

October 31 2022

Ukraine crisis and inflation lead to 34% increase in sovereign debt downgrades in past year

- **78 downgrades in past year, compared to 58 in previous year**

Sovereign debt worldwide has been downgraded 78 times by the top three ratings agencies in the last year*, compared to 58 downgrades that sovereign debt received in the previous year, says global specialty (re)insurance group Chaucer*.

Rising interest rates, inflation and a stronger dollar have led to increased concerns over the ability of an increasing number of countries to service their debt. Countries which have seen downgrades in the past year include Mexico, Turkey, Chile and Sri Lanka.

In October, rating agencies Standard & Poor's and Fitch cut the outlook on UK Government debt from "stable" to "negative" (a step short of a full downgrade) following the Government's recent "mini-Budget".

Governments are borrowing significant amounts to alleviate the effects of rising energy prices and broader inflation on their populations. At the same time, rising interest rates are increasing Governments' debt servicing costs. At least 45 countries have raised interest rates so far this year**. Governments with large amounts of dollar-denominated debt are in an even tougher position, as the strong dollar increases the cost of making coupon payments on that debt.

Increased concerns over the state of public finances globally has increased demand for contract frustration insurance, which insures against non-payment or cancellation of contracts by Governments

When Governments find themselves under financial pressure, they become increasingly likely to breach contracts that they or other public sector bodies have with businesses.

Jonathan Bint, Senior Analyst & Underwriter at Chaucer says: "More and more countries are struggling to pay their bills, which makes it ever more likely they will cancel or seek not to pay contracts with businesses."

Due to the uncertain global environment, businesses are increasingly looking to mitigate the risk of contract cancellation by Governments. Insurers are therefore seeing increased demand for contract frustration insurance as businesses seek a safety net.

One area of demand is from private equity investors supporting infrastructure projects in emerging markets who are now looking to additional insurance against potential losses caused by Government's cancelling infrastructure projects.

Other businesses which are particularly concerned about suffering losses as Governments come under financial pressure include construction companies with contracts related to Government infrastructure projects, as well as the energy and mining sectors.

As the global economic outlook deteriorates, businesses' fears over cancelled contracts extend far beyond emerging markets. Insurance firms are also seeing increased enquiries about contract frustration insurance in what had previously been 'safe' investment destinations such as the UK and the EU.

The worsening outlook for heavily indebted nations has already led to one default this year, when Sri Lanka failed to meet its debt payments in May. The Sri Lanka default was caused by the Government's decision to stop paying its mounting debts in order to conserve its foreign currency reserves for the importation of vital materials, including fuel.

Jonathan Bint says: "As the increase in sovereign debt downgrades suggests, the risk of losses from cancelled Government contracts is likely to grow further. Even countries such as the UK have been known to cancel major commercial contracts during times of economic stress. Contract frustration insurance is a way for businesses to shield themselves from subsequent losses."

*Analysis of sovereign debt ratings data from ratings agencies Fitch Ratings, Moody's and S&P Global Ratings, year ending September 30

**Source: IMF

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About Chaucer

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We are defined by an enterprising, bespoke approach to (re)insurance, enabled by the individual character, experience and imagination of our expert teams.

Chaucer is a member of the China Re Group and backed by their financial and operational resources. China Re is one of the world's largest reinsurance companies whose outstanding and comprehensive strength is rated A (excellent) by AM Best and A (strong) by S&P Global Rating.

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