Which countries appear to be on a positive debt trajectory?

November 2023

Kaspar Hense
BlueBay Senior Portfolio Manager, Investment Grade team
BlueBay Fixed Income Team

"Greece has been one of the success stories of the last decade, achieving huge deleveraging."

A falling debt to GDP ratio is a useful indicator of creditworthiness, and a number of countries appear to be moving in the right direction.

Interest rates are higher than they have been for a long time, and we don't see them beginning to fall for another 12 months or so. This represents a fundamental change – after a long spell when low refinancing rates encouraged countries to increase their leverage, the opposite is now true.

As sovereign debt investors, we're looking for countries that are managing this deleveraging process effectively, and one of the metrics we can look at is a country's overall debt to GDP ratio. It's not perfect and there can be caveats, but it is a useful guide.

In the current environment, we see levels of 150-200% as a conservative number. Germany already sits in the bracket, but what other countries are in a good position to get there? Here are three countries which we think are currently on a positive trajectory.

Greece – a debt success story

Greece has been one of the success stories of the last decade, achieving huge deleveraging. Their tradable (ex-EU loans) debt is now down to just 90%, having been 40 percentage points higher in 2020. And the trend continues, we foresee government debt levels to fall another 20 percentage points.

Within the next six months, we expect Greek sovereign debt to be reclassified as investment grade and, when that happens, passive funds could buy up to USD 20bn. This is close to a quarter of Greece's total tradable debt, which we believe will tighten the country's spreads to Bunds quite substantially.

The wider economic and political picture is also supportive of further progress. The green transition is working well for Greece, with solar power acting as the country's sole provider of electricity for more than a month this summer. And the current centre-right government was re-elected in June, confirming our view that Greece will continue its efforts to reduce government debt in the coming years.

Sweden – a lesson learnt

Sweden has learnt its lesson from a housing and debt crisis in the 1990s. As a result, they've come into this crisis with very low government debt (gross debt at 30%), and the private sector – which has been quite leveraged – has brought its overall debt ratio quickly down from 180% to 160% in less than a year. Overall debt levels have fallen from 300% to 275% now.

Furthermore, they've managed to do this without too much pain. That's in large part because net assets are high – although housing assets are fairly illiquid, corporates and even households have had enough assets in stock markets and other liquid assets to help pay down their debts.

Sweden's true situation is also probably better than its debt to GDP figure would suggest. Household debt is only 85% of GDP, which is very manageable. And while corporate debt is higher, Swedish companies are very international in nature, so they're not as levered as a ratio which Sweden's GDP would suggest.

United States – anticipating a soft landing

Deleveraging is ultimately a healthy process to go through, but it can lead to disruptions, which is where we start to think about hard and soft landings.

The US is currently engaging in some deleveraging, going from 260% to 250% in recent times. This is positive, as is the fact that now they own more of this debt themselves – foreign ownership of the US government debt market has fallen from 40% to 30% over the last five years.

Forward rates are rising rapidly but from very low levels, so overall we are still in the soft-landing camp. However, quickly rising government debt is a problem in the US. With 8% budget deficits and gross government debt levels alone rising from 120 to 150% in the foreseeable future, even the Federal Reserve chair, Jerome Powell, mentioned that the US is not on a sustainable path. We need to see a major reshuffle away from high cash balances and high stock ratios among private households in order to absorb net new Treasury issuance over the coming years.

Portfolio Manager Perspectives
Our experts offer their perspectives on the latest developments in global credit and the state of the markets.

LEARN MORE

This document was prepared by RBC Global Asset Management (UK) Limited (RBC GAM UK), authorised and regulated by the UK Financial Conduct Authority (FCA), registered with the US Securities and Exchange Commission (SEC) and a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC).

In the United States, this document may also be provided by RBC Global Asset Management (U.S.) Inc. ("RBC GAM-US"), a SEC registered investment adviser. The entities noted above are collectively referred to as "RBC BlueBay" within this document. The registrations and memberships noted should not be interpreted as an endorsement or approval of RBC BlueBay by the respective licensing or registering authorities.

With respect to the investment performance presented, past performance is not indicative of future performance. Actual account performance may or will vary from the performance shown because of differences in market conditions; client-imposed investment restrictions; the time of client investments and withdrawals; tax considerations; economies of scale; portfolio turnover; the number, type, availability, and diversity of securities that can be purchased at a given time; differences in the underlying currency of the assets in the account, and other factors. Client assets managed using these strategies in separate accounts or different vehicles may be subject to restrictions, fees or expenses that are materially different than those found in the non-US funds.

This document is confidential and, without RBC BlueBay's consent, may not be (i) copied, photocopied or duplicated in any form by any means or (ii) distributed to any person that is not an employee, officer, director or authorized agent of the recipient.

Information herein is believed to be reliable but RBC BlueBay does not warrant its completeness or accuracy. This document contains information collected from independent third-party sources. For purposes of providing these materials to you, neither RBC BlueBay nor any of its affiliates, subsidiaries, directors, officers, or employees, has independently verified the accuracy or completeness of the third-party information contained herein.

The information contained herein does not constitute investment, tax, accounting or legal advice. Recipients are strongly advised to make an independent review with their own advisors and reach their own conclusions regarding the investment merits and risks, legal, credit, tax and accounting aspects of all transactions. Any risk management processes discussed refer to efforts to monitor and manage risk but should not be confused with and do not imply no or low risk. No chart, graph, or other figure provided should be used to determine which strategies to implement or which securities to buy or sell.

Copyright 2023 © RBC BlueBay. RBC Global Asset Management (RBC GAM) is the asset management division of Royal Bank of Canada which includes RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management Inc., RBC Global Asset Management (UK) Limited and RBC Global Asset Management (Asia) Limited, which are separate, but affiliated corporate entities. ® / Registered trademark(s) of Royal Bank of Canada and BlueBay Asset Management (Services) Ltd. Used under licence. RBC Global Asset Management (UK) Limited, registered office 77 Grosvenor Street, London W1K 3JR, registered in England and Wales number 03647343. All rights reserved.

RBC Global Asset Management (U.S.) Inc.
Minneapolis | Boston | Chicago
800.553.2143 | **rbcgam.com**