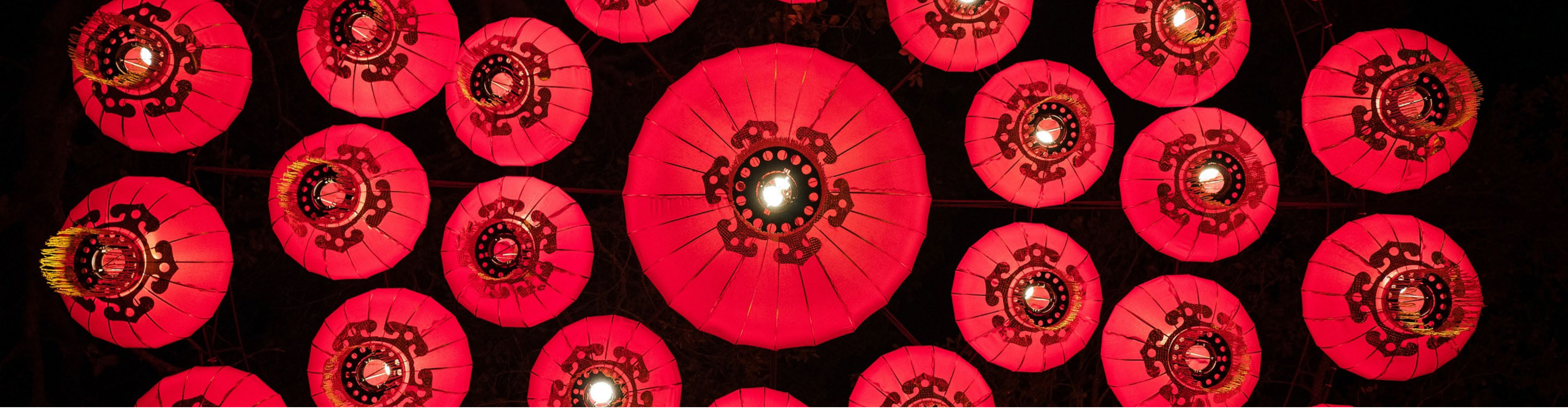

Subnational Government Outlook 2025: Emerging Markets

Borrowing Will Rise On Funding Needs And Capex

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S&P Global Ratings

This report does not constitute a rating action

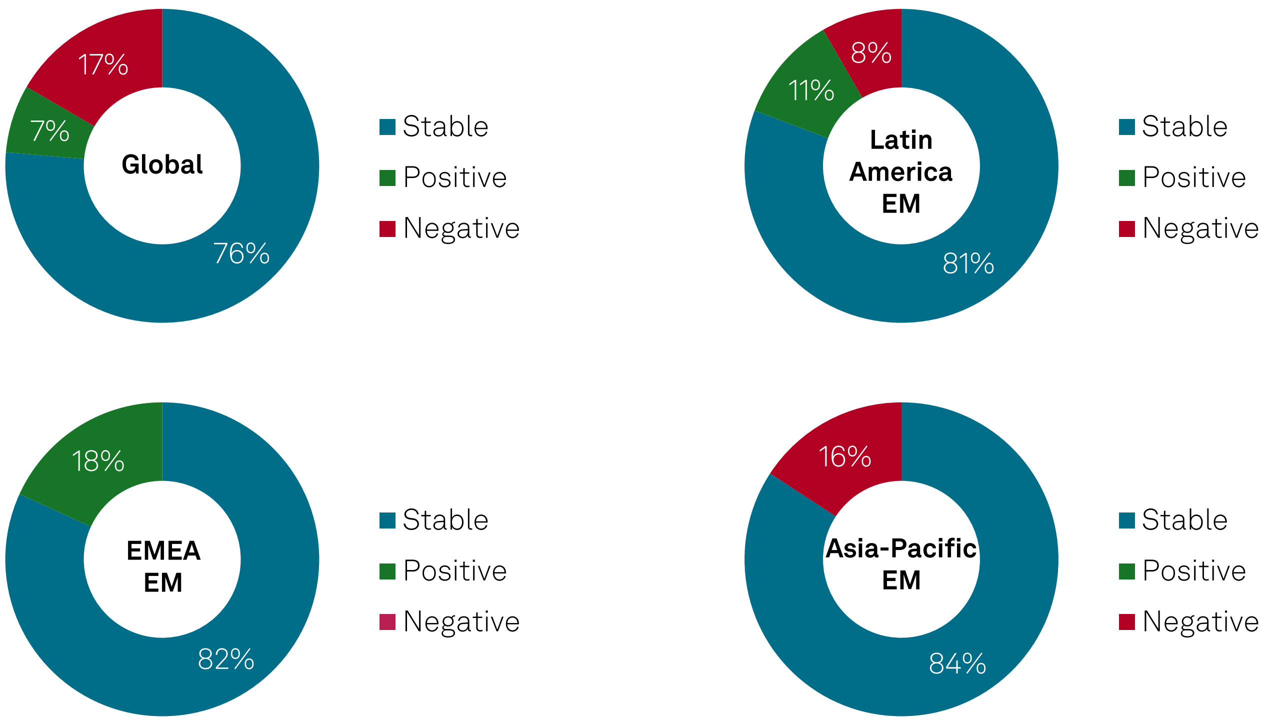
Key Takeaways

- Going into 2025, more than three-quarters of our rating outlooks on local and regional governments (LRGs) in the emerging markets are stable.
- LRG debt in China and India remains substantially higher than LRG debt in other emerging markets (EMs). The median ratio of debt to operating revenue for LRGs in other EMs is 35%, vis-à-vis our 2024 estimates of over 200% for Chinese LRGs and 160% for Indian LRGs.
- EM LRGs' operating surpluses should remain elevated, helping to fund capital expenditures--as seen by the sharp drop in balances after capex to levels closer to zero.
- EM LRG gross borrowing is set to increase in the next two years, reflecting pressing funding needs to finance forthcoming amortizations, as well as some capex.
- We project gross borrowing of US$1.5 trillion in 2025, slightly above the 2024 level, with Chinese LRGs and Indian LRGs as the two largest borrowers in U.S. dollar terms.
- Outside of China and India, we expect that gross and net borrowings will remain mostly flat, and we think they'll continue to represent a small portion of the global figures.
- Outside of China and India, it's the Latin American LRGs--LRGs in Argentina, Brazil, and Mexico--that have the highest debt levels in U.S. dollar terms. (They account for 75% of all EM LRG indebtedness when Chinese and Indian LRGs are excluded.) But that's not the case when considering debt-to-revenue burdens.

Rating outlooks for EM LRGs are predominantly stable

Outside of the Asia-Pacific region, the pressure is to the upside

The distribution of LRG rating outlooks, by region



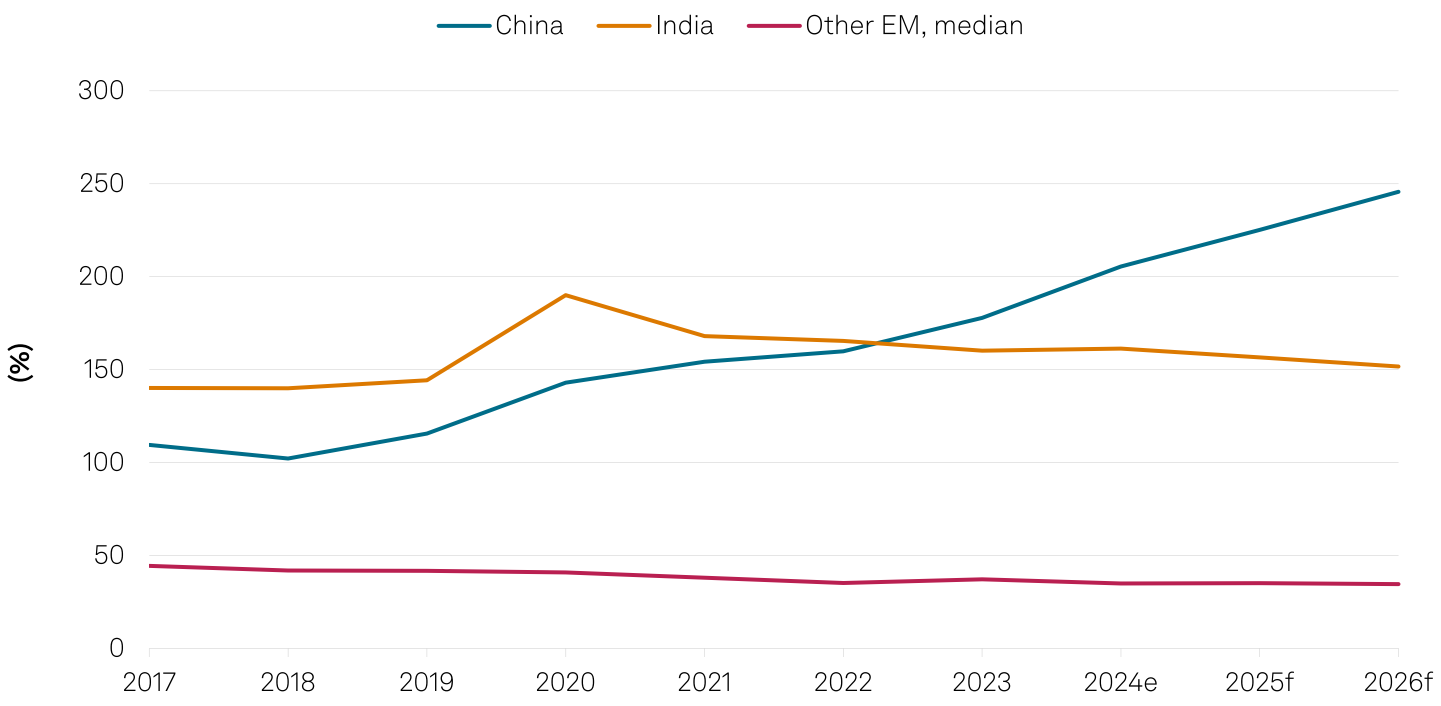
Note: None of our LRG ratings globally are currently on CreditWatch. LRG--Local and regional government. Source: S&P Global Ratings.

- The majority of our EM LRG ratings have a stable outlook--as is the case for our LRG ratings globally.
- Among EM LRG ratings in Latin America, the balance of outlooks is slightly positive, reflecting upside pressure for some Mexican LRG ratings given low and declining debt.
- For our EM LRG ratings in EMEA, the positive balance of outlooks reflects Croatian LRGs' and Bulgarian LRGs' upside pressure coming from their countries' capital cities.
- For our EM LRG ratings in the Asia-Pacific region, the negative balance of outlooks mostly reflects downside risk for Chinese LRG ratings.

The debt burdens of Chinese and Indian LRGs remain the highest across EM

Chinese LRGs' indebtedness continues to increase, while it trends lower elsewhere

Total LRG debt stock (as a percentage of operating revenue)



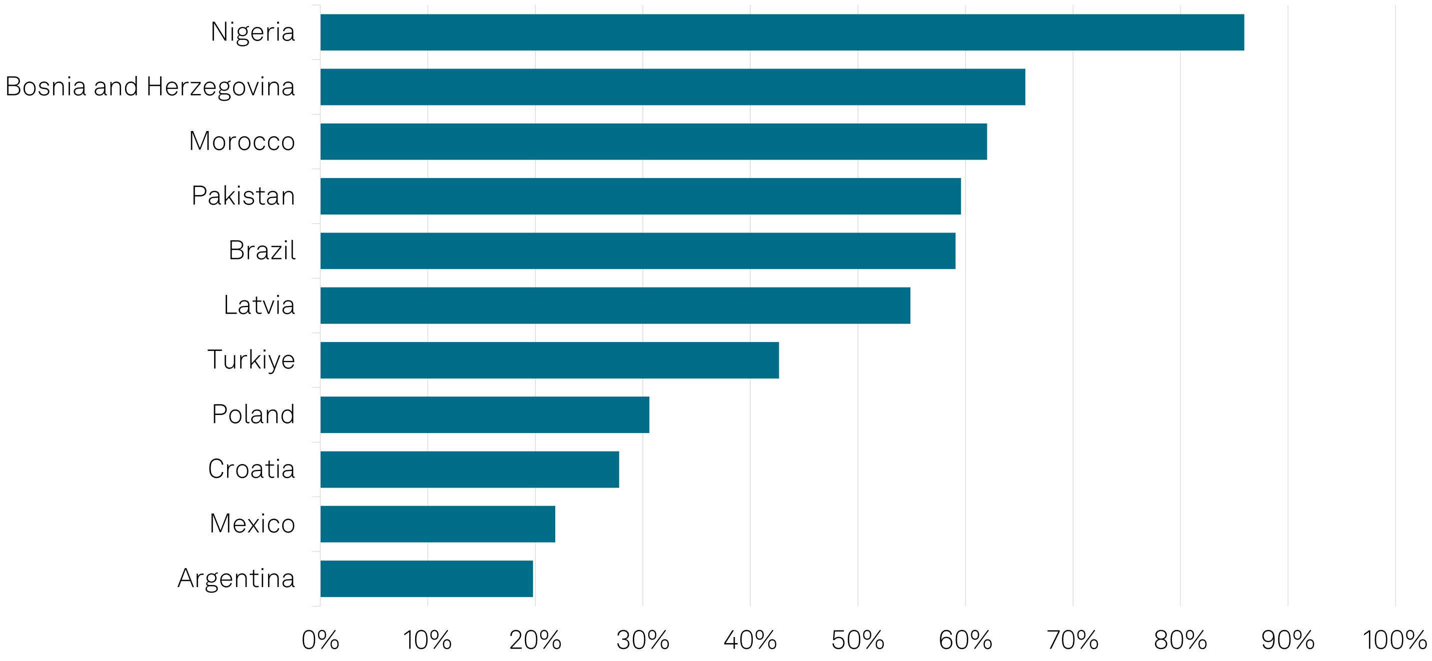
LRG--Local and regional government. EM--Emerging markets. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Chinese LRGs' debt reflects the sizable amount of special bonds the LRGs issued as they bring hidden GRE debt onto the balance sheet via swaps.
- Persistent after-capex deficits in Indian LRGs (20% of revenue) keep debt high because of weak operating balances and relatively high capital spending.
- Elsewhere in EM, debt below 50% masks variability across countries and regions.
- In EMEA, LRGs in Bosnia and Herzegovina, Nigeria, Morocco, and Latvia have posted debt burdens over 50%.
- In Asia-Pacific (except for those in Pakistan), LRG debt burdens are less than 20%.
- In Latin America, Brazilian LRGs' near 60% debt burden is the highest.

Some EMEA EM LRGs have the highest debt burdens outside of China or India

But debt generally doesn't exceed 100% of revenue

Estimated total LRG debt stock in 2024 (as a percentage of operating revenue)



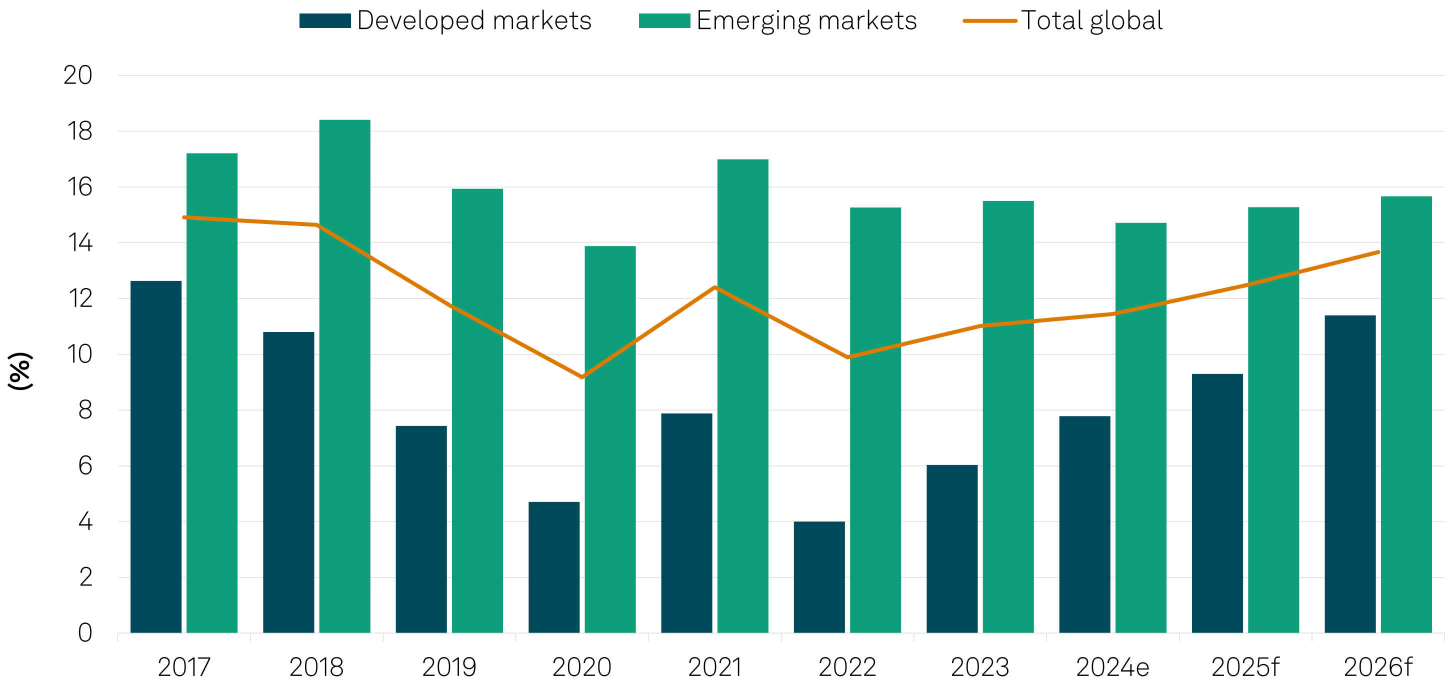
LRG--Local and regional government. Source: S&P Global Ratings.

- Nigerian LRGs' debt--a mix of local currency and foreign currency debt, and commercial and official debt--is high vis-à-vis the LRG revenue base, but it's only equal to 4% of national GDP.
- In Bosnia and Herzegovina, LRG debt mostly reflects government-related enterprises that invest in capex, as well as a strategy to hedge against possible restrictions on market access.
- In Pakistan and Brazil, LRGs have limited access to commercial borrowing. Their debt is mostly local currency debt and with the government.
- Moroccan LRGs' debt is predominantly local currency bank loans.
- The same is true for Latvian LRGs, where high investment underpins debt levels.

EM LRGs run higher operating balances than DM LRGs to help fund capex

This reflects less fluid access to commercial borrowing or national restrictions on borrowing

Median operating balance (as a percentage of operating revenue)



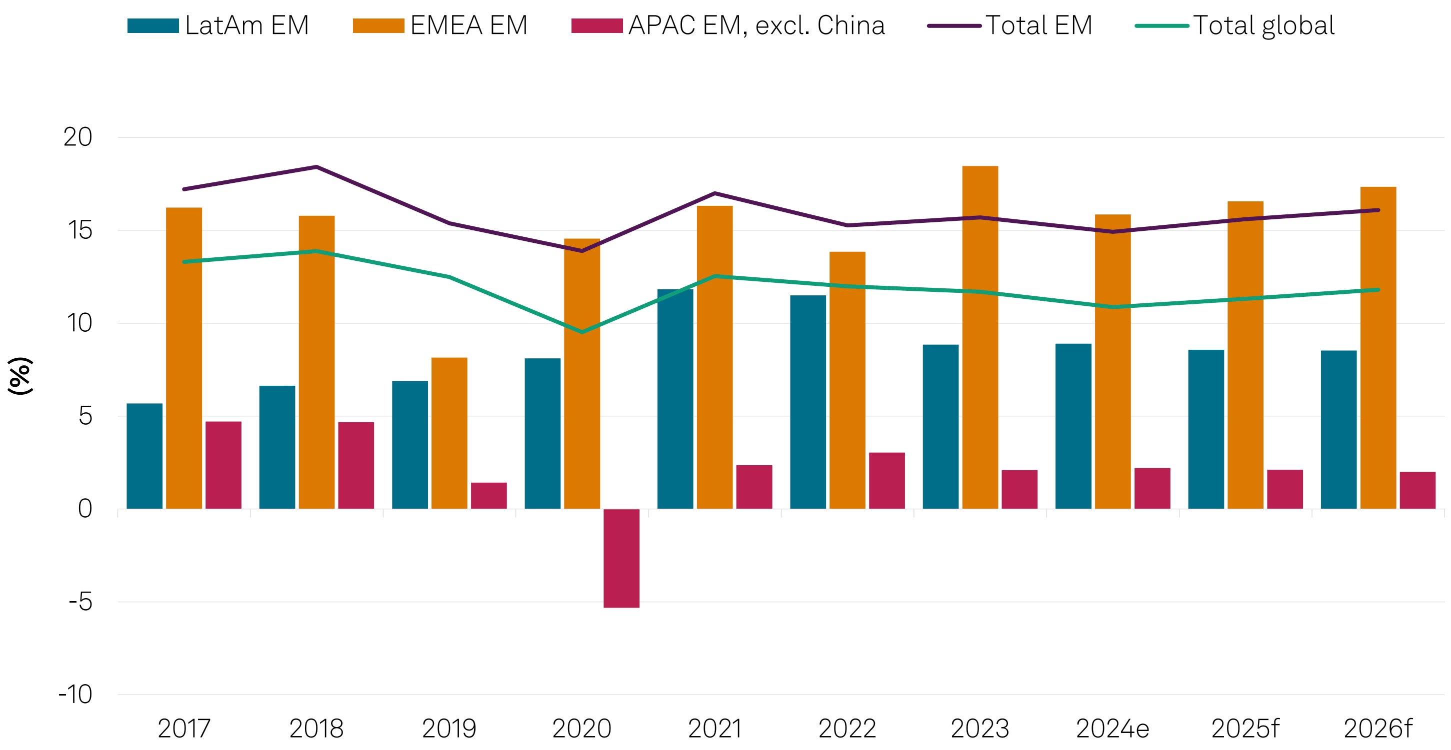
e--Estimate. f--Forecast. Source: S&P Global Ratings.

- EM LRGs' operating balances will average 16% of operating revenue in 2024-2026.
- In the past, that's almost double the figures that developed-market LRGs have posted.
- Less fluid access to diverse funding options forces EM LRGs to rely more on their own source funding or savings.
- Some LRGs lean to conservative budgeting because of uncertainty about grants and transfers.
- That said, operating balances above 20% of operating revenue for LRGs in China, Czech Republic, Nigeria, Philippines, South Africa, and Thailand weigh heavily on the EM fiscal indicators.

EM LRGs outside of China still post substantial operating surpluses

EMEA leads, followed by Asia-Pacific and Latin America

Median operating balance (as a percentage of operating revenue)



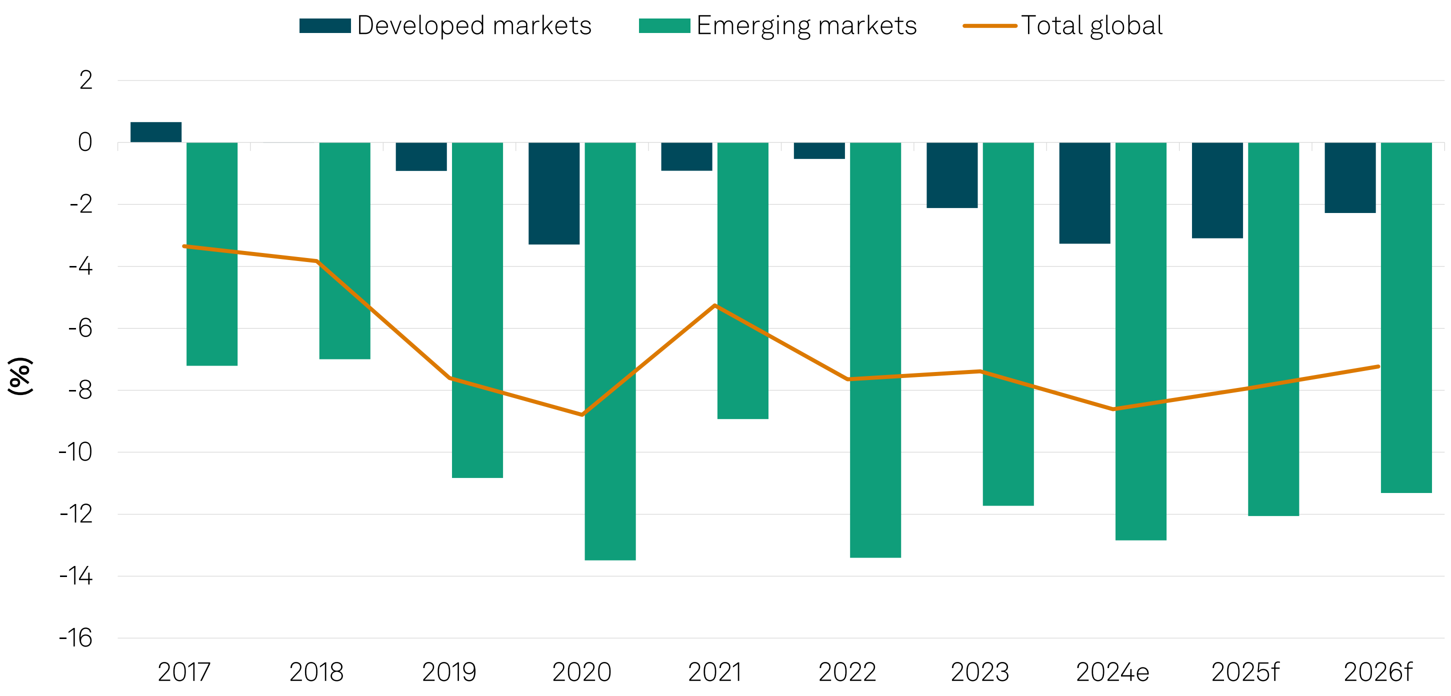
EM--Emerging markets. LatAm--Latin America. EMEA--Europe, the Middle East, and Africa. APAC--Asia-Pacific. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Operating surpluses across EM LRGs in EMEA reflect solid fiscal performance regionwide based on strong revenue while expenditures remain contained. Only Ukrainian LRGs posted minimal operating deficits.
- The slight operating surpluses for EM LRGs overall in the Asia-Pacific region incorporate surpluses of 30% of operating revenue for LRGs in Philippines and Thailand and 2% deficits for LRGs in India and Vietnam.
- During the pandemic, Indian LRGs' operating deficits reached 14% of operating revenue.
- At 8%, the operating surplus for EM LRGs in Latin America aims to finance capex that is still limited relative to capex at other EM LRGs.

Despite high operating surpluses, EM LRGs' after-capex deficits persist

This reflects substantial investment in some key LRGs

Median balance after capex (as a percentage of total revenue)



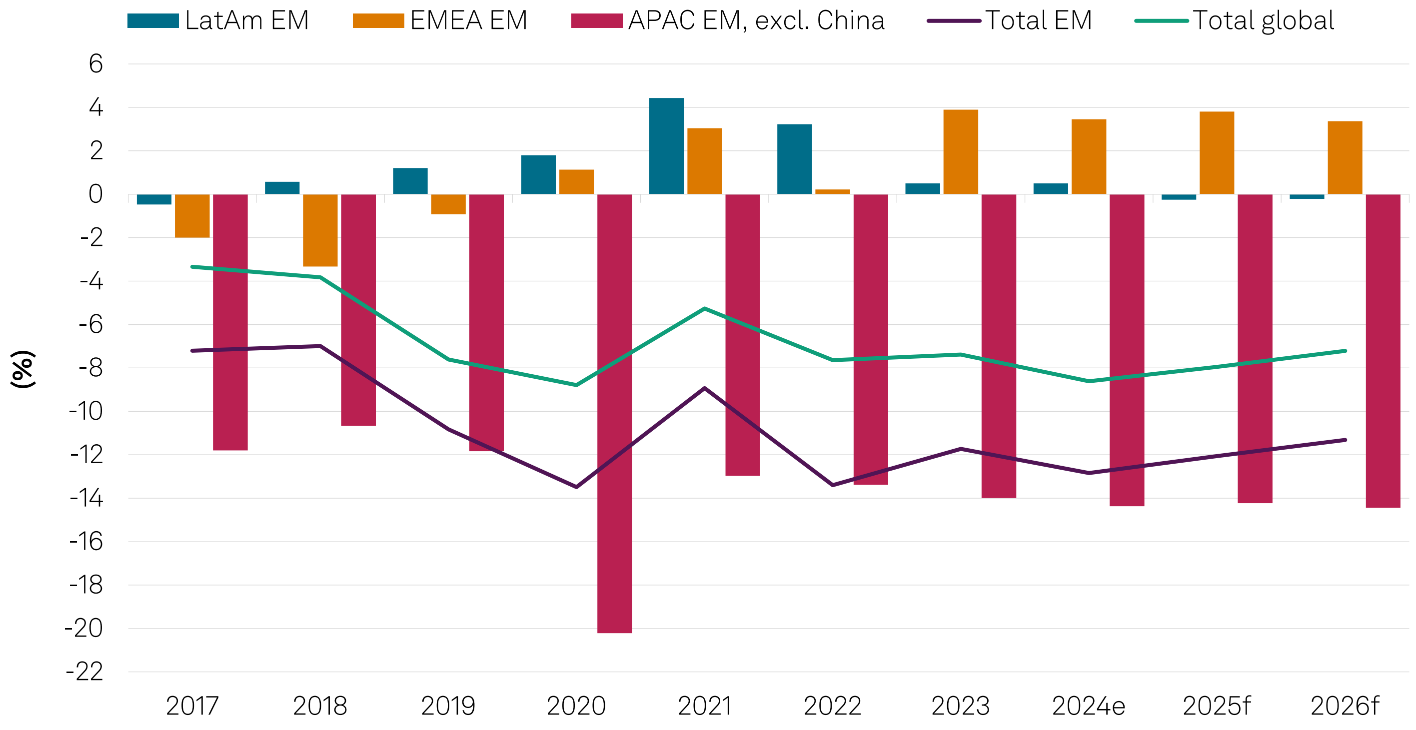
e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Significantly high EM LRG operating balances swing to after-capex deficits, on average.
- In EM EMEA, LRG capex deficits over 2022-2023 were primarily attributed to LRGs in CEE, which benefited from EU grants.
- For Indian and Chinese LRGs, after-capex deficits have been at 25% of total revenue, on average--driving EM LRG results.
- We expect Chinese LRGs' deficit to average 15% of total revenue in 2024-2026.
- Elsewhere, expected after-capex figures range from surpluses of almost 20% of operating revenue for LRGs in Philippines and Czech Republic to deficits of almost 9% for Turkish LRGs for 2024-2026.

Infrastructure execution pressures EM LRGs' after-capex balances

The divergence in performance has been more pronounced after the pandemic

Median balance after capex (as a percentage of total revenue)



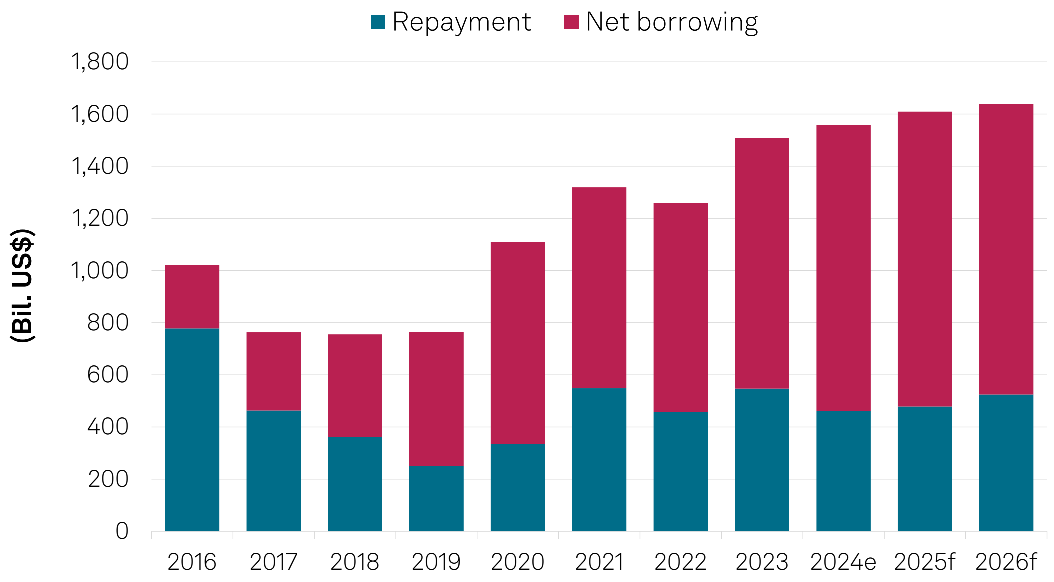
EM--Emerging markets. LatAm--Latin America. EMEA--Europe, the Middle East, and Africa. APAC--Asia-Pacific. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- On balance, EM LRGs in EMEA posted a surplus--with after-capex deficits above 10% for Turkish LRGs more than offset by surpluses across other EM LRGs in EMEA.
- Deficit figures for Asia-Pacific EM LRGs (excluding Chinese LRGs) are dominated by large deficits for Indian LRGs, which reached 30% of total revenue in 2020.
- This contrasts with surpluses for LRGs in Pakistan, Philippines, and Thailand.
- The slight deficit for EM LRGs in Latin America is balanced among LRGs in Argentina, Brazil, and Mexico. But we expect some deterioration for Argentine LRGs as they aim to recoup investment after cuts in 2024.

EM LRG borrowing will reach record levels, driven by Chinese and Indian LRGs

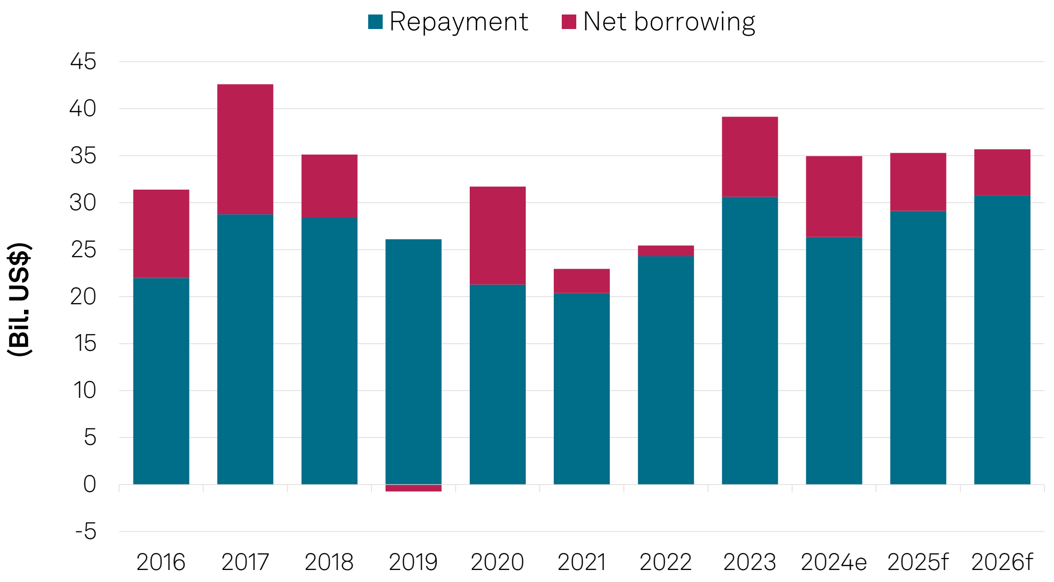
- We expect US$1.1 trillion of new borrowing, on average, in 2024-2026.
- Chinese and Indian LRGs will continue to account for 97% of EM LRGs' borrowing.
- Gross borrowing by EM LRGs in Latin America--LRGs in Argentina, Brazil, and Mexico--will be the primary driver for the remaining 3%.

Gross borrowing breakdown



e--Estimate. f--Forecast. Source: S&P Global Ratings.

Gross borrowing breakdown, excl. Chinese and Indian LRGs

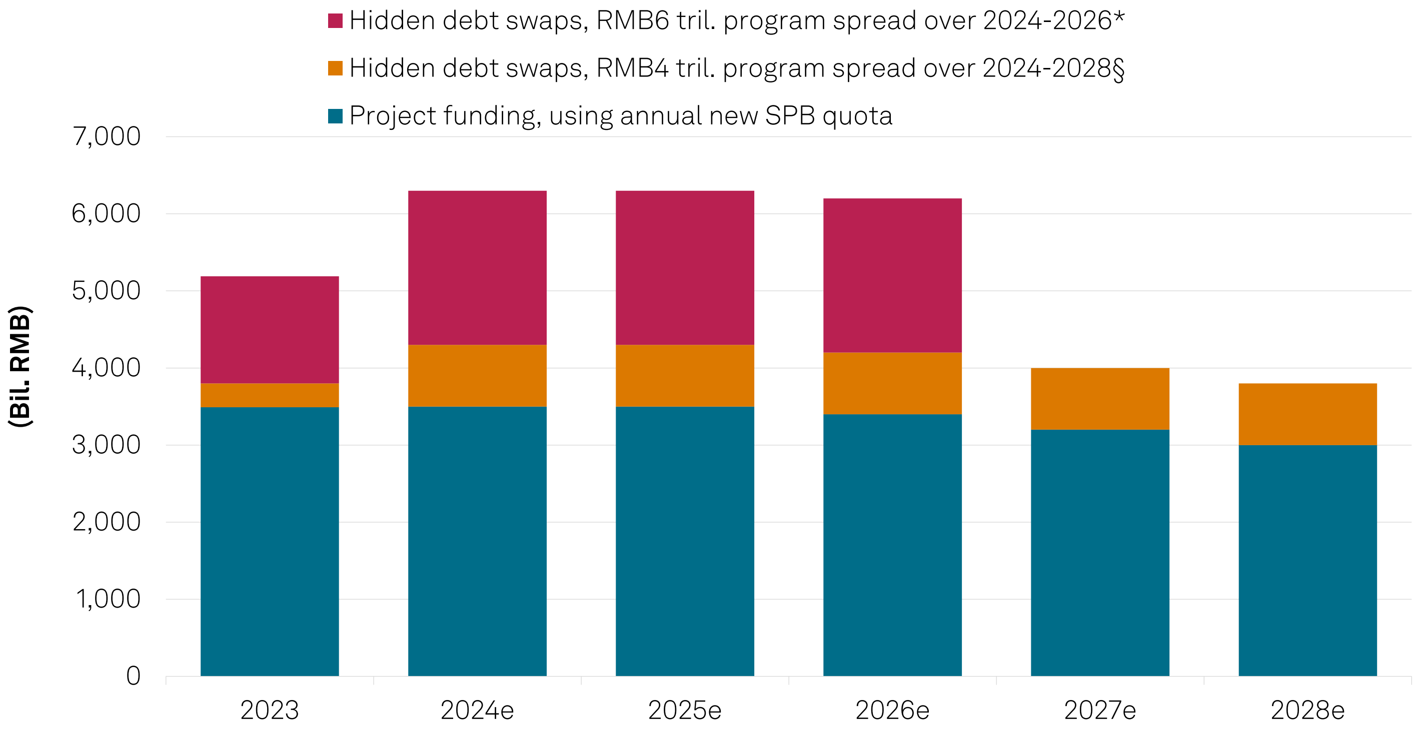


LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

Chinese LRGs' gross borrowing will increase on hidden debt swaps

Key share of upcoming SPB issuance is expected to be used to bring hidden debt on LRG balance sheets

Special-purpose bonds by type and purpose (our five-year estimates)



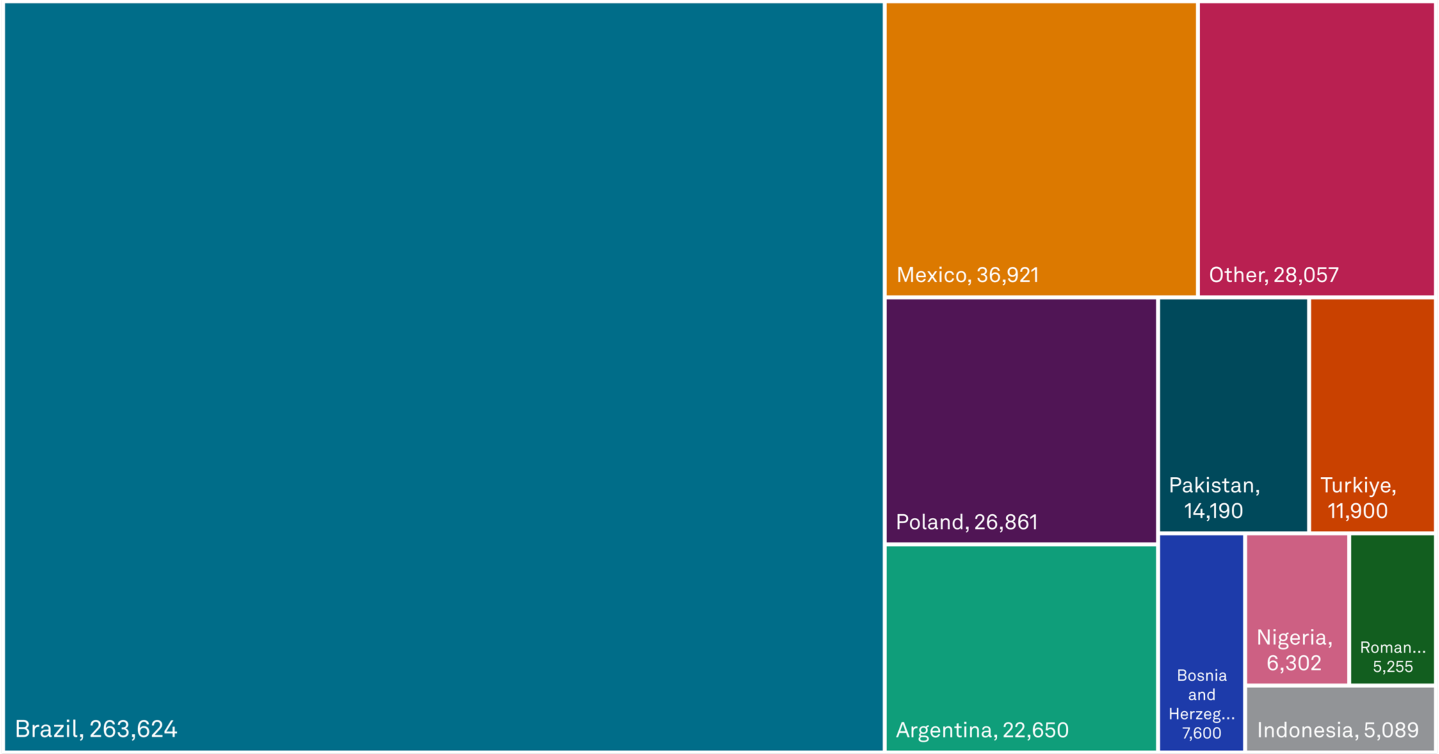
Excluding refinancing of mature bonds. *The RMB6 trillion program is a one-off program of new quota awarded in 2024 and spread over three years. §The RMB4 trillion program is carved out of annual new SPB quota and spread over five years. SPB--Special-purpose bond. e--Estimate. RMB--Chinese renminbi. Source: S&P Global Ratings ("China Brief: More Transparency Means More Official Debt For Local Governments," published Nov. 11, 2024).

- In China, the provinces account for 40% of Chinese general government borrowing.
- Gross borrowing is set to increase mostly as LRGs issue a sizable amount of special-purpose bonds (SPBs). There's more uncertainty about borrowing for capex.
- The SPB swap issuance intends to bring "hidden debt"--namely, off-budget borrowing issued via local government financing vehicles--formally onto LRGs' official balance sheets.
- These swaps cut our estimates of "hidden debt" to RMB2 trillion by 2028 (from RMB14 trillion currently).
- We believe this increased transparency could lower funding costs for Chinese LRGs as they mobilize new borrowing.

Outside of China and India, LatAm EM LRGs have the most debt in USD terms

EM LRGs in Latin America account for two-thirds of EM subnational government debt

LRGs' direct debt, 2024 estimate (mil. US$)



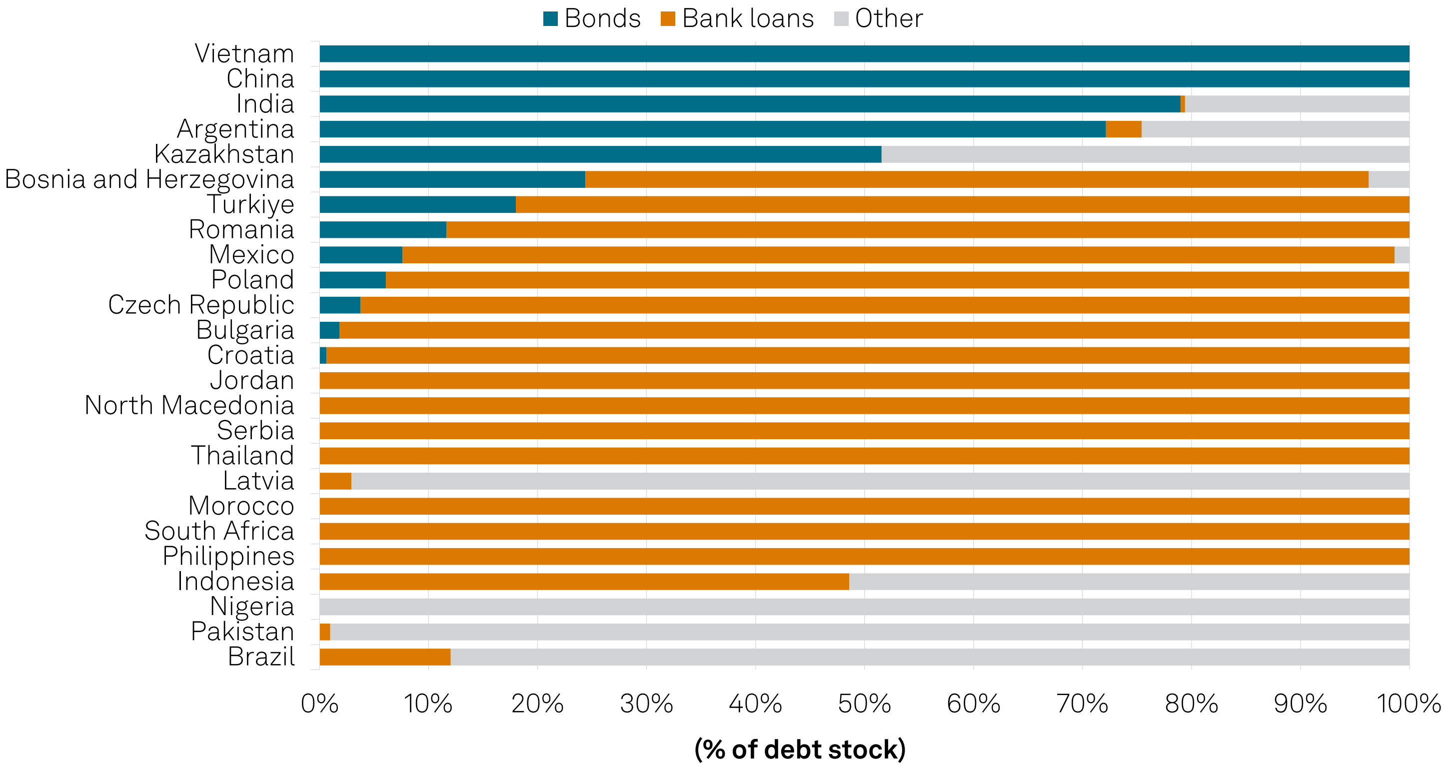
LRG--Local and regional government. Source: S&P Global Ratings.

- Four states account for 70% of Brazilian LRGs' outstanding debt. Still, the legacy of the 1990s bailout, indexation to inflation, and interest rates limited the decline in the debt burden.
- Mexican LRG debt (around 2% of GDP) is set to edge lower, given LRGs' reluctance to take on debt despite compressed capex.
- LRG debt in Poland can mostly be attributed to co-financing of EU projects, higher costs, and local elections in April 2024. We project that debt will increase going forward, but at more moderate levels.
- A decline in Argentine LRG debt assumes limited refinancing of the upcoming amortization of the restructured global bonds, given the impediments to market access.

Bank loans are the main funding source for EM subnational governments

Few LRGs are tapping the capital markets with public bond issuances

Breakdown of LRG debt stock, by type of funding



LRG--Local and regional government. Source: S&P Global Ratings.

- The vast majority of EM LRGs rely on bank loans as their main funding source.
- Mexican LRGs are a prime example: A municipal bond market has not developed.
- For Polish and South African LRGs, local currency (LC) bank loans dominate funding for capex.
- LRGs in China, India, and Vietnam rely on LC commercial bond markets.
- Brazilian and Pakistani LRG debt is mostly with central governments and in LC.
- In Argentina and Turkiye, there's greater flexibility on foreign currency (FC) borrowing--which includes FC global bond issuance. This creates vulnerabilities.

Local currency debt is the most common type of EM LRG debt

Most EM LRG borrowers face local restrictions on borrowing in foreign currency

Legal restrictions explain EM LRGs' lower FX exposure

EM LRG debt denominated in local currency

100%	80%-100%	50%-80%	30%-50%	Less than 30%
China	Brazil	Czech Republic	Bulgaria	Argentina
Croatia		Nigeria		Turkiye
India				Bosnia and Herzegovina
Indonesia				Pakistan
Jordan				
Kazakhstan				
Latvia				
Mexico				
Morocco				
Philippines				
Poland				
Romania				
Serbia				
South Africa				
Thailand				
Vietnam				

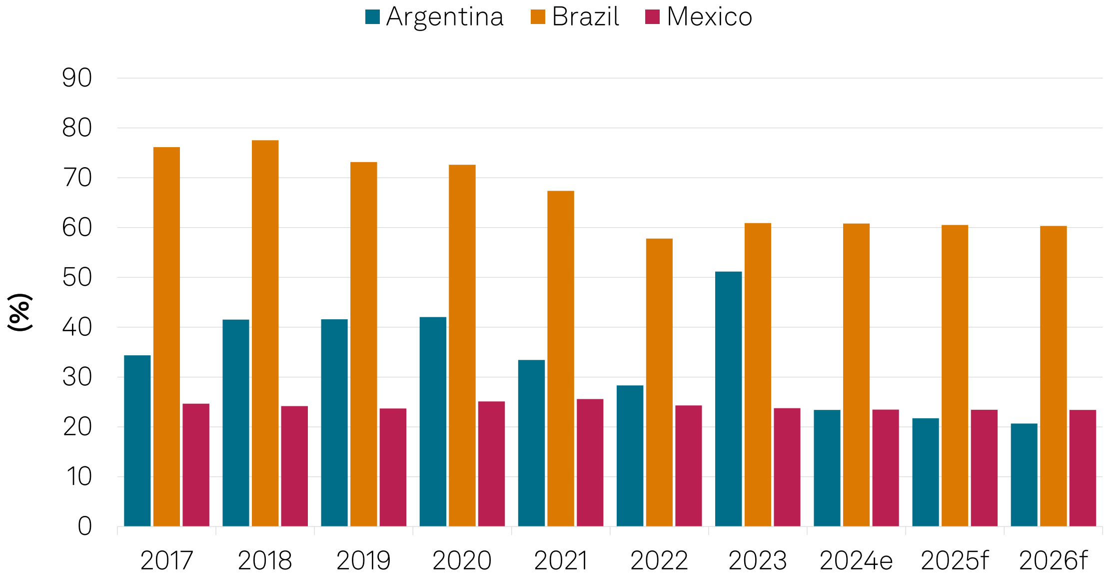
EM--Emerging market. LRG--Local and regional government. FX--Foreign exchange. Source: S&P Global Ratings.

- Widespread restrictions aim to mitigate currency-related vulnerabilities on debt burdens.
- Argentine LRGs stand out for having issued many FC bonds in the global capital markets with risks including access to official foreign exchange.
- For LRGs in Turkiye and in Bosnia and Herzegovina, FC borrowing is mostly with local financial institutions.
- Nigerian LRGs' FC debt is commercial and official, with limits on commercial bonds.
- For Brazilian and Pakistani LRGs, all FC exposure stems from MLI. In the case of Brazilian LRGs, MLI debt is guaranteed by the central government.

LatAm EM LRGs are the most indebted, after Chinese and Indian LRGs

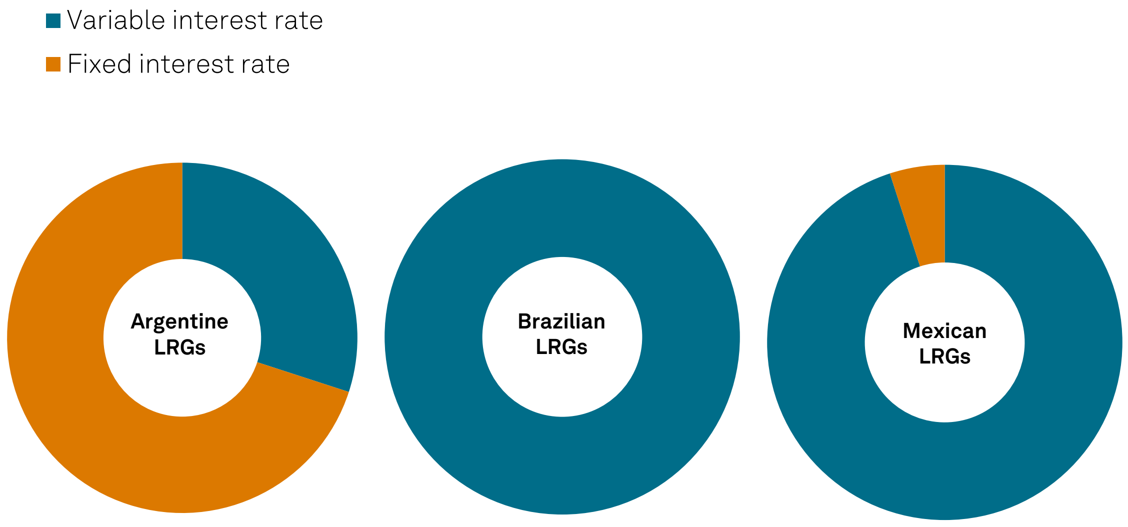
- The decline in Argentine LRG debt, essentially in FC, reflects real appreciation of the Argentine peso and limitations to roll over debt.
- Indexation of Brazilian LRGs' LC debt (interest and inflation) limits the ability to lower debt ratios.
- Mexican LRGs' variable-rate LC debt is mostly long term and backed by government transfers.

LRGs' direct debt (as a percentage of operating revenue)



LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

Debt composition varies across Latin American EM LRGs

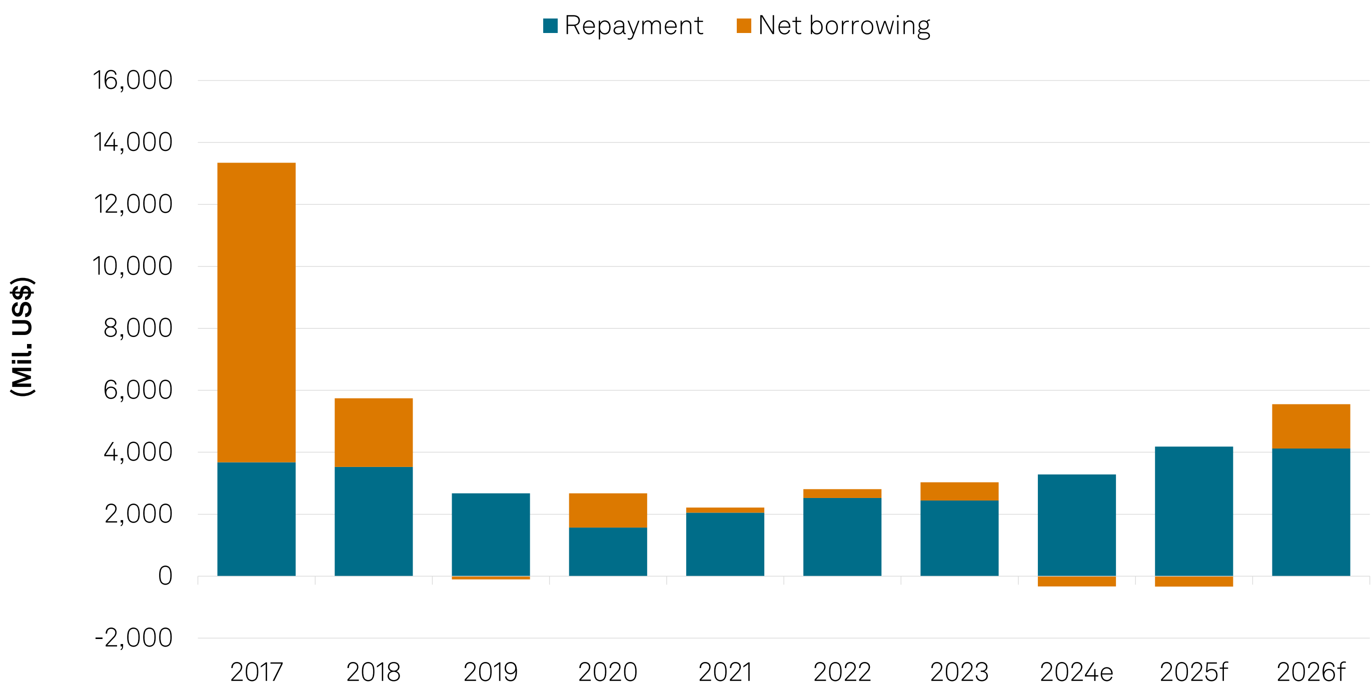


Data as of 2024. LRG--Local and regional government. Source: S&P Global Ratings.

No net borrowing by Argentine LRGs in 2024-2025; will markets open in 2026?

Forced fiscal correction and limited financing underpin negative net borrowing

Gross borrowing breakdown



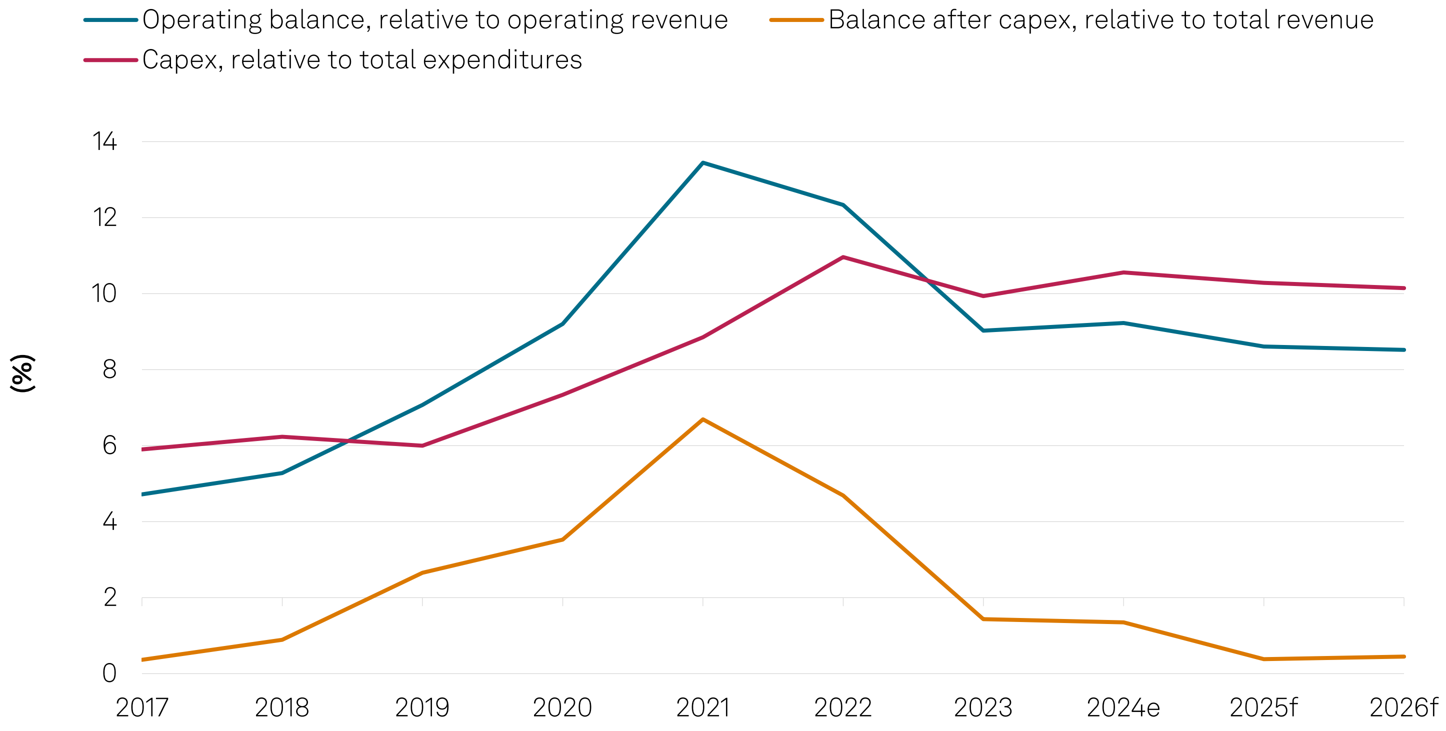
e--Estimate. f--Forecast. Source: S&P Global Ratings.

- There was provincial consolidation in 2024 amid economic contraction, cuts in discretionary federal transfers, and no global market access.
- LRGs streamlined spending--particularly payroll (postponing inflation-related wage increases) and capex.
- Except for La Rioja, LRGs serviced their debt last year in a timely manner, as the sovereign didn't impede access to FX.
- Continued fiscal constraints in 2025 include: spending pressure rising faster than a recovery in revenue, higher bond amortization, and uncertainty about regaining global market access.
- We assume no global market access for LRGs in 2025, except City of Buenos Aires.

Capital investment levels at Brazilian LRGs are fairly steady

A spending reduction at the national level could imply some downside

Brazilian LRGs' fiscal performance



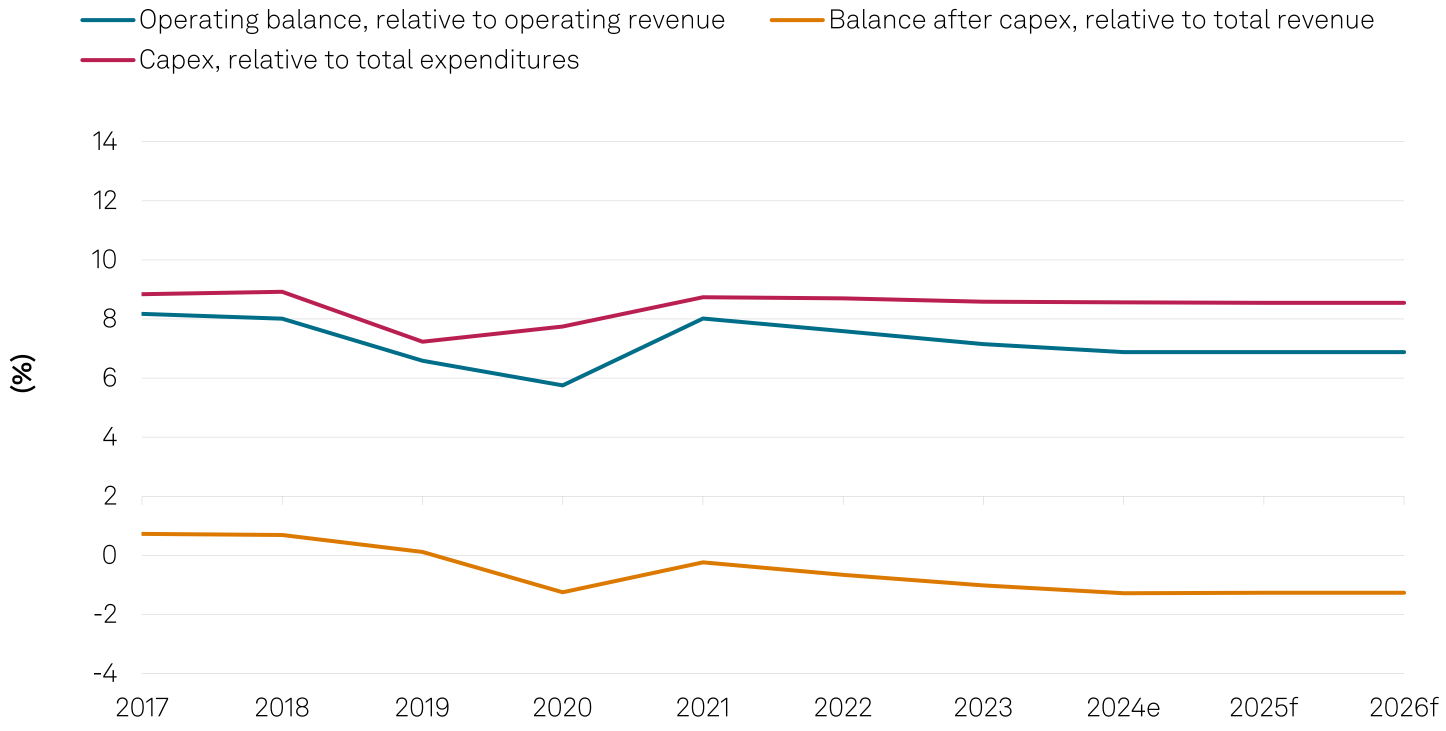
LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Growth boosted LRG revenue more than initially expected in 2024, facilitating better fiscal outcomes (including a pickup in capex ahead of local elections).
- In 2025, persistent inflation and higher monetary policy rates--to which debt services are indexed--could pressure the budgets of highly indebted states.
- A federal program to help alleviate LRGs' high debt service (PROPAG) is being considered by the national Congress.
- Phased implementation of the 2023 VAT reform across LRGs will span 2027-2033.
- Competitiveness (and local revenue) gains should be longer term, while revenue losses would be mitigated by relief from various compensation funds through the 2070s.

Mexican LRGs will keep squeezing capex regardless of fiscal performance

A generally limited appetite to assume long-term debt constrains the upside to capex

Mexican LRGs' fiscal performance



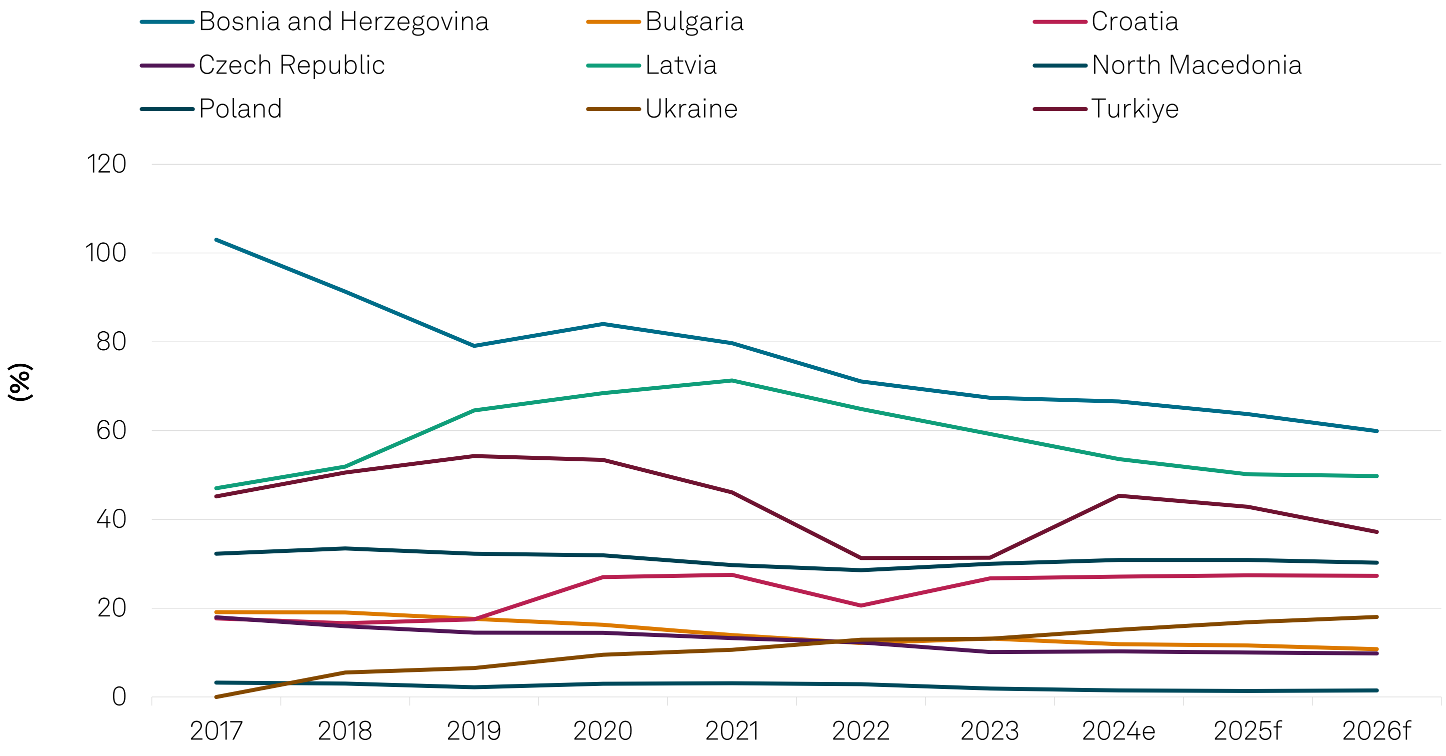
LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- States--and to a lesser degree, municipalities--rely heavily on automatic federal transfers, rather than own-source taxation, for budgetary resources.
- In addition, a general reluctance to increase indebtedness limits the upside to capital investment.
- That said, bank loans--from national development bank Banobras and commercial banks--finance infrastructure.
- We continue to expect operating surpluses (at roughly 8% of operating revenue) to finance capex, with limited after-capex imbalances.

The debt burdens for European EM LRGs are mostly below 40%

Apart from declines for LRGs in Bosnia and Herzegovina and in Latvia, debt has been fairly stable

LRGs' direct debt (as a percentage of operating revenue)



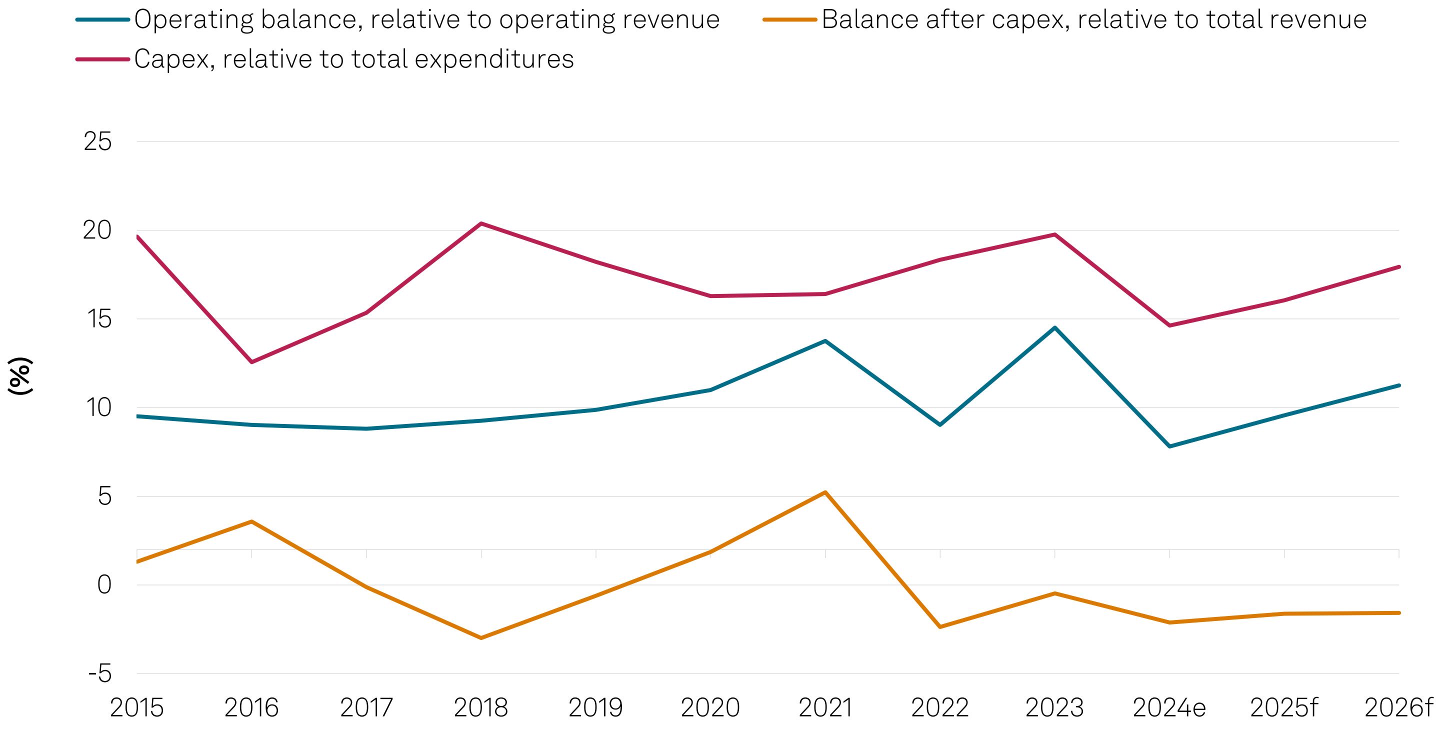
LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Steady debt for Polish LRGs accounts for the 2024 revenue reform.
- Ups and downs in Turkish LRG debt reflect currency swings.
- Rising debt indicators for Croatian LRGs are mainly driven by EU accession and post-earthquake reconstruction.
- Despite geopolitical uncertainties, we expect Ukrainian LRGs' borrowing to increase--in local currency and with multilaterals--as capex rises.
- In Bosnia and Herzegovina, operating surpluses and limited access to financing determine capex execution, while the FC composition of debt strains indicators.
- For Latvian LRGs, economic recovery provides fiscal relief amid borrowing rules.

Polish LRGs should slowly recover their borrowing capacity following reform

We expect LRGs to improve their revenue and cash flow predictability

Operating performance will improve under the new tax system



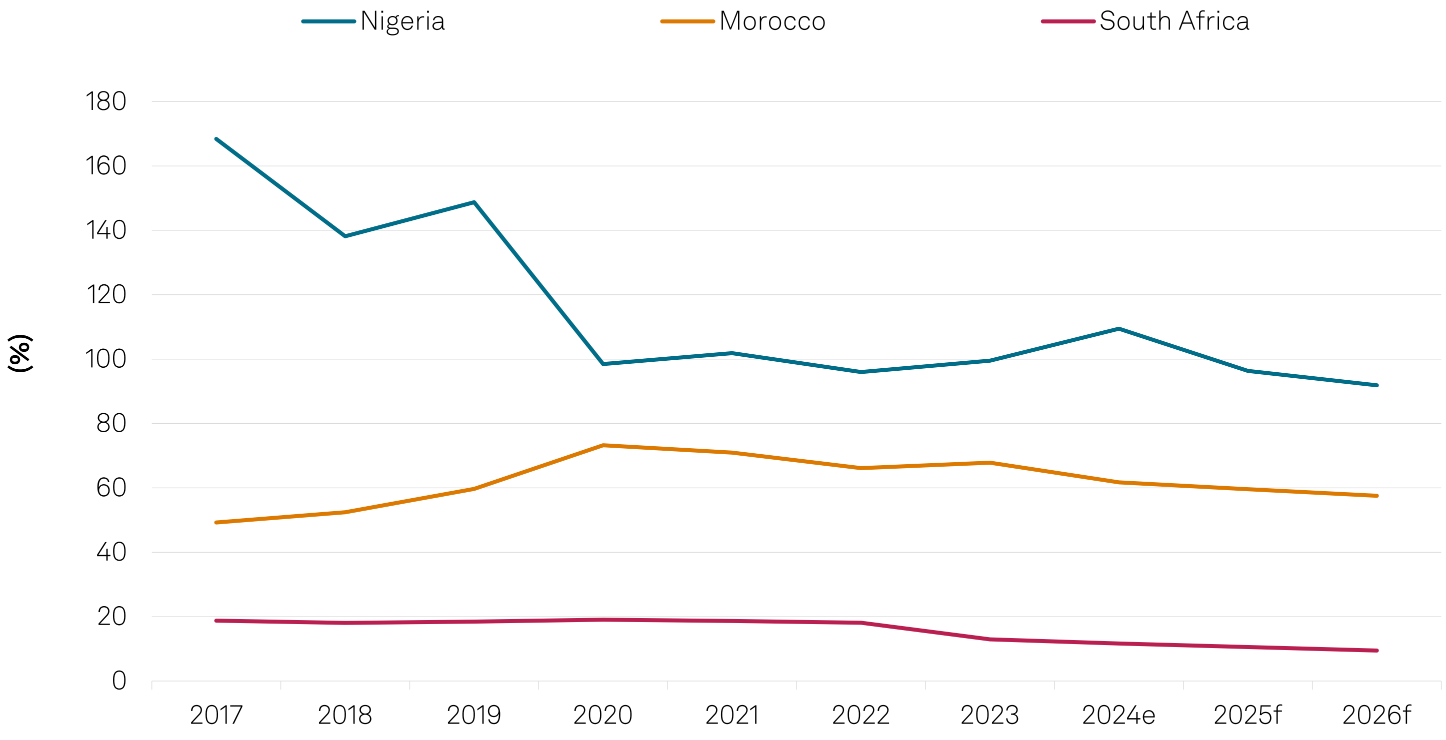
e--Estimate. f--Forecast. Source: S&P Global Ratings.

- The 2024 reform that changed the calculation of personal and corporate income taxes will help restore financial performance, as well as a prudent financial framework.
- The change partly reversed the 2022 reform, which hurt LRG revenue and impaired local borrowing capacity amid a softening of debt rules. At the same time, LRGs had elevated capex spending until 2023 tied to the EU cycle.
- Restrictions on LRG borrowing include debt service limits related to the average net surplus vis-à-vis revenue.
- Greater LRG revenue buoyancy should support continuous capex spending alongside the new EU cycle and additional borrowing capacity.

Elsewhere in EMEA (except South Africa), the EM LRG debt burden is higher

Debt burdens for Nigerian and Moroccan LRGs are set to surpass the rest of EM, excluding China and India

LRGs' direct debt (as a percentage of operating revenue)



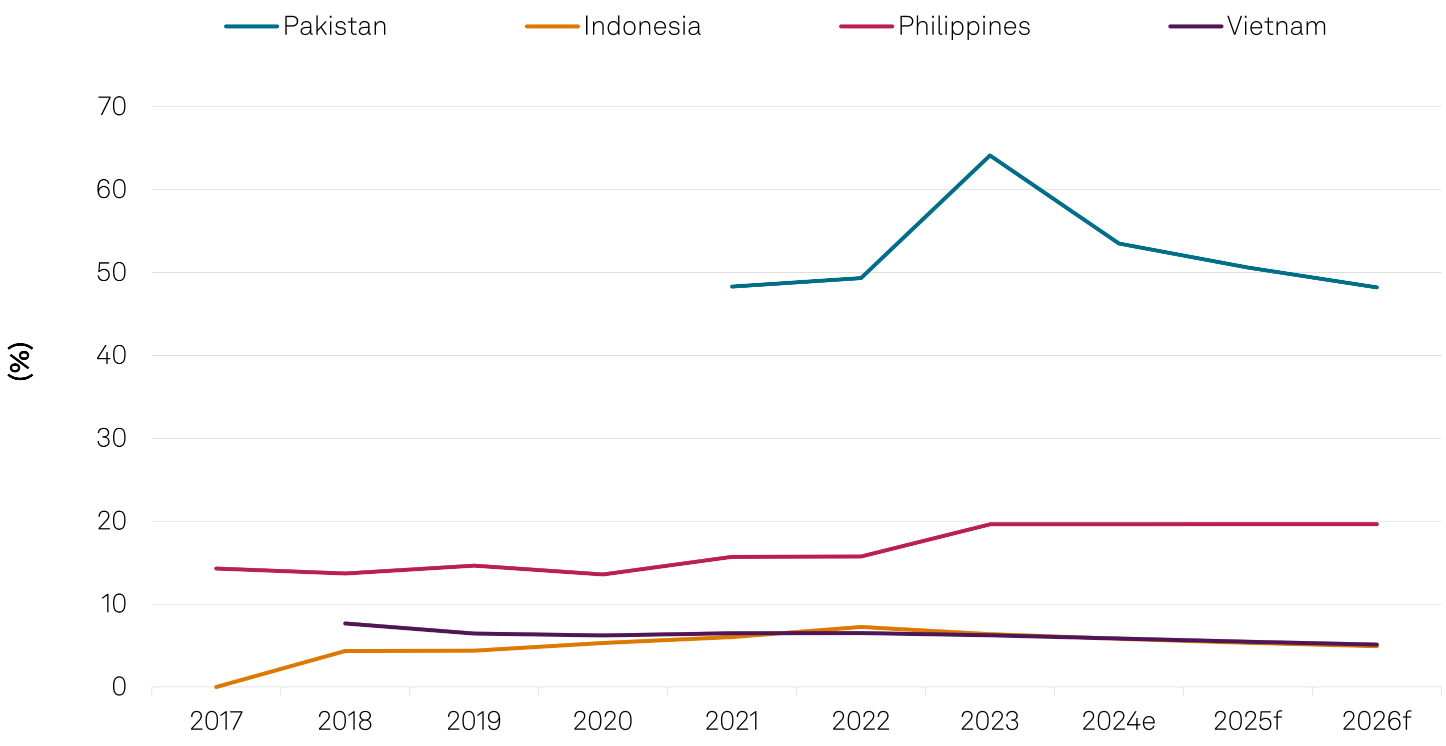
LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- In Nigeria, there are no meaningful restrictions on LRG borrowing--which is both FC and LC--and we see the decline in debt stabilizing.
- Moroccan LRG debt is steady, as those LRGs continue to generate budget surpluses.
- Low debt for South African LRGs reflects limits on FC borrowing for municipalities, which should only borrow for capex.

Outside of China and India, most APAC EM LRGs have modest debt levels

This tends to reflect restrictions on the amount and composition of debt

LRGs' direct debt (as a percentage of operating revenue)



LRG--Local and regional government. e--Estimate. f--Forecast. Source: S&P Global Ratings.

- Pakistani LRGs can't access local or global markets. Their borrowing is a mix of LC and FC debt that's mostly multilateral loans, for medium-term public investment in infrastructure and for budgetary support.
- LRG debt for development in the Philippines is limited by statute to 20% of annual revenue. And LRGs aren't permitted to access the global markets.
- Low debt for Vietnamese and Indonesian LRGs reflects rules that constrain LRG budgetary imbalances and limit the ability to raise debt to the local capital market. FC exposure stems from onlending from the central government.
- For Indonesian LRGs, LC borrowing tends to be for short-term working capital purposes, given limits imposed on local taxing power.

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