

Sovereign Outlook 2026

Europe showing resilience but significant risks ahead

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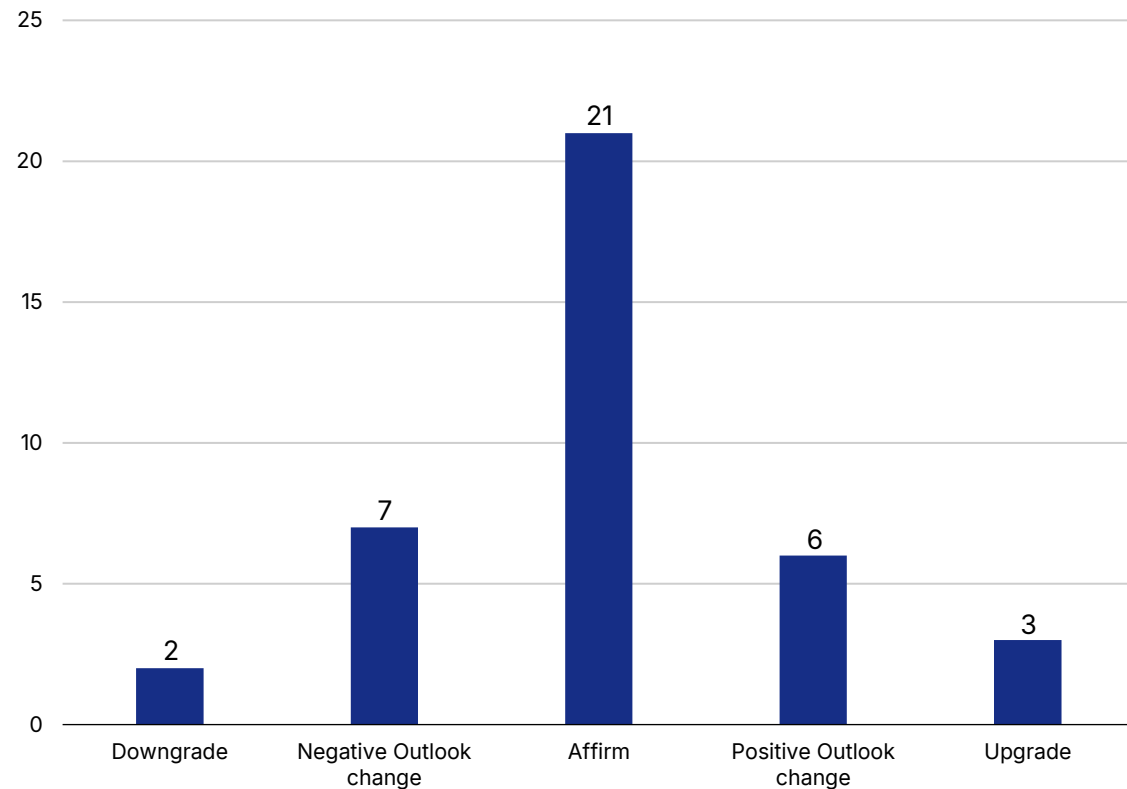
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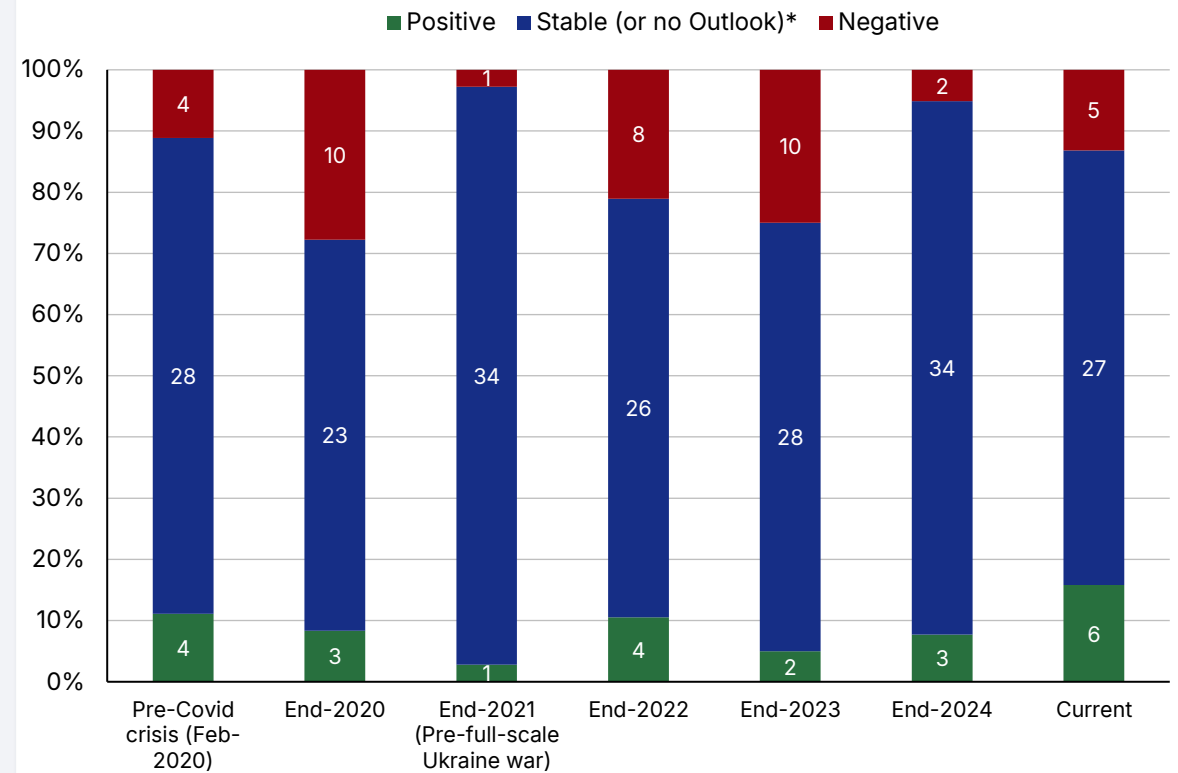
Scope's sovereign rating portfolio

- In 2025, of 38 publicly rated sovereigns, we upgraded three, downgraded two, revised the Outlook upwards for six and downward for seven.
- The current portfolio has five sovereigns on a Negative Outlook (AT, FI, FR, SK, GE) and six on a Positive Outlook (CY, ES, GR, HR, IT, PT)

Sovereign rating actions in 2025



Sovereign rating outlooks*

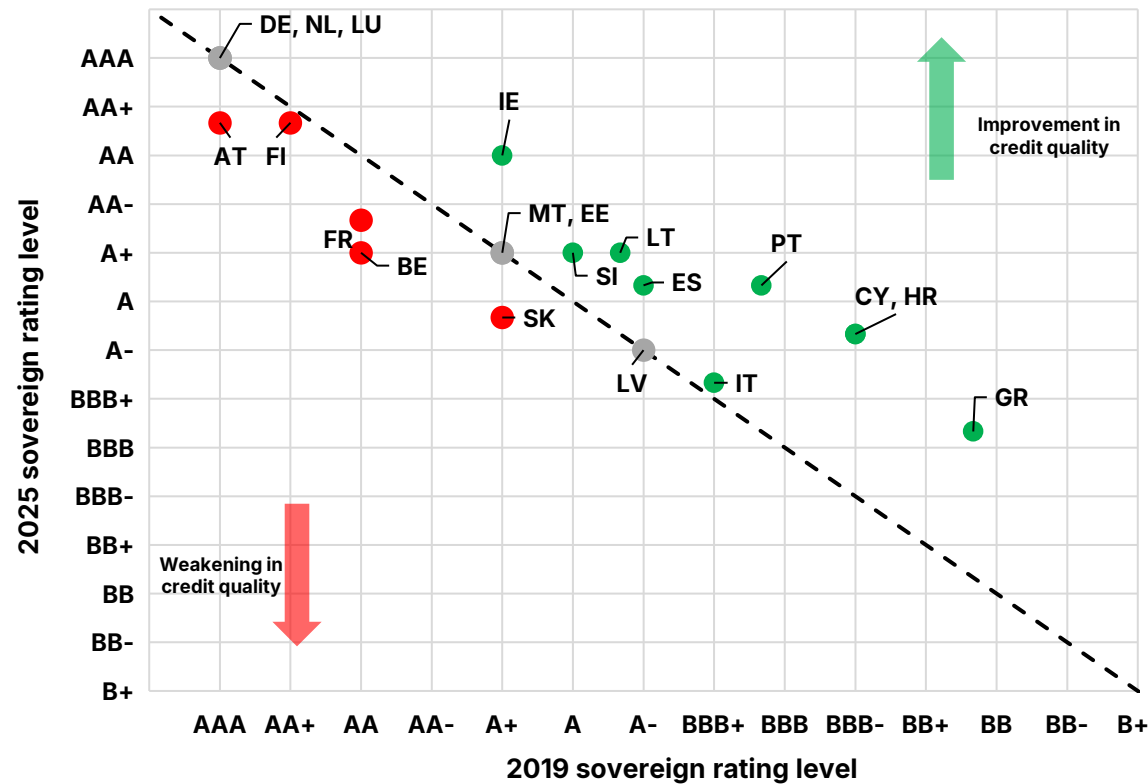


*as of 24 November 2025. No rating Outlook currently assigned on Ukraine in selective default. Displayed are Outlooks on long-term issuer ratings in foreign currency. Source: Scope Ratings

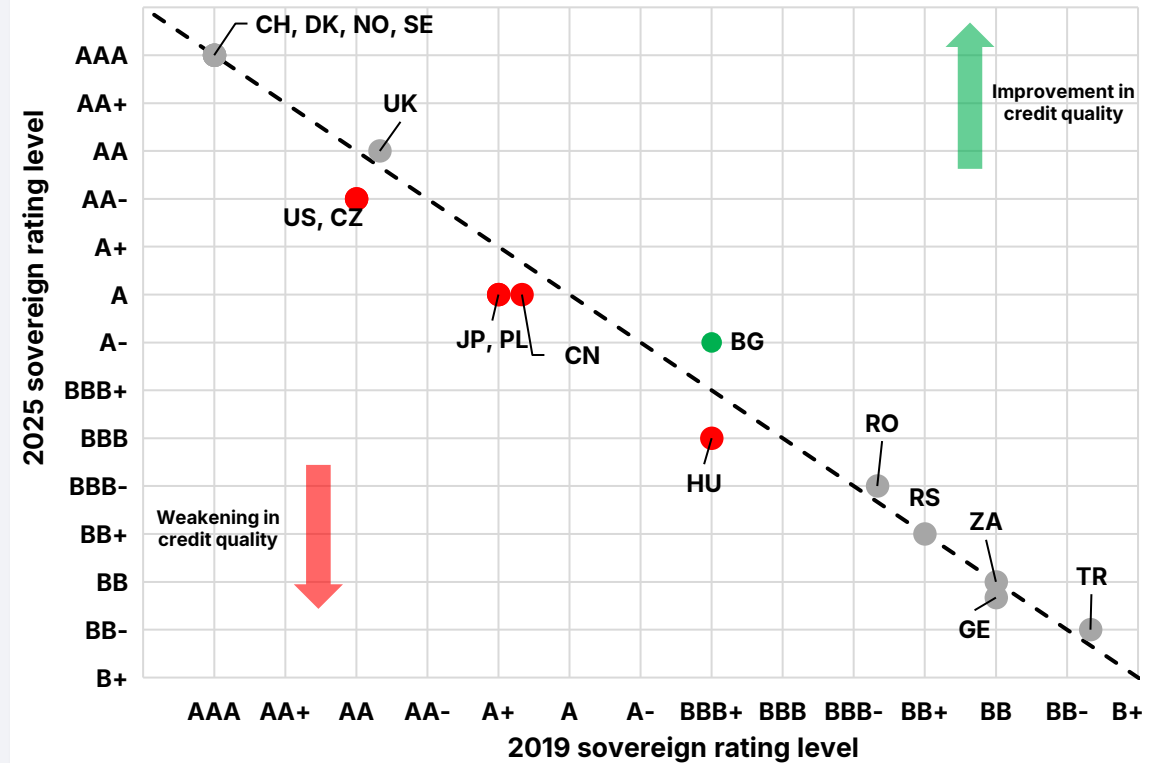
Rating convergence since 2019

- Upside pressure on previously lower rated sovereigns: GR, PT, IT, CY, ES, IE: political stability, growth momentum, ongoing fiscal consolidation
- Downside pressure: AT, FI, FR, BE, US: sustained structural fiscal pressures, complicated governance, insufficient reform

EA sovereign ratings End-2019 vs Latest 2025



Non-EA sovereign ratings End-2019 vs Latest 2025



Source: Scope Ratings

Negative sovereign outlook for 2026

- Geopolitical tensions will remain a key external risk for sovereign ratings in 2026
- Increased political polarisation weakens long-term reform momentum, posing a challenge to countries facing significant structural fiscal pressures
- The significant risks outweigh possible positive impacts from stronger growth and some pockets of fiscal resilience in the EU

Geopolitical tensions

United States: foreign policy enforcement through tariffs, sanctions and reallocating defence priorities

China: control of rare earth minerals gives leverage over global supply chains; increase in high-value goods production challenges established players

Russia: increased focus on hybrid warfare against European countries; evolution of Russia-Ukraine war key for European sovereigns

Political polarisation

Key elections: Hungary and US mid-terms in 2026; France, Spain, Poland, Italy in 2027

Political polarisation in Europe including growing public support for political extremes weighs on structural reform drive

Weakened US governance reduces predictability and stability of US policymaking; increased risk of policy missteps; Fed governance and mid-term elections key for US Outlook

Fiscal challenges

Europe: high spending pressure on defence, ageing and interest; high and/or rising public debt ratios; challenges implementing necessary structural reform

United States: government shutdowns likely in 2026; deteriorating public finances only partially offset by tariff revenues; constrained budgetary flexibility

China: high fiscal stimulus and spending pressures lead to a sharp increase in public debt; continued weakness in the real estate sector

Stronger growth

EU reform agenda: deepening the single market, enhancing energy market integration, and structural reforms under NGEU could support growth

AI investments: adoption could support stronger productivity growth globally

Deregulation: the strong focus on deregulation in the US could accelerate similar reforms in other jurisdictions

Pockets of fiscal resilience

EU resilience: several European sovereigns continue to benefit from past reforms, leading to a sustained decline in public debt ratios; EU-based funding programmes can reduce funding costs of member states facing high yields in financial markets

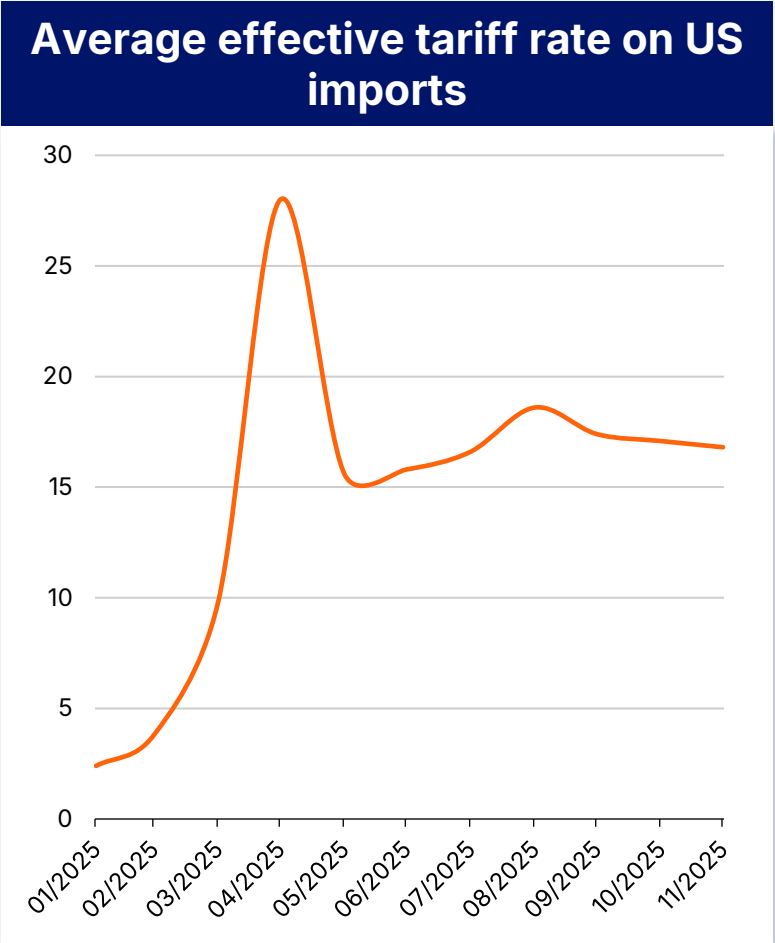
Fiscal space: While facing significant structural pressures, some European economies still have significant fiscal space

1. Geopolitics – economic competition and military tensions

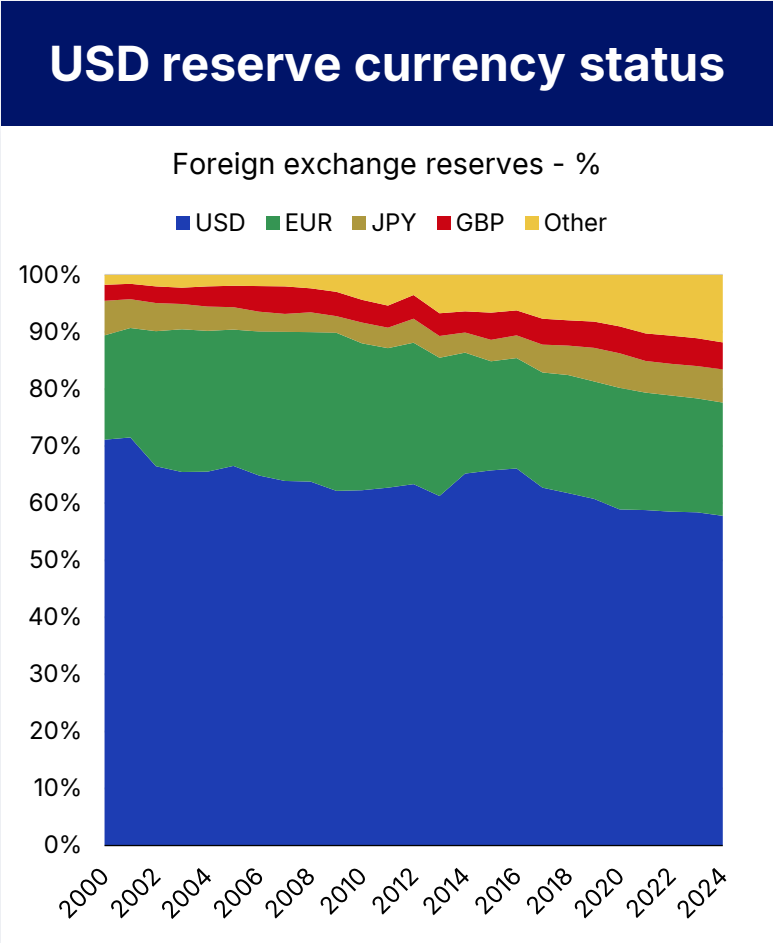


United States' shifting policy stance

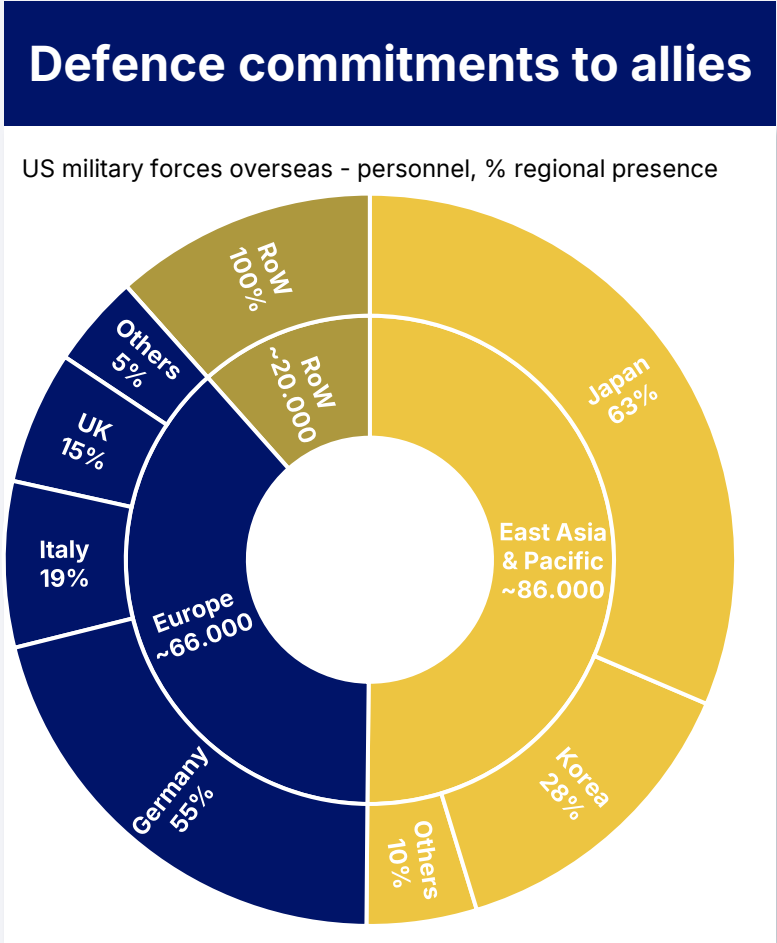
- Reshaping international trade order with volatile policymaking regarding tariffs and international sanctions
- Testing resilience of security commitment vis-à-vis Europe



Source: The Budget Lab at Yale



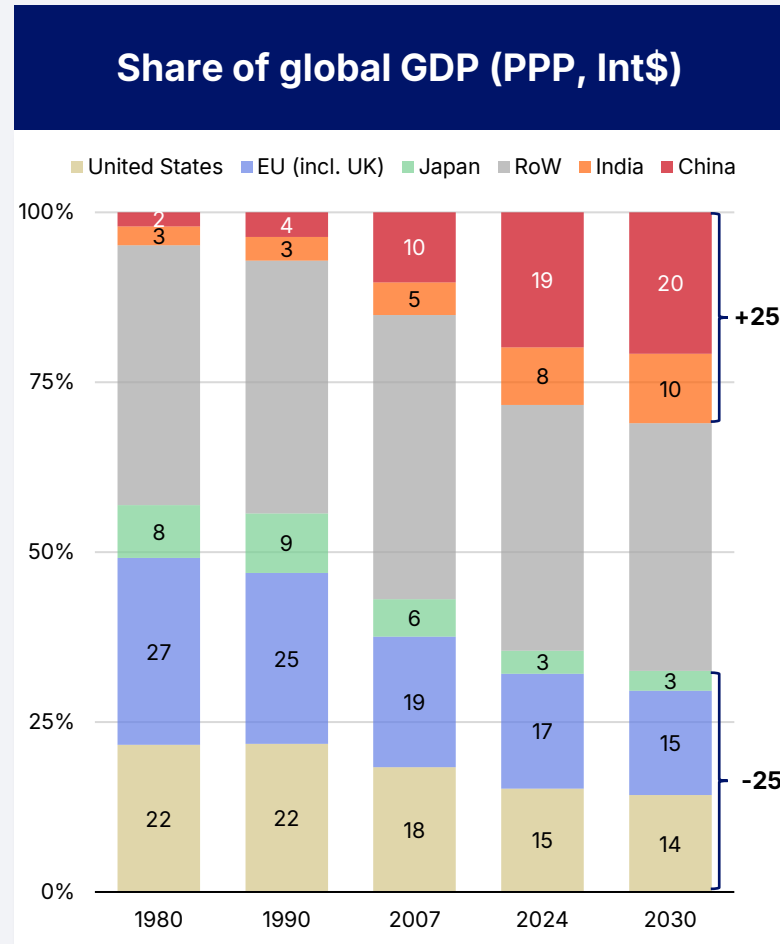
Source: IMF COFER



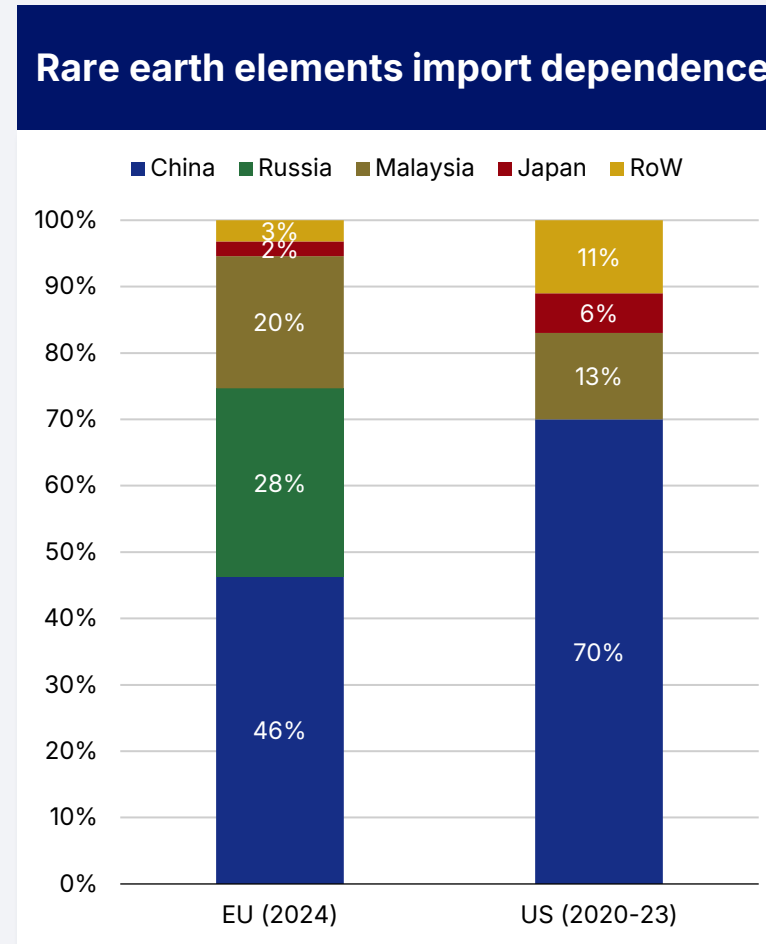
Source: Defence Manpower Data Center, Office of the Secretary of Defense, 2025

China dominates manufacturing production and moves up the value chain

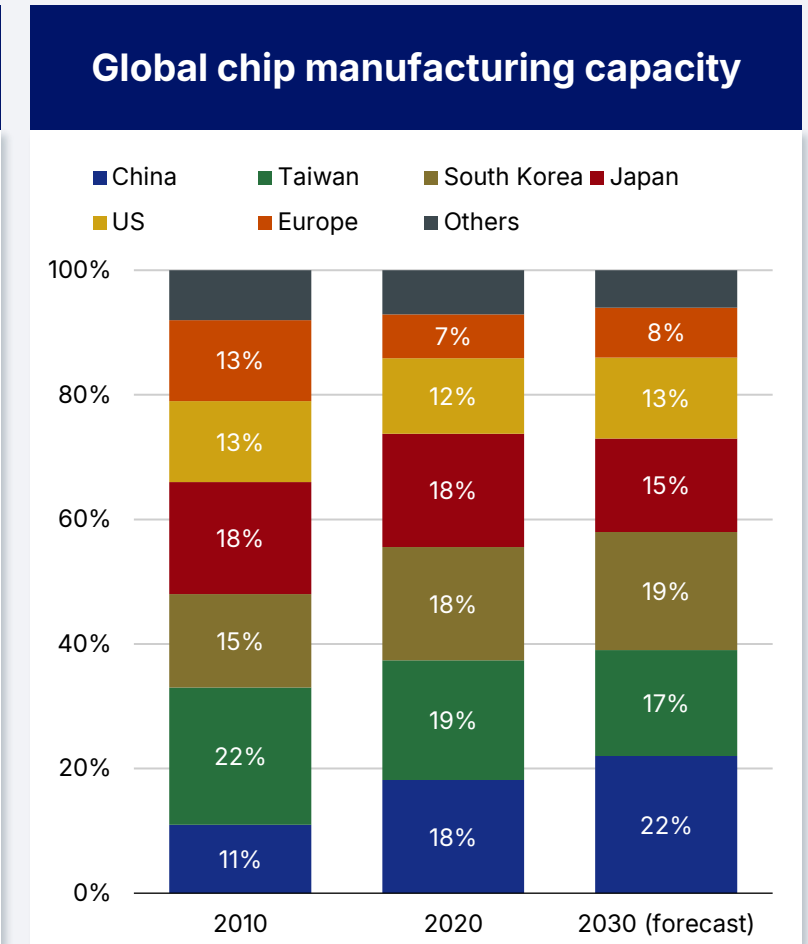
- Controlling entire value chains from inputs to manufacturing and exports
- Moving up value chains through critical inputs and domestic innovations



Source: IMF WEO, Scope Ratings



Source: Eurostat, US Geological Survey

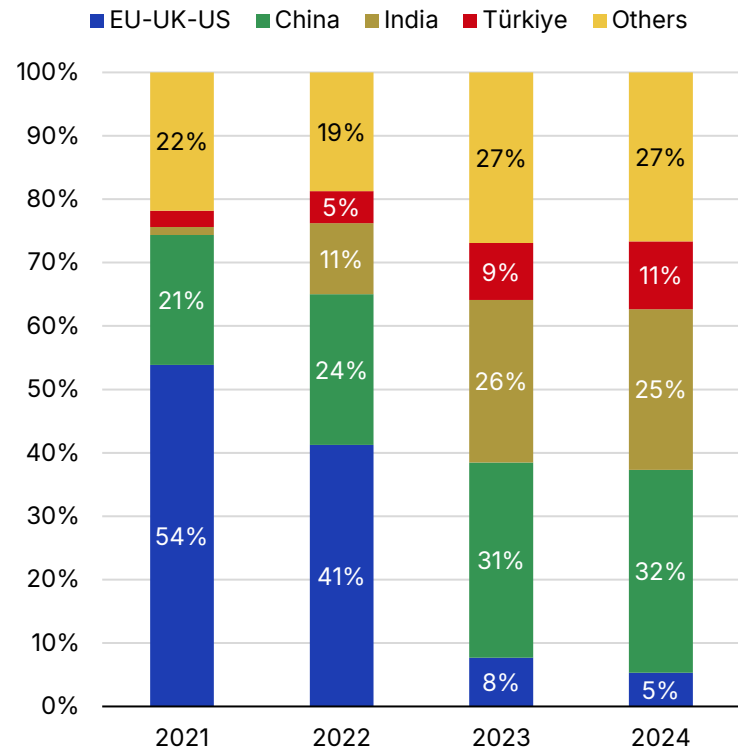


Source: ECA based on BCG and SIA study - *Emerging resilience in the semiconductor supply chain*, 2024

Russia-Ukraine: financial resources critical for war outcome

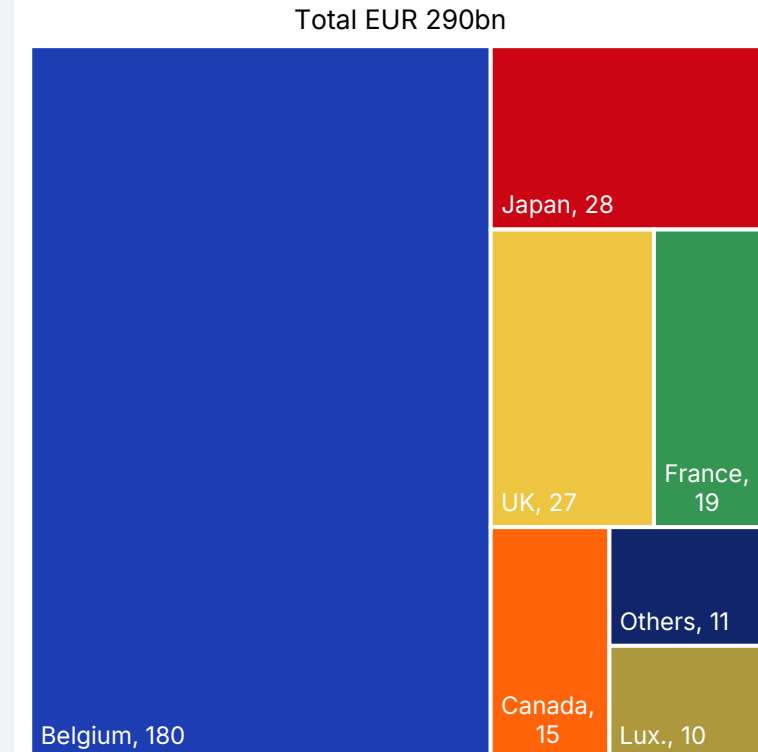
- Baseline: war continues; EU to shoulder most financially, US mostly militarily; potential use of Russian assets for EUR 140bn reparation loan
- Optimistic: ceasefire; probably requires China and India to moderate purchases of Russian fuels
- Adverse: escalation; 'Ukraine fatigue' among EU-US (elections 2027-28), China's support for Russia continues

Russian oil exports by country, % total



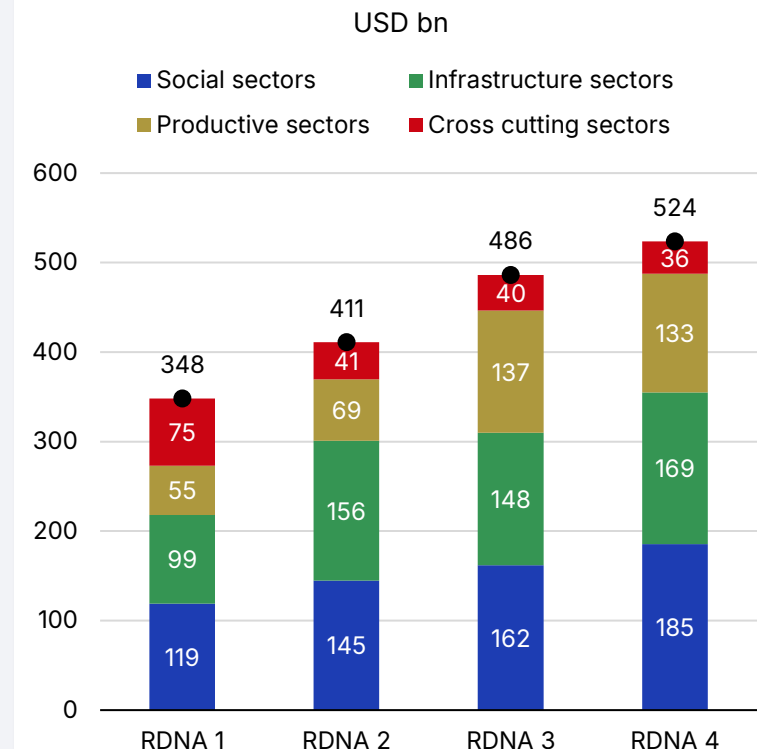
Source: International Energy Agency, Scope Ratings

Frozen Russian assets by jurisdictions



Source: European parliament, Scope Ratings

Recovery & reconstruction needs over 10 years



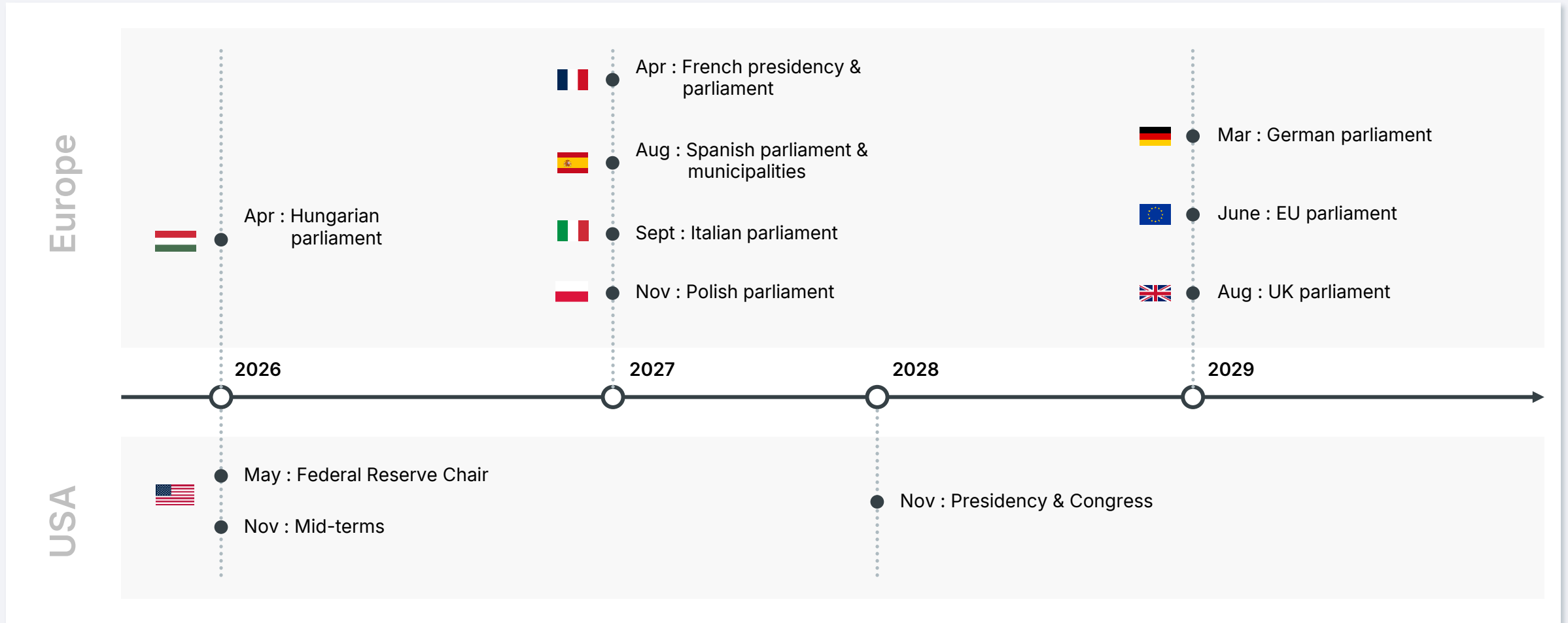
Note: Rapid Damage and Needs Assessment. RDNA 4 of February 2025.
Source: World Bank, Scope Ratings

2. Politics – fragmentation and polarisation



Governance decisions and key elections out to 2030

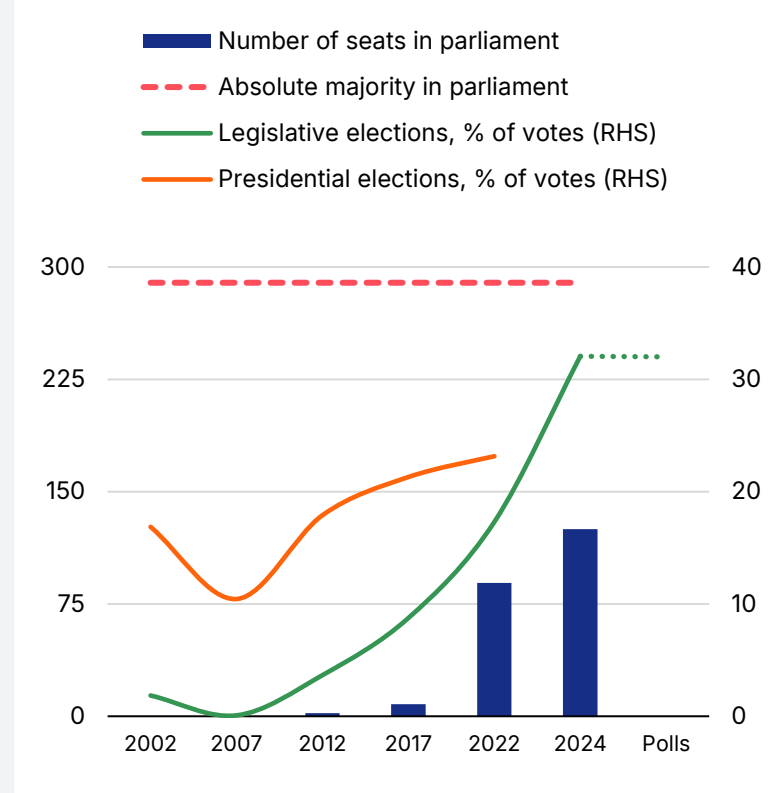
- 2026 and 2028 focus on US governance and elections while 2027 and 2029 focus is on Europe
- French 2027 election likely the most decisive European political event until the end of the decade



EU: 2027 elections critical for integration agenda and EU's resilience

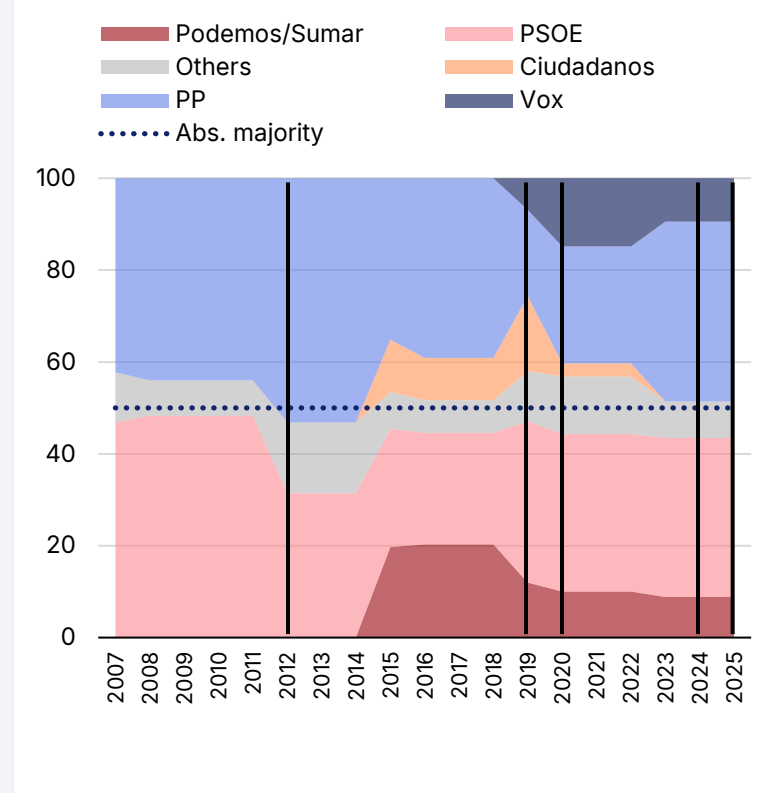
- FR: will RN gain legislative majority and/or the presidency? 2027 governance: absolute, relative majority or 'cohabitation'? RN policy shift à la Meloni?
- ES: parliamentary fragmentation, minority governments since 2016, inability to pass budget since 2023
- DE: will the coalition hold until 2029? Will AfD and Die LINKE extend success to Western Germany and maintain their 1/3 blocking majority?

FN/RN party electoral results



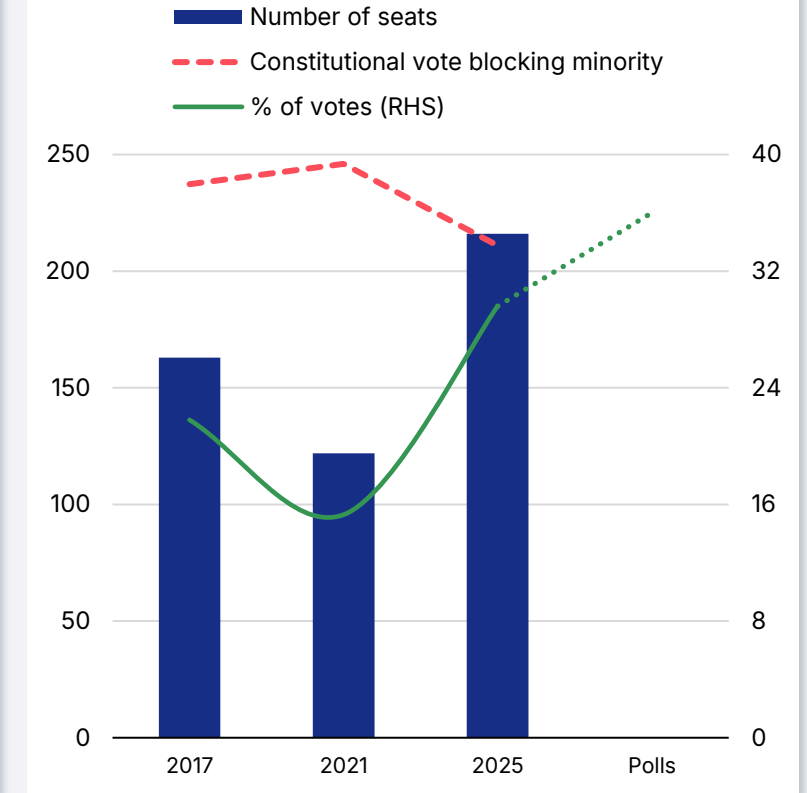
Note: Vote shares obtained for the first round of the ballot.
Source: French Ministry of the Interior, Politico Poll of Polls, Scope Ratings

Spanish Congress of Deputies composition, % of total



Note: Vertical lines highlight years when the central government budget was not passed.
Source: Spanish Ministry of the Interior, Scope Ratings

AfD & Die Linke parties legislative election results

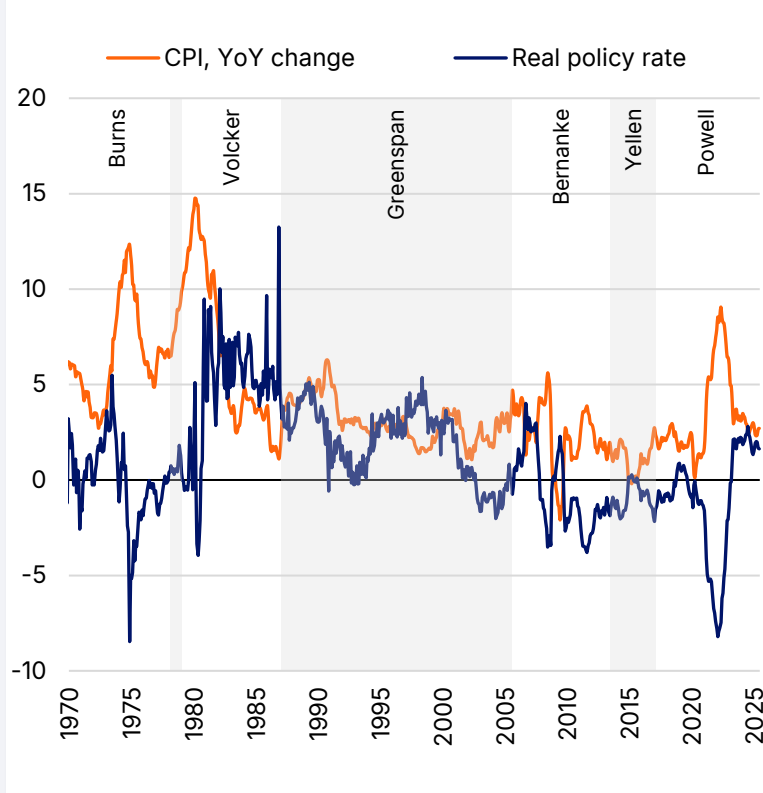


Source: German Federal Returning Officer, Politico Poll of Polls, Scope Ratings

US: Governance, Fed independence, mid-terms key for US outlook...

- FOMC decisions and perceived political influence critical; risk of unanchored inflation expectations and the return of fiscal dominance?
- 2026 November mid-terms: will Democrats flip the House? Senate (35/100 seats contested: 22 R; 13 D) likely to stay Republican
- 'BBB' deal raised debt ceiling by USD 5 trillion to USD 41.1 trillion, a level expected to be reached by end-2027

Inflation & policy rates, %



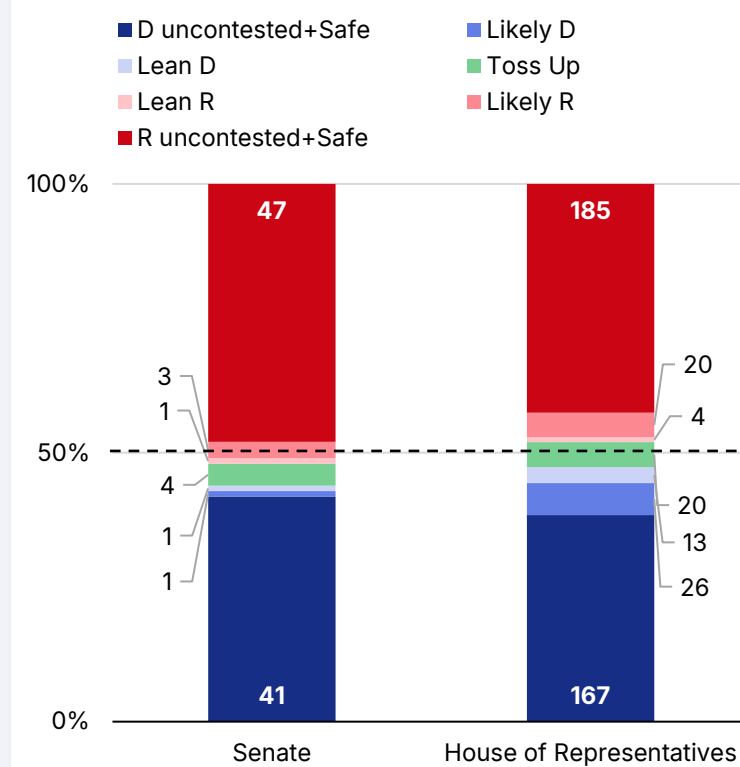
Source: Federal Reserve, Scope Ratings

Note: CPI = Consumer Price Index for all urban consumers (U.S. City Average).

Real policy rate as approximated by Federal Funds Effective Rate - CPI.

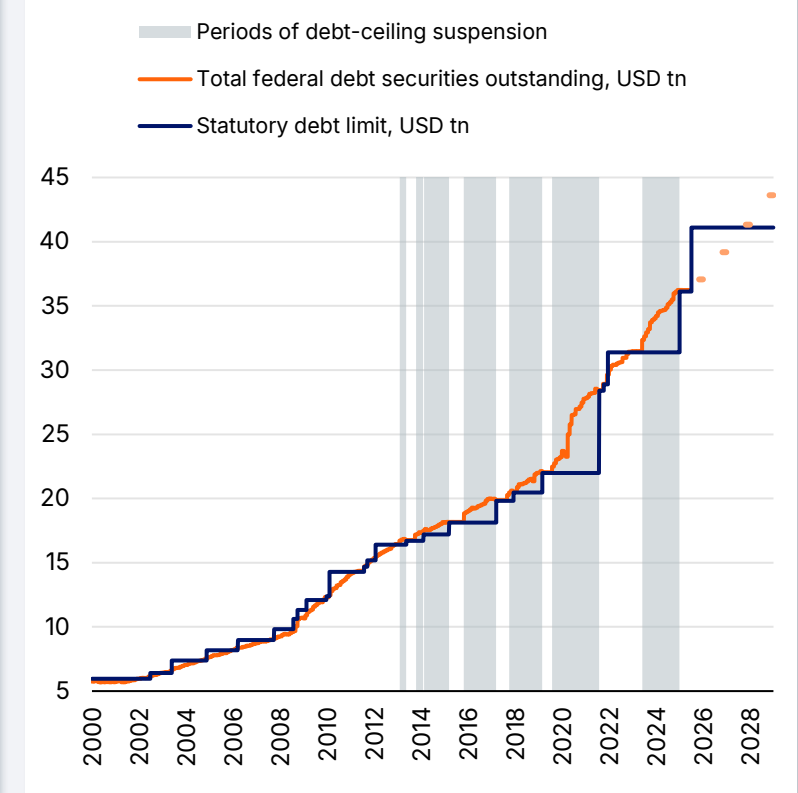
Sovereign & Public Sector Ratings

2026 mid-terms latest polls, % of seats



Source: 270towin.com, Scope Ratings

Debt ceiling risks



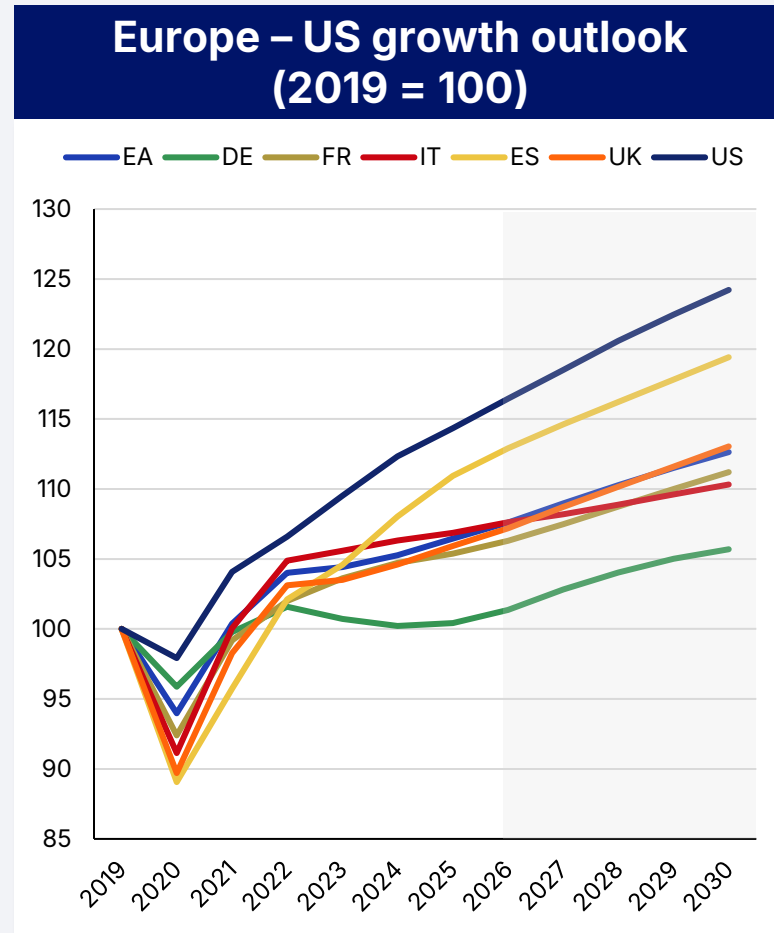
Source: U.S. Department of Treasury, U.S Congress, Scope Ratings forecasts

3. Macro, Fiscal, Markets

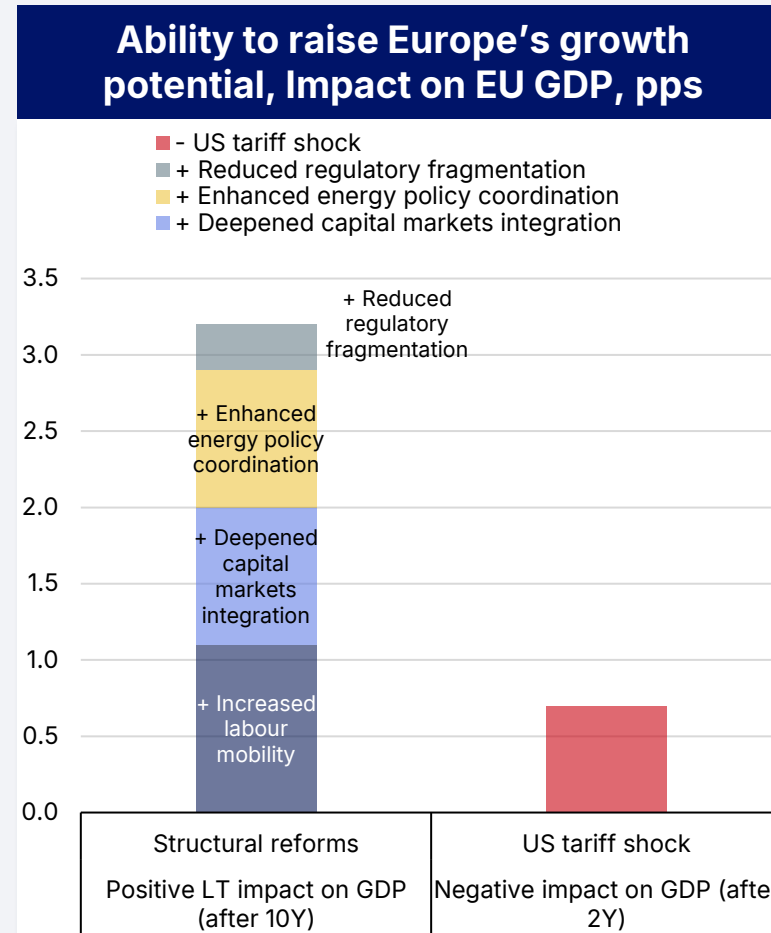


Lower EU internal barriers can raise growth amid tariff shock, CN competition

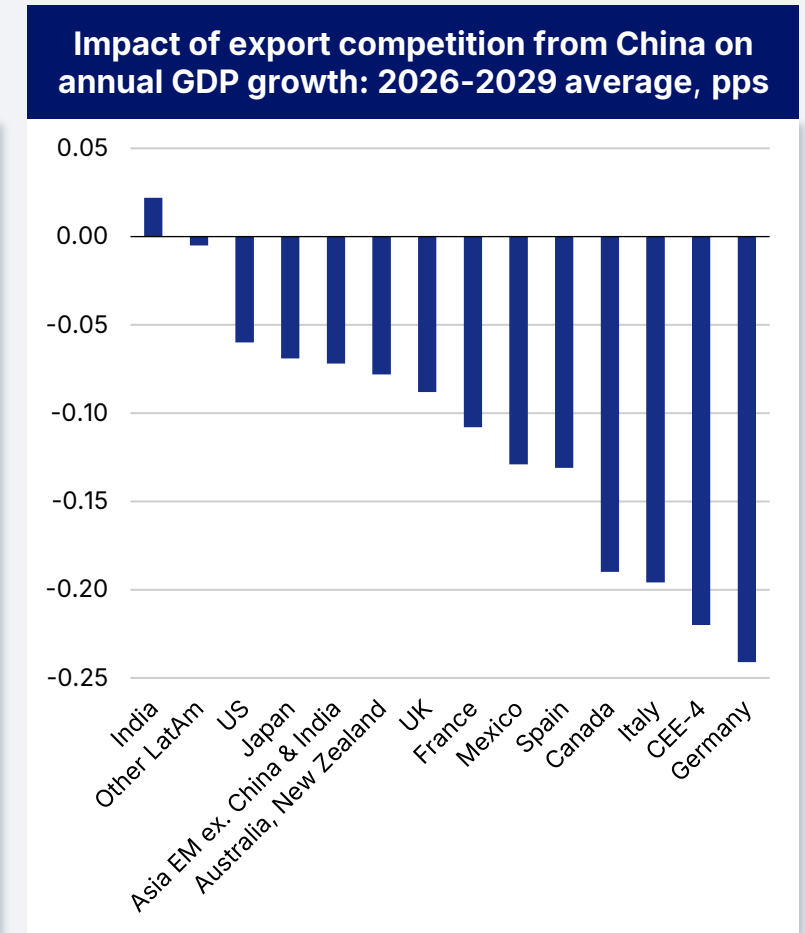
- Uneven growth outlook, Germany expected to return to growth following debt brake reform
- Draghi & Letta: completing EU Single Market, deepening CMU, co-ordination of energy markets could strengthen growth potential
- China's rapid move towards becoming a leader in high-tech, high-value industries challenges growth potential of other economies



Source: IMF, Scope Ratings



Source: IMF Working Paper, June 2025 - *Lifting Binding Constraints on Growth in Europe*, Scope Ratings

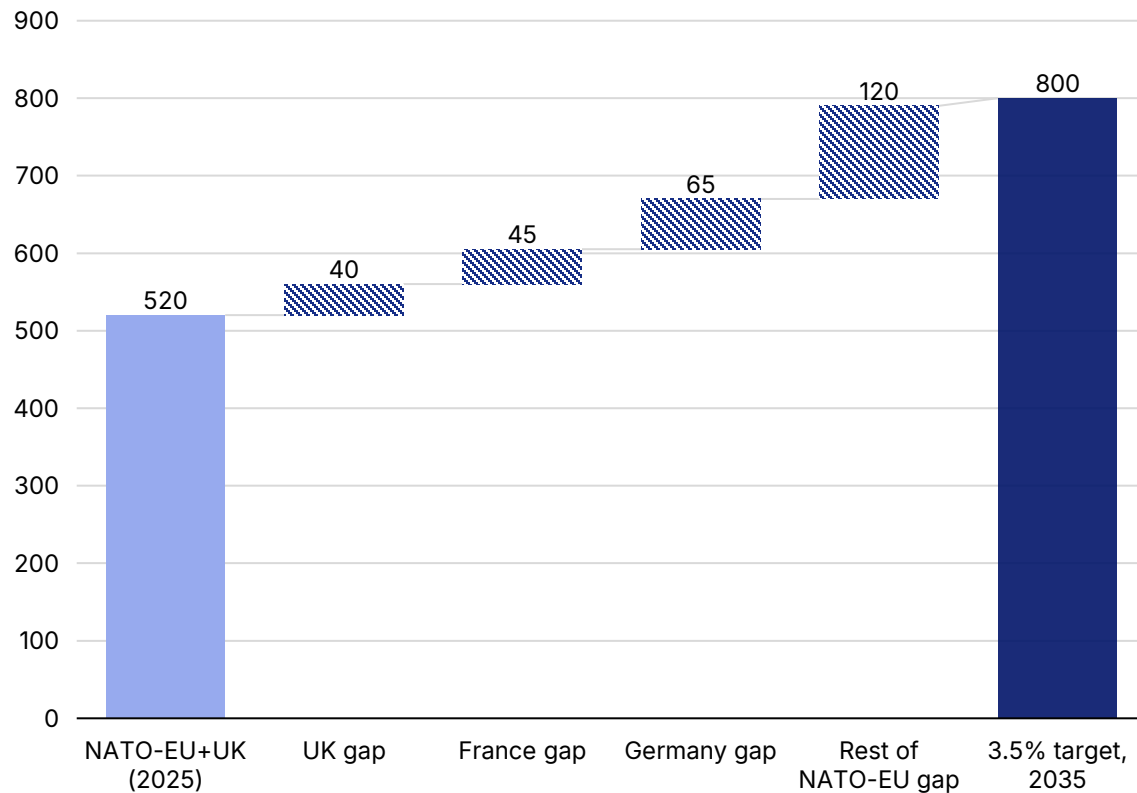


Source: Goldman Sachs, Scope Ratings

Manageable defence expenditure needs to appease President Trump and deter Russia...

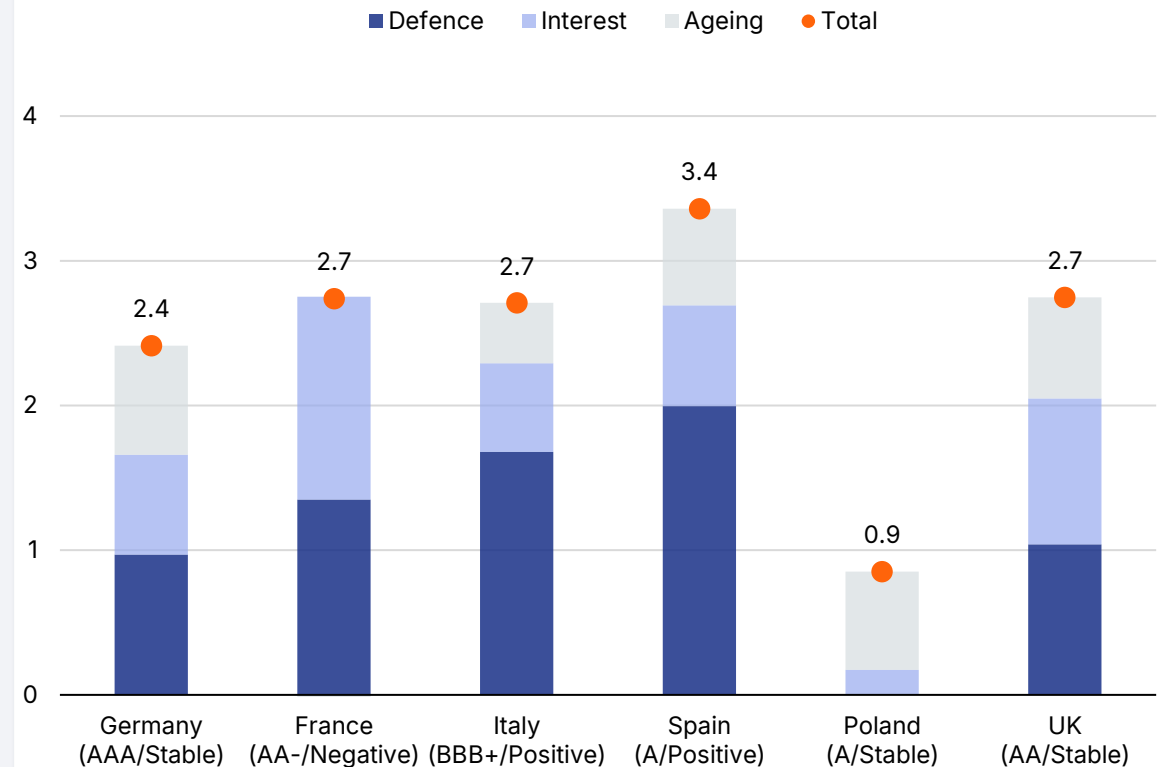
- Revised 3.5% NATO target implies aggregate annual military expenditure increase of ~ EUR 300bn (~ 1.5% of GDP) by 2035
- Competes with unavoidable market (interest payments) and politically sensitive (welfare) spending, adding to fiscal pressures

Current and targeted defence spending volumes, USD bn



Source: NATO, IMF, Scope Ratings
Note: Values shown in constant 2025 EUR.

Medium-term spending pressures, 2024-30 change, % of GDP

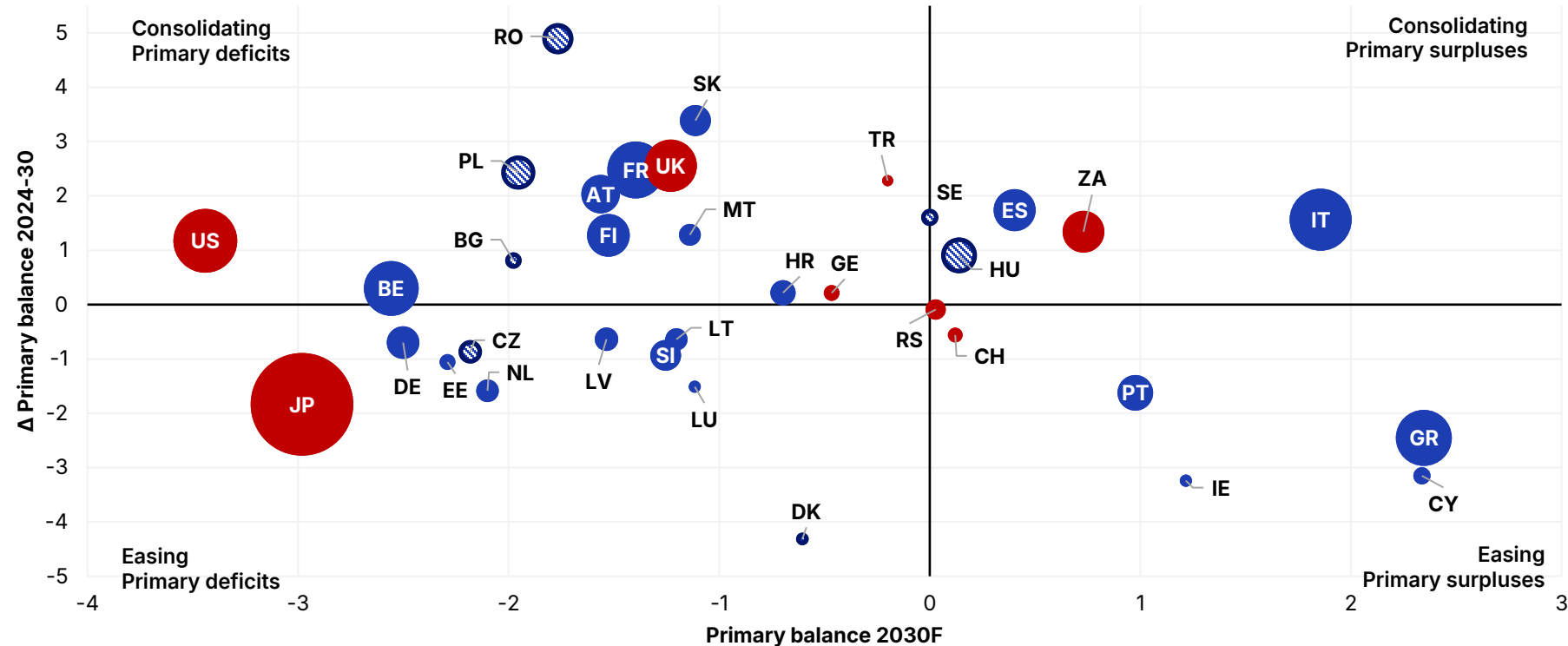


Source: European Commission - 2024 Ageing Report, Institute for Fiscal Studies, NATO, IMF, Scope Ratings
Note: Defence spending as defined according to Eurostat (Germany, France, Italy, Spain, Poland) and ONS (UK) accounting standards. Linear increase assumed until 2032.

...but divergent fiscal positions and perceived security threats drive national responses

- Germany to increase defence expenditure.; other member states constrained by limited fiscal space or perceived need; 3.5% target by 2035 (end of next US administration)

Change in primary balance (2030F vs 2024), % of GDP

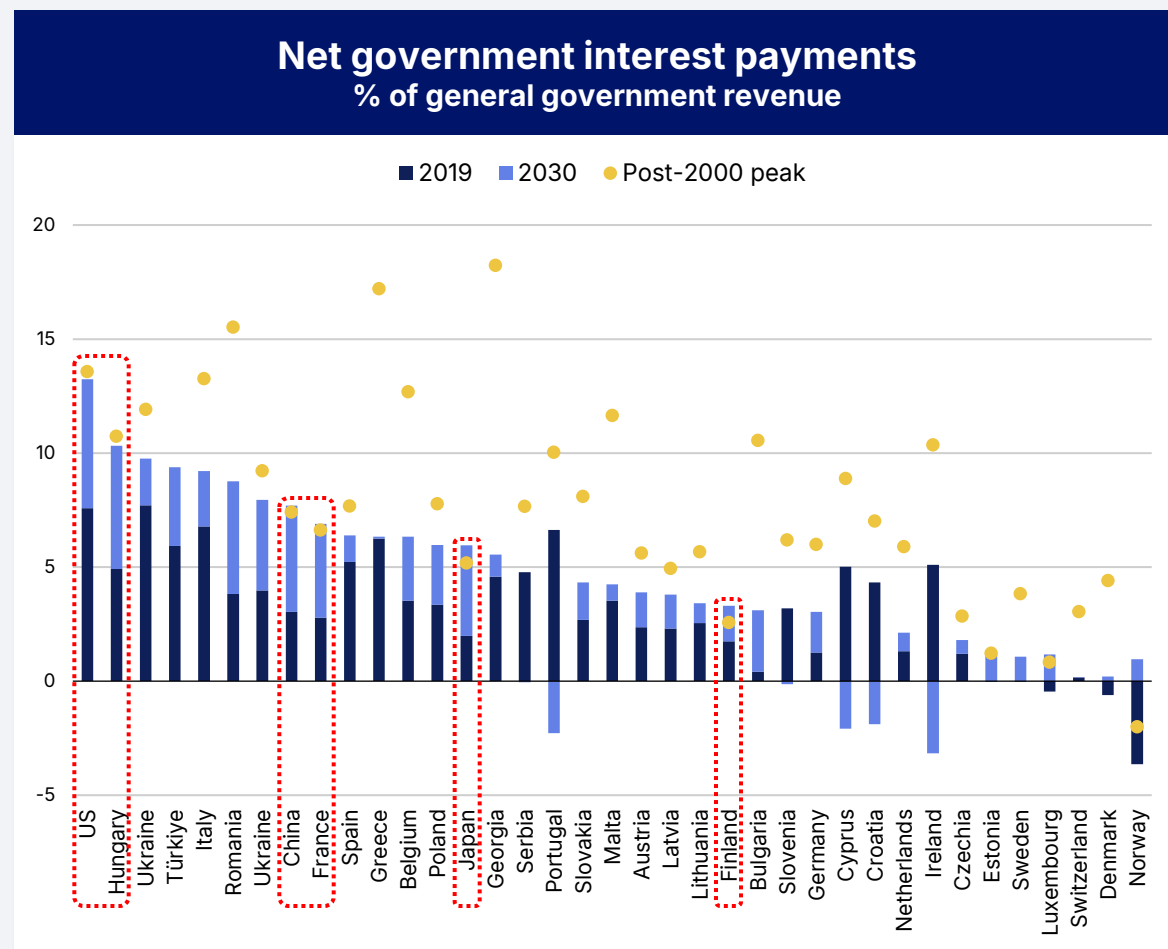


Source: IMF, Scope Ratings forecasts

Note: Euro-area (EA) members are shown in blue, non-EA EU members are shown in shaded-blue, rest of world is shown in red. Dot sizes reflect the projected debt-to-GDP ratios for 2030, in relative terms.

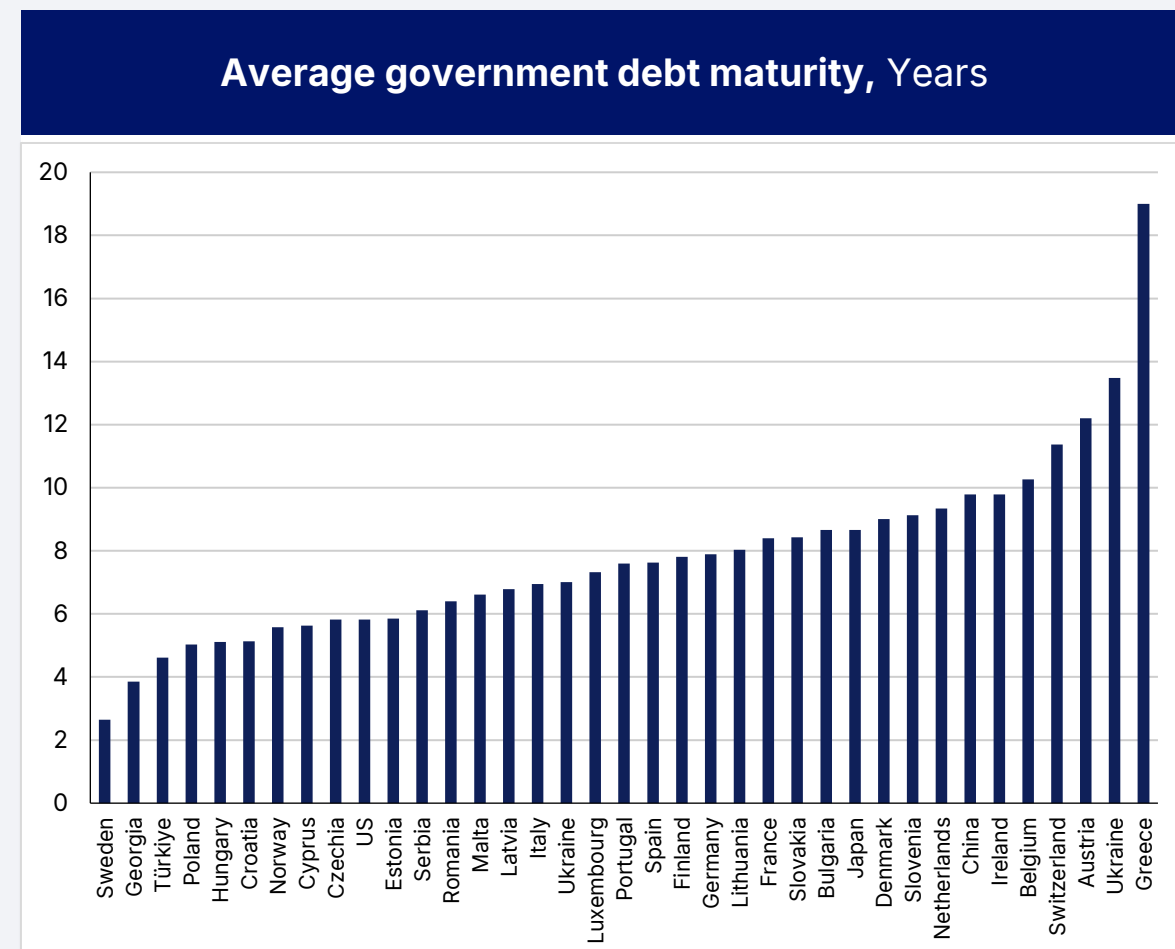
Sovereigns face budget pressures from rising interest payments

- Sovereigns whose budget pressure from interest spending will be near or above long-term highs include US, HU, CN, FR, JP, FI
- Longer average government debt maturities help to delay the impact of higher bond yields for some sovereigns



Source: IMF, Scope Ratings

Note: Post-2000 peak value for Türkiye amounted to 50.2%

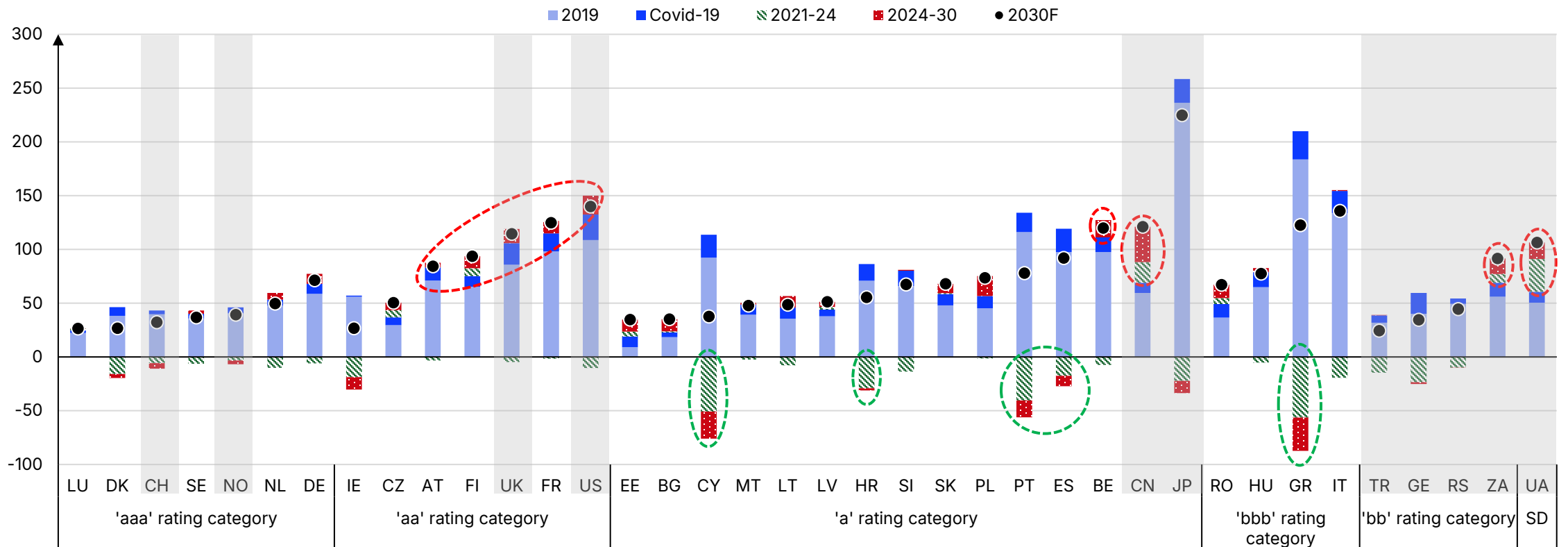


Source: Bloomberg, Scope Ratings

Fiscal pressures and growth outlooks drive debt dynamics until 2030

- Significant debt reduction expected in recently upgraded sovereigns (Greece, Cyprus, Portugal, Spain)
- Continuous fiscal pressures in Austria, Finland, UK, France, US, Belgium, China

General government debt ratios are forecast to rise across most EU member states, % of GDP



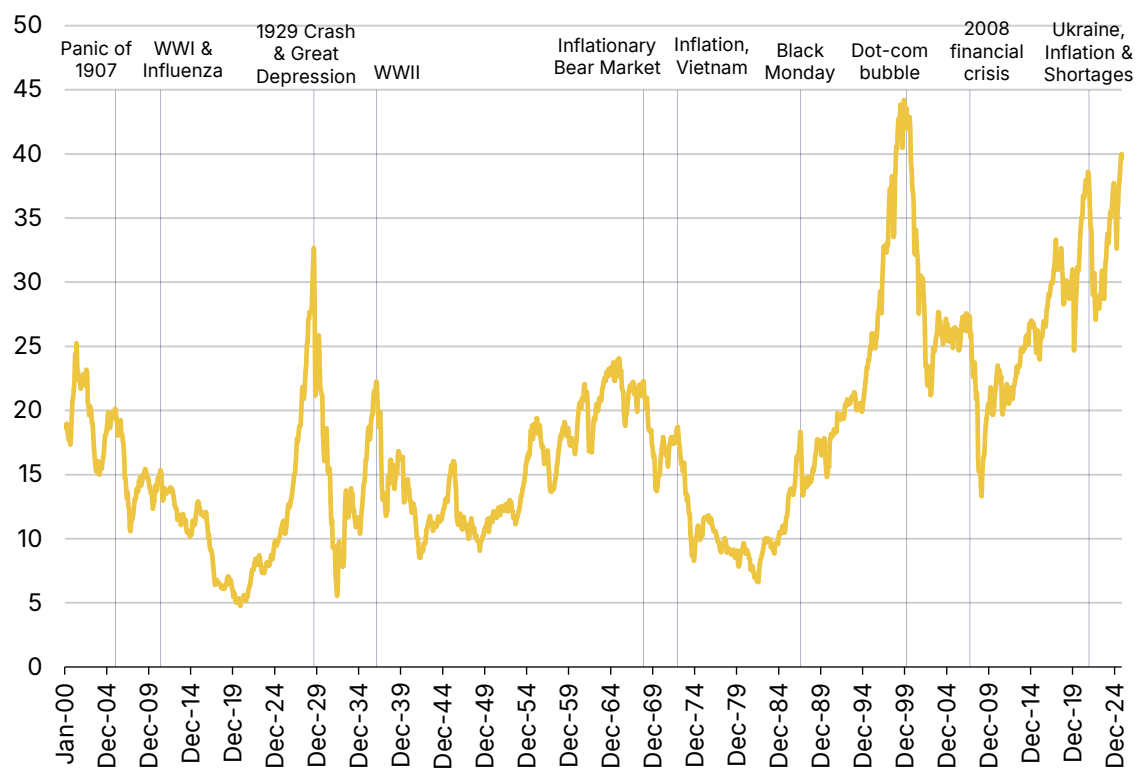
Source: IMF, Scope Ratings forecasts

Note: Shaded areas indicate non-EU countries.

US: High valuations and concentration in US markets driven by Big Tech and AI

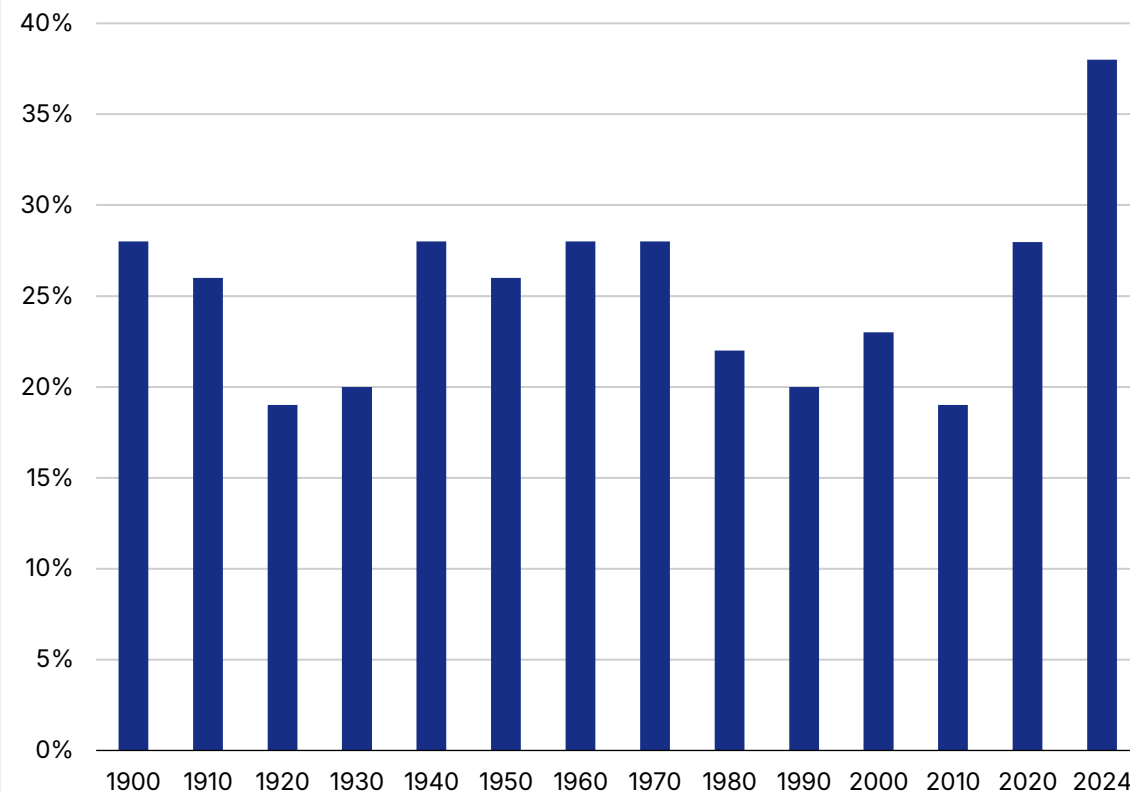
- Price-earnings ratios are near historical all-time highs; ~ 90% of US growth in 2025 driven by AI investments
- Concentration within S&P 500 is at the highest level for more than a century, driven by the Magnificent 7 and AI-related expectations

Cyclically Adjusted Price Earnings Ratio (CAPE)



Source: R.J. Shiller, S&P Global

Share of top 10 stocks of the S&P 500's market cap



4. Global tensions, EU resilience – scenarios



2030: significant uncertainty from potential political swings in Europe & US

- European elections and US governance critical for shaping policy environment; French voters and US Supreme Court decisions decisive
- Distinct possibility that Europe faces 'scenario 6' in mid 2027 but other outcomes also possible

Political drivers		US governance	
		Continues to weaken (Trump emboldened)	Remains broadly intact (Trump contained)
EU mainstream parties	Empowered & push reforms (Draghi & Letta)	1. EU renaissance Bold European reforms; ambitious EU budget (+ UA support); US volatility vs Europe as relative safe-haven	2. Improved outlook, lower uncertainty EU accelerates reforms but lingering complacency; US governance concerns ease
	Remain mostly complacent/ stuck	4. Status quo; high uncertainty (2025) Muddling through; credit broadly stable Continued volatility and uncertainty	3. Europe's relative decline continues (2024) Investors gain more confidence in US (& USD); (institutions withstand Trump shock)
	Weakened, lose to nationalists (RN)	6. Populist governance in EU & US Significant credit risk Reversal of EU integration: will institutional guardrails hold? <u>Potential Russian escalation</u>	5. Europe's relative decline accelerates European integration slows & EU loses further ground to US

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