SCOPE | Ratings

European Sub-Sovereign Outlook 2025

Overall finances remain stable amid fiscal challenges and widening regional disparities

13 February 2025

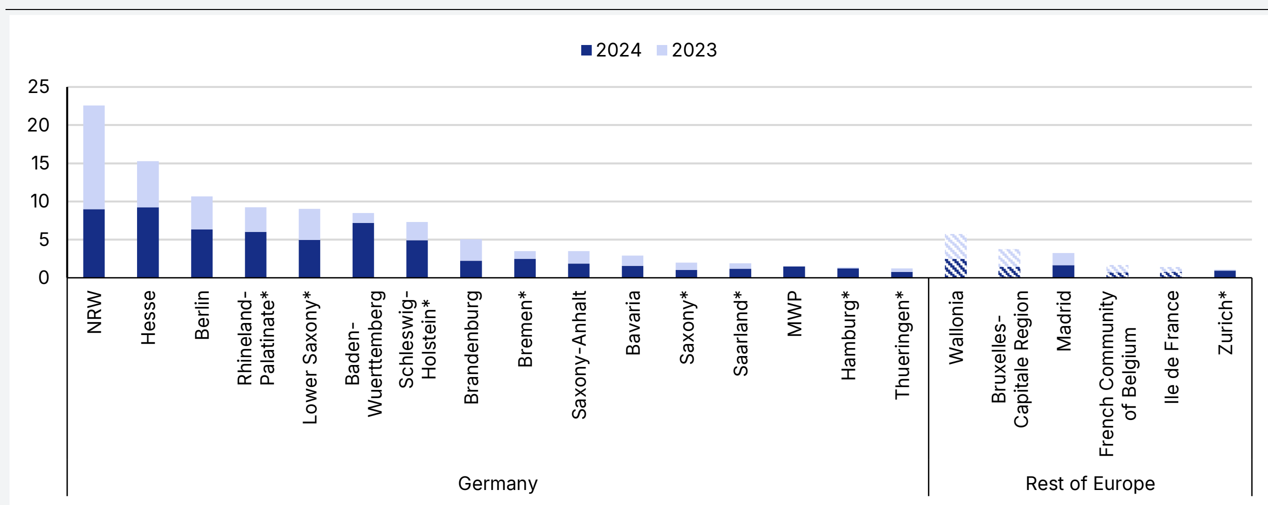
Executive summary

The Outlook for European sub-sovereigns in 2025 is broadly stable, supported by strong institutional frameworks and central government backing. However *regional disparities are widening, with weaker regions facing rising fiscal pressures and greater reliance on central government support. Political uncertainty in France, Belgium, Germany may impact fiscal strategies and increase financial volatility. Effective EU funding absorption and fiscal consolidation will be key to managing rising regional debt.*

Key risk drivers for 2025

- **German Länder** strong institutional framework and revenue equalisation system, and federal backing, ensure financial stability and sound market access. High debt, budget constraints and uncertainty surrounding February 2025 elections pose fiscal risks. Despite the debt brake (Schuldenbremse), bond issuance exceeded EUR 60bn in 2024, with a similar amount expected this year, making fiscal discipline key to maintaining stable ratings.
- **Spain's regional finances** are improving unevenly, with budget deficits and rising borrowing costs posing risks. Stability gained from state backing for 60% of regional debt comes at the cost of the regions' continued financial dependence on central government and EU funding. Refinancing will drive increases in bond issuance in 2025.
- **French regions** rely on strong central government support, but current political uncertainty in France (AA-/Stable) and cuts to central transfers pose fiscal-planning challenges. Operating surpluses and sound debt affordability provide stability, but debt is set to rise further due to ambitious investment programmes.
- **Belgium's federated entities** benefit from predictable transfers and policy influence, but credit risks are tilted to the downside given the sovereign's negative Outlook (AA-/Neg). Fiscal performance is likely to improve as inflation recedes and revenue recovers, yet debt will continue to rise on the need to fund investment.
- **Italian regions and municipalities** face balanced risks, with stable tax revenues and EU funds supporting budgetary performance but rigid fiscal structures limit flexibility. Economic disparities across regions create extra fiscal pressures, while reliance on sovereign on-lending ties sub-sovereign credit risk to national debt sustainability.
- Among non-EU European sub-sovereign issuers, **Swiss cantons** maintain strong credit profiles, despite high debt and social spending pressures, due to revenue equalisation and national backing. SNB profit distribution and Switzerland's economic resilience should ease fiscal strains in 2025. **Norwegian sub-sovereigns** are financially stable due to state alignment and equalisation, but limited revenue flexibility and growing investment needs pose long-term challenges.

Figure 1: Leading sub-sovereign bond issuers in Europe, EUR bn



*Rated on subscription, accessible on ScopeOne. As of 25 January 2024. Source: Bloomberg Finance L.P., Scope Ratings

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Contacts

Alvise Lennkh-Yunus
Managing Director, Head of Sovereign and Public Sector
+49 69 667738 985
a.lennkh@scoperatings.com

Jakob Suwalski
Senior Director
+49 30 221823 948
j.suwalski@scoperatings.com

Eiko Sievert
Senior Director
+49 69667738 979
e.sievert@scoperatings.com

Julian Zimmermann
Director
+49 69667738 989
j.zimmermann@scoperatings.com

Brian Marly
Senior Analyst
+33 186 261 882
b.marly@scoperatings.com

Alessandra Poli
Analyst
+49 698700 27498
a.poli@scoperatings.com

Elena Klare
Associate Analyst
+49 69 667738 921
e.klare@scoperatings.com

Key Themes for 2025

1.1 Stable credit outlooks but some downside pressure

The outlook for European sub-sovereigns in 2025 is broadly balanced, supported by strong institutional frameworks and central government backing. However, regional disparities are widening within the EU, with weaker regions facing rising fiscal pressures and reliance on central government support. Political uncertainty and policy shifts in some countries (France, Belgium, Germany) could affect fiscal strategies and increase volatility in financial planning. The successful absorption of EU funds and national fiscal consolidation will be important for mitigating risks, as regional debt levels continue rising.

The outlook for **German Länder** remains stable, supported by strong institutional frameworks, a robust revenue equalisation system, and substantial federal government backing. AAA-rated Länder such as Baden-Württemberg, Bavaria, Berlin, Hesse, North Rhine-Westphalia, and Saxony-Anhalt continue to benefit from financial stability, good market access, and flexible funding options as benchmark sub-sovereign debt issuers in Europe.

Still, German Länder face several important risks and challenges. High debt levels pose long-term fiscal risks, while budget constraints limit revenue growth and expenditure flexibility, requiring careful financial management. Some Länder face contingent liabilities from municipal short-term debt burdens (*Kassenkredite*). Additionally, economic uncertainty, driven by a weak federal performance, may further curb investment capacity.

Political risks, particularly the February 2025 elections and potential fiscal policy shifts, could influence borrowing costs and market sentiment, potentially widening bond spreads. Despite the debt brake (*Schuldenbremse*) limiting borrowing, Länder issued over EUR 60bn in bonds in 2024, demonstrating continued market activity. Similar issuance is likely this year, driven by refinancing needs, economic pressures, and fiscal policy adjustments, including potential reforms to the debt brake. Maintaining fiscal discipline while adapting to economic and political shifts will be crucial for preserving stable ratings in 2025.

In Spain (A/Stable), Scope publicly rates the Autonomous Community of Madrid (A/Stable) and several other regions on a subscription basis. Spain's regional finances are improving overall but progress is uneven, with persistent budget deficits in certain regions. Despite increasing diversification in borrowing sources, around 60% of regional debt is owed to the central government. This provides a reliable financial backstop for regions but also reinforces their dependence on state support. This dependence contributes to the relatively narrow indicative rating range for Spanish regions. According to Scope's framework assessment of Spanish autonomous regions (non-foral), this range ypically falls within three notches from the sovereign rating (A/Stable), i.e. ranging from A to BBB.

The central government's proposal to partially assume regional debt provides only modest financial relief, given the already moderate interest payment burden. Despite strong revenue growth, driven by Spain's resilient economy, regional budget deficits persist, with the overall deficit expected to decline only gradually. Fiscal consolidation will be crucial, but rising public investment commitments and increasing non-financial spending could lead to a higher number of regions ending 2025 in deficit. Effective fiscal coordination between regional and central governments will be essential to ensure effective implementation of substantial EU funds in 2025 and 2026 across Spain's Autonomous Communities.

The creditworthiness of the **French regional sector** is anchored by a supportive institutional framework, with an established track record of extraordinary support from the central government (AA-/Stable). Pressures in the medium term relate to the uncertain national policy-making environment, which will hamper regions' ability for long-term planning. Risks to the creditworthiness of French regions are broadly balanced in 2025, despite fiscal pressures resulting from cuts to central government transfers.

The sector's budgetary performance is set to weaken further in 2025 before recovering gradually. While we expect the indebtedness to remain on a gradually increasing trend, in line with the execution of ambitious investment programmes, the regions will achieve comfortable operating surpluses while debt affordability metrics will remain sound, reflecting prudent financial management and moderate financing costs.

Belgian federated entities' credit profiles are anchored by a supportive institutional framework, characterized by substantial and predictable transfers and significant influence over national policy making. Still, risks to the sector are tilted to the downside, compounded by a negative Outlook on the Belgian sovereign rating (AA-), reflecting fiscal pressure and governance uncertainty. After weakening in recent years, the federated entities' budgetary performance will likely improve from this year on, as inflation recedes and revenue growth recovers, if not to pre-pandemic levels. Fiscal consolidation should help reduce funding needs, but we expect indebtedness to continue growing given sustained investment.

Risks to **Italian regions and municipalities** remain broadly balanced in 2025, despite fiscal pressures. While strengthened tax revenue support budgetary performance, the rigidity of the revenue structure poses difficulties in reacting to rising operating costs. Significant economic disparities across regions exacerbate fiscal challenges, with weaker-performing areas struggling to maintain stable budgets. Reliance on sovereign on-lending ties regional fiscal health to national debt dynamics, underscoring the importance of central government stability (BBB+/Stable). Further fiscal consolidation at the national level will come through

reduced capital expenditures transfers. Looking beyond the Recovery Plan, this could challenge the ability of sub-sovereigns to implement investments, potentially impacting regional development and infrastructure projects.

Among non-EU European sub-sovereigns, Scope rates **Swiss cantons** on a subscription basis. The cantons' credit profiles are underpinned by a predictable institutional framework that grants them extensive legislative, fiscal, and financial autonomy. This framework also ensures high levels of political cohesion, as cantons exert significant influence on national policymaking. A comprehensive national fiscal-equalisation system and the cantons' proven track record of receiving both direct and indirect financial support during periods of systemic stress are credit strengths.

While Swiss cantons benefit from excellent market access, there are notable differences in their individual credit profiles, which are not entirely offset by the strengths of the institutional framework. Some cantons demonstrate robust budgetary performance, low debt levels with favourable debt profiles, prudent debt and liquidity management, and a strong, affluent economy. In contrast, other cantons face high debt burdens, growing social spending pressures that constrain budgetary flexibility in the medium term, and unfunded pension liabilities. This drives the range of our respective ratings, however, the risks to the ratings of the Swiss cantons remain broadly balanced in 2025. Operating revenues will benefit from the resumed distribution of SNB profits, as well as a resilient and competitive economic environment. This will help to offset spending pressures stemming from high operating costs and ambitious investment plans.

In **Norway (AAA/Stable)**, Scope rates publicly the Counties of Akershus (AAA/Stable) and Rogaland (AAA/Stable), and the City of Trondheim (AAA/Stable). Norwegian sub-sovereigns benefit from a highly integrated institutional framework, closely aligned with the Norwegian sovereign (AAA/Stable). This results in an indicative rating range of AAA to AA for counties and AAA to AA- for cities. The framework ensures financial stability through fiscal equalisation, central grants, and state support, balancing autonomy with oversight. Counties and cities rely heavily on central transfers, with counties more dependent, but typically characterized by a more resilient budget performance.

The individual credit profiles vary with increasing market financing and divergent regional demographic dynamics, impacting investment requirements and debt levels. Looking ahead, strong public lender support should sustain low financing costs, but economic shifts, population trends, and transition risks will influence individual credit profiles in 2025 and beyond. Limited revenue and expenditure flexibility remain important challenges, requiring proactive financial management.

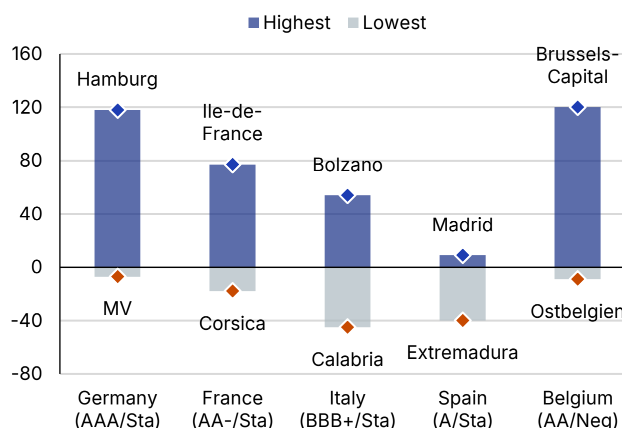
1.2 Rising regional disparities: fiscal challenges for euro area sub-sovereigns

Sub-sovereigns across the EU face rising fiscal disparities and risks due to structural economic imbalances, demographic shifts, and climate change vulnerabilities. These factors require enhanced fiscal coordination between national and regional governments to ensure financial sustainability. While EU and national funding mechanisms remain critical to mitigate these risks, their uneven deployment continues to limit their effectiveness.

Between 2020 and 2023, public finances across the euro area came under unprecedented strain, as the Covid-19 pandemic and the inflationary crisis linked to the Ukraine war exacerbated fiscal vulnerabilities. These crises highlighted structural weaknesses in regional financial management, underscoring the need for stronger fiscal frameworks to navigate future shocks.

The fallout from these crises has widened regional disparities, leading to divergent individual credit risk profiles among sub-sovereigns. The ability of regions to recover and sustain fiscal stability is increasingly polarized, with wealthier, high-value industry hubs (technology, finance, advanced manufacturing), such as Île-de-France and Hamburg, demonstrating resilience and economic growth, while weaker, structurally disadvantaged regions remain vulnerable to sustained fiscal stress (**Figure 2**).

Figure 2: Regional GDP per capita, % of EU average, 2022



Source: Eurostat, Scope Ratings

For sub-sovereigns, the main risks from growing divergence across regions include growing revenue constraints and revenue volatility, infrastructure and investment gaps that exacerbate regional inequalities, and growing dependence on domestic fiscal transfers or EU funds.

Additionally, weaker regions are often more reliant on central transfers and typically face difficulties in funding critical infrastructure projects, widening the economic gap with more developed regions. Conversely, richer regions are often more reluctant to increase transfers, challenging the cohesion of the financial equalisation system.

The EU's cohesion policies aim to mitigate these disparities, but uneven absorption and implementation of Recovery and Resilience Facility (RRF) funds across European regions have so far limited their effectiveness. Regions with relatively weaker administrative capacities often struggle to deploy these funds efficiently, diminishing their potential impact.

Demographic pressures and fiscal risks for sub-sovereigns

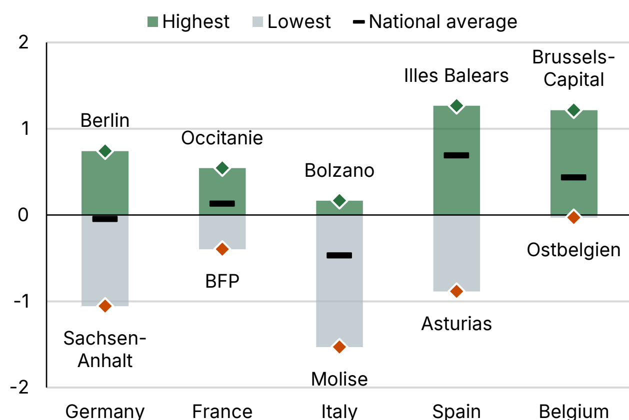
Demographic shifts – aging populations and youth emigration but also population inflows – are increasingly challenging fiscal sustainability across European sub-sovereigns. These trends erode local revenue bases while driving up social expenditure, particularly in regions experiencing economic stagnation and depopulation while regions with significant population growth face enormous public service investments.

Sub-sovereigns with aging and shrinking populations will face increasing budget constraints, particularly in Italy's South, Spain's interior regions, and parts of Belgium's French Community. These regions risk structural budgetary deficits due to rising social spending and declining tax revenues.

For example, while Northern regions such as Trentino-Alto Adige, Lombardia, and Emilia-Romagna continue to attract economic activity and maintain population stability, Southern regions like Molise, Basilicata, and Calabria are experiencing persistent population decline. Despite significant national and EU investment programmes, these southern regions struggle to retain skilled workers, leading to weaker economic growth and fiscal pressures.

Similarly, in Spain, Castilla y León, Asturias, Galicia, and Extremadura are experiencing rapid population decline and aging demographics, which are leading to higher healthcare and pension costs while eroding the local tax base. This structural imbalance limits regions' ability to achieve long-term fiscal sustainability, reinforcing their dependence on national transfers.

Figure 3: Working age population, year-on-year growth, %, 2019-23 average



Source: Eurostat, Scope Ratings

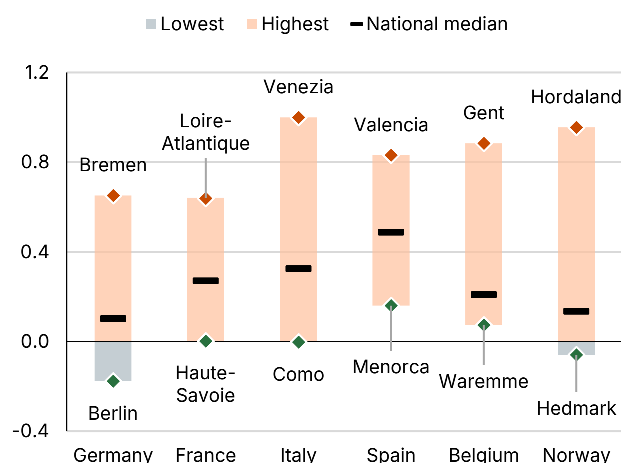
Conversely, higher investment needs due to rising infrastructure and public service (education and healthcare) demands driven by population inflows and/or youth population growth are the main challenges in rapidly growing metropolitan regions, such as Madrid or Berlin, or coastal regions like Corsica and Occitanie but also Catalonia, Balearic Islands, Valencia, and Andalusia. This creates budgetary pressures despite strong tax revenue growth.

Fiscal frameworks must thus adapt to demographic realities, ensuring efficient distribution of resources to prevent widening disparities and safeguard fiscal stability across European sub-sovereigns. A strong institutional framework, efficient fund absorption through strategic projects, and effective project execution are crucial, especially as a significant portion of RRF funds is set for implementation in 2025 and 2026. A continuously widening divide risks undermining the financial sustainability of weaker regions and exacerbating systemic imbalances.

Climate change and risks for European sub-sovereigns

As climate change accelerates, its impact on regional economies is becoming an increasingly critical factor in assessing sub-sovereign credit risk. The ability of regions to adapt to climate-related disruptions—ranging from extreme weather events to shifting economic structures—plays a key role in determining their long-term fiscal resilience. The Indicator of Aggregate Impact of Climate Change on Regions (**Figure 4**) highlights the uneven distribution of climate risks among European sub-sovereigns.

Figure 4: Indicator of aggregate impact of climate change on selected European regions



Note: indicator reflects weighted combination of physical (weight 0.19), environmental (0.31), social (0.16), economic (0.24) and cultural (0.1) potential impacts of climate change at the territorial (NUTS 3) level. Highest negative impact is set at 1.
Source: EPSON Climate, Scope Ratings

Regions such as Valencia (Spain), Venezia (Italy), and Hordaland (Norway) exhibit high climate risk exposure, while Menorca (Spain), Como (Italy), and Hedmark (Norway) show lower vulnerability. Southern European regions (Spain, Italy, France) face elevated climate risks due to rising temperatures, water stress, and increased extreme weather events. Northern and

coastal regions (Norway, Belgium, Germany) are more exposed to rising sea levels, floods, and economic transition risks related to climate adaptation. Regions reliant on agriculture and tourism (e.g., Valencia, Venezia) are also more vulnerable due to economic sensitivity to climate events, affecting long-term revenue stability, as climate variability affects crop yields, water availability, and visitor demand.

We expect climate risk to widen economic inequalities, with weaker regions struggling to finance adaptation without external aid. High-risk areas will face rising fiscal pressure from infrastructure resilience investments, increasing reliance on central or EU funds. Sectors like agriculture, tourism, and coastal industries will see greater revenue volatility, complicating budget planning. Investors may demand higher risk premiums, raising borrowing costs for exposed regions. Effective adaptation, integration into fiscal planning, and securing funding will be vital for mitigating climate-induced financial pressures.

1.3 Sub-sovereign bond market outlook for 2025: risks and main developments

The Outlook for sub-sovereign bond issuance in 2025 remains elevated, mirroring 2024 levels. German Laender will continue to dominate the market, while Spanish regions may adjust their borrowing strategies in response to fiscal policy developments. French regional issuers and Belgian sub-sovereign issuers face the highest uncertainty, given political risks and fiscal consolidation challenges, which could lead to wider spreads. Market conditions will be heavily influenced by ECB policy, sovereign bond spreads, and overall investor appetite for sub-sovereign debt. Maintaining stable funding conditions will require prudent fiscal management and strategic market access.

The modest widening of credit spreads for euro area sub-sovereigns in 2024 was primarily driven by increased bond supply across Europe and the ongoing normalization of monetary policy, which included the reduction of reinvestments by the ECB from its asset purchase programmes. This shift led to a higher volume of bonds being absorbed by private investors. As a result, yields rose and spreads have widened across government bonds, including Bunds, and extending to sub-sovereigns, and agency issuers. The combination of higher supply and reduced central bank support created a more challenging financing environment in 2024, a trend which we expect to continue in 2025.

Key market drivers and risks in 2025

Political risks will be a main factor shaping sub-sovereign market conditions in 2025, with French and German regional issuers facing headwinds due to national political uncertainty. The potential for early legislative elections in France could lead to wider spreads for French regional and municipal bonds. Uncertainties about France's fiscal consolidation path could also push funding costs higher. Germany may also see political volatility, particularly if economic growth remains weak and pushes up borrowing by the Länder. Political uncertainty surrounding the February 2025 federal election could also impact market sentiment. Moreover, potential reforms to the fiscal debt brake (Schuldenbremse) could alter regional funding strategies.

The ECB's policy stance and interest rate dynamics will also be critical in determining market conditions in 2025. With reduced ECB reinvestments, sub-sovereigns will increasingly rely on market funding to meet financing needs. This shift will lead to greater issuance as easing monetary policies in 2025-2026 should improve financing conditions.

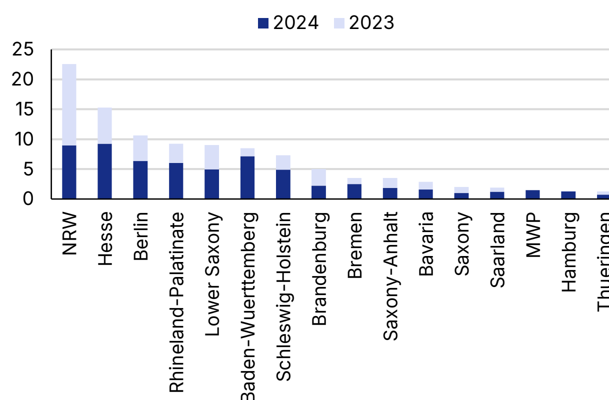
Regarding market liquidity and spread trends, we expect diverging paths for sub-sovereign issuers across the EU. High-rated German Länder and larger Spanish regions could see tighter spreads, benefiting from improving fiscal positions and market confidence. By contrast, French regional issuers may face higher risk premiums given investor concerns over fiscal policy direction.

Bond issuance Outlook 2025

The sub-sovereign bond market is set to remain active in 2025, with total gross issuance levels projected to pick up due to high refinancing needs. We expect increased reliance on market funding, particularly for the German Länder and Spanish regions, which were among the most active issuers in 2024.

German Länder remained leading players in the sub-sovereign bond market in 2024, with issuance exceeding EUR 60bn, reflecting their active role in capital markets despite the constraints of the debt brake (*Schuldenbremse*). While the fiscal rule formally limits new borrowing, Länder retain some flexibility, allowing them to adjust debt issuance. We expect this dynamic to persist in 2025, with elevated supply levels already evident year-to-date. Higher refinancing needs, economic uncertainties, and potential shifts in fiscal policy following federal elections could further shape borrowing patterns.

Figure 5: German Laender bond issuance, EUR bn



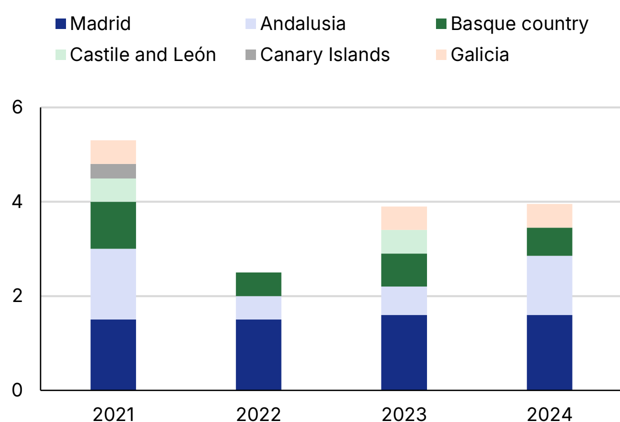
Source: Bloomberg

French agencies and regions will issue around EUR 18bn in 2025, though final borrowing might be less than that if spreads widen more. French regions primarily rely on bank loans and private placements for funding. Only Ile-de-France predominantly funds itself via bond issuances. Some larger issuers (including Provence-Alpes-Côte d'Azur, Auvergne-Rhône-Alpes) tap into bond markets regularly, while others do so more occasionally. Additionally, sovereign on-lending plays a role in their financing strategies, providing an alternative to direct market access.

French regions will continue to tap bond markets as an important part of the funding mix. The French prudential and regulatory authority (ACPR) has aligned the exposure of local authorities with those of the state in terms of the prudential requirements imposed on credit institutions. As a result, French regions' debt is now classified as HQLA level 1 and benefits from a reduction in its risk weighting from 20% to 0%, making bonds issued by the regions more attractive to investors.

Spanish regions are likely to see similarly high, or even increased, capital market issuance in 2025 compared to 2024. This reflects both substantial refinancing needs and a broader trend toward greater reliance on market funding. In 2025, we expect that benchmark issuance volumes of the past two years (EUR 2.9bn in 2022, EUR 3.95bn in 2023, and around EUR 4bn in 2024) will be exceeded. Bond issuance is likely to remain concentrated among the largest recent issuers, with Madrid and the Basque Country expected to lead the market

Figure 6: Spanish regions bond issuance, EUR bn



Source: Bloomberg

Easing monetary policies in 2025-2026 should improve financing conditions, supporting further regional bond issuance.

However, potential debt relief measures from the central government could alter borrowing patterns. Total regional funding needs in 2025 are estimated at EUR 39bn, flat compared to 2024. These gross regional borrowings are expected to decrease to EUR 36bn in 2026, largely driven by improved debt management strategies, with many regions securing longer maturities. Despite this moderation in borrowing, government liquidity remains the dominant funding source (60% of regional debt).

Bond issuance has become an increasingly important component of regional funding strategies, signaling growing financial autonomy for select regions. A gradual move towards private funding sources began in 2019, with regions like Asturias, Castile-Leon, Andalusia, and the Balearic Islands intermittently accessing the bond market. The trend reversed in 2022, as financial market instability and tighter bank lending conditions led to reduced access for some regions. The share of bond issuance in total gross borrowings has steadily increased from 5% in 2022 to 8% in 2023 and is estimated to rise further to 10% in 2024 and 12% in 2025 and 2026.

In 2024, Spanish regional bond issuance totaled around EUR 4 bn with Andalusia, Galicia, and Madrid among the most active issuers, while private placements and bank loans amounted to around EUR 12bn. Foreign demand was concentrated in larger issuers such as Madrid and Basque Country. Smaller issuers such as Andalusia and Galicia rely more on national investors.

We expect seven regions to fully access capital markets in 2025 and 2026 (Asturias, Canary Islands, Castile-Leon, Galicia, Madrid, and the foral regions Navarre and Basque Country), one region (Andalusia) will mix both funding sources (around 80% capital markets and 20% state funding), and the remaining regions will remain fully reliant on the extraordinary liquidity mechanisms. This mixed funding model adopted by Andalusia could set a precedent for other regions in the future, potentially leading to a more diversified approach to regional financing.

Country views for 2025

1.4 German Länder: balanced risks but continuous spending pressures and declining buffers

Institutional events

The November 2023 Federal Constitutional Court ruling reinforced fiscal rules, restricting the use of emergency funds and limiting budgetary flexibility for the Länder. Despite these restrictions, some flexibility under the debt brake regulations remains available, which we expect Länder to utilize in 2025 for infrastructure investments and other structural needs. However, the sums unlocked are modest.

In early 2025, the Federal Ministry of Finance proposed a draft law for federal support to address municipal debts (*Altschulden*). The draft suggests the Bund could absorb up to 50% of municipal debt if the respective Länder relieve their municipalities of excessive liquidity loans as of December 31, 2023. Overall, the proposal underscores the disparities in fiscal conditions and debt management strategies among the Länder. However, this initiative requires a constitutional amendment, and thus a two-thirds majority in both the Bundestag and Bundesrat. Such support is unlikely before the federal elections in February 2025, and potentially thereafter too, challenging its implementation.

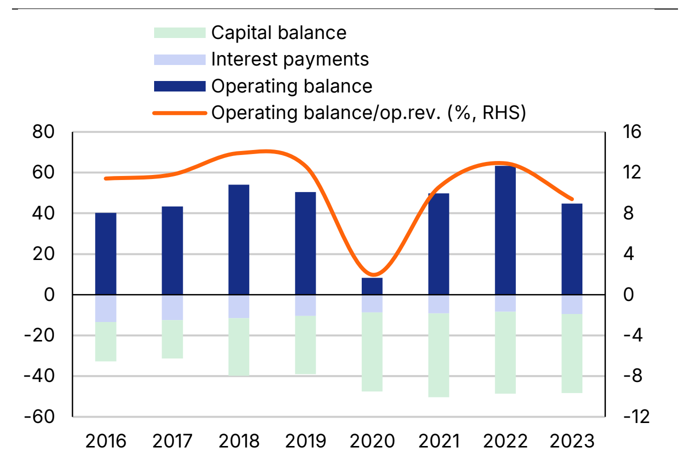
The potential impact of the federal proposal to address municipal debts varies across the Länder due to significant differences in municipal debt burdens as well as differences in the timing, scale, and structure of their respective debt relief initiatives. Hesse, for instance, took a proactive approach by launching the Hessenkasse programme in 2018. This initiative aimed to eliminate excessive municipal liquidity loans and stabilize local finances by providing direct support to municipalities. As a result, many municipalities in Hesse have already addressed their debt burdens, reducing their reliance on) future federal relief efforts. Conversely, around two thirds of all *Kassenkredite* are by NRW's municipalities, which often face structural challenges, including higher unemployment rates, aging infrastructure, and greater social expenditure needs.

Budgetary performance and outlook

Economic stagnation at the federal level continues to strain Länder budgets. Tax revenues, which stabilized at high levels in 2023, are projected to grow modestly at 3.1% in 2024, 4.2% in 2025, and 3.8% in 2026. Revised tax estimates from May and October 2024 reduced budgetary headroom for all Länder.

In the first three quarters of 2024, the Länder recorded a EUR 7.3bn deficit[1], a sharp reversal from the EUR 3.1bn surplus in the same period in 2023. This deficit is primarily driven by extra budgets, which have been increasingly used in recent years to respond to crises and/or enable investments such as for climate change and major infrastructure projects. In some cases, these extra budgets operate beyond the regulations of the Schuldenbremse. Moreover, budgetary pressures stem mostly from rising costs related to operating expenses, interest payments, and capital expenditures (**Figure 7**). At the same time, reserve levels, which stood at EUR 68bn at the end of 2022, have dropped to EUR 41bn by the end of 2023. Given current budgetary headwinds, we expect most reserves to be depleted by end-2025.

Figure 7: Aggregate budgetary performance, EUR bn (LHS), % of operating revenue (RHS)



Source: Destatis, Scope Ratings.

Personnel expenses accounted for one-third of operating expenditures in 2023. Wage increases following December 2023 agreements and upcoming negotiations for civil servants in the fall will further strain budgets. Inflation-driven growth in administrative and municipal transfers will add to these pressures. However, capital expenditures, which average 11% of total spending, remain substantial and consistent with historical trends. Financial transactions provide limited room for borrowing, offering some flexibility for investments, but not enough to offset structural budget challenges.

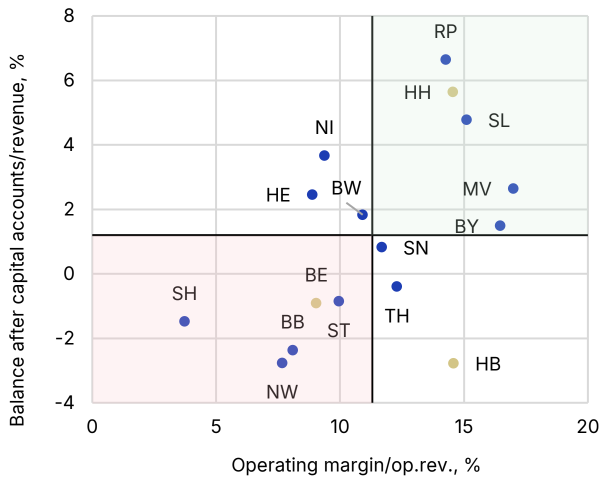
The financial performance of the German Länder varies (**Figure 8**) despite the federal fiscal equalisation system, which aims to balance disparities. This variation stems from differing underlying conditions, such as economic structures, demographic trends, and fiscal policies. For instance, the fiscal responses to the pandemic and energy crisis during 2020-2022 were designed and implemented differently across the Länder, reflecting their unique challenges and priorities.

Growing budgetary pressures on German municipalities constrain their ability to make investments. Their *Finanzierungssaldo* (balance before debt movement, including budgetary offsetting)

[1] Refers to the *Finanzierungssaldo* including the balance of budgetary offsetting.

recorded a deficit of EUR 25.9bn per Q3 2024, more than double the deficit reported during the same period in 2023.

Figure 8: Budgetary performance, by region, 2021-23 average



Note: Axes cross at the respective median. Source: Destatis, Scope Ratings.

Debt burden and affordability

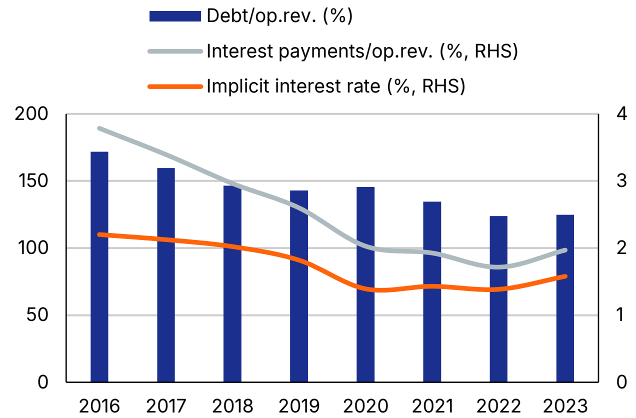
Aggregate debt of the German Länder amounted to around EUR 600bn as of September 2024, broadly stable since 2022. Prior to 2020, debt had been on a multi-year downward trajectory, reflecting the Länder's consolidation efforts in preparation for the implementation of debt-brake limitations (**Figure 9**).

Despite the focus on fiscal consolidation, borrowing activity of around EUR 60bn in 2024 exceeded original projections by around EUR 10bn. This uptick was driven by weak economic growth, federal budgetary constraints, and sustained high levels of investment. To address budgetary pressures, the Länder have relied on i) cyclical borrowing within the debt brake framework, as used by NRW, Hesse, and Baden-Württemberg; and ii) financial transactions, as undertaken by Hesse and Berlin, to access additional funding. As we do not expect near-term reform of the debt brake, Länder will likely continue leveraging the remaining flexibilities under the framework. While these measures provide short-term relief, they highlight the challenge of balancing fiscal consolidation with investment needs.

All German Länder benefit from excellent debt affordability, supported by historically low interest rates and relatively controlled debt levels. The average debt-to-operating revenue ratio stabilized at approximately 125% in 2023, following a decline between 2020 and 2022. Total interest payments amounted to EUR 9.4bn in 2023, equivalent to just 2% of operating revenues.

We expect the strong debt affordability to remain intact over 2025-26, with only a moderate increase in interest payments. The robust debt profiles, characterized by long maturities, imply refinancing needs will materialise only gradually. Exposure to interest-rate and foreign exchange risk remains minimal.

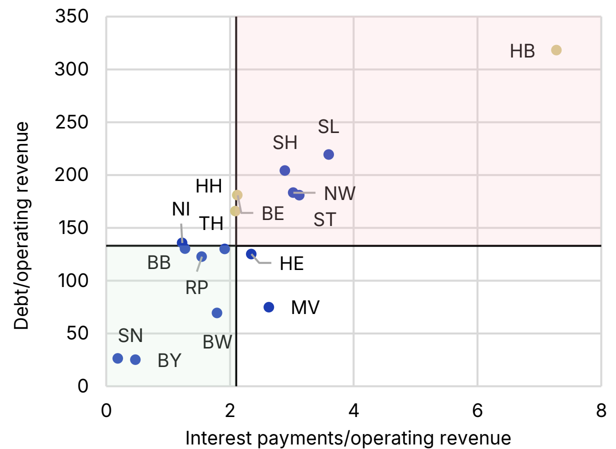
Figure 9: Aggregate debt and interest burden, %



Source: Destatis, Scope Ratings.

While all Länder maintain strong debt affordability, debt levels vary significantly among the Länder (**Figure 10**), reflecting differing legacy positions, structural budgetary profiles, and approaches to fiscal consolidation in the years leading up to 2020. These disparities impact their individual credit profiles.

Figure 10: Debt and interest burden, by region, 2023



Note: Axes cross at the respective median. Source: Destatis, Scope Ratings.

Low-debt Länder like Bavaria and Saxony benefit from greater financial flexibility, while high-debt Länder such as Saarland and Bremen rely on federal support and targeted consolidation efforts to stabilize their fiscal positions.

Saarland and Bremen carry high debt burdens, including by international standards. Both Länder participate in federal consolidation programmes and receive dedicated transfers to address their fiscal challenges. These two Länder will also benefit from additional allocations under the fiscal equalisation system following the 2022 census, providing further support. Saarland has made progress in reducing its debt and interest burden in 2023 while Bremen agreed to a consolidation programme for 2025-2027 with Germany's Stability Council in December 2023.

1.5 Spanish regions: strong revenue growth amid spending pressures and a gradual market return

Institutional events

In 2024, Spain's central government proposed partially assuming regional debt to improve debt metrics for regions reliant on central lending. If realized, we expect the proposed partial write-off of regional debt owed to the central government to provide only modest financial relief. Spanish regions already maintain low interest burdens, averaging 1.9% of operating revenue in 2023 (down from 6.7% in 2014) due to sovereign credit support. Additionally, regions expected to benefit most from debt relief typically face higher budget deficits, meaning that transferring some liabilities to the central government's balance sheet provides only modest financial easing. In contrast, Madrid (A/Stable) holds no debt to the central government, while other regions carry relatively little debt. Partial debt forgiveness as sole policy measure for select regions could thus spark conflicts.

The proposal of partial debt forgiveness also raises concerns about fiscal discipline among regions, as there is a tendency to overspend. On a positive note, the proposal may drive overdue reforms in Spain's excessively complex regional financing system for Spain's regions in 2025, which, for example, does not fully account for demographic asymmetries, leading to funding gaps in certain regions. While high-growth regions face rising spending needs, regions with a growing proportion of elderly people lack sufficient revenues to sustain public services.

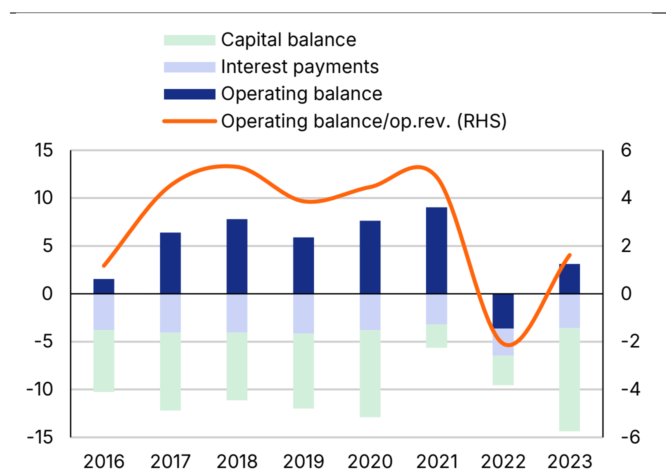
Recent policy discussions include proposals for a creation of a transitory equalisation fund. This fund aims to supplement the revenues that are below the national average in per capita financing, considering factors like population dispersion, aging, and school-aged children. However, without addressing underlying fiscal imbalances, such measures may offer only short-term respite.

Budgetary performance and outlook

We project an improvement in the aggregate budgetary performance of the Spanish Autonomous Communities (*Comunidades Autónomas*) in 2024, driven by additional revenues from the overall financing system, including budgetary allocations and liquidations. Despite robust revenue growth, we expect the overall regional budget balance to remain negative due to rising non-financial expenditures. We project the regions' deficits decreasing from -0.9% of GDP in 2023 to -0.5% in 2024, and to -0.4% in 2025. This is more pessimistic than the forecasts in Spain's Medium-Term Fiscal and Structural Plan submitted to the European Commission, which expects an overall balanced budget for the regions in 2025.

We project Spanish regions' average operating margin to increase from 1.6% of operating revenues in 2023 to around 3% in 2024, remaining below the pre-pandemic operating margins of around 10%. The modest operating surpluses primarily reflect structurally rising non-financial expenditures. We expect the robust revenue growth in 2024 to continue into 2025, driven by Spain's resilient economy enhancing tax receipts. Consequently, we forecast that Spanish regions will achieve an average operating margin of 4.5% by 2025, assuming that expenditure growth stabilizes. We project that Spain's regions will undertake substantial investment spending in the coming years, with financing primarily sourced from EU funds, a significant portion designated for regional implementation. This increased EU funding is expected to enhance sub-sovereign liquidity positions, supporting the final balance after investments.

Figure 19: Aggregate budgetary performance, % of total revenue (LHS), % of operating revenue (RHS)



Source: Ministerio de Hacienda, Scope Ratings.

Budgetary allocations and liquidations via the regional financing system are critical for common-regime regions, as they account for over 80% of their non-financial revenues. For 2024, resources from allocations and liquidations for the Spanish regions increased by around EUR 20bn compared to 2023 (a growth rate of 14.6%). This increase in resources largely explains the projected deficit reduction for the Spanish common-regime regions in 2024.

By Autonomous Community, there are diverging budget trends, with overall budget deficits gradually improving but disparities persisting across regions. In 2024, we estimate that seven regions will close the year with budget deficits, a marked improvement from twelve in 2023 and fifteen in 2022. We expect the highest deficits in Valencia (-2.0% of GDP) and Murcia (-1.7%), while more moderate shortfalls are expected in Catalonia (-0.4%), Castilla-La Mancha (-0.3%), Madrid, Navarra, and País Vasco (-0.2% each).

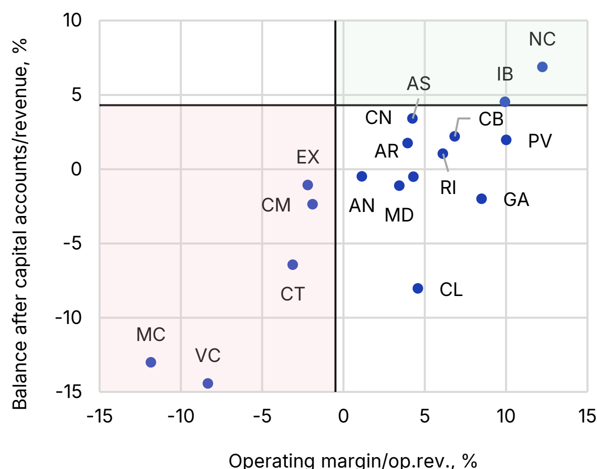
Looking ahead to 2025, we expect fiscal consolidation efforts to keep the overall budget deficit on the regional level stable, near 2024 levels. However, we project the number of regions ending the year in deficit to rise to twelve, reflecting higher public investment commitments. We expect Asturias, the Canary Islands, Cantabria, and Navarra to achieve the highest budget

surpluses, benefiting from effective fiscal management and controlled expenditure growth.

In contrast, Valencia, Murcia, and Catalonia are set to remain the most fiscally challenged regions, with persistent deficits driven by rising public spending, particularly in public consumption. Additionally, regional disparities in revenue growth will continue to influence fiscal outcomes, underscoring the importance of structural reforms and targeted fiscal adjustments to ensure long-term budgetary sustainability.

Risks for the sector include persistent budget deficits in key regions, limiting their fiscal flexibility and increasing vulnerability to economic downturns. Additionally, expenditures on employee remuneration and intermediate consumption are growing at rates that outpace nominal GDP growth, necessitating consolidation measures. Effective implementation of Spain's fiscal consolidation efforts requires robust collaboration between the central government and the Autonomous Communities, for instance to better control expenditure growth, and enhance revenue streams.

Figure 20: Budgetary performance, by region, 2021-23 average



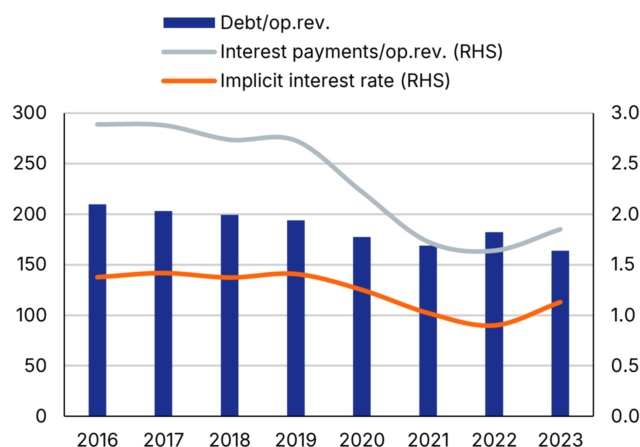
Note: Axes cross at the respective median. Source: Ministerio de Hacienda, Scope Ratings.

Debt burden and affordability

Spanish regional debt levels have improved significantly since 2015, supported by lower interest rates, economic growth, and central government transfers. However, rising borrowing costs and divergent fiscal performance among regions pose challenges. Going forward, a stable debt-to-revenue ratio is expected, but regions with persistent deficits may face refinancing risks, requiring prudent fiscal management and targeted structural reforms.

The debt-to-operating revenue ratio of Spanish regions has followed a downward trajectory over the past decade, improving from 215.4% in 2015 to 163.8% in 2023. This reflects fiscal consolidation efforts, robust economic growth, and an improving revenue base. The decline was pronounced between 2020 and 2021, largely due to pandemic-era fiscal support, higher transfers from the central government, and a rebound in economic activity.

Figure 21: Aggregate sector debt and interest burden, %



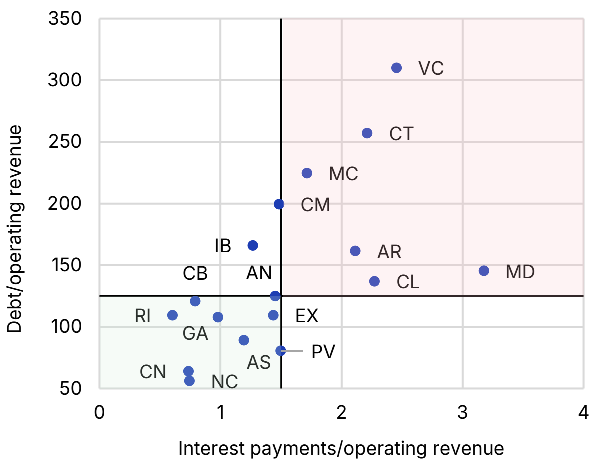
Source: Ministerio de Hacienda, Scope Ratings.

However, the uptick in 2022 (182.3%) suggests a temporary reversal, driven by higher spending commitments, inflationary pressures, and regional investment programmes. The renewed decline in 2023 (163.8%) is due to fiscal improvement, supported by strong revenue performance.

Interest payments as a share of operating revenues fell from 6.7% in 2014 to a low of 1.6% in 2022, reflecting favourable financing conditions and historically low interest rates. However, the increase in 2023 to 1.9% signals the beginning of a higher interest rate environment. The implicit interest rate (average cost of debt) followed a similar trend, declining from 3.3% in 2014 to 0.9% in 2022, before rising to 1.1% in 2023. This highlights the impact of higher refinancing costs as existing low-interest debt matures and is replaced by more expensive borrowing. Looking ahead, we expect interest payments as a share of revenue to increase gradually, reaching 2.2%-2.5% by 2025-2026. A stronger revenue base due to Spain's economic resilience and continued fiscal transfers from the central government should help moderate the interest-payment burden.

While we expect the overall debt-to-revenue ratio to remain around 160-170% by 2025, high-deficit regions (Valencia, Murcia, Catalonia) could see a more pronounced increase, while regions with fiscal surpluses (Canary Islands, Asturias, Cantabria) may continue improving their debt metrics. Still, rising financing costs could increase pressure on highly indebted regions, particularly those with structural budget deficits. Additionally, regional investment programmes could add to borrowing needs, offsetting some of the debt reduction efforts. The regions' ability to service their debts is assured by access to central government liquidity if needed.

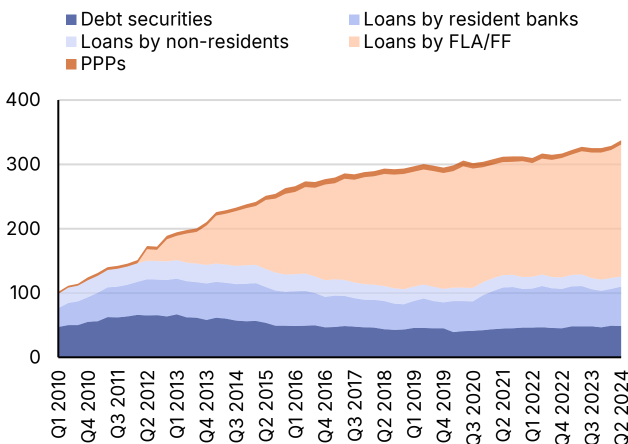
Figure 22: Debt and interest burden, by region, 2023



Note: Axes cross at the respective median. Source: Ministerio de Hacienda, Scope Ratings.

As of June 2024, 60.7% of the Spanish regions' debt was owed to the central government (**Figure 23**), slightly down from the peak of 61.6% in June 2020. Despite the pandemic and inflationary crises, regions have increased their borrowing from the private sector through loans and debt securities by around EUR 18bn (a 16% increase) from June 2020 to June 2024, while debt borrowed from the central government rose by around EUR 16bn (9% growth). This shift indicates a gradual diversification of debt sources, enhancing the regions' financial resilience amid ongoing economic uncertainties.

Figure 23: Aggregate debt structure of Spanish regions, EUR bn



Source: Banco de España, Scope Ratings.

The trend towards greater reliance on market-based financing reflects Spanish regions' efforts to manage their debt maturities more proactively. However, government funding will remain the backbone of regional finances, particularly for those regions that lack consistent market access. As borrowing needs gradually decline, regions with stronger credit profiles and established investor relationships will continue to expand their bond issuance, while others remain reliant on central government liquidity.

1.6 French regional governments: national political uncertainty weighs on recovery

Institutional events

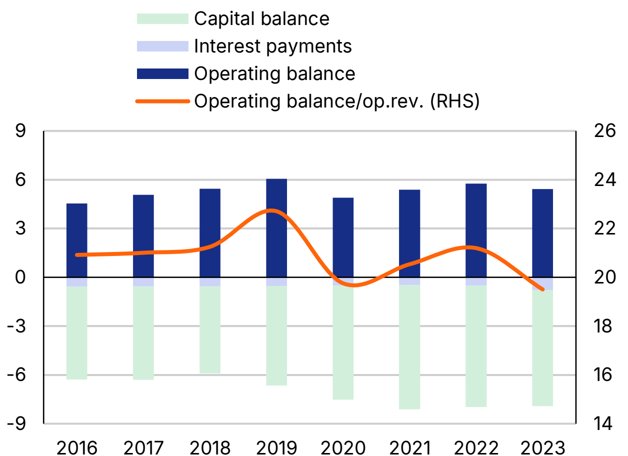
While the creditworthiness of the French regional sector remains well-anchored by a supportive and mature institutional framework, main pressures over the medium-run relate to the uncertain national policy-making environment, which will hamper regions' ability for long-term planning. Significant uncertainty remains following the breakdown of the previous cabinet in December 2024 over budget talks and in the absence of a final budget for 2025.

We expect the French government's fiscal consolidation strategy to weigh on the budgetary trajectory of the broader French local and regional government sector. Measures included in the initial draft budget bill came at a net cost of around EUR 5bn for sub-sovereigns, primarily from reduced transfers. While this figure is likely to be reduced ahead of the conclusion of budget talks, this pressure will hinder the recovery of regions' operating performances. Furthermore, the increase in funding costs for the French sovereign, which followed the 2024 early legislative elections, will adversely affect borrowing conditions for the French regional sector, at a time of still-elevated financing needs from capital expenditure.

Budgetary performance and outlook

After declining in 2023, the operating performance of the French regional sector is estimated to have moderated further last year, from the impact of persistent pressure from inflation and indexation-mechanisms (particularly affecting personnel costs), alongside lower-than-anticipated VAT receipts (more than half of operating revenue) amid weak consumption growth.

Figure 11: Aggregate budgetary performance, EUR bn (LHS), % of operating revenue (RHS)



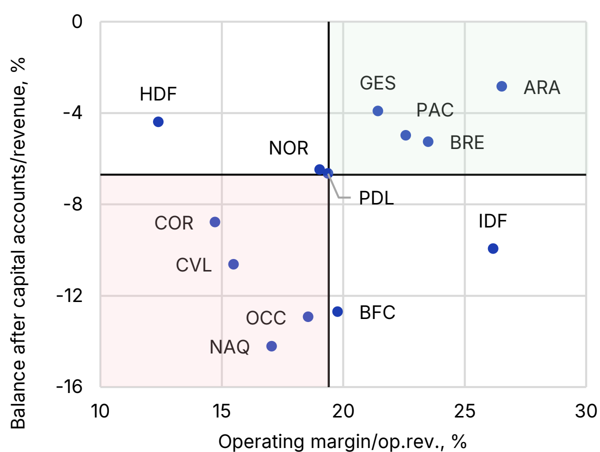
Source : Observatoire des finances et de la gestion publique locales (OFGL), Scope Ratings.

Looking ahead, VAT revenue growth is expected to pick-up gradually in line with the recovery of the French economy. Spending-side pressures are expected to subside as a result of normalizing price dynamics. At the same time, policy uncertainty and lower transfers will delay the recovery over the medium run.

We expect French regions to implement measures to limit expenditure growth in response to this cut, primarily via operating cost controls and the postponement of some investment projects. As such, the operating margins of French regions are expected to recover from next year onwards and to remain comfortable, all the while stabilizing below historical averages.

A high level of capital expenditure (around a third of total spending) leaves regions with flexibility to adjust in case of shocks. The budgetary outlook furthermore benefits from the largely non-cyclical responsibilities of French regions, particularly regarding spending on transport and secondary education (accounting for more than half of regions' operating expenditures on average). While weakening labour market dynamics may lead to increased demand for vocational training, associated expenditures are largely compensated by the state.

Figure 12: Budgetary performance, by region, 2021-23 average



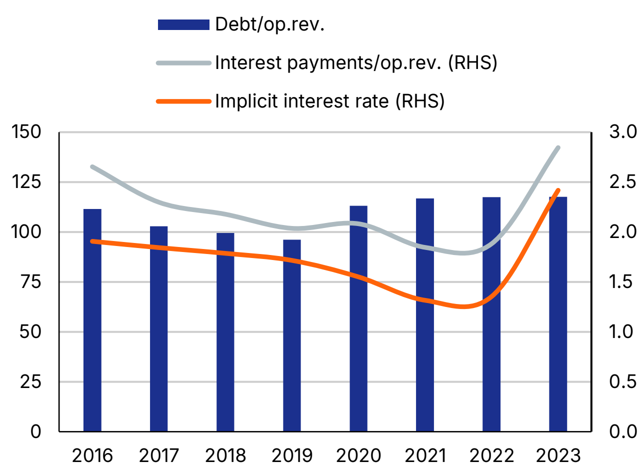
Note: Axes cross at the respective median. Source: OFGL, Scope Ratings.

Debt burden and affordability

The indebtedness of French regions has grown steadily in recent years. We expect it to remain on an upwards trend over coming years given the execution of investment programmes, primarily focusing on transportation and education infrastructure, despite the expected downwards revision of multi-year capital investment plans. Higher market rates and sustained borrowing should maintain upwards pressures on interest payments, all the while remaining comparatively moderate.

Debt affordability metrics remain sound, underpinned by large operating surpluses. French regions need to maintain comfortable operating margins to support creditworthiness in the years ahead.

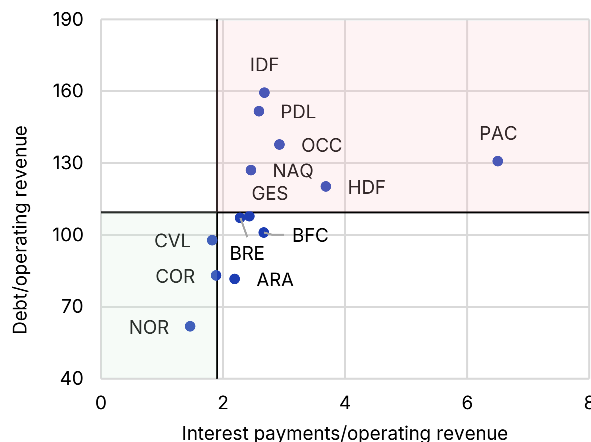
Figure 13: Aggregate debt and interest burden, %



Source: OFGL, Scope Ratings.

Prudent debt management practices result in generally smooth amortisation profiles and limit refinancing risks. Liquidity is anchored by the supportive monthly tax-revenue transfer system, strong access to external liquidity lines, including from institutional lenders, and the availability of emergency short-term financing from the state to French LRGs through a system-wide cash pooling mechanism.

Figure 14: Debt and interest burden, by region, 2023



Note: Axes cross at the respective median. Source: OFGL, Scope Ratings.

The predominantly fixed-rate debt structure and relatively long average maturity of French regions provide partial protection against high borrowing rates. However, the sector's interest burden is expected to gradually rise, driven by recent pressures on sovereign risk premia, the refinancing of low-rate debt issued before the inflation shock, and sustained funding needs linked to ongoing investment plans.

1.7 Belgian federated entities: slow recovery after inflation shock

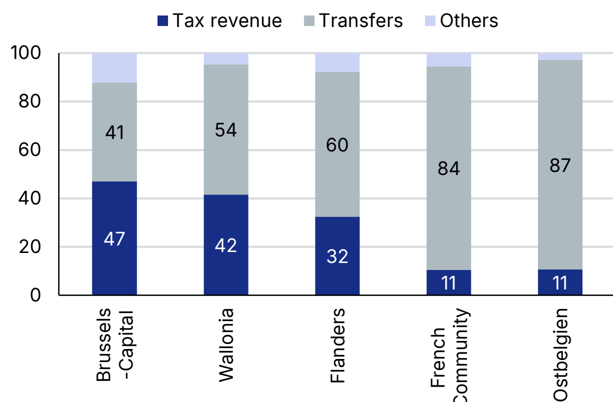
Institutional events

Belgium's fragmented political system continues to weigh down on governance and policy coordination, posing risks for sub-sovereigns. The division of powers between regions (economic matters) and communities (education and social policies) works against fiscal and administrative coherence.

Following prolonged post-election negotiations, Bart De Wever's five-party 'Arizona' coalition has taken power, with a regionalist agenda advocating greater autonomy, i.e. the transfer of competencies from the federal government to federated entities. However, major institutional reforms require broad linguistic and parliamentary support, which the coalition lacks, making structural changes to the federal system unlikely in the near term.

On the fiscal front, regional alignment within the coalition (Flanders, Wallonia, and the French community) may enhance policy coordination, potentially supporting fiscal consolidation. However, budgetary pressures and governance complexities remain main risks for sub-sovereigns, especially with no government in Brussels-Capital.

Figure 15: Operating revenue structure, % of total



Source: National Bank of Belgium (NBB), Scope Ratings.

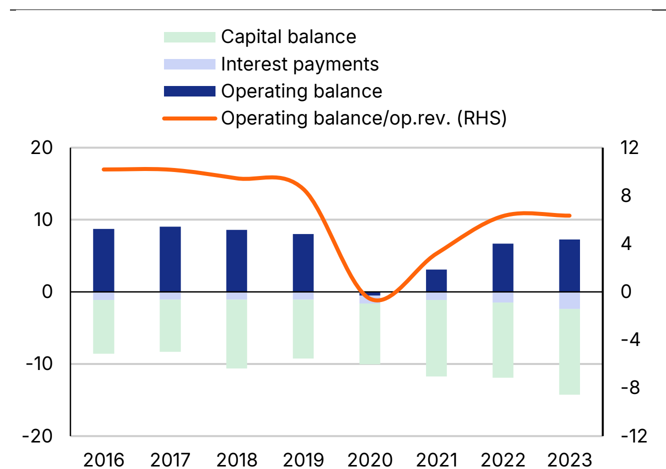
Budgetary performance and outlook

There are significant disparities in terms of fiscal autonomy between regions and communities. While regions benefit from a relatively high degree of tax independence, communities have little to no direct tax revenue, instead relying on transfers and shared-tax revenue allocations.

Belgium's communities have relatively low budgetary flexibility, in line with their mandate. Nearly all revenue comes from formula-based transfers, leaving little room for discretionary adjustments. Capital expenditure is typically low (around 5% of total spending in the French and German-speaking Communities). Their budgets are largely dominated by rigid expenditure items (wages) and policy areas (education, social protection). Despite these constraints, the indexation mechanism for central government transfers to communities - linked to real growth and consumer price dynamics - helps mitigate the negative effects of inflation on budget performance and provides some buffer against potential adverse revenue developments. In contrast, regions enjoy robust tax flexibility, as they have the authority to levy their own taxes, including property taxes and transfer duties, as well as surcharges on personal income tax. Regional budgets are also largely composed of inflexible spending items, though a greater share of capital expenditures (around 15% of total) leaves them with more room to adjust to shocks.

The Belgian federated entities' operating performance has deteriorated from the impact of recent shocks. Inflation indexation mechanisms quickly translated rising prices into higher costs, while moderate economic growth has resulted in subdued revenue increases.

Figure 16: Aggregate budgetary performance, EUR bn (LHS), % of operating revenue (RHS)



Source: NBB, Scope Ratings.

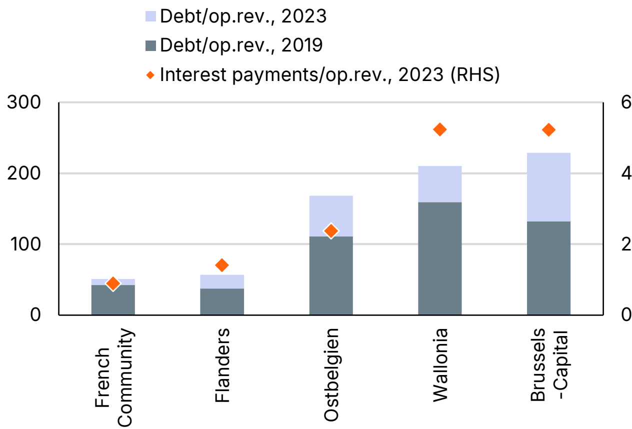
Looking ahead, operating margins should recover only gradually, in line with expectations of a slow rebound in revenue and lingering cost pressures. Newly elected governments have introduced consolidation plans to tackle this fiscal decline. Nonetheless, the recovery in the operating performance of federated entities is expected to be slow and partial, hindered by limited revenue growth due to a sluggish economic recovery and challenges in significantly adjusting spending. As a result, budget deficits are projected to decrease only gradually, mirroring the slow improvement in operating balances and commitments to sustained investment levels.

Debt burden and affordability

Belgian communities and regions' debt levels have risen in recent years and totaled EUR 104bn by end-2023, up from 60bn in 2019 (+64%). Indebtedness varies significantly across the sector, however, with the French and Flemish communities maintaining

moderate debt levels relative to operating revenue, while the Walloon and Brussels-Capital regions and Ostbelgien experienced sharp increases in leverage since 2019.

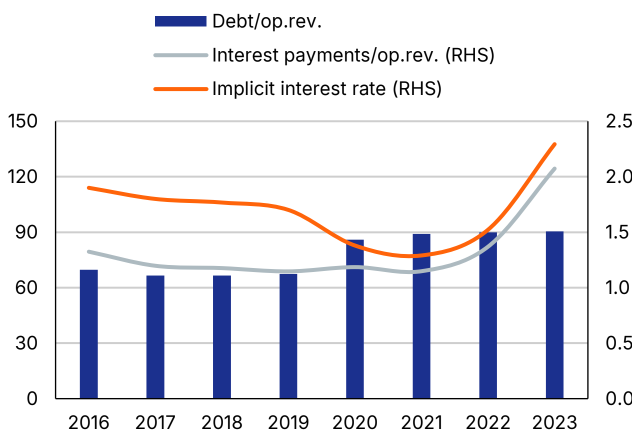
Figure 17: Debt and interest burden by federated entity, %



Source: NBB, Scope Ratings.

Federated entities display strong debt affordability metrics, supported by sophisticated debt management practices and very strong access to diverse funding sources. Despite a gradual increase in interest costs, debt affordability metrics are expected to remain favorable. They are anchored by a resilient structure, with limited exposure to interest rate or currency risks and relatively smooth refinancing profiles.

Figure 18: Aggregate debt and interest burden, %



Source: NBB, Scope Ratings.

Internal liquidity buffers benefit from predictable and regular cash flows, primarily through transfers from the federal government. Additionally, regions have access to ample external liquidity sources, including commercial paper programs and dedicated credit lines. The institutional framework also includes a strong safety net to potential liquidity stress, as regions and communities can address payment delays by contracting loans guaranteed by the federal government.

1.8 Italian regions and cities: fiscal consolidation pressures and investment challenges

Institutional events

While the institutional framework enforces fiscal prudence among Italy's sub-sovereign entities, it also restricts their financial autonomy. This, coupled with obligations toward national fiscal consolidation and high public debt levels, presents ongoing to the individual credit profiles of Italian regions and municipalities, which remain subject to strict borrowing constraints and limited fiscal flexibility in 2025.

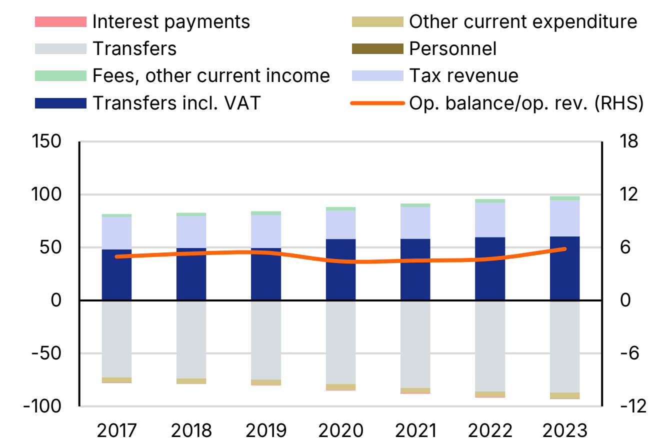
In the event of external shocks, these entities are heavily reliant on additional transfers from central government. Revenue autonomy is further constrained by obligations related to fiscal consolidation, particularly since the sovereign debt crisis.

Budgetary performance and outlook

The budgetary performance of Italian regions has shown consistent improvement from 2021 to 2023, supported by increased transfers from the central government and a steady recovery in tax revenue, which surpassed pre-pandemic levels as early as 2022 (**Figure 24**).

However, the revenue structure of regions remains rigid, with tax revenue accounting for a low share of operating revenue, while the share in VAT is paid out via transfers based on pre-determined funding needs. Consequently, offsetting budgetary pressures resulting from elevated operating costs, attributable to higher inflation compared to previous periods, will persist as a considerable challenge.

Figure 24: Operating performance – sample of eight regions, EUR bn (LHS), % of national average (RHS)



Source: Ragioneria generale dello Stato, Scope Ratings.

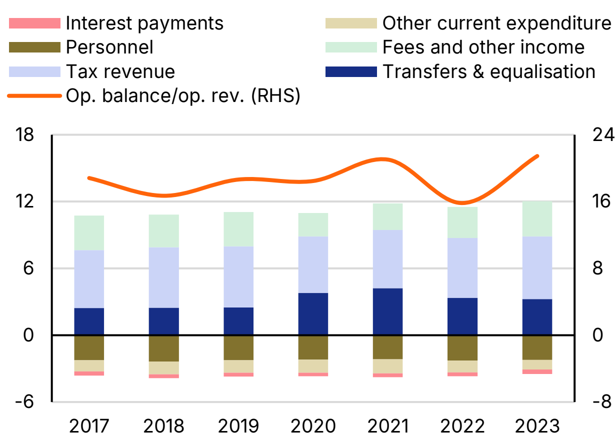
We expect regional budgetary margins to remain under pressure in the coming years, given the reintroduced effort required to regional governments to contribute to the national consolidation in the context of the new EU fiscal framework, as well as difficulties in limiting cost inflation given the prominence of healthcare spending, the main cost item for regions.

The 2025 Budget Law increased resources for the national healthcare fund by 1.2% on average between 2025 and 2030, bringing total funds from EUR 136.5bn in 2025 to EUR 144.2bn in 2030. However, this increase remains marginal and is likely not sufficient to adequately address the growing demand for healthcare investments, particularly given the Italy's aging population and resulting higher demand for healthcare services.

Municipal finances have shown consistent improvement since 2021-23, with a steady recovery in tax revenue following the pandemic. This has helped compensate for the gradual withdrawal of central government transfers. As with regions, the revenue structure of Italian municipalities remains rigid, largely due to the high share of the less cyclical property tax, which poses some difficulties in reacting to increasing operating costs (**Figure 25**).

Operating margins for municipalities will face pressures in the coming years. This is due to the withdrawal of extraordinary central government transfers related to the pandemic and the cost of energy shocks. These will be accompanied by the required contribution to the national fiscal consolidation effort.

Figure 25: Operating performance – four largest cities, EUR bn (lhs), % of operating revenue (rhs)



Source: Ragioneria Generale dello Stato, Scope Ratings.

The 2025 Budget Law requires municipalities to set aside a portion of their annual current spending and, provided that the municipality records an operating surplus, allocate this share to the financing of future capital expenditure.

Concurrently, government transfers for capital expenditure will be reduced by nearly EUR 9bn between 2025 and 2034. The negative impact of this measure on current expenditure will be partially offset by higher resources for the Municipality Solidarity Fund, which will increase by EUR 306m from 2030.

However, the reduction in funding for capital expenditure will challenge the ability of municipalities to mobilize resources and implement investments in the medium term, as well as their capacity to properly manage and maintain public works realized in the context of the National Recovery Plan.

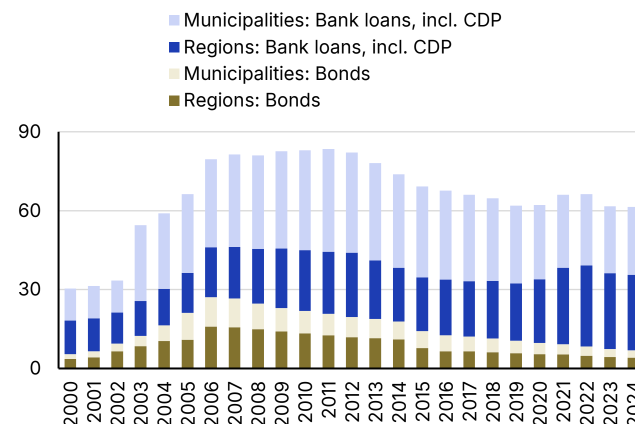
Debt burden and affordability

We anticipate limited recourse to debt financing by Italian sub-sovereigns in the coming years, primarily due to the need to ensure fiscal consolidation at the general government level, stringent borrowing regulations and budgetary constraints, and the substantial allocation of EU funds expected to support investment financing.

Most local governments' borrowings are in the form of loans from the state-owned development bank Cassa Depositi e Prestiti (CDP). This arrangement reduces the exposure of sub-sovereign debt to interest rate risks. Additionally, the amortizing nature of CDP loans contributes to a reduction in refinancing risks (**Figure 26**).

Italy’s National Recovery Plan for 2026 includes a set of reforms aimed at reshaping the financing framework. Among these is a plan to increase the financing autonomy of Italian regions, known as "fiscal federalism." However, this reform has not seen significant progress since 2009.

Figure 26: Sub-sovereigns’ debt, by instrument, EUR bn



Source: Bank of Italy, Scope Ratings.

In 2024, the Italian Parliament approved a law introducing "autonomia differenziata", a mechanism to allow regions to request greater responsibilities and spending powers over some policy functions currently held by the central government.

While the reform aims to enhance resource management at the local level, its implementation faces some resistance from the Constitutional Court, putting the project's feasibility in question. Additionally, the reform does not include a parallel overhaul of regional financing and revenue powers, which could pose risks for local public finances.

1.9 Swiss cantons: public finances absorb higher operating costs and ambitious investment plans

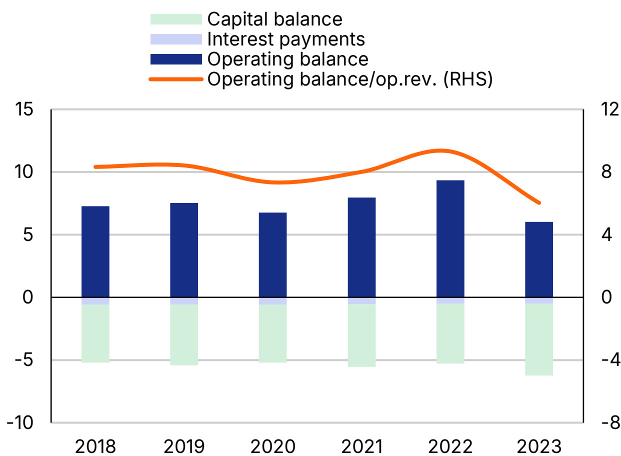
Institutional events

Switzerland's cantons have significant fiscal and borrowing autonomy compared to other European sub-sovereigns, with no formal exceptional support mechanism in place. However, recent shocks, including the Covid-19 crisis, demonstrated the strength of the Swiss federal system, benefiting from robust policy coordination, fiscal equalisation, and central government support. The federal government also uses financing and co-financing as main fiscal tools during system-wide shocks.

Budgetary performance and outlook

The fiscal performance of Swiss cantons has remained resilient in 2023, despite pressures on both the revenue and expenditure sides. On the revenue side, the distribution of SNB profits was missed, and on the expenditure side, higher operating costs were incurred. However, the rise in operating, borrowing, and investment costs has remained more manageable compared to other European countries, largely due to Switzerland's lower inflation rate of 2% on average over 2022-24, as opposed to 5.4% in the euro area. Consequently, monetary policy was less tight, with the SNB's policy rate peaking at 1.75% in 2023 and gradually being cut to 0.5% at the end of 2024 (**Figure 27**).

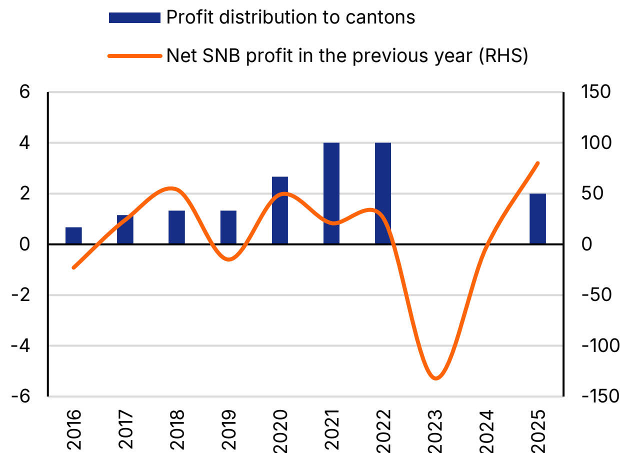
Figure 27: Budget performance, CHF bn (lhs), % of operating revenue (rhs)



Source: Finanzdirektorenkonferenz, Scope Ratings.

We expect that cantonal finances will remain robust in the coming years. Operating revenues are expected to be bolstered by the SNB's anticipated resumption of profit distribution in 2025. Preliminary estimates indicate that the SNB reported net profits of CHF 16bn in 2024, following net losses of CHF 132bn in 2022 and CHF 3bn in 2023. This positive shift will enable the central bank to distribute CHF 3bn in dividends this year, of which CHF 2bn (around 2% of 2023 operating revenue) will be allocated to the cantons (**Figure 28**).

Figure 28: SNB dividend distribution to the cantons, CHF bn



Source: Swiss National Bank, Swiss Federal Finance Administration, Scope Ratings.

Potential additional support to operating revenue could come from the introduction of the OECD/G20 minimum tax rate for multinationals in the form of supplementary tax implemented in 2024. Preliminary government estimates indicate an initial increase in tax revenue of about CHF 1-2.5bn, of which three quarters will be directly allocated to the cantons.

However, recent international developments, including the US withdrawal from the agreement, have introduced uncertainty regarding further implementation steps and the actual tax revenue benefits.

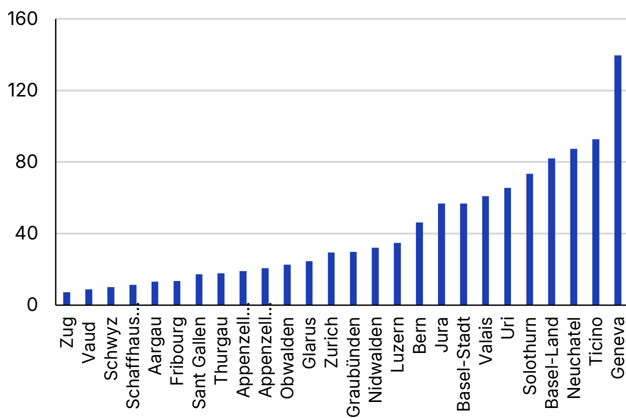
These factors should help offset potential negative impacts on tax revenue from the initiative of some cantons to preserve competitiveness by lowering the tax burden and increasing operating costs, mostly for healthcare and social services.

Debt burden and affordability

Swiss cantons generally benefit from strong debt affordability and limited exposure to rising interest rates. However, the levels of indebtedness vary significantly among the cantons. This is due to the significant autonomy granted to cantons in terms of fiscal and borrowing rules, as well as notable variations in economic structures and sizes. Consequently, debt ranged from 7% of operating revenue to as high as 140% in 2023 (**Figure 29**).

Ambitious investment plans, particularly in transport, green transition and digitalization, will likely lead to an increase in debt levels for the Swiss cantons, although favourable funding costs and debt profiles, given the deep domestic capital markets, will support debt sustainability. Contingent liabilities represent relevant credit challenges for the cantons. These liabilities are primarily related to maintenance obligations and/or guarantees for cantonal bank debt, pension liabilities, equity participations, and direct financial contributions to cantonal hospitals. The finances of these hospitals have recently experienced pressure due to rising operating costs and insufficient tariff adjustments.

Figure 29: Cantons' debt burden, % of operating revenue, 2023



Source: Finanzdirektorenkonferenz, Scope Ratings.

Higher interest rates should support the financial position of pension funds and the profits of cantonal banks, which typically benefit from sound finances. Reforms aimed at apportioning healthcare costs between insurance providers and cantons might mitigate contingent liability risk linked to cantonal hospitals.

1.10 Norwegian counties and cities: increasing budgetary pressures amid high investment needs

Institutional events

The Norwegian counties have concluded the first full year after the latest restructuring became effective on 1 January 2024, during which three former counties were split, resulting in an increase in the number of countries from 11 to 15. The split, in most parts, reversed the merger of counties implemented on 1 January 2020, which had reduced the number of counties from 19 to 11.

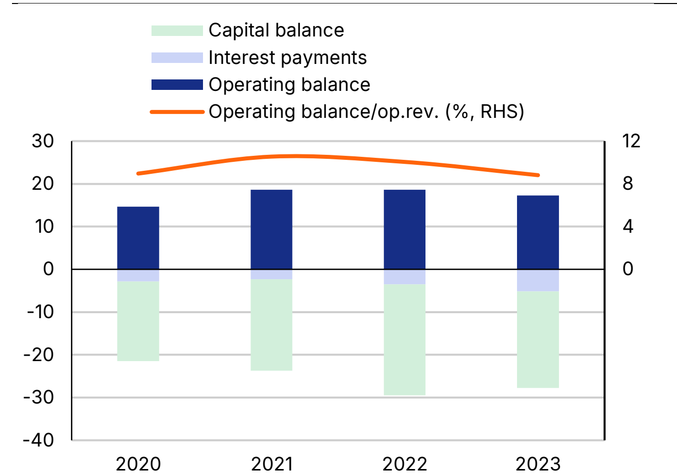
The institutional framework for both the counties and municipalities is stable. The revamped income-equalisation system for municipalities underlines its integrated robustness by increasing the symmetrical smoothing of per capita tax revenues from 60% to 62% in 2025 and to 64% in 2026.

Budgetary performance and outlook

The budget process proved more demanding this year compared with 2024 for counties and municipalities. The county authorities report a need for further NOK 2bn in revenues to avoid streamlining, restructuring and cuts. The municipalities' deficit amounts to NOK 9bn. The counties estimate net operating surpluses at the same level as in 2024. However, high investment needs persist, especially for roads, estimated at NOK 13.7bn, accounting for 56.4% of total investments.

Pressure on municipalities' budgets has increased in recent years, driven by inflation. In December 2024, 23 municipalities were listed in the register for Governmental Approval of Financial Obligations (ROBEK) – a list of municipalities and county authorities with financial imbalances – compared with only 10 at its lowest in December 2019. In January, Tjeldsund and Hammerfest exited ROBEK. However, central government transfers and cost-containment measures will likely help offset these pressures at county and municipal levels. The national government will increase transfers to municipalities and counties by NOK 5bn in 2025. Many municipalities plan slightly lower investment rates in 2025-27.

Figure 30: Aggregate budgetary performance (counties), NOK bn (LHS), % of operating revenue (RHS)

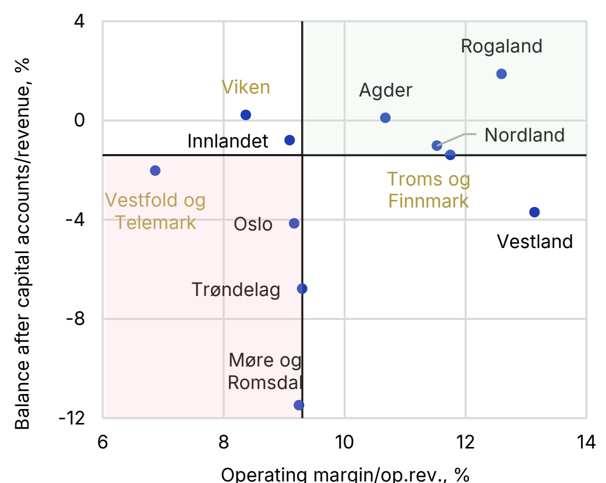


Source: Statistics Norway, Scope Ratings.

Revenue flexibility remains limited given the institutional framework, including the degree of equalisation and the cap on tax rates. Transfers and grants made up over 60% of operating revenues, on average, for the counties in 2023. Most of the remaining 40% stems from shared taxes. Counties' total tax revenue subject to equalization held steady at NOK 41.7bn in 2024, with estimates constantly revised down during the year.

Municipalities tax revenues grew only modestly by 1.4% YoY. However, continuous operating surpluses for both counties (**Figure 30**) and municipalities (on aggregate), support budgets.

Figure 31: Budgetary performance, by county, 2021-23 average



Note: Axes cross at the respective median. Displayed are counties in existence over 20-2023. Brown counties were split on 1 Jan 2024. Source: Statistics Norway, Scope Ratings.

While interest payments have increased over the past years, they can comfortably be covered by operating margins.

However, reserves have declined significantly, with municipalities drawing from a NOK 92bn disposition fund since 2022. By 2024, one in five municipalities has used or considered an overdraft facility.

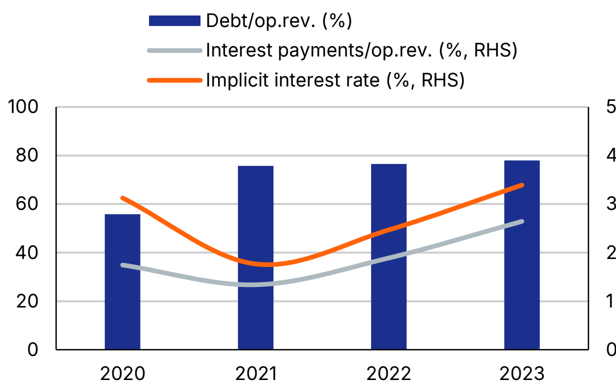
Despite this, robust equalisation systems and state transfers provide financial stability. The outcome of September parliamentary elections may lead to adjustments in national grants, the institutional framework ensures stable funding for local governments.

Debt burden and affordability

Debt levels in the Norwegian sub-sovereign sector are generally high by international standards, especially at the municipal level, both as a share of operating revenue and in levels representing about one third of total general government debt. This reflects important investment responsibilities and financial autonomy.

Given the main responsibilities of local governments, e.g., for schools, healthcare, and transportation, investment funding needs typically surpass available resources. Fiscal buffers are not as strong as in previous years. Still, integration with the national government and a strict financial framework, including rigorous and conservative financial planning supports debt affordability.

Figure 32: Aggregate sector debt and interest burden, %

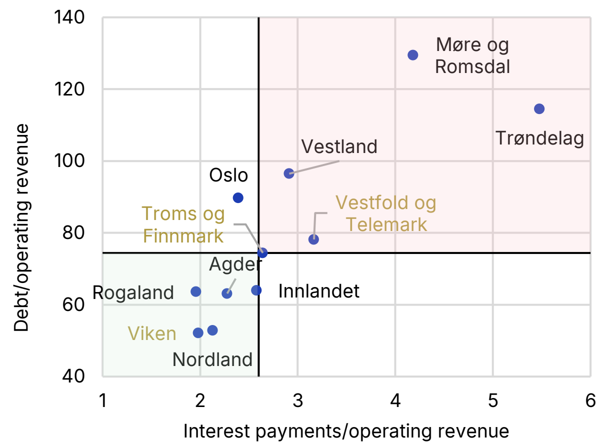


Source: Statistics Norway, Scope Ratings.

Moreover, availability of Kommunalbanken (KBN) lending benefits local authorities providing continuous access to affordable financing. Overall, lending from KBN accounts for around 50% of lending to municipal and county authorities, which consists mostly of loans.

Larger municipalities and 12 of the 15 counties also issued securities in domestic capital markets in 2024. Direct issuance of green bonds by Norwegian municipalities remains limited, as associated costs are high, and municipalities can instead access these funds through Kommunalbanken's green-loan programmes. Norwegian counties can also benefit from green funds via Kommunalbanken. In addition, government related entities like regional toll road operators have issued green bonds that benefit from a guarantee by a county.

Figure 33: Debt and interest burden, by county, 2023



Note: Axes cross at the respective median. Displayed are counties in existence over 20-2023. Brown counties were split on 1 Jan 2024. Source: Statistics Norway, Scope Ratings.

Finally, debt levels vary between counties (**Figure 33**), with Møre og Romsdal and Trøndelag carrying the highest debt burden, at 126.5% and 1144% of operating revenue, respectively.

Annex I: Scope's sub-sovereign and sovereign rating coverage

Figure 12: Scope's publicly issued long-term foreign-currency sub-sovereign credit ratings, as of 10 February 2025

German Länder	
Baden-Wurttemberg	AAA/Stable
Bavaria	AAA/Stable
Berlin	AAA/Stable
Brandenburg	*
Bremen	*
Hamburg	*
Hessen	AAA/Stable
Lower Saxony	*
Mecklenburg-Western Pommerania	*
North Rhine-Westphalia	AAA/Stable
Rhineland-Palatinate	*
Saarland	*
Saxony	*
Saxony-Anhalt	AAA/Stable
Schleswig-Holstein	*
Thuringia	*

Spanish Autonomous Communities	
Andalusia	*
Catalonia	*
Galicia	*
Madrid	A/Stable
Valencia	*

Swiss cantons	
Canton of Geneva	*
Canton of Zurich	*
Canton of Basel Country	*

Norwegian municipalities	
City of Trondheim	AAA/Stable
Akershus County	AAA/Stable
Rogaland County	AAA/Stable

* Rated on subscription, accessible on ScopeOne

Figure 13: Scope's publicly issued long-term foreign-currency sovereign credit ratings, as of 10 February 2025

Europe – Euro area	
Austria	AA+/Stable
Belgium	AA-/Negative
Croatia	A-/Stable
Cyprus	A-/Stable
Estonia	A+/Stable
Finland	AA+/Stable
France	AA-/Stable
Germany	AAA/Stable
Greece	BBB/Stable
Ireland	AA/Stable
Italy	BBB+/Stable
Latvia	A-/Stable
Lithuania	A/Positive
Luxembourg	AAA/Stable
Malta	A+/Stable
Netherlands	AAA/Stable
Portugal	A/Stable
Slovakia	A/Stable
Slovenia	A/Stable
Spain	A/Stable

Europe – Non-euro area EU	
Bulgaria	BBB+/Positive
Czech Rep.	AA-/Stable
Denmark	AAA/Stable
Hungary	BBB/Stable
Poland	A/Stable
Romania	BBB-/Stable
Sweden	AAA/Stable
Other western Europe	
Norway	AAA/Stable
Switzerland	AAA/Stable
United Kingdom	AA/Stable
Emerging Europe	
Georgia	BB/Stable
Serbia	BB+/Positive
Türkiye	BB-/Stable
Ukraine	SD

Rest of the World – Africa	
Egypt	B-/Stable
Morocco	BB+/Stable
South Africa	BB/Stable
North America & Asia	
China	A/Stable
Japan	A/Stable
United States	AA/Negative

Annex II: Related research

Sovereign Outlook 2025: robust fundamentals, rising fiscal pressures and geopolitical uncertainty, December 2024Central and Eastern Europe 2025 Sovereign Outlook: risk balance to ratings broadly neutral for 2025, December 2024

Global Economic Outlook: A resilient world economy faces US election test, October 2024

The Draghi Report: political stalemate and Europe's productivity gap curb growth outlook, September 2024

German Lander to increase borrowing by end-2024 for investment but continued focus on consolidation, July 2024

Global economic update: soft landing reinforces prospect of higher-for-longer interest rates, June 2024

European Sub-Sovereign 2024 Outlook: risks balanced as crisis support eases, growth recovers, February 2024

CEE Sovereign Outlook 2024: Recovering growth, diverging fiscal paths and persistent geopolitical risks, January 2024

Sovereign Outlook 2024: Soft landing, turn of the global rate cycle balance fiscal and geopolitical risks, December 2023

Scope Ratings GmbH

Lennéstraße 5, D-10785 Berlin
Phone: +49 30 27891-0
Fax: +49 30 27891-100
info@scoperatings.com

Scope Ratings UK Limited

52 Grosvenor Gardens
London SW1W 0AU
Phone: +44 20 7824 5180
info@scoperatings.com

Bloomberg: RESP SCOP
Scope contacts
scoperatings.com

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