

## Fitch: Global Economy Stabilising; Medium-term Fiscal Challenge Ahead

Fitch Ratings-London/New York/Singapore-30 June 2009: Fitch Ratings says in a new report that the global economy has likely stopped shrinking and will slowly begin to recover during the second half of this year. However, economic recovery will be anaemic and unemployment will continue to rise through most of next year and, consequently, the world's major central banks are not expected to begin raising policy interest rates until late 2010 at the earliest.

The credit quality of the large 'AAA' sovereigns (US, UK, France, Germany) has been eroded by the financial crisis and severity of the global recession. However, despite the fact that Fitch does not expect fiscal deficits to begin to narrow materially until 2011, credit quality remains within 'AAA' tolerances given the exceptional balance sheet and funding flexibility conferred by 'benchmark' borrower and 'reserve currency' status.

David Riley, Global Head of the Fitch's Sovereign Rating group said, "A key credit support for retaining 'AAA' status is confidence that, over the medium-term, government debt levels will be brought down from the elevated levels forecast. Stable Outlooks on 'AAA' sovereign ratings reflect our expectation that governments will set out stronger medium-term fiscal consolidation plans over the next year or so necessary to place public finances on a sustainable path and underpin confidence in their creditworthiness and commitment to low inflation."

Without cuts in public spending in tandem with tax increases, Fitch predicts that government debt would reach 100% of GDP in the US and UK by 2012 and 2013 respectively, while government debt ratios in France and Germany will exceed 90% of GDP by the middle of the next decade. While the capacity to fund large deficits and debt remains extremely strong and the interest burden remains modest by historical standards, public finances would be much more vulnerable to adverse shocks and less able to pursue counter-cyclical fiscal policy, a key characteristic of 'AAA' sovereigns.

Outside of the advanced economies, emerging market (EM) sovereigns remain buffeted by the global crisis, with the principal rating risk so far centred on sharp declines in private capital flows, including cross-border bank lending, which continue to pressure balance of payments and financial stability, especially in central and eastern Europe. Furthermore, the very weak global economic environment and reduced availability and higher cost of financing is pressurising non-sovereign credit quality, with approximately one third of emerging market companies and banks with international ratings from Fitch (some 700 worldwide) currently on Negative Outlook/Watch, with only 2% on Positive Outlook.

However, while several EM sovereigns have had their ratings downgraded and further downgrades are likely, Riley commented that "EM sovereign credit quality has so far proved resilient in the face of the most severe global financial crisis and economic recession in decades. The benefits of much stronger sovereign balance sheets and policy frameworks built over the last several years have come to the fore during the current crisis." Fitch also believes that the risk of a systemic EM crisis has diminished, in large part because of the impressive international policy response coordinated by the G20.

The full report, entitled, "Sovereign Review," is available on the agency's public website - [www.fitchratings.com](http://www.fitchratings.com)

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