedish policy mix, given the loose monetary conditions and strong cyclical position of the real economy. Fitch judges these financial stability risks to be limited, due primarily to the combination of sound macroeconomic fundamentals and a strong banking sector. The Swedish banking sector has a Banking System Indicator of ‘aa’, the strongest in Europe.

**Negative Sensitivities**

- A severe macroeconomic shock – potentially originating in the household sector – leading to a sharp deterioration in the public finances through higher deficits and lower GDP growth

Latest Rating Review Date: 27 July 2018

Next Rating Review Date: By 27 January 2019

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**Key Indicators**

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<td>40.6</td>
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<td>36.9</td>
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Source: Fitch
Switzerland (AAA/Stable)

Strong Structural Fundamentals: Switzerland’s ‘AAA’ rating reflects its track record of prudent economic and fiscal policies, a diversified and wealthy economy, high levels of human development and strong governance metrics. Switzerland surpasses its peers on most key indicators. GDP per capita is estimated to be 1.4x the ‘AAA’ median.

Key Developments

Economic Growth Picking Up: Economic growth was 0.6% in 1Q18 on a qoq basis. We expect growth to remain upbeat this year, boosted by weakness in the Franc and a still buoyant external environment. Growth will also be boosted by spending related to ticketing, licensing and broadcasting of major sports events given that international sports organisations are located in Switzerland. Our forecast for 2018 is for growth to pick up to 2.1% from 1.1% in 2017, before easing back to 1.9% in 2019 and 1.7% in 2020. Switzerland’s real GDP growth in the five years to 2017 was substantially lower than the ‘AAA’ median (at 1.6% compared with an estimate of 2.1% respectively).

Inflation Dynamics Still Subdued: Consumer price inflation turned positive in 2017, averaging 0.6%. Inflation dynamics are still expected to be somewhat subdued over the next two years, with inflation forecast to average 0.8% this year and 1.3% in 2019 and 2020. On 21 June, the Swiss National Bank (SNB) left its expansionary monetary policy stance unchanged. The SNB underlined that it remains willing to intervene in the foreign exchange market as necessary.

Real Estate Prices, Credit: Low interest rates have helped boost demand for housing. Real estate prices remain historically high, even if price dynamics show a mixed picture among different types of housing. Rising prices are also reflected in a continued rise in the credit/GDP ratio. The SNB retains a countercyclical capital buffer of 2% for risk-weighted assets invested in mortgage lending. Switzerland has a score of ‘2’ on Fitch’s Macro-Prudential Risk Indicator, denoting moderate vulnerability.

Public Finances Improvement: The general government balance is estimated to have risen from a surplus of 0.4% of GDP in 2016 to 1.1% in 2017 thanks to a sharp rise in tax receipts. We expect some of the strength in tax receipts to unwind this year and next. Our public finance projections would be consistent with the government debt/GDP ratio falling to 28.7% by 2020.

Negative Sensitivities

- Fitch assesses that Switzerland’s credit metrics are very strong and that downside risks to the ‘AAA’ rating are currently not material. Nonetheless, negative rating action could result from a material shock to the financial sector, for example due to a sharp correction in the Swiss residential real estate market, or large losses on trading and international lending portfolios.

Latest Rating Review Date: 23 March 2018
Next Rating Review Date: 21 September 2018
**United Kingdom (AA/Negative)**

**Negative Outlook, Uncertainty:** The UK’s ratings balance a high-income, diversified and advanced economy against comparatively high public indebtedness. Sterling’s reserve currency status, deep capital markets and strong governance indicators further support the ratings. The Negative Outlook reflects the continued downside risks of a disruptive exit from the EU, which would have negative consequences for UK trade, investment and economic prospects in the short to medium term.

**Key Developments**

**Smooth Transition Less Likely:** An intensification of the political divisions within the UK and slow progress in negotiations with the EU mean there is such a wide range of potential Brexit outcomes that no individual scenario has a high probability. We no longer believe it is appropriate to identify a specific base case. An acrimonious and disruptive “no deal” Brexit is a material and growing possibility. This would substantially disrupt customs, trade and economic activity, with the depth of disruption depending on how quickly a “bare bones” deal could be reached.

**Growth Uncertainty as Brexit Date Approaches:** Following real GDP growth of 1.7% over the course of 2017, the UK economy slowed down in 1Q18, with growth on a qoq basis of 0.2%. We continue to expect Brexit-related uncertainty to weigh on business investment this year. Consumption growth will also be relatively subdued, with the saving ratio at historical lows. This translates to a decline in GDP growth to 1.3% for 2018. There should be scope for growth to pick up in 2019 and 2020 to 1.7%, but this forecast is highly uncertain, and still assumes a smooth transition following the UK’s departure from the EU in March 2019. In a more disruptive Brexit, we could substantially reduce our growth forecasts and revise our unemployment, inflation and exchange rate projections.

**Positive Sensitivities**

- Evidence that the UK’s growth prospects are proving resilient to the consequences of the EU referendum
- Further improvements in public finances leading to a steady decline in the government debt/GDP ratio

**Negative Sensitivities**

- An outcome of the negotiations on Brexit and future trade relations with the EU that adversely affects UK economic growth prospects and public finances
- Political developments that impede a clear determination of the UK’s future relationship with the EU or undermine the economic policy framework and economic performance
- Worsened public finances developments leading to a rise in the government debt/GDP ratio

**Latest Rating Review Date:** 27 April 2018

**Next Rating Review Date:** 26 October 2018

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**Contributions to GDP Growth Outturns and Projections**

- **Consumption**
- **Investment**
- **Net trade**
- **Other**
- **Real GDP**

**Current Account Balance**

- **Trade balance**
- **Primary income**
- **Secondary income**
- **Current account**

**Exchange Rate**

- **USD/GBP (LHS)**
- **GBP/ERI (LHS)**
- **USD/GDP (RHS)**

**Confidence Indicators**

- **Consumer confidence**
- **Business confidence - manufacturing**
- **Business confidence - services**

**Key Indicators**

<table>
<thead>
<tr>
<th>Year</th>
<th>2016</th>
<th>2017</th>
<th>2018f</th>
<th>2019f</th>
<th>2020f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (% change)</td>
<td>1.9</td>
<td>1.7</td>
<td>1.3</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Current account balance (% GDP)</td>
<td>-5.8</td>
<td>-3.9</td>
<td>-4.0</td>
<td>-3.7</td>
<td>-3.5</td>
</tr>
<tr>
<td>Net external debt (% GDP)</td>
<td>21.4</td>
<td>36.4</td>
<td>32.7</td>
<td>30.8</td>
<td>28.5</td>
</tr>
<tr>
<td>Government balance (% GDP)</td>
<td>-3.0</td>
<td>-1.9</td>
<td>-1.7</td>
<td>-1.5</td>
<td>-1.4</td>
</tr>
<tr>
<td>Government debt (% GDP)</td>
<td>88.2</td>
<td>87.7</td>
<td>86.7</td>
<td>85.1</td>
<td>83.5</td>
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Source: Fitch
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