Subnational Government Outlook 2025

Anticipating A Year Of Change

S&P Global Ratings

Felix Ejgel

Lisa M. Schineller

Noa Fux

Louise Morteveille

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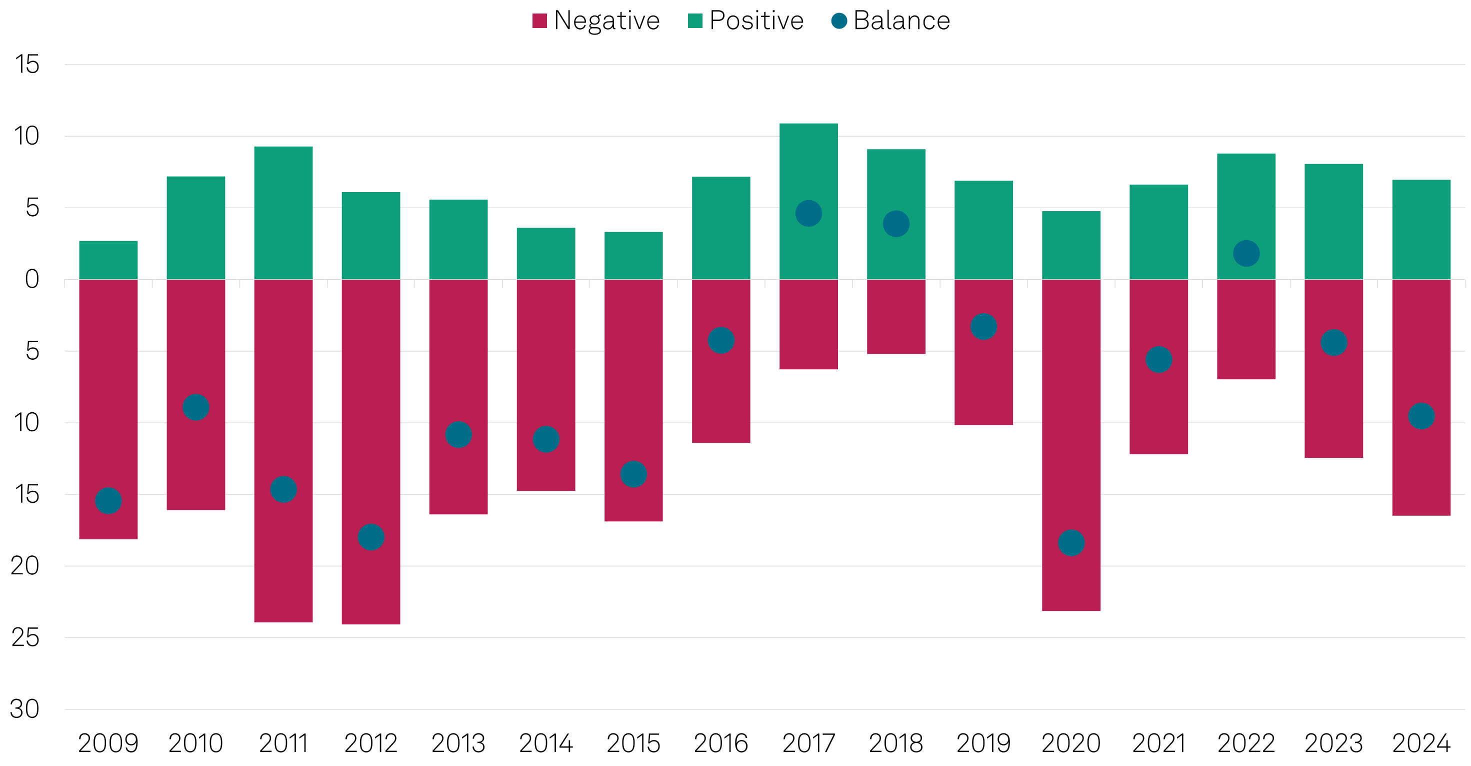
This report does not constitute a rating action

Key Takeaways

- In 2025 we anticipate a relatively large number of countries outside the U.S. will implement material changes in government financing systems, to address imbalances between revenue sources and spending responsibilities of their respective local and regional governments (LRGs).
- With moderating economic growth and persistent spending pressure, LRG fiscal deficits will stay wide, and global LRG direct debt is on course to reach a relatively high 140% of operating revenues on average by 2026.
- We observe different regional patterns: China's LRGs will take on balance sheet some debt of their enterprises, while Australian states, New Zealand councils, and Canadian provinces will make large investments. In many European and Latin American (LATAM) countries where regional governments must comply with national fiscal restrictions, some spending is being transferred to lower tiers of government or public-sector enterprises, or spending is being cut. The latter could create backlogs in provision of public services and reduction in social and physical investment spending. This, in turn, will weigh on growth prospects and hinder a sustainable improvement in financial indicators.
- In the meantime, more outlooks on rated LRGs are turning negative, suggesting a prevalence of downward rating actions in 2025. As of now, a relatively high number of ratings on the largest borrowers in international markets--three out of 10--have negative outlooks.

Negative Outlook Bias Strengthens While Three-Quarters Of Ratings Are Stable

LRG outlook balance (% of total ratings)

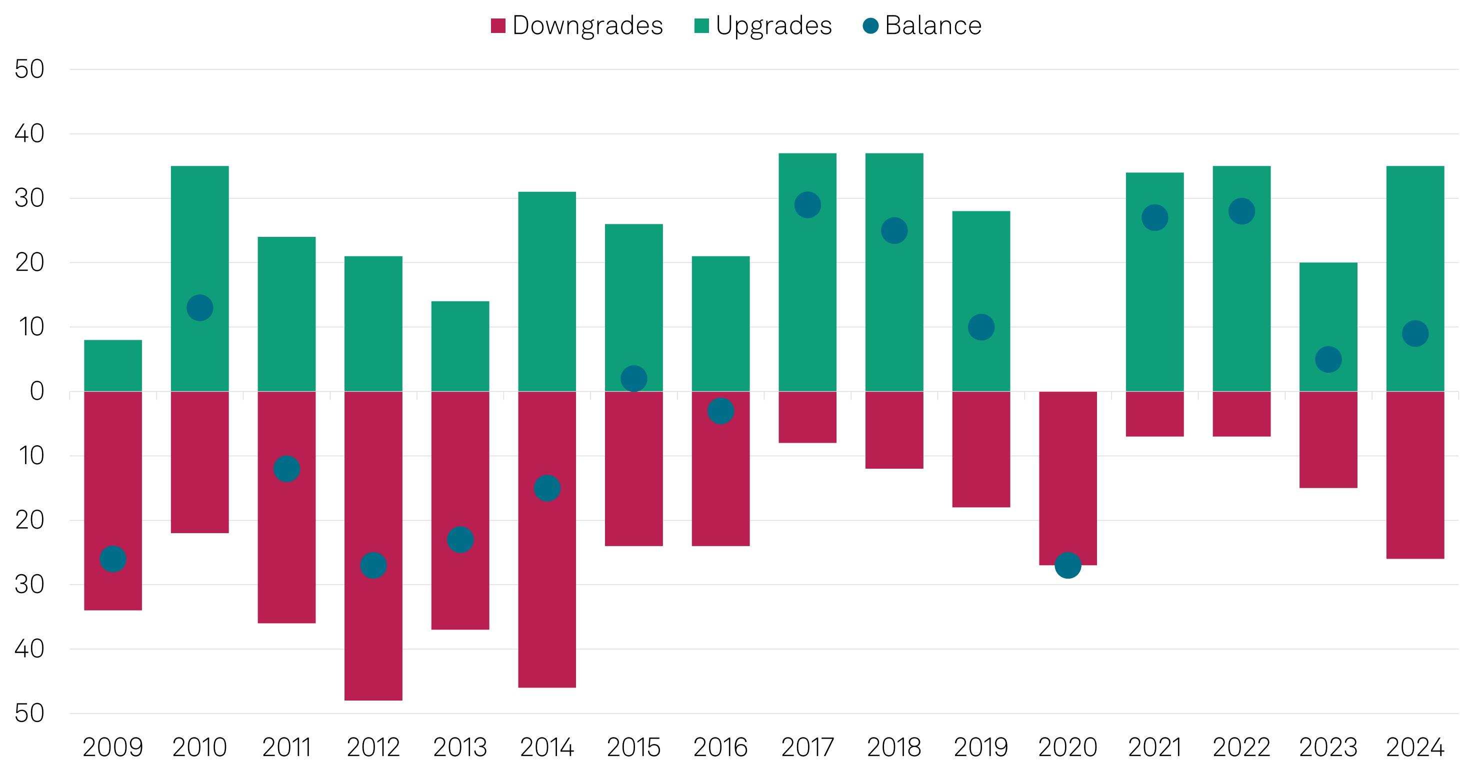


Source: S&P Global Ratings.

- We expect the credit quality of most LRGs to remain stable over the next two to three years, but the downward pressure is rising.
- The share of ratings with stable outlooks is the lowest since 2012 (except for during 2020 which was affected by the pandemic), suggesting a rise in the number of rating actions in 2025.
- The outlook bias has become more negative, with more than 15% of ratings having negative outlooks. This is the highest share since 2020 when the COVID pandemic was at its peak.
- Ratings on three large global issuers have a negative outlook: the Canadian province of British Columbia, the German state of North Rhine-Westphalia and the Australian state of New South Wales.

The Number Of Rating Actions On LRGs Has Increased

Number of upgrades and downgrades

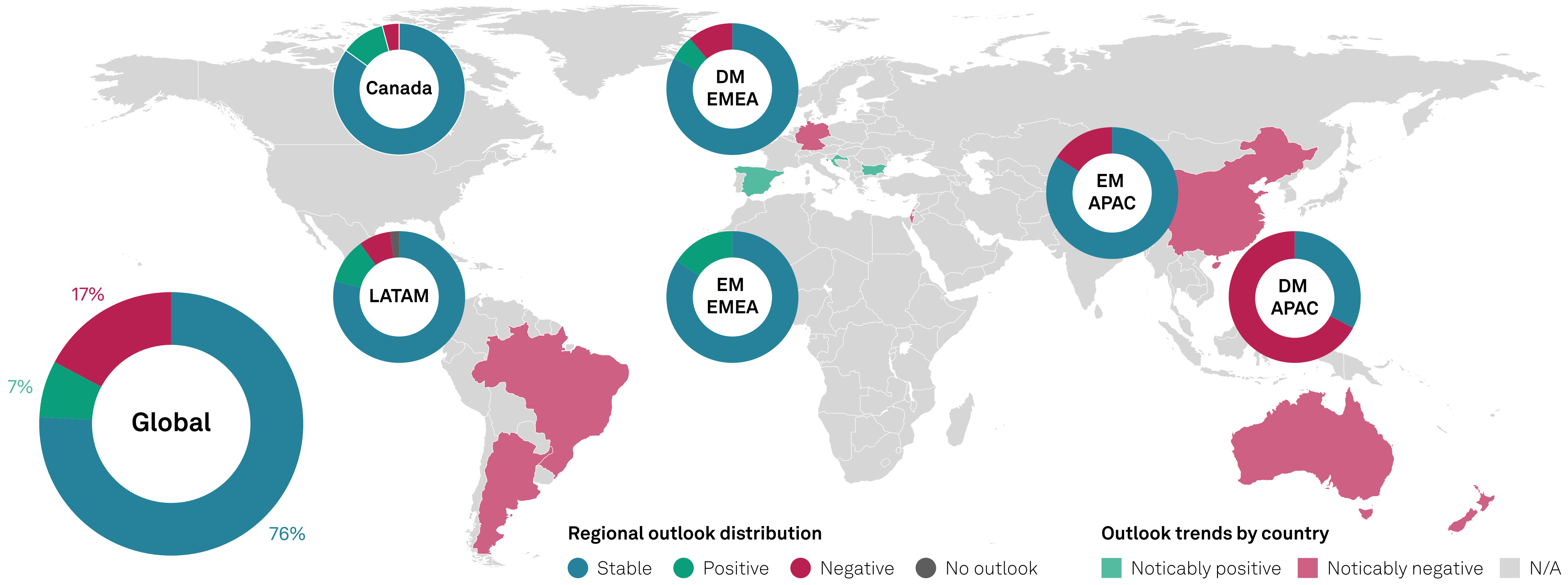


Source: S&P Global Ratings.

- As another side of elevated rating volatility, in 2024 we made the highest number of upgrades and downgrades of LRGs in a decade.
- The number of downgrades has been steadily increasing since 2021 and reached 26 by the end of the year.
- Most rating upgrades in 2024 were of entities rated in 'BB' category and below, where we would expect to see more volatility.

Rating Volatility Could Be Highest In Asia-Pacific And Emerging EMEA

Regional outlook distribution



DM--Developed markets. EM--Emerging markets. N/A--Not applicable. Source: S&P Global Ratings.

Rating Volatility Could Be Highest In Asia-Pacific And EMEA

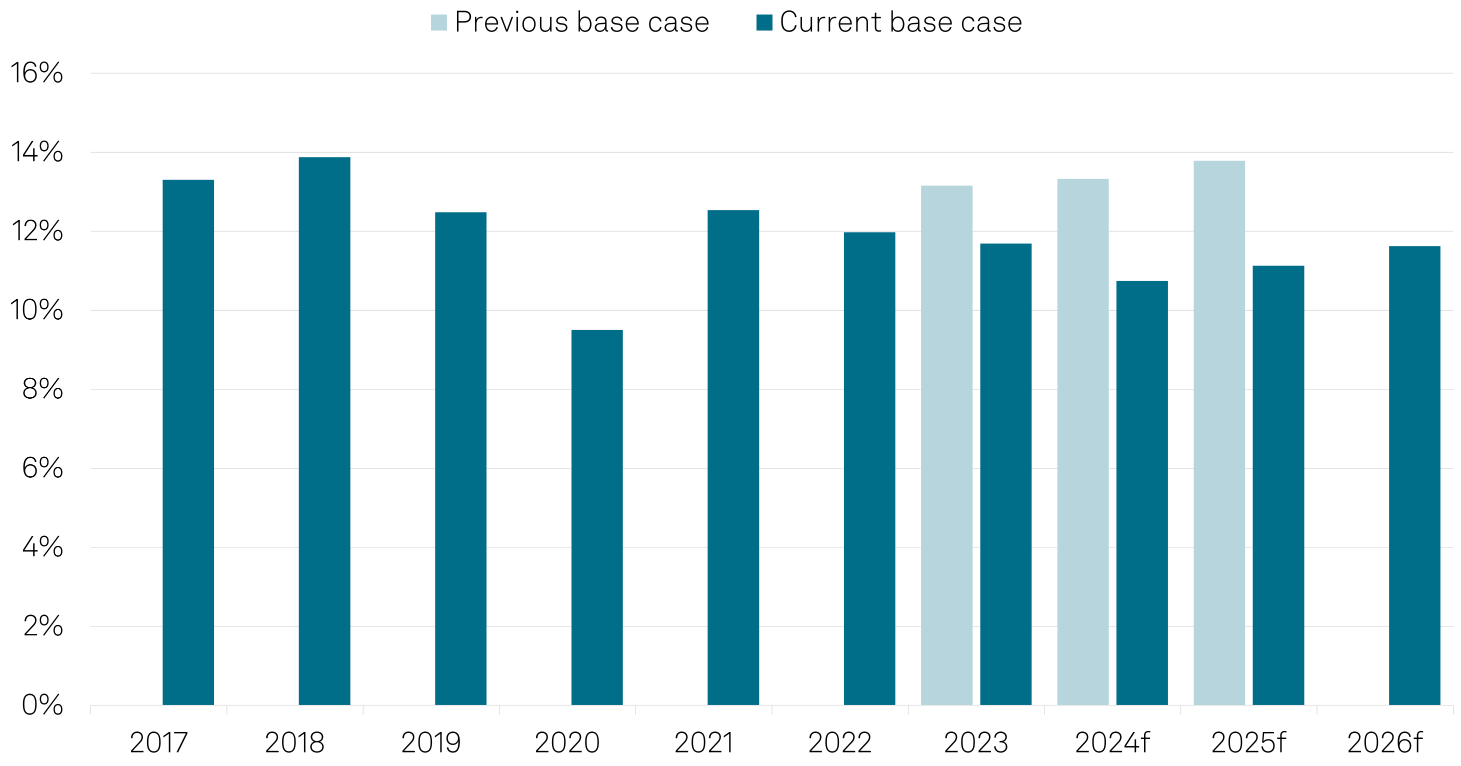
- Asia-Pacific shows a higher-than-average proportion of negative outlooks on LRGs--primarily in Australia and New Zealand--because of high budget deficits reflecting large investment needs.
- China's upper-tier LRGs will also increase their direct debt following a new sizable debt swap program, although they will lend much of the new issuances to lower tiers of government.
- Extended economic stagnation adds to financial weaknesses of German states and municipalities, while the economic impact of military conflicts in the Middle East is taking its toll on the credit quality of Israeli municipalities.
- Cities in Bulgaria and Croatia benefit from sound economic growth due to strong demand in the tourism sector and anticipated or actual eurozone accession.
- Some Spanish LRGs are benefitting from a solid economic recovery and access to EU funds to finance capital spending.
- In LATAM, outlooks are tilted to the upside in Mexico, whereas there is a slight negative bias in Brazil and Argentina.

Key Risks To Our Base Case Forecasts

- The economic growth forecast is subject to various geopolitical risks. Our view on global and regional economic growth patterns will likely be affected by decisions of the incoming U.S. administration, as well as new governments in Germany, Canada, and Australia on trade and migration, and retaliatory measures from affected counterparties. Moreover, the evolution of the two ongoing regional wars in the Middle East and Eastern Europe will also be material for economic prospects and global prices.
- We anticipate that the ongoing and planned reforms in financial and administrative frameworks for LRGs could affect their budgetary performance, but the scope and timing of most initiatives remain uncertain. Changes we anticipate include: the implementation of the water management reform in New Zealand; further devolution of public services in Italy and the U.K.; debate around the sustainability of balanced budget requirements in Germany that might influence the view on fiscal sustainability rules in Europe; amendment of fiscal rules and additional revenue sources for local governments in Poland; contribution to consolidation efforts from LRGs in Brazil and France; and regional debt write-off and possible reform of the regional financing system in Spain.
- Economic growth stimulus measures may increase the already high debt burden of China's LRGs. In Europe, the strong performance of far-left and far-right parties at the latest regional and national elections raises the probability that fiscal rules will be relaxed.

Global Operating Surplus Is Sound Amid Modest Economic Growth

Operating balance (% of adjusted operating revenues)

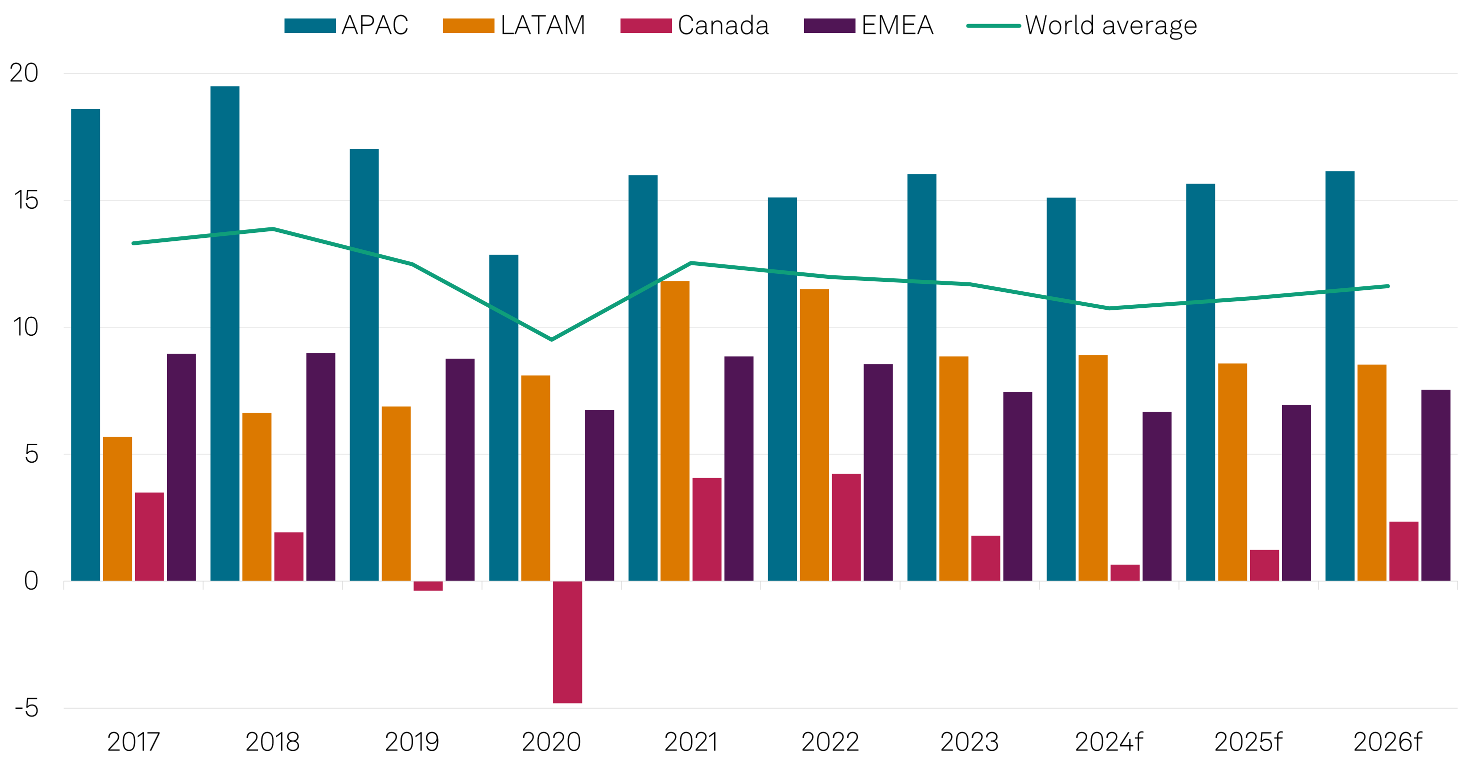


Using actuals whenever available. The data set covers consolidated LRG sector of countries included in the report. Please note that data might differ compared to previously published reports, due to constant data analysis and change of countries included. f--Forecast. Source: S&P Global Ratings.

- On a global basis, we project a solid operating surplus of just below 12% of operating revenues in 2025, although this is notably weaker than pre-pandemic.
- Operating revenue growth will be contained because of modest economic growth, while spending pressures will remain. These reflect high demand for social and health care services, shortage of labor, as well as higher inflation and interest rates compared with pre-pandemic.
- We now project the global operating surplus will be weaker than our previous forecast.

Operating Surpluses Are Weaker Than Average In Canada And Europe

Operating balance (% of adjusted operating revenues)



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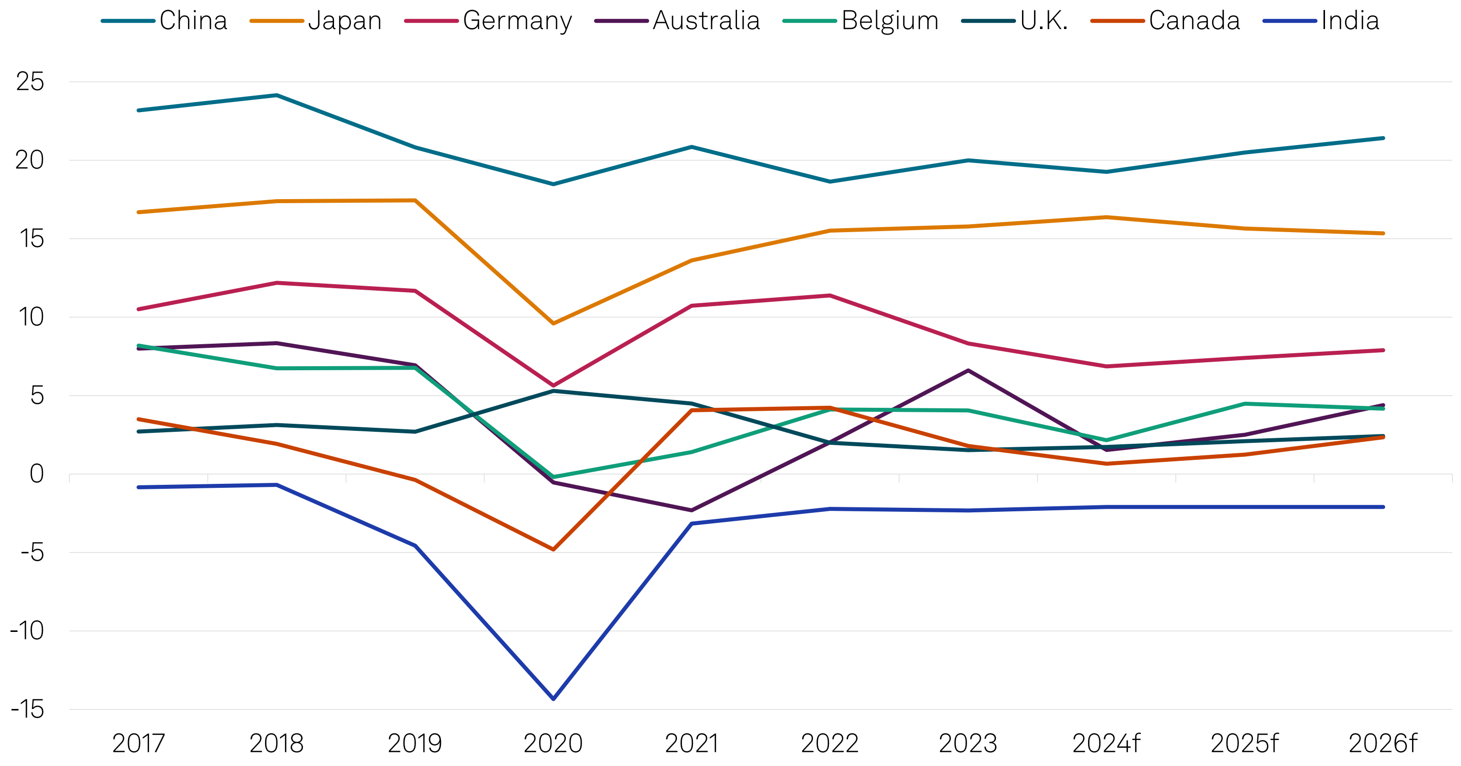
- Solid average operating performance globally is inflated by strong surpluses in APAC, outside Australia and India.
- EMEA's operating performance will remain subdued. Slow economic growth in Western Europe will restrict revenue growth while spending pressure rises. Balanced budget requirements will contain further weakening of operating performance but could also result in a backlog in providing services, or a transfer of spending to public-sector firms.
- Operating performance will remain particularly weak in Canada. Provinces' operating spending will remain inflated as a result of wage settlements.
- In LATAM, solid operating surpluses of just below 10% reflect inability to fluidly acquire financing, including for capital spending.

Many LRGs Are Unlikely To Reach Pre-Pandemic Surpluses

Operating balance (% of adjusted operating revenues)



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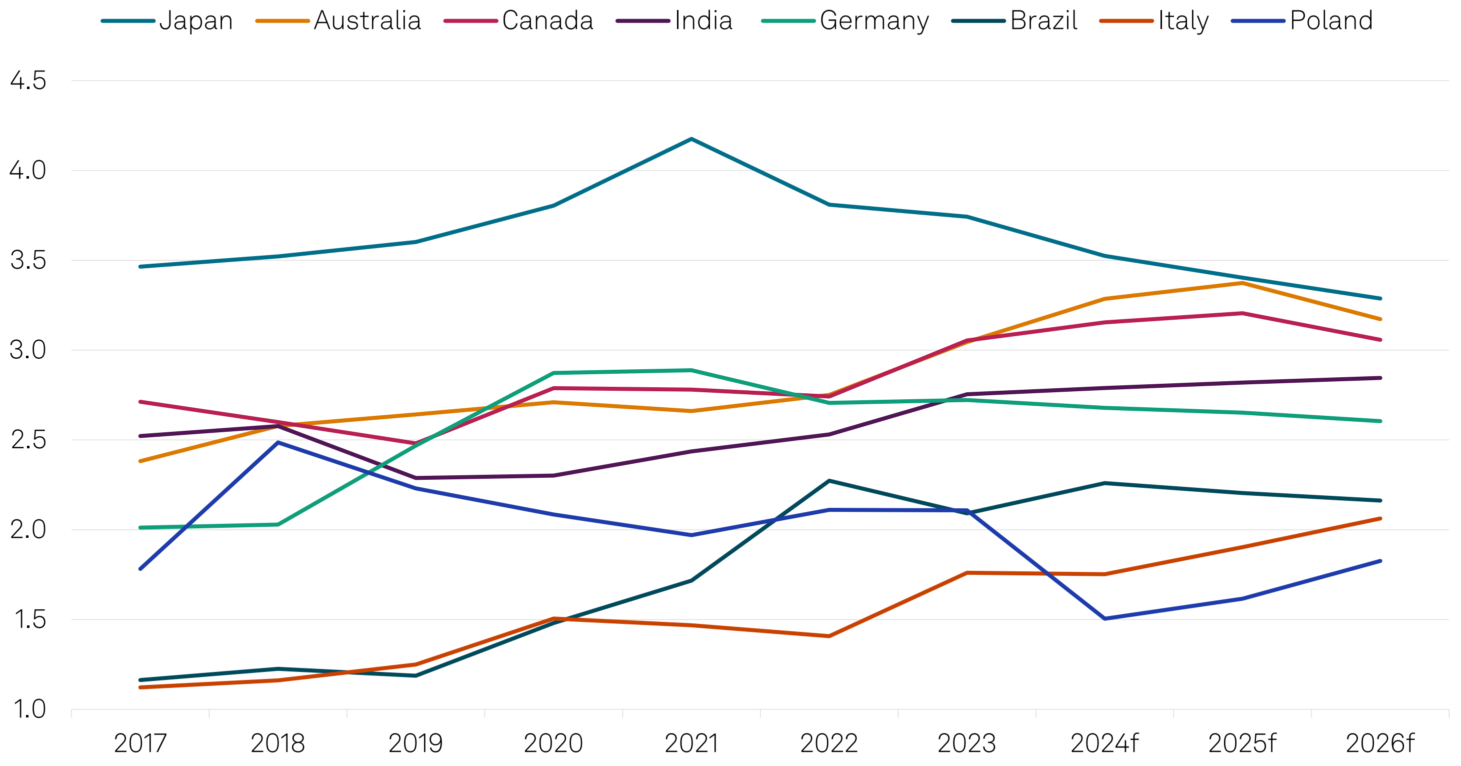
- Chinese and Japanese LRGs will maintain a strong operating surplus, much higher than that of global peers.
- German states will maintain sound operating surpluses despite slow economic growth, as cost increases will be contained.
- Australian states' operating margins to remain in surplus despite increased election spending and commodity prices normalizing.
- LRGs in the U.K. and Belgium will demonstrate weak performance compared with European peers because of spending pressures and demand for services.
- Subnational governments in India continue to pursue aggressive financial policy on the back of a strong economic growth.

Converging Paths Of Public Investment?

Capital expenditures (as % of GDP)



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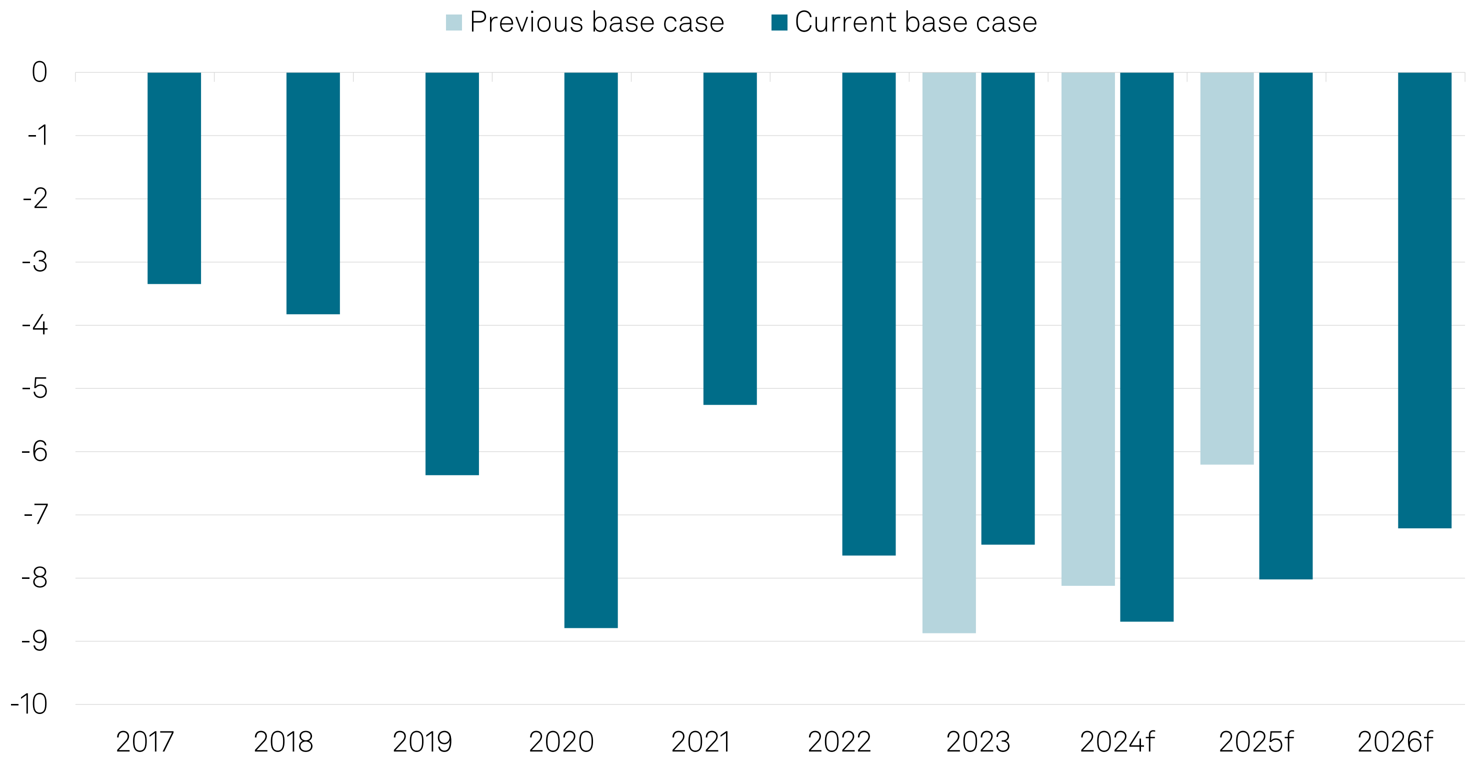
- Very strong population growth is driving up capex in Australia, New Zealand, and Canada. New Zealand's councils are focusing on water management, while regional governments in Canada and Australia are investing in healthcare, transportation, and energy.
- In Europe and Japan, we expect LRGs to stabilize or even reduce capex, except for in Italy and Spain where Next Generation EU funds are available.
- In many emerging markets, including China, Mexico, and Central and Eastern Europe, LRG investments are set to decline. This is due, respectively, to the property market crisis and focus on debt levels, limited management capacity, and the EU budget cycle. As a rare exception, Indian LRGs will continue with high levels of investments.

Global Balance After Capex Is Under Pressure

Balance after capital accounts (% of adjusted total revenues)



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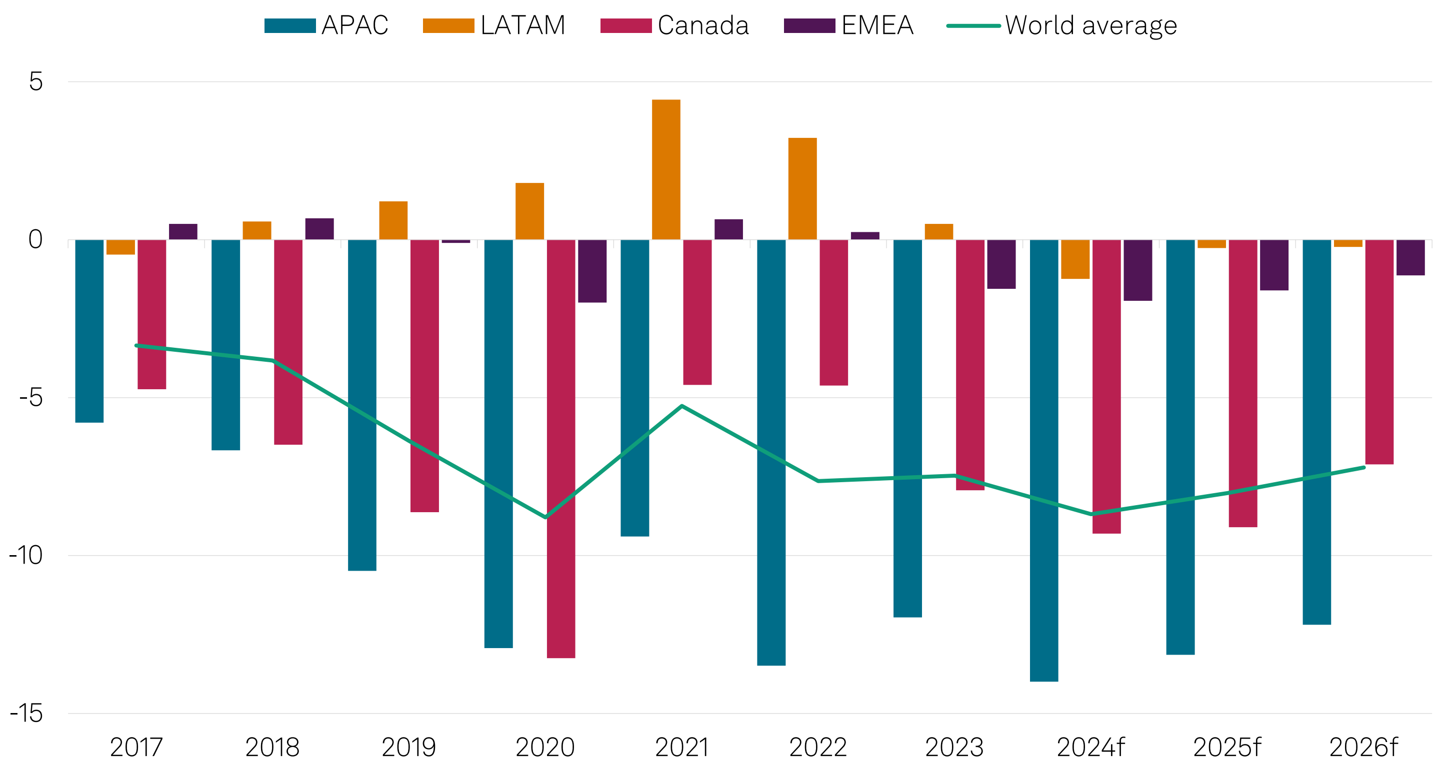
- We anticipate that LRG fiscal deficits will modestly improve from weak levels in 2024. The average deficit will stay much higher than in 2017-2018.
- Our budget deficit projections are slightly higher than our previous forecast due to a combination of weaker operating surpluses, lower proceeds from asset sales, and still-high demand for capital investments.
- In many European and LATAM countries where regional governments must comply with national restrictions, LRGs transfer spending to lower government tiers and public-sector enterprises. Alternatively, LRGs cut spending, especially on capital investments. This can dampen economic resilience and create backlogs in public spending that will prevent material medium-term improvement in financial indicators.

Investments In Asia-Pacific And Canada Drag On Performance

Balance after capital accounts (% of adjusted total revenues)



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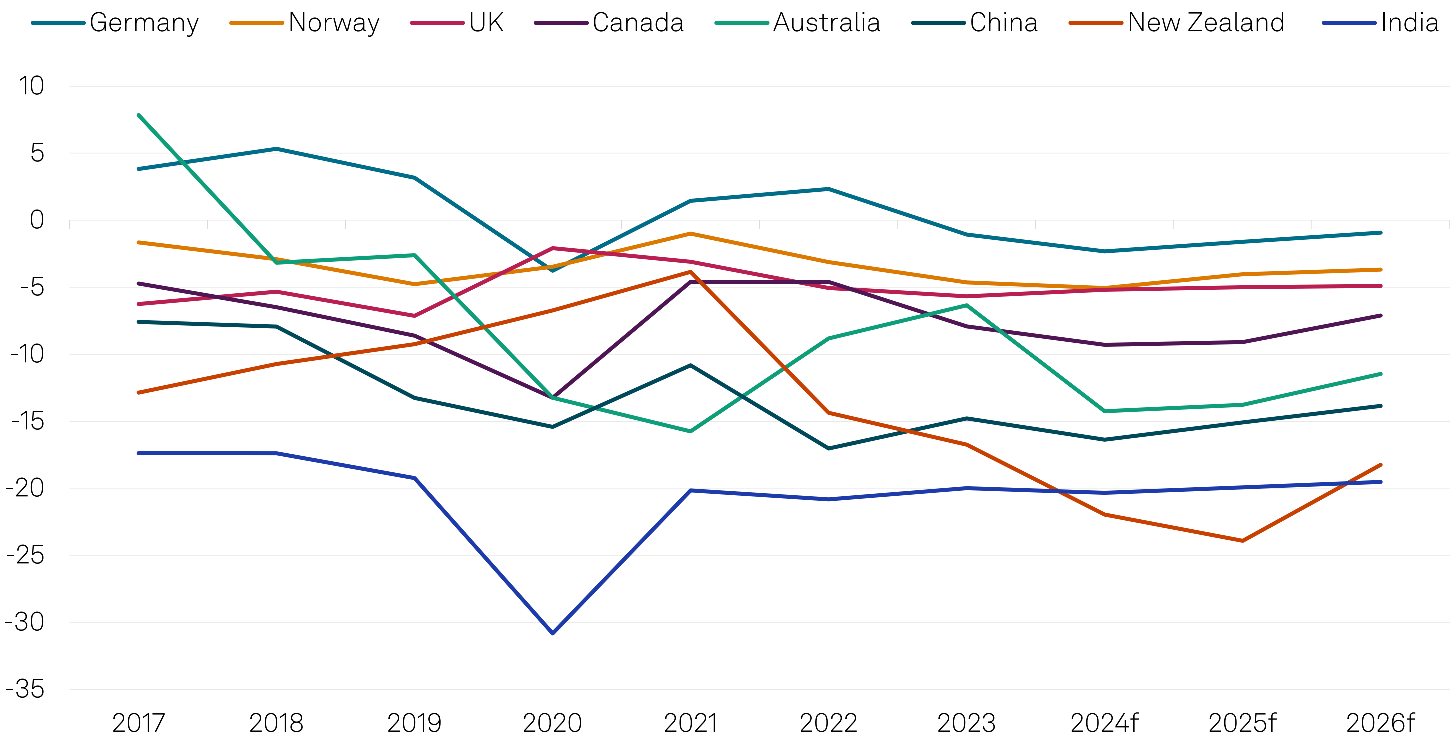
- Despite stronger operating surpluses, overall budget deficits are highest in APAC.
- Canadian provinces are planning to moderate investments in 2025-2026, which would stabilize the LRG deficit at about 8% of total revenue.
- In contrast, LATAM LRGs' fiscal performance should be broadly balanced. In Mexico, this reflects a short planning horizon for investment projects and reluctance to take on debt. In Argentina, recession and limited access to financing is forcing budgetary adjustments.
- In 2023 and 2024, the post-pandemic return to stricter national regulations on debt buildup and deficits will lead to only minor deficits for LRGs in Europe.

Deficits Will Remain Highest In India And New Zealand

Balance after capital accounts (% of adjusted total revenues)



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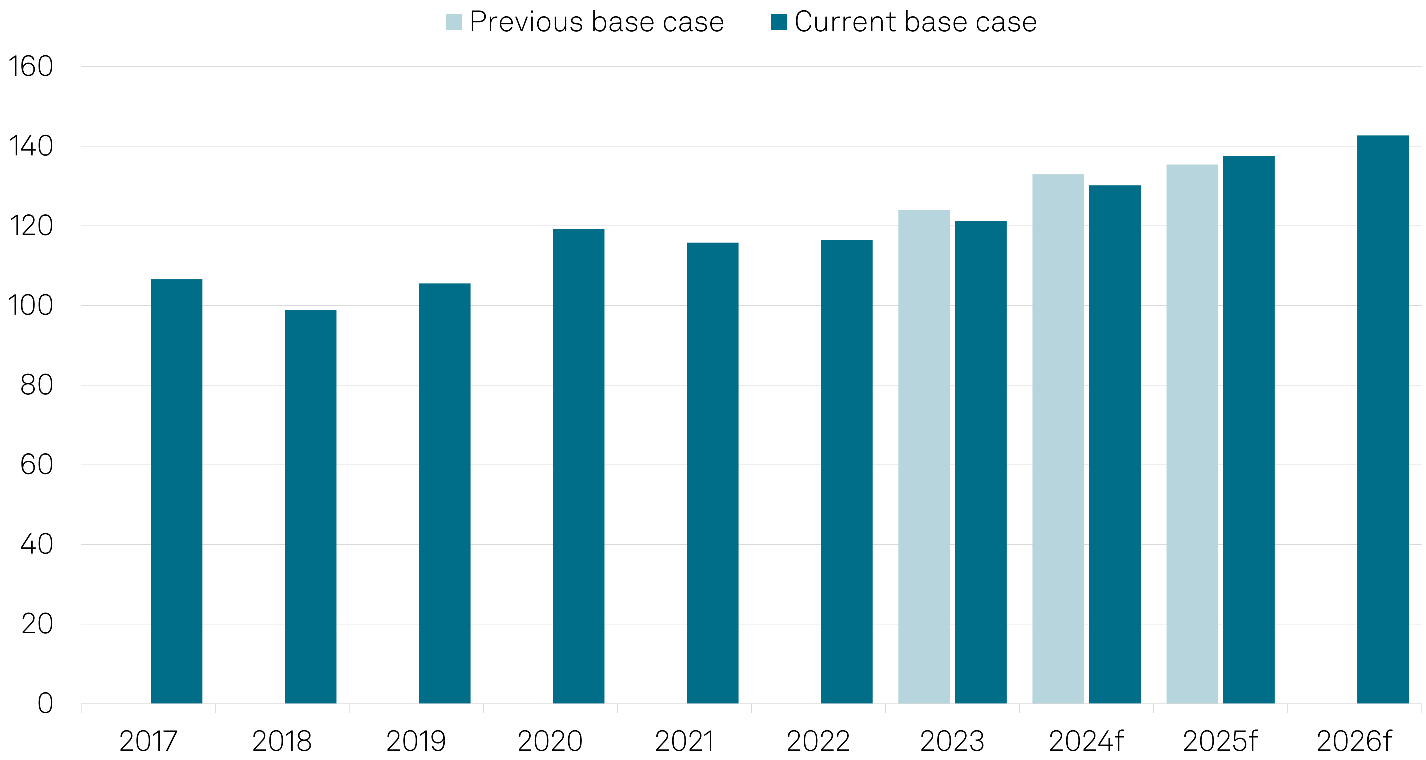
- A lack of strict nationwide fiscal rules and high infrastructure investment needs will keep Australian states', Canadian provinces', and Chinese LRGs' deficits relatively high.
- In New Zealand, rising capex, including on water infrastructure, will drive LRGs' large deficits. We expect some improvement in performance after 2025, as New Zealand councils belatedly roll out large increases in property rates.
- India continues to fuel economic growth with public investments that keep budget deficits relatively wide.
- While deficits are relatively contained in Europe, immigration and net-zero greenhouse gas targets, combined with relatively small operating surpluses, will lead to wider deficits in Norway and the U.K.

Global Debt Burden Will Continue To Climb

Direct debt (% of adjusted operating revenue)



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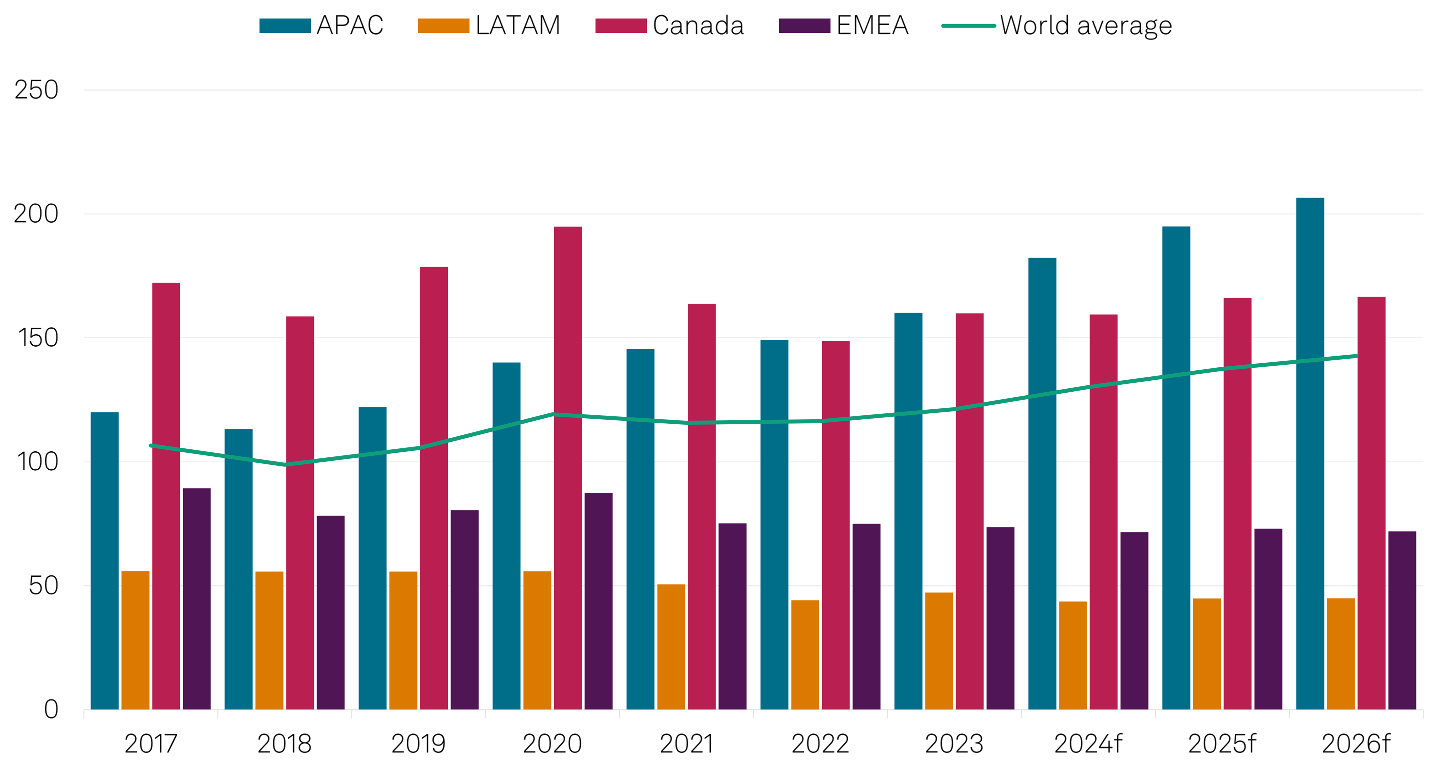
- As a consequence of LRGs' relatively sizable average deficit after capital accounts, their debt burden will increase to above 140% of operating revenue in 2026.
- By 2026, the debt burden will have grown materially compared with the levels we observed before the COVID-19 pandemic.
- Our forecast is higher than our previous one, but not substantially.

Debt Burden Keeps Growing In Asia-Pacific And Canada

Direct debt (% of adjusted operating revenue)



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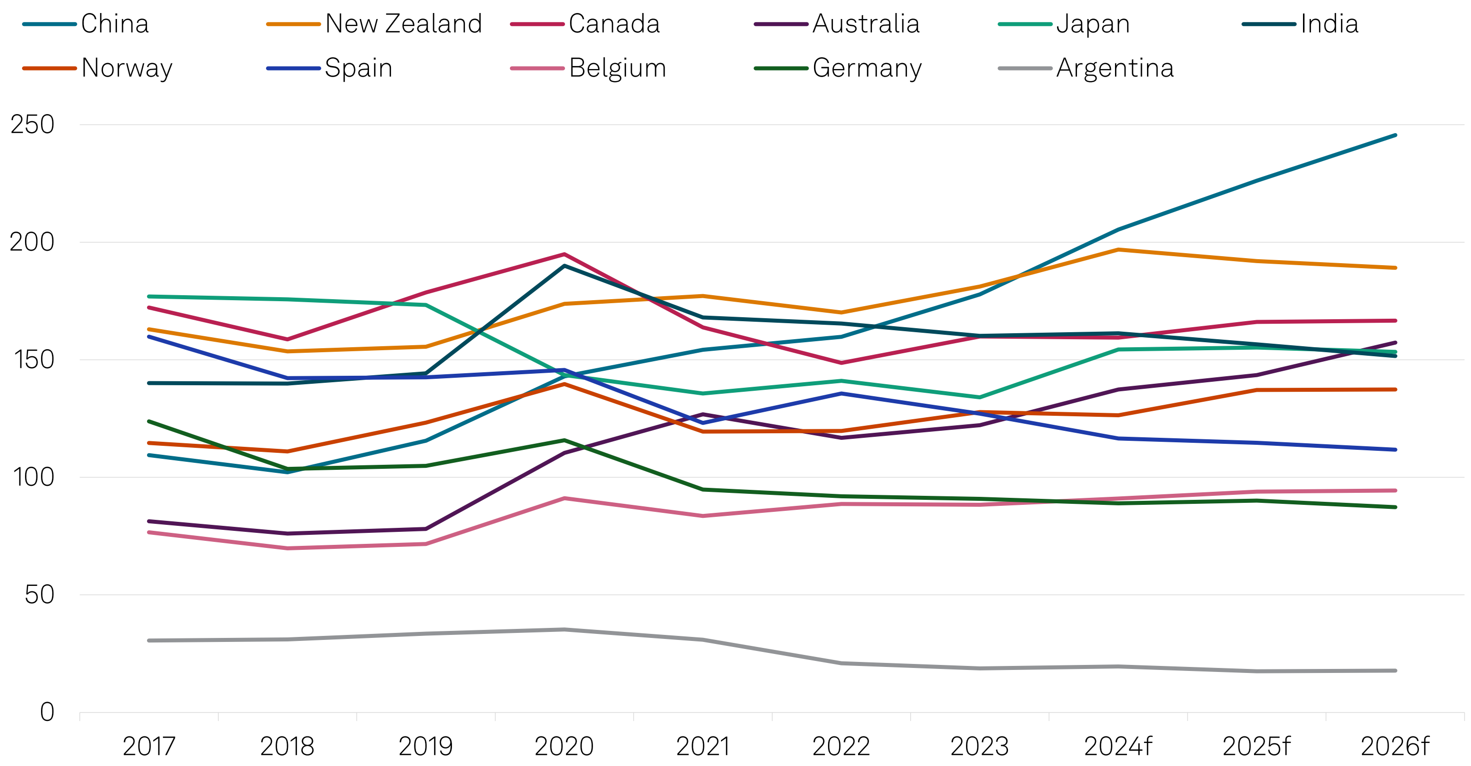
- Predominantly debt-financed investment programs of large Australian states, Canadian provinces, and New Zealand councils will fuel the increase in the global LRG debt burden.
- China's provinces will substantially increase their direct debt after refinancing of debt raised by local government financing vehicles (the debt swap program). This will in turn reduce "hidden debts" in the next five years. Tier-1 LRGs are the official issuers of such refinancing debt but will lend the majority to lower tiers.
- Debt loads for LATAM LRGs will remain subdued, despite infrastructure gaps, because funding options are severely limited in Mexico and Argentina, while Brazilian governments are being strongly encouraged to consolidate their budgets.

Fast Debt Growth For LRGs In Australia, China, And New Zealand

Direct debt (% of adjusted operating revenue)



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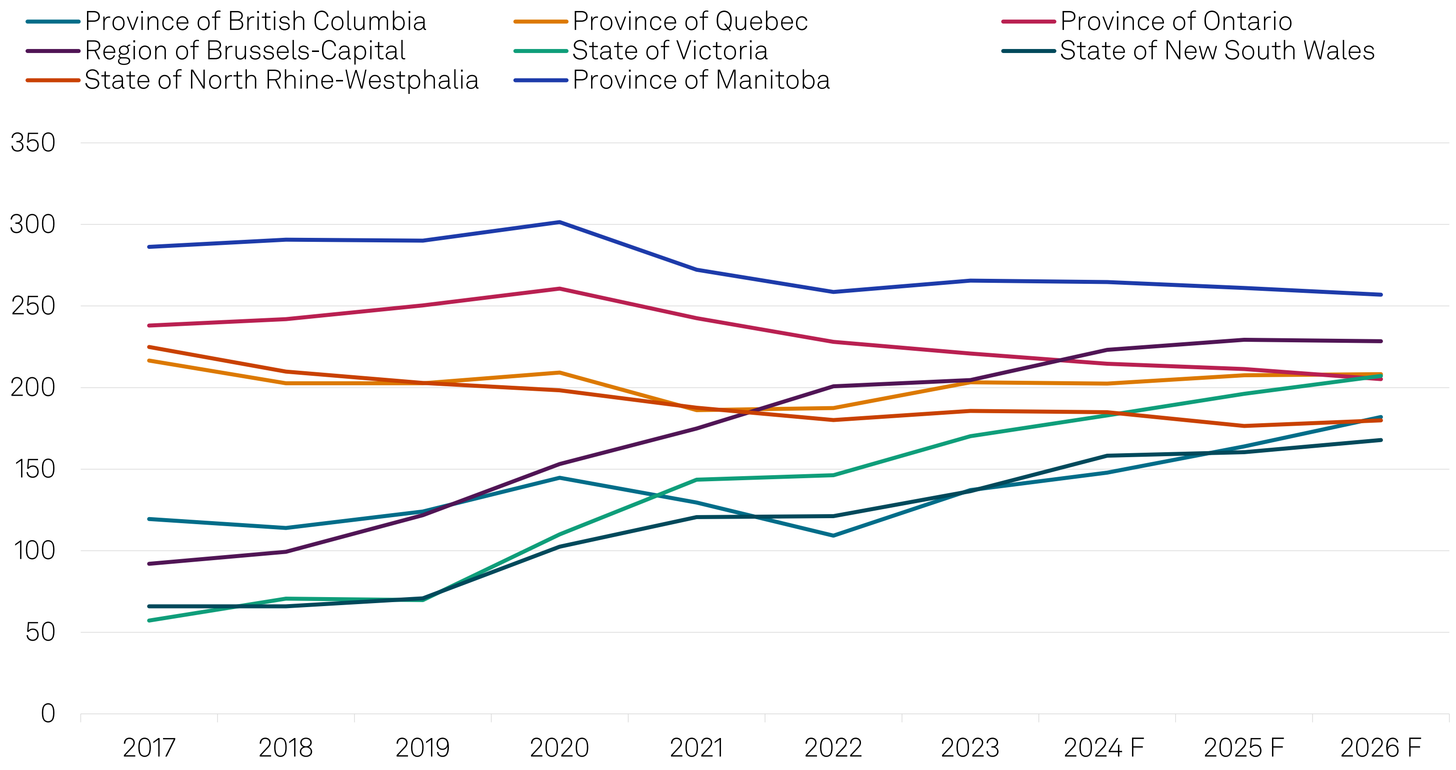
- As a result of the debt swap, we anticipate a large increase in Chinese LRGs' official debt, reaching nearly 250% of revenue by 2026.
- In Australia and New Zealand, where governments are prioritizing infrastructure development to accommodate ballooning population growth, debt burdens are set to increase further.
- Despite large budget deficits, Indian LRGs will stabilize direct debt at about 150% of operating revenue due to fast revenue growth.
- German states' debt burden will stabilize at about the global average, after deleveraging since 2015; fiscal rules are containing rising spending. Spain's strong economic development is allowing its LRGs to continue reducing debt, albeit more slowly.

Debt Burdens Are Still Rising For Most Large Bond Issuers

Tax-supported debt (% of consolidated operating revenue)



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- A few regions in federal countries such as in Australia, Belgium, Canada, and Germany maintain particularly high indebtedness, with tax-supported debt above 150% of operating revenues.
- We expect the region of Brussels, the states of New South Wales and Victoria, and the province of British Columbia to continue debt accumulation at a faster pace than peers over the next two years to address rising demand for services .
- German states, like North Rhine-Westphalia, are containing deficits because of the balanced budget requirement, and are reducing their debt burden.

Countries Covered In This Report

- Our report on the global LRG outlook encompasses 45 countries: Argentina, Australia, Austria, Belgium, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, China, Croatia, Czech Republic, Denmark, Finland, France, Germany, India, Indonesia, Israel, Italy, Japan, Jordan, Kazakhstan, Latvia, Mexico, Morocco, the Netherlands, New Zealand, Nigeria, North Macedonia, Norway, Pakistan, Philippines, Poland, Romania, Serbia, South Africa, Spain, Sweden, Switzerland, Thailand, Türkiye, Ukraine, the U.K., the U.S., and Vietnam. We consider this sample representative of global LRG sector. We have also published separate and more detailed analyses of LRG sectors in various regions (see Related Research).
- We base our survey on data collected from statistical offices as well as on our assessment of the sector's financial performance, borrowing requirements, and outstanding debt. The reported figures are our estimates and do not necessarily reflect the LRGs' own projections. For comparison, we present our aggregate data in U.S. dollars, unless stated otherwise.

Related Research

- Subnational Government Outlook 2025: Borrowings Are Still On The Rise, Jan. 16, 2025
- Subnational Government Outlook 2025: Capital Expenditure Shows Signs Of Slowing, Jan. 16, 2025
- Subnational Government Outlook 2025: Developed Markets' Regional Differences Intensify, Jan. 16, 2025
- Subnational Government Outlook 2025: Emerging Markets' Borrowing Will Rise On Funding Needs And Capex, Jan. 16, 2025
- Subnational Government Outlook 2025: Nordics Infrastructure Needs Will Keep Investments High, Jan. 16, 2025
- Subnational Government Outlook 2025: Spain's Debt Ratios Are Reducing As Revenue Rises, Jan. 16, 2025
- Subnational Government Outlook 2025: Swiss Cantons Are Navigating Budgetary Pressures And Shifting Debt Dynamics, Jan. 16, 2025
- Subnational Government Outlook 2025: Germany's Weak Growth Will Maintain Budgetary Pressure, Require New Borrowing, Jan. 16, 2025
- Subnational Debt Outlook 2025: Canadian LRG Revenues Will Play Catchup To Meet Higher Operating Costs And Stabilize Debt Growth, Jan. 16, 2025
- China's Upper-Tier Local Governments Are Not Immune From Debt Buildup At Lower-Tiers, Jan. 15, 2025
- China's Local Governments: Downside Risk Is Rising For Fiscal Consolidation, Dec. 16, 2024

Primary Credit Analysts

Felix Ejgel

London

+44-20-7176-6780

felix.ejgel@spglobal.com

Noa Fux

London

+44-20-7176-0730

noa.fux@spglobal.com

Lisa Schineller

New York

+ 1-212-438-7352

lisa.schineller@spglobal.com

Linus Bladlund

Stockholm

+46-8-440-5356

linus.bladlund@spglobal.com

Louise Morteveille

Paris

+33-626-050-419

louise.morteveille@spglobal.com

Manuel Becerra

Madrid

+34-914-233-220

manuel.becerra@spglobal.com

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Secondary Contacts

Anthony Walker

Melbourne

+61-3-9631-2019

anthony.walker@spglobal.com

Martin J Foo

Melbourne

+61-3-9631-2016

martin.foo@spglobal.com

Christopher Yip

Hong Kong

+852-2533-3593

christopher.yip@spglobal.com

Kensuke Sugihara

Tokyo

+81-3-4550-8475

kensuke.sugihara@spglobal.com

Michael Stroschein

Frankfurt

+49-693-399-9251

michael.stroschein@spglobal.com

Dina Shillis

Toronto

+1-416-507-3214

dina.shillis@spglobal.com

Bhavini Patel

Toronto

+1-416-507-2558

bhavini.patel@spglobal.com

Wenyin Huang

Singapore

+65-6216-1052

wenyin.huang@spglobal.com

Constanza Perez Aquino

Buenos Aires

+54-11-4891-2167

constanza.perez.aquino@spglobal.com

Secondary Contacts

Remy Carasse

Paris

+33-14-420-6741

remy.carasse@spglobal.com

Carl Nyrerod

Stockholm

+46-84-40-5919

carl.nyrerod@spglobal.com

Maxim Rybnikov

London

+44-7824-478-225

maxim.rybnikov@spglobal.com

Didre Schneider

Frankfurt

+49-693-399-9244

didre.schneider@spglobal.com

Manuel Orozco

Sao Paolo

+55-11-3039-4819

manuel.orozco@spglobal.com

Omar A De la Torre Ponce De Leon

Mexico City

+52-55-5081-2870

omar.delatoree@spglobal.com

YeeFarn Phua

Singapore

+65-6239-6341

yeefarn.phua@spglobal.com

Alejandro Rodriguez Anglada

Madrid

+34-91-788-7233

alejandro.rodriguez.anglada@spglobal.com

Karen Vartapetov

Frankfurt

+49-693-399-9225

karen.vartapetov@spglobal.com

Secondary Contacts

Jane H Ridley

Englewood

+ 1 (303) 721 4487

jane.ridley@spglobal.com

Christian Esters

Frankfurt

+ 49 693 399 9262

christian.esters@spglobal.com

Alina Czerniawski

Buenos Aires

+ 54 1148912194

alina.czerniawski@spglobal.com

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