



EU Defense Splurge Further Dents the Credibility of Credit Rating Agencies

PHILIP PILKINGTON

HIIA Perspective

Regular publication of the Hungarian Institute of International Affairs.

Publisher:

© Hungarian Institute of International Affairs, 2025.

Author(s):

Philip Pilkington

Copy editor(s): Lillian Aronson

For more publications, see the homepage of the Institute (www.hiia.hu).

Source of cover photo: Shutterstock

May 07, 2025

Philip Pilkington, Senior Research Fellow, HIIA

EU DEFENSE SPLURGE FURTHER DENTS THE CREDIBILITY OF CREDIT RATING AGENCIES

Recent assessments by major credit rating agencies reveal a growing inconsistency and politicization in how sovereign debt is evaluated across Europe, particularly in light of increased defense spending. Despite rising military expenditures and widening deficits, countries like Poland and Germany have seen their credit ratings maintained or even positively framed, while others have faced downgrades for reasons that appear to be politically motivated rather than fiscally justified. This trend erodes the credibility of credit rating agencies, as they increasingly disregard traditional economic metrics in favor of subjective institutional critiques. The key takeaway is that the geopolitical rearmament of Europe is not only reshaping defense budgets but also distorting financial markets and undermining trust in the institutions meant to objectively assess sovereign risk.

The Fitch Ratings agency released a [report](#) entitled, “CEE Sovereigns: Impact of Higher Defence Spending on Fiscal Deficits and Debt.” In it, the credit rating agency argues that while increased defense spending will certainly “challenge fiscal stability and debt reduction efforts,” Fitch believes that “the impact on sovereign ratings will be moderate compared to the pandemic and energy shocks.” In a separate [press release](#), the agency is even more aggressive, stating that “CEE sovereign ratings [are] unlikely to be affected by [the] defence spending rise.” Once again, Fitch Ratings uses extreme events like the pandemic and the energy crisis as benchmarks for comparison.

Fitch is not the only credit rating agency that has decided to give countries a free pass on military-related expenditure. Recently, Moody's—which offers credit ratings ranging from Aaa (the highest rating) to C (the lowest rating)—undertook its review of Poland's credit rating and [reaffirmed](#) its previous rating of A2, citing “strong economic dynamics and improved relations with the European Union.” The agency also forecasts that the Polish government budget deficit is “likely to decrease from 6.1% of GDP in 2024 to 5.8% of GDP in 2025 given further increase in defence spending.” It is hard to make sense of this statement, as it appears to say that despite much higher military expenditure, the Polish budget deficit will decrease. Yet the OECD recently [called on Poland](#) to raise taxes and cut spending because its budget deficit was getting out of control. A week earlier, Fitch had also [held Poland's credit rating steady](#).

The reluctance to change the ratings of these governments is very difficult to understand when we look at recent changes to ratings in other countries in Central Europe. In December 2024, before discussions of massive military spending became popular, Moody's lowered the credit rating of Slovakia from A2—Poland's current rating—to A3. Consider that in Poland in 2024, the budget deficit rose from 5.1 percent of GDP the previous year to 5.3 percent, while it fell from 5.2 percent to 4.85 percent in Slovakia. Poland has a slightly lower debt load than Slovakia—51.4 percent of GDP compared to 58.2 percent—but in terms of trajectory, Slovakia seems to be doing better. The rationale for Slovakia's downgrade consists of political arguments rather than economic ones. The decision to downgrade Slovakia “reflects the country's broad institutional challenges amid political tensions.” The agency states that a “comprehensive reform program on the judiciary and the media will weaken the country's checks and balances.” None of these issues should have any impact on a country's credit rating, which should depend on its fiscal situation.

The comparison between Slovakia and Poland shows that credit rating agencies have been biased and politicized for some time. Since the beginning of the discussions around military spending started, however, it has beco-

me less subtle. Credit rating agencies and other forecasters and analysts in the corporate appear to be simply ignoring massive increases in spending. At the beginning of March, S&P Global [argued](#) that German spending on military equipment would be “a ‘positive’ for its prized triple-A sovereign credit rating.” This makes no sense as economists view investment spending on military equipment as wasteful: Since this equipment will either be destroyed in a war or sit idly waiting for a war that never happens, it adds nothing to the economy, unlike a government-financed road or railway. Yet European institutions and now global financial institutions are stating that military spending is good for the economy, while other forms of government spending remain bad.

We get a sense of just how fevered this “analysis” has become if we turn to ING Global, a multinational banking and financial services company. In early March, the company released a [report](#) entitled, “Rearming: The European Market Outlook.” The report seems to imply that increased defense spending is good for the European economy, and it is full of loaded, pro-militarization language. For example, the authors write, “All of this leaves us with a hugely symbolic and signaling effect that Europe has finally woken up.” Shortly after highlighting Europe’s apparent great awakening, they note that the market reaction to increased spending has been a very sharp rise in borrowing costs, especially in Germany. “The large rise in Bund yields is much more than just an issuance story,” the authors concede, “and reflects an overhaul of markets’ economic outlook further in the future.” This is a theme in recent literature: Massive increases in spending are positive and will not impact the ability of these countries to borrow in the future, even though markets are driving borrowing costs aggressively higher.

Hungary has had problems with credit rating agencies before. Most recently, in November 2024, Moody’s [downgraded](#) its outlook on Hungarian sovereign government debt due to “governance issues.” The reasoning is similar to the one used in the case of Slovakia and has no economic rationale. Moody’s rated Hungary as Baa2—just above junk status—despite having a broadly similar fiscal situation to most other countries in the region.

Compare this to the recent upgrade of Italy by S&P from BBB to BBB+, which news reports at the time [noted](#) came “just days after Meloni’s government slashed its forecast for 2025 GDP growth to 0.6% from 1.2%.” Italy is well known for having one of the worst public debt burdens in the world, at around 135 percent of GDP, with current [projections](#) showing that this burden will only grow larger due to falling productivity growth and tariffs. Hungary’s public debt burden is almost half of Italy’s at 73.5 percent of GDP and yet Moody’s rating places Hungary only one rank above Italy’s Baa3 rating, with both in the same “non-investment grade” basket.

It is becoming increasingly hard to take the credit rating agencies seriously. Institutional buyers of sovereign bonds, like pension funds, are often forced by regulations to factor in the rating agencies when purchasing debt—raising questions about whether these markets are “markets” or whether they are simply technocratic, international governance institutions. But outside of the formal institutional structures, many finance professionals are cynical about the agencies and see them as politicized institutions that provide manipulated ratings. The recent arguments surrounding the European defense buildup are going to dent the credibility of these institutions further. Countries that have been caught on the wrong side of the ratings agencies and given ratings that are obviously not justified by economic fundamentals should seek out access to sophisticated investors who are cynical about the increasingly unbelievable theatrics of the ratings agencies and make their case directly to them. This will increase real market signals in the sector and eliminate the noise created by politicization.



**HUNGARIAN
INSTITUTE OF
INTERNATIONAL
AFFAIRS**

