

Criteria | Governments | Sovereigns:

Sovereign Rating Methodology

December 18, 2017

Key Publication Dates

- Original publication date: Dec. 18, 2017
- Effective date: These criteria are effective immediately.
- These criteria address the fundamentals set out in "[Principles Of Credit Ratings](#)," published on Feb. 16, 2011.

Overview and scope

1. S&P Global Ratings' global methodology applies to sovereign governments and monetary authorities and aims to give market participants a clear picture of how we rate both types of entities. These criteria apply to issuer credit and issue ratings. For the purpose of these criteria, we define a sovereign as a state that administers its own government and is not subject to or dependent on another sovereign for all or most prerogatives. In particular, one of the most important prerogatives of a sovereign, in our view, is the right to determine the currency it uses, as well as the political and fiscal frameworks in which it operates.
2. These criteria replace the previous criteria titled "Sovereign Rating Methodology," published on Dec. 23, 2014. The update is limited in its substance and aims at further enhancing the transparency of our approach to assigning sovereign ratings, as well as at covering our approach to assigning ratings to monetary authorities. The latter was so far addressed by a separate criteria ("Monetary Authorities Rating Methodology," published on Sept. 11, 2013). The three main changes from our previous sovereign methodology are as follows:
 - We now limit a local-currency sovereign rating to no more than one notch above the foreign-currency sovereign rating, compared to up to two notches previously (as described in section C. Determining A Sovereign Local-Currency Rating);
 - We now more clearly base our initial fiscal assessment on the change in net as opposed to gross general government debt (net general government debt is debt minus general government liquid financial assets); and
 - We now use current account payments (CAP) instead of current account receipts (CAR) in the denominator of certain ratios that we use in our external assessment.
3. All references to sovereign ratings in this article pertain to a sovereign's ability and willingness to service financial obligations to nonofficial (commercial) creditors. The issuer credit rating (ICR) on a sovereign does not reflect its ability and willingness to service other types of obligations, such as obligations:

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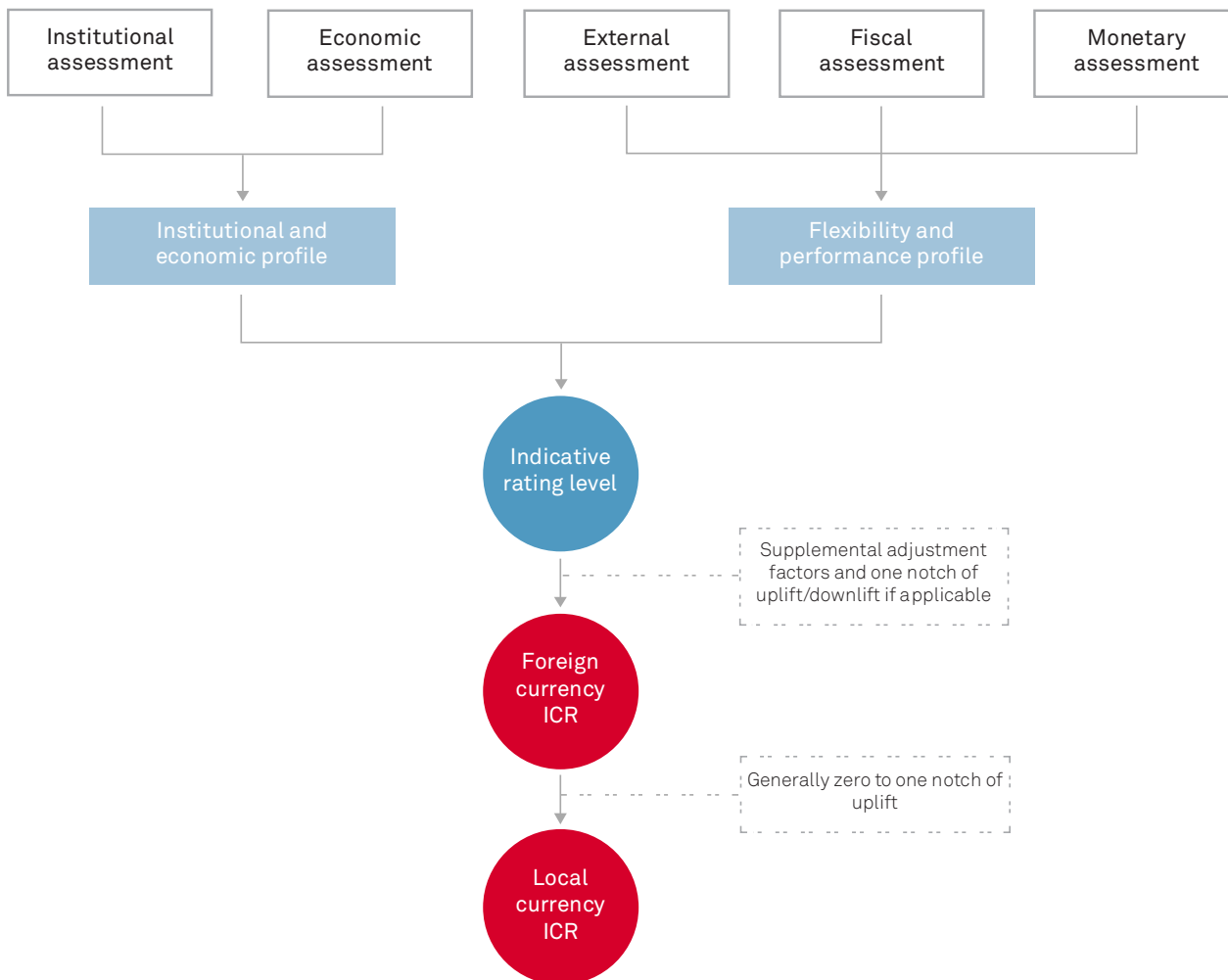
Sovereign Rating Methodology

- To other governments (Paris Club debt or intergovernmental debt);
 - To supranationals, such as the International Monetary Fund (IMF) or the World Bank;
 - To honor a guarantee not meeting our criteria for credit substitution (see "Guarantee Criteria," published Oct. 21, 2016); or
 - To public-sector enterprises or local and regional governments.
4. The methodology does take into account these obligations' potential effect on a sovereign's ability to service its commercial financial obligations. In this article, "rating" refers to an ICR if not otherwise specified. For further information on what we consider a default for sovereigns, please refer to ["What does S&P Global Ratings Consider A Default For Sovereign And Non-U.S. Local And Regional Governments?"](#) published April 13, 2017.
 5. Our sovereign rating criteria incorporate the factors that we believe affect a sovereign government's willingness and ability to service its financial obligations to nonofficial creditors on time and in full. The foundation of our sovereign credit analysis rests on five pillars (see chart 1).

Chart 1

Sovereign Issuer Criteria Framework

Five Key Areas To Determine A Sovereign'



ICR--issuer credit rating.

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Sovereign Rating Methodology

6. The institutional assessment reflects our view of how a government's institutions and policymaking affect a sovereign's credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks. It also reflects our view of the transparency and accountability of data, processes, and institutions; a sovereign's debt repayment culture; and potential external and domestic security risks.
7. The history of sovereign defaults suggests that a wealthy, diversified, resilient, and adaptable economy ultimately boosts its debt-bearing capacity. The economic assessment incorporates our view of:
 - The country's income levels as measured by its GDP per capita, indicating broader potential tax and funding bases upon which to draw, which generally support creditworthiness;
 - Growth prospects; and
 - Its economic diversity and volatility.
8. A country's external assessment, which refers to the transactions and positions of all residents (public- and private-sector entities) vis-à-vis the rest of the world, is primarily driven by our view of:
 - The status of a sovereign's currency in international transactions;
 - The country's external liquidity, which provides an indication of the economy's ability to generate the foreign exchange necessary to meet its public- and private-sector obligations to nonresidents; and
 - The country's external position, which shows residents' assets and liabilities (in both foreign and local currency) relative to the rest of the world.
9. The fiscal assessment reflects our view of the sustainability of a sovereign's deficits and its debt burden. This measure considers fiscal flexibility, long-term fiscal trends and vulnerabilities, debt structure and funding access, and potential risks arising from contingent liabilities. Given the many dimensions that this assessment captures, the analysis is divided into two segments, "fiscal performance and flexibility" and "debt burden."
10. The monetary assessment considers our view of the monetary authority's ability to fulfill its mandate while sustaining a balanced economy and attenuating any major economic or financial shocks. We derive the monetary assessment by analyzing:
 - The exchange rate regime, which influences a sovereign's ability to coordinate monetary policy with fiscal and other economic policies to support sustainable economic growth; and
 - The credibility of monetary policy as measured, among other factors, by inflation trends over an economic cycle and the effects of market-oriented monetary mechanisms on the real economy, which is largely a function of the depth and diversification of a country's financial system and capital markets.

Methodology

11. Each of the above mentioned five factors is assessed on a six-point numerical scale from '1' (strongest) to '6' (weakest). Both quantitative factors and qualitative considerations form the basis for these forward-looking assessments.
12. The sovereign's institutional and economic profile (the average of the institutional assessment and the economic assessment) reflects our view of the resilience of a country's economy, the strength and stability of its civil institutions, and the effectiveness of its

Sovereign Rating Methodology

polycymaking. The sovereign's flexibility and performance profile (the average of the external assessment, the fiscal assessment, and the monetary assessment) reflects our view of the sustainability of a government's fiscal balance and debt burden, in light of the country's external position, as well as the government's fiscal and monetary flexibility (see chart 1).

Table 1

Indicative Rating Levels From The Combination Of The Institutional And Economic Profile With The Flexibility And Performance Profile

		Institutional and economic profile												
		Category	Superior	Extremely strong	Very strong	Strong	Moderately strong	Intermediate	Moderately weak	Weak	Very weak	Extremely weak	Poor	
		Category	Assessment	1	1.5	2	2.5	3	3.5	4	4.5	5	5.5	6
Flexibility and performance profile	Extremely strong	1 to 1.7	aaa	aaa	aaa	aa+	aa	a+	a	a-	bbb+	bb+	bb-	
	Very strong	1.8 to 2.2	aaa	aaa	aa+	aa	aa-	a	a-	bbb+	bbb	bb+	bb-	
	Strong	2.3 to 2.7	aaa	aa+	aa	aa-	a	a-	bbb+	bbb	bb+	bb	b+	
	Moderately strong	2.8 to 3.2	aa+	aa	aa-	a+	a-	bbb	bbb-	bb+	bb	bb-	b+	
	Intermediate	3.3 to 3.7	aa	aa-	a+	a	bbb+	bbb-	bb+	bb	bb-	b+	b	
	Moderately weak	3.8 to 4.2	aa-	a+	a	bbb+	bbb	bb+	bb	bb-	b+	b	b	
	Weak	4.3 to 4.7	a	a-	bbb+	bbb	bb+	bb	bb-	b+	b	b-	b-	
	Very weak	4.8 to 5.2	bbb	bbb	bbb-	bb+	bb	bb-	b+	b	b	b-	b-	
	Extremely weak	5.3 to 6	bb+	bb+	bb	bb-	b+	b	b	b-	b-	b-	b-	

Note: Assigning 'CCC+', 'CCC', 'CCC-', and 'CC' ratings is based on "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," Oct. 1, 2012. Source: S&P Global Ratings.

13. We then use the flexibility and performance profile and institutional and economic profile to determine an "indicative rating level" (see table 1). We expect that our sovereign foreign-currency rating would, in most cases, fall within one notch of the indicative rating level. For example, for a sovereign we view as having a "moderately strong" institutional and economic profile and a "very strong" flexibility and performance profile, we would most likely assign a rating within one notch of 'AA-'.
14. In some cases, a sovereign foreign-currency rating might differ by more than one notch compared with the indicative rating level if it meets one or more of the supplemental adjustment factors described in the section "Supplemental Adjustment Factors And Caps." If a sovereign has several of these characteristics, the foreign-currency rating on the sovereign would be adjusted by the cumulative effect of those adjustments or the caps indicated by those adjustments. These factors could be negative (an extremely high fiscal debt burden, extremely weak external liquidity, event risk, or very high institutional risk and high debt burden) or positive (very large liquid financial government assets). When relevant, our sovereign ratings may also be informed by the methodologies described in "[Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings.](#)" published Oct. 1, 2012, or "[Rating Implications Of Exchange Offers And Similar Restructurings, Update.](#)" May 12, 2009.

Sovereign Rating Methodology

15. Absent supplemental adjustment factors, our sovereign foreign-currency rating is within one notch of the indicative rating level. The main factors that can lead to an ICR that is one notch higher or lower than the indicative rating level are the following:
- At least one of the five rating factors is in a positive or negative transition that supports or detracts from creditworthiness and that is not already fully captured in the indicative rating level;
 - The sovereign is a sustained and projected over- or underperformer among similarly rated sovereigns for at least one of the key rating factors, unless already captured elsewhere in the methodology;
 - We view the change in a particular assessment as temporary and expect it either to revert or to be offset (over the medium to long term) by an opposite dynamic in other assessments. An example is deterioration in the external assessment because of large investment projects that we expect, if successful, will improve economic growth potential over the medium term;
 - A change in only one rating factor can sometimes lead to a multinotch change in the indicative rating in our indicative rating matrix (see table 1). In this case, the final rating may be set one notch apart from what's indicated in the table. For example, if a sovereign has an institutional and economic profile assessment of 2.0 and a flexibility and performance profile assessment of 4.8, the final rating might be set at 'BBB' (absent supplemental factors), instead of 'BBB-' as indicated in the matrix, if one assessment change would be sufficient to raise the indicative rating level to 'bbb+'; and
 - Other factors that are not fully captured in the indicative rating and that have a positive or negative impact on our view on creditworthiness could also lead us to adjust the indicative rating level by one notch.
16. We determine a sovereign local-currency rating by applying up to usually no more than one notch of uplift over the foreign-currency rating. Sovereign local-currency ratings can be higher than sovereign foreign-currency ratings because local-currency creditworthiness may be supported by the unique powers that sovereigns possess within their own borders, including issuance of the local currency and regulatory control of the domestic financial system. When a sovereign is a member of a monetary union, and thus cedes monetary and exchange-rate policy to a common central bank, or when it uses the currency of another sovereign, the local-currency rating is, under our criteria, equal to the foreign-currency rating.

A. Key Credit Factors

1. Institutional assessment

17. The institutional assessment comprises our analysis of how a government's institutions and policymaking affect its credit fundamentals by delivering sustainable public finances, promoting balanced economic growth, and responding to economic or political shocks.
18. A sovereign's initial institutional assessment combines the following (see table 2):
- The effectiveness, stability, and predictability of its policymaking and political institutions; and
 - The transparency and accountability of its institutions, data, and processes, and the coverage and reliability of statistical information.
19. The final institutional assessment could be worse than the initial assessment after considering two potential adjustment factors:
- The sovereign's debt payment culture; and
 - External security risks.

Effectiveness, stability, and predictability of policymaking, political institutions, and civil society

20. We analyze these factors based on:

- The track record of a sovereign in managing past political, economic, and financial sector crises; maintaining prudent policymaking; and delivering balanced economic growth. This includes a timely implementation of various reforms (such as to health care or pensions, to ensure sustainable public-sector finances over the long term), prudent monetary policy management, and effective management of external pressures;
- The predictability in the overall policy framework and developments that may affect policy responses to a future crisis or lead to significant policy shifts;
- Actual or potential challenges to political institutions, possibly involving domestic conflict, from popular demands for increased political or economic participation, or from significant challenges to the legitimacy of institutions on ethnic, religious, or political grounds; and
- The cohesiveness of civil society, as evidenced by social mobility, social inclusion, prevalence of civic organizations, degree of social order, and capacity of political institutions to respond to societal priorities.

21. Effective policymaking and stable political institutions enable governments to address periods of economic distress and take measures to correct imbalances. This helps sustain long-term growth prospects and limit the risk of sharp deterioration of a sovereign's creditworthiness. Stable and well-established institutions generally ensure a certain degree of predictability in the general direction of policymaking, even when political power shifts between competing parties, with resulting policy changes. Conversely, succession risks, a high concentration of power, and potential or actual challenges to political or judicial institutions are factors that can pose risks to institutional stability and, in turn, lead to substantial policy shifts and affect the continuity of key credit characteristics. The analysis of the risk of challenges to political institutions is based on the history of internal political conflicts, including extra-constitutional changes of government.

Transparency and accountability of institutions, data, and processes

22. We analyze these factors based on the following:

- The existence of checks and balances between institutions;
- The perceived level of corruption in the country, which correlates strongly with the accountability of its institutions;
- The unbiased enforcement of contracts and respect for the rule of law (especially property rights), which correlates closely with respect for creditors' and investors' interests; and
- The independence of statistical offices and the media, and the history of data revisions or gaps, as measures of the transparency and reliability of the information.

23. The independence of statistical offices and the media includes an assessment of the quality and consistency of the relevant data. These data are generally based on estimated values and are not always measured with precision. Thus, when there is a history of significant data revisions, poor forecasting, or data gaps and inconsistencies (either from one source or between sources), the criteria call for interpreting the data in light of these discrepancies.

Sovereign Rating Methodology

24. The transparency and accountability of institutions bear directly on sovereign creditworthiness because they reinforce the stability and predictability of political institutions and the political framework, even though they may not reinforce the stability of a ruling political class or party. In addition, transparent and accountable institutions, processes, and data are important because they enhance the reliability and accuracy of information and help make known in a timely manner any significant shifts in a country's policymaking or the occurrence of risks relevant to sovereign credit risk.
25. Table 2 elaborates on the factors above and list the characteristics we generally expect for each of our assessment levels. A government might exhibit a majority but not all of them.

Sovereign Rating Methodology

Table 2

A Sovereign's Institutional Assessment

On a scale from '1' to '6', with '1' the strongest and '6' the weakest

	Effectiveness, stability, and predictability of policymaking, political institutions, and civil society	Transparency and accountability of institutions, data, and processes
1	<ul style="list-style-type: none"> – Proactive policymaking and a strong track record in managing past economic and financial crisis and delivering economic growth – Ability and willingness to implement reforms to ensure sustainable public finances and economic growth over the long term – Cohesive civil society, as evidenced by high social inclusion, prevalence of civic organizations, degree of social order and capacity of political institutions to respond to societal priorities 	<ul style="list-style-type: none"> – Extensive checks and balances between institutions – Unbiased enforcement of contracts and respect for rule of law – Free flow of information throughout society, with open debate of policy decisions – Timely and reliable data and statistical information
2	<p>Compared with '1', any of the following apply:</p> <ul style="list-style-type: none"> – Generally strong, but shorter, track record of policies that deliver sustainable public finances and balanced economic growth consistently over the long term – Weaker ability to implement reforms because of a slow or complex decision-making process. – Cohesive civil society, but slightly less in degree than countries we assess '1' 	<ul style="list-style-type: none"> – Generally effective checks and balances – Unbiased enforcement of contracts and respect for rule of law – Free flow of information throughout society, with open debate of policy decisions – Timely and reliable data and statistical information
3	<ul style="list-style-type: none"> – Generally effective policymaking in recent years, promoting sustainable public finances and balanced economic growth. But policy shifts are possible because of changes in administration or the potential destabilizing influences of underlying socioeconomic or significant long-term fiscal challenges. – Cohesive civil society, but less in degree than countries we assess '1' or '2', either because of ethnic, racial, or class tensions or because of higher level of crime 	<ul style="list-style-type: none"> – Evolving checks and balances between various institutions – Generally unbiased enforcement of contracts and respect for rule of law – Free flow of information throughout society, but with policy decisions not fully and openly debated – Statistical information that may be less timely than for the higher categories or subject to large revisions
4	<p>One of the following is present:</p> <ul style="list-style-type: none"> – Policy choices may weaken support for sustainable public finances and balanced economic growth – Reduced predictability of future policy responses because of an uncertain or untested succession process or moderate risk of challenges to political institutions resulting from highly centralized decision-making and parts of the population desiring more political or economic participation – Civil society with ethnic, racial, or class tensions; rising crime rates; and a reduced capacity of political institutions to respond to societal priorities. Low probability, however, of social upheaval 	<ul style="list-style-type: none"> – More uncertain checks and balances between institutions, less enforcement of contracts and respect for the rule of law than in above categories – Relatively weak transparency, owing to interference by political institutions in the free dissemination of information, material gaps in data, or reporting delays
5	<p>One of the following is present:</p> <ul style="list-style-type: none"> – Policy choices likely weaken capability and willingness to maintain sustainable public finances and balanced economic growth, and thus, debt service – High risk of challenges to political institutions, possibly involving domestic conflict, because of demands for more economic or political participation by parts of the population, or significant ethnic or religious challenges to the legitimacy of political institutions – Future policy responses are difficult to predict because of a highly polarized political landscape, highly centralized decision-making or an uncertain or untested succession process – Frayed civil society with difficult ethnic, racial, or class tensions; high crime; and a reduced capacity of political institutions to respond to societal priorities. Rising chance of social upheaval 	<ul style="list-style-type: none"> – Unassured enforcement of contracts and respect for rule of law – Impaired transparency, owing to at least one of the following factors: moderate to high levels of perceived corruption, material data gaps, or significant interference by political institutions in the free dissemination of information.
6	<p>One of the following is present:</p> <ul style="list-style-type: none"> – Weak political institutions, resulting in an uncertain policy environment in periods of stress, including diminished capability and willingness to maintain timely debt service – Considerable risk of breakdown between political institutions, including significant risk of domestic conflict – Distressed civil society; sharp ethnic, racial, or class tensions; inability or unwillingness of political institutions to respond to societal priorities; or present danger of social upheaval 	<ul style="list-style-type: none"> – Unassured enforcement of contracts and respect for rule of law – Impaired transparency, owing to several of the following factors: frequent and material data revisions or lack or suppression of data and information flows; or high levels of perceived corruption of political institutions

Sovereign Rating Methodology

26. The institutional assessment equals the initial assessment adjusted for:
- Debt payment culture. A sovereign with a weak debt payment culture receives an institutional assessment of '6'.
 - External security risks. The institutional assessment is one or two categories worse than the initial assessment when there is risk of war, but the risk is not expected to materialize within two to three years.

Sovereign's debt payment culture

27. The first potential adjustment to the initial institutional assessment relates to debt payment culture. Willingness to default is an important consideration when analyzing a sovereign's creditworthiness, partly because creditors have only limited legal redress. As a result, a sovereign can, and sometimes does, default on its obligations even when it possesses the capacity for timely debt service. History demonstrates that countries can graduate from being serial defaulters, although the path to doing so may be long. The first default may be costlier than later ones, hence the idea that, with each successive default, serial defaulters have less of a good reputation to lose.
28. In cases where we believe a sovereign's debt payment culture is a credit risk, we adjust the overall institutional assessment such that it cannot be better than '6'. For this to happen, a sovereign would typically have one or more of the following characteristics:
- Significant and sustained arrears on bilateral official debt (i.e., debt owed to foreign governments and government-owned entities);
 - A public discourse that questions the legitimacy of debt contracted by a previous administration (so-called odious debt); and
 - No material policy change since the last default on commercial debt.

External security risks

29. The second potential adjustment to the initial institutional assessment relates to geopolitical and external security risks, including war or threats of war stemming from conflicts or from strained relations with neighbors. When there is a long-standing risk of war, but we do not foresee a likelihood of it materializing over the next two to three years, we could set the institutional assessment one to two categories worse than the initial assessment, depending on the potential impact on the real economy, fiscal expenditure, and external performance. However, when these risks are imminent or rapidly rising, it would affect the overall rating (see Supplemental Adjustment Factors And Caps).

2. Economic assessment

30. The history of sovereign defaults suggests that a wealthy, diversified, resilient, market-oriented, and adaptable economy--coupled with a track record of sustained economic growth--provides a sovereign with a strong revenue base, enhances its fiscal and monetary policy flexibility, and ultimately boosts its debt-bearing capacity.
31. The key drivers of our economic assessment are a sovereign's:
- Income levels,
 - Growth prospects, and
 - Economic diversity and volatility.

Sovereign Rating Methodology

32. We derive an initial assessment based on a country's income level, as measured by its GDP per capita, which then can receive a positive or negative adjustment by up to two categories based on the economy's growth prospects, its potential concentration or volatility, and the potential material data inconsistencies, gaps, or discontinuities.

Table 3

A Sovereign's Economic Assessment

On a scale from '1' to '6', with '1' the strongest and '6' the weakest

On a scale of '1' to '6' based on GDP per capita*

Positive adjustment factors	Negative adjustment factors
<p>The following factor generally improves the initial economic assessment by one category:</p> <ul style="list-style-type: none"> – Above average economic growth, as measured by real GDP per capita trend growth that is consistently well above that of sovereigns in the same GDP per capita category (for further details, see "Economic growth prospects") 	<p>Each of the following factors generally weakens the initial economic assessment by one category:</p> <ul style="list-style-type: none"> – Below average economic growth, as measured by real GDP per capita trend growth that is consistently well below that of its sovereigns in the same GDP category (for further details, please see "Economic growth prospects") – Economic growth primarily resulting from a rapid increase in depository corporations claims, indicating a credit bubble (for further details, please see "Economic growth prospects") – Volatile or concentrated economy (for further details, see "Economic diversity and volatility") – Material data inconsistencies, gaps or discontinuities (for further details, see "Material data inconsistencies, gaps, or discontinuities")

The economic assessment equals the initial assessment, adjusted by a maximum of two categories up or down based on the net effect of the adjustment factors outlined above.

*Current year estimate. If the GDP per capita falls near the cut-off point (typically by 10%) we can assign either the score that corresponds to the range into which a sovereign's per capita GDP falls, or assign the nearest adjacent score.

Income levels

33. GDP per capita is our most prominent measure of income. With higher GDP per capita, a country has broader potential tax and funding bases upon which to draw, which generally support creditworthiness. Our economic assessment uses the current-year estimate for GDP per capita from national statistics, converted to U.S. dollars. The commentary "[GDP Per Capita Thresholds for Sovereign Rating Criteria](#)," is updated twice per year to provide GDP per capita ranges we use to derive the initial economic assessments that are in line with the projections for global nominal U.S. dollar annual GDP per capita growth. To determine the changes, we use data from the IMF's World Economic Outlook (for global U.S. dollar GDP) and the United Nations Development Programme (for global population figures). Based on these data, we calculate the expected nominal growth of the global GDP per capita and we then apply similar growth rate to all thresholds figures. In addition, our thresholds are rounded to the nearest \$100. If a country's GDP per capita falls near the cut-off point (typically by 10%), we can assign either the score that corresponds to the range into which a sovereigns' per capita GDP falls, or assign the nearest adjacent score. Possible reasons for applying this flexible assessment could, for example, include the expectation that exchange-rate movements (local currency versus U.S. dollar) may move the GDP per capita into the adjacent bracket within the ratings horizon. Another reason could be that we deem current GDP per capita unsustainable in the longer term for other reasons, be they structural or business-cycle related.

Economic growth prospects

34. A sovereign's economic assessment is generally one category better or worse than the initial assessment when its growth prospects are well below or above those of sovereigns in the same GDP per capita category. The key measure of economic growth is real per capita GDP trend growth.
35. The term "trend growth" refers to estimates of the rate of sustainable GDP growth over an extended period (without creating inflationary pressure, asset bubbles, or other economic dislocations). Such estimates are generally derived from empirical observations based on the recent past and longer-term historical trends, and they attempt to look through the fluctuations of an economic cycle. Our analysis focuses on per capita GDP growth to standardize, in part, for growth driven more by inputs than productivity.
36. To form the trend growth measure used in table 3, we consider the average growth in a country's real per capita GDP over a 10-year period, to cover generally at least one economic cycle. More specifically, our measure of real per capita GDP trend growth is the average of:
 - Six years of historical data,
 - Our current-year estimate, and
 - Three-year forecasts.
37. The latest historical year, current-year estimate, and forecasts are weighted 100%, while previous years are assigned a lower weight, to avoid a steep drop or increase when an exceptional year drops out of the 10-year average. If the selected 10-year period does not adequately cover the country's observed economic cycle, the trend growth can be adjusted to more closely reflect past cycles. In particular, we adjust trend growth calculation for one-off items, such as changes in the statistical base, one-off sizable investments, or material changes in population because of extraordinary events, such as temporary strong migration flows.
38. Sovereigns with higher or lower growth rates than sovereigns in the same GDP category would generally receive a positive or negative adjustment with respect to the initial assessment. For economies (usually resource-based) where nominal economic growth may be a better indicator of prosperity and resources, the negative adjustment may not apply if the wealth of the economy (GDP per capita at least 1.5x higher than the threshold for the initial assessment of '1') could substantially cushion potential risk.
39. A sovereign's economic assessment would generally be one category worse than the initial assessment when GDP growth seems to be fueled mostly by a rapid increase in depository corporation claims on the resident nongovernment sector. Combined with sustained growth in inflation-adjusted asset prices, this indicates vulnerability to a potential credit-fueled asset bubble. We believe that risks for a sovereign's creditworthiness are particularly acute when credit growth is largely funded externally. The determination is made in consideration of the BICRA economic imbalance score (excluding the external imbalances subcomponent) (see "[Banking Industry Country Risk Assessment Methodology And Assumptions.](#)" Nov. 9, 2011).

Economic diversity and volatility

40. In addition, a sovereign exposed to significant economic concentration and volatility receives an economic assessment that is generally one category worse than the initial assessment if:

Sovereign Rating Methodology

- It carries significant exposure to a single cyclical industry (typically accounting for more than about 20% of GDP, based on the current year and the expected trend for the next two to three years unless historical data are more relevant); or
 - Its economic activity is vulnerable because of constant exposure to natural disasters or adverse weather conditions.
41. However, the assessment might not receive an adjustment if:
- The sovereign has an initial economic assessment of '5' or '6';
 - We view the sovereign as having growth below sovereigns at comparable levels of development and our view is supported by the underperformance of a single cyclical industry; or
 - The government is in a net asset position of 50% of GDP or more (based on the current year and the expected trend for the next two to three years unless historical data are more relevant).
42. Economic concentration and volatility are important because a narrowly based economy tends to correlate with greater variation in growth than a more diversified one. Pronounced economic cycles tend to test economic policy flexibility more harshly and impair the government's balance sheet more significantly than shallow ones.

Material data inconsistencies, gaps, or discontinuities

43. Finally, we could also lower a sovereign's economic assessment by generally one category in cases where national accounts data display material data inconsistencies, gaps, or discontinuities, or where there is reason to believe that the quality of national accounts data is hampered by technical or administrative shortcomings or political interference.

3. External assessment

44. The external assessment reflects a country's ability to obtain funds from abroad necessary to meet its public- and private-sector obligations to nonresidents. It refers to the transactions and positions of all residents (public- and private-sector entities) vis-à-vis those of nonresidents because it is the totality of these flows and stocks that affects a country's level of reserves and exchange-rate developments.
45. Three factors determine a country's external assessment:
- The status of its currency in international transactions;
 - The country's external liquidity, which provides an indication of the economy's ability to generate the foreign exchange necessary to meet its public- and private-sector obligations to nonresidents; and
 - The country's external position, which shows residents' assets and liabilities (in both foreign and local currency) relative to the rest of the world.

Currency status in international transactions

46. The first step in the external assessment relates to the degree to which a sovereign's currency is used in international transactions. We assign a better external assessment to sovereigns controlling a "reserve currency" or an "actively traded currency." We differentiate between sovereigns with reserve currencies and those with actively traded currencies as follows.
47. ***Sovereigns with a reserve currency.*** A sovereign in this category generally benefits from a currency (which it controls) that accounts for more than 3% of the world's total allocated foreign exchange reserves based on the IMF report "Currency Composition of Official

Sovereign Rating Methodology

Foreign Exchange Reserves." Demand for the debt of these sovereigns tends to rise in periods of global economic stress (flight to quality), reflecting characteristics described in section "Specific considerations for members of monetary unions," such as the credibility of their policies and institutions, their strong financial systems, and large and open capital markets.

48. ***Sovereigns with an actively traded currency.*** A sovereign in this category generally benefits from a currency that is bought or sold in more than 1% of global foreign exchange market turnover, based on the Bank for International Settlement (BIS) report "Triennial Central Bank Survey," that is not a reserve currency as defined above and that meets the characteristics specified in "Specific considerations for members of monetary unions."
49. These sovereigns have a common attribute: their currencies are widely used in financial transactions outside their own borders, which means that they may be less vulnerable to shifts in investors' portfolios of cross-border holdings than are those of other countries. The international use of these currencies, in turn, stems from the:
 - Credibility of the country's policies and institutions;
 - Strength of its financial systems;
 - The country's large and open capital markets, with market-determined interest and foreign exchange rates; and
 - Use of its currencies as units of account in global capital markets.
50. These characteristics may push the external obligations of the sovereigns issuing these currencies to relatively high levels. But this does not necessarily present the same degree of risks as for countries with non-actively traded currencies because these sovereigns' policy settings may more readily preserve foreign investor confidence.
51. For countries with a reserve currency or an actively traded currency, we focus on a measure of external indebtedness, defined as the ratio of narrow net external debt over CAR, or over CAP if assets included in that measure exceed external debt as explained in "External indebtedness" and table 4. The more flexible monetary positions of these countries allow less reserve accumulation and permit higher short-term debt levels than sovereigns with less monetary flexibility, making quantitative comparison based on an external liquidity ratio less meaningful.
52. For other countries, we combine the assessment of a sovereign's external indebtedness with the analysis of its external liquidity to derive its initial external assessment (see table 4).

External liquidity

53. Our key measure of a country's external liquidity is the ratio of gross external financing needs to the sum of CAR plus usable official foreign exchange reserves.
54. The gross external financing needs in table 4 are the average of the current-year estimate and our forecasts for the next two to three years.
55. Usable foreign exchange reserves are the sum of:
 - Liquid claims in foreign currency on nonresidents under the control of the central bank; and
 - Gold holdings.
56. The calculation of usable foreign exchange reserves is explained in Appendix C. For most sovereigns, they serve as a financial buffer during periods of balance-of-payments stress. However, sovereigns with freely floating exchange rates and deep foreign exchange

Sovereign Rating Methodology

markets typically hold a low level of reserves. Their central banks are usually not called upon to be last-resort sellers of foreign exchange, and a single external borrower having trouble rolling over its debt does not threaten the foreign exchange regime.

External indebtedness

57. Our key measure of a country's external indebtedness is the ratio of narrow net external debt to CAR (or CAP if external liquid assets exceed external debt).
58. The term "narrow" refers to a more restricted measure of assets than some widely used international definitions of net external debt. The calculation of narrow net external debt subtracts from gross external debt only official foreign exchange reserves and liquid external assets of the public sector and all financial-sector assets (see Appendix C for more details on this calculation). We use this special definition for two reasons:
 - Financial-sector assets may be generally more liquid than those of the nonfinancial private sector; and
 - Most financial institutions manage external assets and liabilities, which is not the case for many nonfinancial private-sector entities, some of which may be primarily holders of assets, and others primarily holders of liabilities.
59. In a downside scenario, nonfinancial private-sector entities may not repatriate external assets, or they may even transfer their assets in the domestic financial system to foreign accounts.
60. A sovereign's external assessment equals the initial assessment derived from table 4, adjusted by up to three categories based on the net effect of the positive and negative adjustment factors listed in table 4.

Sovereign Rating Methodology

Table 4

A Sovereign's External Assessment

On a scale from '1' to '6', with '1' the strongest and '6' the weakest

Other sovereigns' measure of a country's external liquidity:

Gross external financing needs/
(CAR + useable reserves)*

Measure of a country's external indebtedness:		Sovereigns with a reserve currency	Sovereigns with an actively traded currency	Below or equal to 50%	50%-100%	100%-150%	Above 150%
Narrow net external debt/ CAP (%)††	Below or equal to -50%	1	1	1	1	1	2
	-50%-0%	1	1	1	1	2	3
Narrow net external debt/ CAR (%)††	0%-50%	1	2	1	2	3	4
	50%-100%	2	2	2	3	4	5
	100%-150%	2	3	3	4	5	5
	150%-200%	3	4	4	5	5	6
	Above 200%	3	4	5	6	6	6

Positive adjustment factors

Each of the following factors generally improves the initial external assessment by one category:

- Countries displaying a significantly stronger net external position
- Countries with actively traded currencies running consistent current account surpluses

For further details, see "Adjustments for the trend and funding composition of the balance of payments"

Negative adjustment factors

Each of the following factors generally weakens the initial external assessment by one category:

- Countries exposed to a risk of marked deterioration in external financing
- Countries exposed to significant volatility in terms of trade
- Countries where low external debt reflects debt constraints
- Countries with material data inconsistencies
- Countries with actively traded currencies running high current account deficits

The following factor worsens the initial assessment by two categories:

- Sovereigns with actively traded currencies running very high current account deficits

For further details, see "Adjustments for the trend and funding composition of the balance of payments"

The external assessment equals the initial assessment, adjusted by a maximum of three categories based on the net effect of the adjustment factors outlined above

Anchor assessment measures that fall at or nearing the cut-off points (within roughly 10% of the closest threshold) may receive a better assessment if trends are improving and a worse assessment if trends are weakening, reflecting the expected future level.

*Based on the average of the current-year estimate and two- to three-year forecasts.

††Based on the current-year estimate and the expected trend for the next two to three years.

Sovereign Rating Methodology

61. Each of the following two conditions generally improves a sovereign's external assessment by one category (see table 4):

- The sovereign controls an actively traded currency and displays a current account surplus, on average, over the last historical year, the current year, and the next two forecast years.
- The country has significant and liquid nonfinancial private-sector external assets, income-earning net direct investment abroad, and net portfolio equity investment abroad. This is generally reflected in a net international investment position more favorable than the narrow net external debt position by over 100% of CAR (based on the current year and the expected trend for the next two to three years unless historical data are more relevant).

62. Each of the conditions listed below generally weakens a sovereign's external assessment by one category (see table 4).

- The sovereign has an actively traded currency and displays a high current account deficit (consistently more than 10% of CAR), likely indicating a structural problem (competitiveness, an overleveraged domestic economy, or both), or its external short-term debt by remaining maturity generally exceeds 100% of CAR. Sovereigns with an actively traded currency, displaying a very high current account deficit (consistently more than 20% of CAR) generally receive a negative adjustment of two categories.
- There is a risk of marked deterioration in the cost of or access to external financing related to our assessment of the following factors: (i) the financial sector operating in a more difficult environment because of weakening asset quality or rising funding pressures; (ii) systemically important financial and nonfinancial public enterprises are facing increasing external funding risks; (iii) a potential significant reduction in the availability of official funding due to noncompliance with the lending conditions; (iv) a potential significant loss of nonresident deposits in sovereigns where those deposits are important given the size, concentration, and vulnerabilities of the national banking system; this risk is further exacerbated if these nonresident deposits are lent onshore; or (v) a potential significant shift in foreign direct investments or portfolio equity investments, especially in countries where the net external liability position is substantially worse than the narrow net external debt position (generally by over 100% of CAR).
- The country is exposed to significant volatility in terms of trade (see Appendix C) because of a narrow or concentrated export base (including commodity-exporting countries), as measured, for instance, by the standard deviation of the change in terms of trade typically exceeding 10%, unless the country has a large net external asset position (external assets typically exceeding external liabilities by more than 50% of CAP). We generally calculate the standard deviation based on data over the past 10 years, adjusted for one-off items.
- The country's low external debt or low external financing needs reflect very limited market access, recent debt rescheduling, or similar restructuring (improving the amortization profile) typically within the past 10 years (or shorter if the debt relief was modest); arrears to official external creditors; or other similar characteristics, suggesting external vulnerabilities despite the seemingly strong ratios. Less debt, a lower interest rate, or a lighter amortization schedule following a debt rescheduling provides more fiscal room and diminishes rollover risks, but the loss of credibility and weakened payment culture negatively affect the assessment despite stronger debt statistics. We would no longer apply this negative adjustment as a sovereign establishes a track record of predictable and effective debt management and improves its debt payment culture.
- The country's external data lack consistency (for instance, because of persistently high errors and omissions, or significant unexplained stock-flow mismatches) or the country's net income indicates a significantly worse position than the net international investment position does.

Specific considerations for members of monetary unions

63. Each sovereign belonging to a monetary union receives an external assessment based on its individual external position, using table 4, and depending on the currency of the union. This is because the external liquidity and balance sheet situations of members of a monetary union may vary greatly, even though they all share a common currency and common capital markets. However, although the currency of a monetary union as a whole may be a reserve currency, individual members of the union would be treated as if the currency was just actively traded because they do not control the common currency alone.

Sovereigns with limited external data

64. A few sovereigns have insufficient data on external stocks and flows for us to apply the previously described criteria for determining the external assessment. They predominately use the currency of another sovereign as legal tender in their own jurisdictions. Several are offshore financial centers.
65. Where the data needed for external measures are not available, the sovereign's external assessment is computed in several steps.
66. The first step is to assign an initial assessment, which is the same as the initial external assessment for the sovereign issuing the currency used (the "host" country).
67. The second step is to apply a negative adjustment to the initial assessment when the lack of external data is an information deficiency and could be indicative of higher credit risks.
68. We could generally apply an additional negative adjustment if we have reason to believe the following:
- The domestic economy uses external financing and we consider that there is an appreciable risk of a sudden reduction of cross-border interbank lines, a sudden loss of nonresident deposits, or some other financial outflow that would hurt the domestic economy;
 - The financial business on which the domestic economy depends is facing rising risks from tax regimes or regulatory changes potentially occurring in the host country or countries with which that small sovereign is closely related; or
 - Other external factors or country-specific developments hurting the country's reputation as a stable international financial center might diminish its attractiveness, leading to significant deterioration in the local economy, employment, or government revenues.
69. This additional negative adjustment may not be warranted if one or more of the mitigating factors below apply:
- The sovereign is related to the host country by a treaty and banks domiciled in its jurisdiction have the same access to the host country's central bank's lender-of-last-resort and other supportive facilities as banks incorporated in the host country itself;
 - The financial system is predominantly owned by foreign parents rated in the 'A' category or higher that have access to a central bank that issues a reserve or actively traded currency and that are, in our view, strategically committed to their operations in the sovereign under consideration; or
 - There is sufficient evidence that the public and private sectors bear a significantly stronger net external asset position than the host country (when public-sector assets are sufficient to cushion the impact of potential sudden external shocks on the economy).

4. Fiscal assessment

70. The fiscal assessment reflects the sustainability of a sovereign's fiscal balances and debt burden. It considers:
- Fiscal flexibility,
 - Long-term fiscal trends and vulnerabilities,
 - Debt structure and funding access, and
 - Potential risks associated with contingent liabilities.
71. Given the many dimensions of this assessment, the analysis is divided into two segments:
- Fiscal performance and flexibility, and
 - Debt burden.
72. The overall assessment is the average of the two.

Fiscal performance and flexibility

73. To determine a sovereign's fiscal performance and flexibility, we first derive an initial assessment based on the prospective change in net general government debt calculated as a percentage of GDP (see table 5). The initial assessment in table 5 is based on the average of the current-year estimate and forecasts for the next two or three years. Our current-year estimate and forecasts are established first by reviewing the government's own projections, as well as those of external institutions such as the IMF, and then by making adjustments, when necessary, to reflect the effect of forecast economic growth or the prospects of contingent risks. In cases where the period average is distorted by one-off items, the assessment is based on the level of change in net general government debt that excludes them. Then we may adjust our initial assessment up or down by up to two categories based on the factors listed in table 5. Those factors relate to a government's fiscal flexibility and vulnerabilities, as well as long-term trends.

Sovereign Rating Methodology

Table 5

A Sovereign's Fiscal Performance And Flexibility Assessment

On a scale from '1' to '6', strongest to weakest

Change in net general government debt (% of GDP*)	<0%-1%	0%-3%	2%-4%	3%-5%	4%-7%	Greater than 6%
Initial assessment	1	2	3	4	5	6
Positive adjustment factors	Negative adjustment factors					
Each of the following factors generally improves the initial fiscal assessment by one category:	Each of the following factors generally worsens the fiscal assessment by one category:					
<ul style="list-style-type: none"> - A government with large liquid financial assets - A government with greater ability to increase general government revenues or cut general government expenditures in the short term compared with governments in countries with a similar level of development 	<ul style="list-style-type: none"> - Unsustainable or volatile revenue base that may boost fiscal performance over the period average - A government with limited ability to raise general government revenues in the short term compared with sovereigns with a similar level of development - Shortfalls in basic services and infrastructure - Unaddressed medium-term pressure due to age-related expenditure 					
For further details, see "Fiscal flexibility, long-term fiscal trends, and vulnerabilities"	For further details, see "Fiscal flexibility, long-term fiscal trends, and vulnerabilities"					

The fiscal performance and flexibility assessment equals the initial assessment, adjusted by a maximum of two categories up or down based on the net effect of the adjustment factors outlined above. When a sovereign's increase in net general government debt as a percentage of GDP could correspond to two possible categories, the initial assessment is decided based on the trend of the government's fiscal performance. For instance, a sovereign with an average change in net general government debt to GDP of 2.9% of the four-year period could receive an initial assessment of '2' or '3'. If the size of the net general government debt increase is declining, then the sovereign could receive a '2' initial assessment. If the trend is increasing, then the initial assessment would be '3'. *Based on the average of S&P Global Ratings current-year estimate and a two- to three-year forecast.

Fiscal performance

74. Our key measure of a government's fiscal performance is the change in net general government debt stock expressed as a percentage of GDP. In contrast with the reported deficit, this measure captures the impact of exchange rate movements, the recognition of contingent liabilities, and other factors that may be more important than headline deficits (see "[Common Characteristics of Rated Sovereigns Prior to Default.](#)" published Jan. 28, 2013). In addition, the headline deficit is sometimes affected by political and other considerations, possibly creating strong incentives to move expenditures off budget. Focusing on net general government debt enables us to reflect situations where fiscal deficit is covered rather by asset sales than by debt issuance, or situations where a government issues debt for certain reasons while being in fiscal surplus. The calculation of our ratio of change in net general government debt stock as a percent of GDP is explained in Appendix C. The initial assessment in table 5 is based on the average of the current-year estimate and forecasts for the next two or three years.
75. In some circumstances, the initial assessment may be exposed to large swings in cases of significant exchange rate, interest rate, or financial market movements and no longer reflect the sovereign's fiscal stance. In those cases, if we believe the fiscal accounts capture most fiscal activities, with minimal off-budget or extra-budget activities, we will derive the initial adjustment from the general government fiscal balance. General government fiscal balance figures are based on the average of the current-year estimate and forecasts for the next two or three years. In such cases, we use the same buckets as those in table 5 but apply the fiscal deficit as a percent of GDP to derive the initial fiscal assessment.

Sovereign Rating Methodology

76. We focus on measures at the general government level--the aggregate of the national, regional, and local governments--including social security but eliminating intergovernmental transactions. Relative to the central government, this measure better captures the economic effect of fiscal policy and is most closely aligned with issues relating to macroeconomic stability and economic growth.

Fiscal flexibility, long-term fiscal trends, and vulnerabilities

77. Fiscal flexibility provides governments with the ability to mitigate the effect of economic downturns or other shocks, and to restore fiscal balance. Our assessment of a sovereign's revenue and expenditure flexibility, vulnerabilities, and long-term trends is primarily qualitative.
78. Each of the following conditions generally improves a sovereign's fiscal performance and flexibility assessment by one category as shown in table 5:
- The general government has large liquid financial assets (typically, more than 25% of GDP) available to mitigate the effect of economic cycles on its fiscal performance. These assets are typically highly liquid and, if deposited in the central bank, available for withdrawal without disrupting macroeconomic policy, and if deposited in a commercial bank, available for withdrawal without hurting the bank's own liquidity positions or otherwise disrupting financial stability.
 - The government has a greater ability and willingness to raise revenues through increases in tax rates, in tax coverage, or through asset sales in the near term compared with governments in countries with a similar level of development. Revenue flexibility is a qualitative assessment based on the government's policy or track record, but also taking into account potential constitutional, political, or administrative difficulties, as well as potential economic or social consequences of such measures. Similarly, the government has a greater ability and willingness to reduce general government expenditures in the near term despite the economic, social, or political effect compared with economies with a comparable level of development. Expenditure flexibility can be determined by looking at the level and trend of public-sector wages and entitlement expenditures (pensions and health care), the mix of operating and capital expenditures, and the government's track record and policy with regard to implementing expenditure cuts when needed.
79. Each of the following conditions generally weakens a sovereign's fiscal performance and flexibility assessment by one category as shown in table 5:
- A government's revenue base is potentially volatile, stemming, for example, from a high reliance on real estate turnover taxes or royalties on the extractive industries (generally above 25% of revenues).
 - A government has a more limited ability to increase tax revenues than governments in countries with a similar level of development, for instance because of a large shadow economy or low tax collection rates, or because its economic model is based on being a low tax regime, making an increase in tax rates inconsistent with the model.
 - The country has a significant shortfall in basic services to the population and infrastructure that is likely to result in spending pressure for a long period of time, as reflected, for instance, by a "medium" or "low" UNDP human development index.
 - The sovereign faces unaddressed medium-term pressure due to age-related expenditure.

Debt burden

80. A sovereign's debt burden assessment reflects its prospective debt level. Factors underpinning the assessment are:
- Debt relative to GDP,

Sovereign Rating Methodology

- The interest cost of the debt relative to general government revenue,
 - Debt structure and funding access, and
 - The magnitude of and likelihood that contingent liabilities may become government debt.
81. In general, our measure of debt burden does not include the expected net present value of pensions and other age-related benefits, whether for civil servants, retired military personnel, or for the population at large. In our view, for central governments, these commitments are more akin to promises than outright contractual financial obligations, such as loans and bonds. Breaking a promise of such nature does not constitute a default.
82. The combination of these factors determines a sovereign's debt burden assessment (see table 6). We derive an initial assessment from two key measures of the general government debt level and cost of debt. Then, we can adjust the initial assessment based on our analysis of the government's debt structure, funding access, and contingent liabilities:
- Positively up to one category, or
 - Negatively by as many as three categories.

Sovereign Rating Methodology

Table 6

A Sovereign's Debt Burden Assessment

On a scale from '1' to '6', strongest to weakest

		Debt level				
		Net general government debt (% of GDP*)				
Cost of debt	General government interest expenditures (% of general government revenues [¶])	Below or equal to 30%	30%-60%	60%-80%	80%-100%	Above 100%
	Below or equal to 5%	1	2	3	4	5
	5%-10%	2	3	4	5	6
	10%-15%	3	4	5	6	6
	Above 15%	4	5	6	6	6
Positive adjustment factors		Negative adjustment factors				
<p>For sovereigns in a net general government debt position and benefitting from concessional lending, the debt assignment is generally one category better than the initial assessment if we assess that a government's borrowing needs are likely to be covered by official funding during the next two to three years.</p> <p>For further details, see "Access to funding and debt structure"</p>		<p>For sovereigns in a net general government debt position, the debt assessment is one category worse than the initial assessment if at least two of the four conditions apply:</p> <ul style="list-style-type: none"> – More than 40% of gross government debt is denominated in foreign currency[§], or the average maturity is typically less than three years – Nonresidents hold consistently more than 60% of government commercial debt[§] – The debt service profile is generally subject to significant variations – The banking sector's exposure to the government is typically above 20% of its assets <p>For further details, see "Access to funding and debt structure"</p>				
Negative adjustment for contingent liabilities:						
<p>The debt assessment is generally one category worse than the adjusted assessment when we view contingent liabilities as "moderate," two categories when we view them as "high," and three when they are "very high," in accordance with table 7.</p>						
<p>The debt assessment equals the initial assessment, adjusted by a maximum of three categories based on the net effect of the adjustment factors outlined above</p>						
<p>*Based on the current-year estimate and the expected trend for the next two to three years. [¶]Based on the average of the current-year estimate and two- to three-year forecasts. [§]Applicable to sovereigns with net general government debt over 10% of GDP.</p>						

Debt level and cost of debt

83. The initial analysis of a sovereign's debt level focuses on the following two measures:
- General government interest expenditures as a percentage of general government revenues, and
 - Net general government debt as a percentage of GDP.
84. The calculation of net general government debt is generally more restrictive than national measures of net general government debt because it deducts from the general government debt only the most liquid financial assets (for our definitions, please see Appendix C). For instance, the following assets are not deducted:
- International monetary reserves held by the central bank, which are typically held for the country's balance of payment needs and not for government support;
 - Loans to or investments in majority-government-owned companies; and
 - Assets for which liquidity might be impaired in a sovereign stress scenario.

Sovereign Rating Methodology

85. As such, we deduct from the general government debt only those assets to which the government will have timely access in the event of financial distress to support sovereign creditworthiness and prevent default.
86. Neither general government nor public-sector statistics typically include the central bank. In instances where a central bank issues debt that may be used for other than monetary policy purposes, we typically include the debt in our general government debt measure. It is often difficult to draw the line between monetary and fiscal operations. We could include central bank debt in general government debt if it is large enough to have an analytical impact and if it rises most years (as a percentage of GDP) and, thus, appears to be more structural than cyclical.
87. We deduct sovereign debt held by defined benefit social security funds and public-sector pension funds from the calculation of gross general government debt. We would not deduct such debt from both gross and net general government debt in exceptional cases, where all of the following apply:
- A material portion of the accumulation of such debt reflects involuntary purchases, reflecting a lack of voluntary internal buyers, for example, where such purchases represent a material amount of the financing of the government budget deficit;
 - Such debt is a large proportion of the central government debt; and
 - There is a lack of other liquid assets in the pension fund (i.e., where central government debt is the majority of assets in the pension fund).

Access to funding and debt structure

88. For sovereigns in a net general government debt position, the debt assessment is one category worse than the initial assessment if at least two of the four conditions below apply:
- Net government debt is over 10% of GDP and has significant and unhedged exposure to exchange rate movements and refinancing risk, such that, on average, more than 40% of gross government debt is denominated in foreign currency (after swaps) or the average debt maturity is typically less than three years;
 - Net government debt is over 10% of GDP and nonresidents hold consistently more than 60% of the government commercial debt;
 - Debt service is vulnerable due to a lumpy amortization profile or because of possible acceleration from puts or rating triggers; and
 - A large share (typically more than 20%) of the resident banking sector's balance sheet is exposed to the government sector via loans, government securities, or other claims on the government or its closely held agencies, indicating a limited capacity of the national banking sector to lend more to the government, without possibly crowding out private-sector borrowing.
89. On the other hand, the debt assessment is generally one category higher than the initial assessment if the following applies:
- Concessional official financing is expected to cover the government's gross borrowing requirements in the next two to three years, with the government satisfying the conditionality of official loans.

Contingent liabilities

90. Contingent liabilities refer to obligations that have the potential to become government debt, or more broadly affect a government's fiscal profile, if they materialize. Some of these

Sovereign Rating Methodology

liabilities may be difficult to identify and measure, but they can generally be grouped in three broad categories:

- Financial institutions' related contingent liabilities (financial institutions comprise public and private depository corporations and nondepository financial institutions),
- Contingent liabilities related to nonfinancial public-sector enterprises (NFPEs),
- Guarantees and off-budget contingent liabilities.

91. Contingent liabilities are assessed by estimating and rank-ordering the direct costs to the government that could be incurred due to distress in these institutions. This assessment does not include the broader costs associated with an economic downturn. Specifically, it does not include fiscal costs stemming from automatic stabilizers (lower tax revenues and higher expenditure needs) or the costs associated with stimuli, liquidity, and other support typically provided through monetary and fiscal measures. These costs and rising risks would be directly reflected in our economic, fiscal, external, and monetary assessments.
92. The contingent liabilities assessment ranks as follows: limited, moderate, high, and very high. It will lead us to generally modify the debt assessment respectively by zero, one, two, or three categories (see table 6).
93. This assessment should be interpreted as relative measures of risks. They provide only an indicative ranking of contingent liabilities' risks to the sovereign, as opposed to the broader estimate of fiscal and monetary costs. This is why we use the estimate of contingent liabilities as a qualifier when assessing a government's debt burden (see table 6). This is not a point-in-time estimate of a financial system's recapitalization needs or other costs from contingent liabilities over the rating horizon, and, therefore, is not additive to the government's existing debt.
94. The analysis of contingent liabilities is divided into the following steps:
- First, we estimate the depository corporation (bank)-related contingent liabilities.
 - Then, the bank-related contingent liability category can be adjusted down (i.e., worsened) due to risks from nondepository financial institutions, nonfinancial public enterprises, and other contingent liabilities.
95. **Bank-related contingent liabilities.** We derive the bank-related contingent liabilities by combining the Bank Industry Country Risk Assessment (BICRA; see "[Banking Industry Country Risk Assessment Methodology and Assumptions.](#)" published Nov. 9, 2011, and our monthly publication of updated BICRAs) with the size of the banking system. BICRA is a globally consistent, relative ranking of economic and industry risks across national banking systems. A BICRA is scored on a scale from '1' to '10', ranging from the lowest-risk banking systems (group 1) to the highest-risk (group 10). For those systems where we don't maintain an updated BICRA analysis, we may use BICRA internal proxies, apply the analysis of another national banking system for which BICRA assessments exist and we deem comparable, or take the weakest BICRA assessment of those that we assign.

Table 7

A Sovereign's Contingent Liability Assessment

BICRA group	Banks' assets to GDP				
	Below or equal to 50%	50%-100%	100%-250%	250%-500%	Above 500%
1 to 5	Limited	Limited	Limited	Limited	Limited or moderate
6 or 7	Limited	Limited	Limited	Limited or moderate	Moderate or high
8 or 9	Limited	Limited	Limited or moderate	Moderate or high	High or very high
10	Limited	Limited or moderate	Moderate or high	High or very high	High or very high

Sovereign Rating Methodology

96. We may improve the BICRA score we use for our contingent liability assessment (see in table 7) by up to two notches if we don't expect the cost of the potential banks' distress to be fully borne by the government. This could be due to recapitalization from foreign banks, if the banking system is characterized by a high share of foreign ownership--provided that the parent institutions are headquartered in jurisdictions with stronger BICRA assessments than their branches in the considered country. The number of notches applied depends on the share of foreign-owned institutions in the banking system and on the parent institutions' willingness and ability to provide support in a period of stress. If the support from a stronger parent is available and expected, we generally improve the BICRA group by one notch if the share of foreign ownership is over 50%, and by two notches if the share is over 75%. We believe the parent is able to support the subsidiary if:
- The company's head office is located in a country with a BICRA assessment better than that of a country where the subsidiary is located; and
 - The parent is rated no lower than 'BBB-' and its creditworthiness is equal to or better than the stand-alone credit profile (SACP) or, if the subsidiary is not rated, an estimate of its stand-alone creditworthiness.
97. Where possible, we analyze the willingness of the parent to support a subsidiary in the context of the status of the subsidiary within the group and the resulting likelihood of group support. Specifically, we believe that subsidiaries with "strategically important" or stronger status within the group, if rated under the "[Group Rating Methodology](#)," published Nov. 19, 2013, will be supported by their parents. Another example could be a track record and expectation of a "bail-in" of private-sector creditors or uninsured depositors. Yet another example could be a presence of a distinct, externally funded entity in charge of the banking sector's recapitalization.
98. We combine the BICRA group (adjusted if applicable) with the size of the banking system's assets to derive the category of bank-related contingent liabilities. Contingent liabilities to the sovereign may arise from both the investment and lending portfolios. We therefore include the banking system's total assets as a share of GDP in our assessment. We may exclude domestic bank exposures to government-related enterprises (GREs) and to the general government (as accounted for in our general government debt ratio), depending on information availability and our assessment of materiality.
99. In table 7, the resulting bank-related contingent liabilities are ranked in the following four categories: limited, moderate, high, and very high. When the estimate corresponds to two possible classifications, we make our determination of the contingent liabilities category based on qualitative judgment, including the position within the range, the risk trend in the banking system, the proportion of holdings of general government-related debt in the banks' assets (if we have not already made a quantitative adjustment, a significant exposure may lead us to a better assessment), and any other factors specific to the sovereign that are not reflected elsewhere in this assessment. The choice of category may depend, for example, on factors such as particularly low or high levels of capitalization or risk in the banking system, the general assessment of falling or rising bank contingent liabilities, or a high level of public ownership of the banking sector with a degree of directed lending.
100. After having determined the bank-related contingent liabilities category, we may adjust the assessment down (e.g., worsen to moderate from limited) for each of these factors:
- Contingent liabilities related to the non-deposit-taking institutions,
 - Contingent liabilities related to NFPEs, and
 - Guarantees or other contingent liabilities.

Sovereign Rating Methodology

101. These negative adjustments are typically made unless these non-deposit-taking institutions, NFPEs, guarantees, or other contingent liabilities are already captured in the general government debt or risks are addressed elsewhere in the criteria.
102. ***Contingent liabilities related to the non-deposit-taking institutions.*** Non-deposit-taking institutions, such as development banks, finance companies, securities dealers, or insurance companies, as well as other public-sector financial enterprises, can present contingent liabilities risk to the sovereign.
103. We generally worsen the bank-related contingent liabilities assessment by one category if condition 1 below and either condition 2a or 2b are met:
- (1) The size of these institutions is material in relation to the size of deposit-taking institutions or GDP.
 - (2a) The non-deposit-taking institutions are systemically important institutions that we deem undercapitalized, or operate in subsectors that we judge inadequately regulated.
 - (2b) The likelihood of the extraordinary government support for these non-deposit-taking institutions is deemed significant, as evidenced by a large (generally, by one rating category or more) rating uplift from the entity's SACP (by applying the GRE criteria) or from the estimated stand-alone creditworthiness if it's not rated.
104. Given the data gaps from one sovereign to another, this assessment will be more qualitative than our assessment of deposit-taking institutions..
105. ***Contingent liabilities related to nonfinancial public enterprises.*** NFPEs can also pose a risk to a sovereign because they are generally formed to further public policies and can suffer from weak profitability and narrow equity bases, which may leave them vulnerable to adverse economic circumstances. NFPEs include most GREs that are outside the financial sector. These are enterprises, often partially or totally under government control, that we believe are likely to benefit from extraordinary government intervention during periods of stress (see GRE criteria "[Rating Government-Related Entities: Methodology and Assumptions,](#)" March 25, 2015).
106. Due to significant differences in the reporting and consolidation of NFPE data by country, the quantitative assessment of NFPE-related contingent liabilities is not always possible. Hence we incorporate NPFE-related contingent liabilities qualitatively, specifically focusing on larger GREs, their financial profile, and government's propensity to support them. As such, similar to the analysis of the non-deposit-taking institutions, we review the materiality and the government's likelihood of extraordinary support of these entities in case of distress.
107. We lower the bank-related contingent liabilities assessment by generally one category (when not already accounted for in the general government debt level initial assessment) if both of the following two conditions are met:
- The sovereign has a material exposure to one or more NFPEs, for example, through ownership, guarantees, or other channels. We usually assess the exposure as material if, when added to the government net debt stock (in case these liabilities materialize), it would result in a weaker initial debt assessment per table 6. For instance, if the initial debt assessment is '2', based on net general government debt of 50% of GDP and an interest burden of 3% of revenues, we would consider an exposure to an NFPE's sector of 15% of GDP to be material because it would increase the debt stock to 65% of GDP and consequently raise the debt assessment to '3'; and
 - The likelihood of extraordinary government support for this NFPE (or a group of NFPEs) is deemed significant, as evidenced by a large (generally, by one rating category or more) rating uplift from the entity's SACP (by applying the GRE criteria) or from the estimated stand-alone creditworthiness, if not rated.

Sovereign Rating Methodology

108. In exceptional cases, due to significant sovereign exposure to NFPEs with deteriorating credit fundamentals (as seen, for example, in a rapid worsening of GREs' SACPs), we may weaken the initial contingent liabilities by up to three categories (for example, to very high from limited).
109. *Other contingent liabilities.* We apply similar qualitative analysis to other contingent liabilities, such as formal or implicit sovereign guarantees not already accounted for in the above categories, as well as quasi-fiscal or other off-budget operations, such as extra-budgetary funds, securitizations, and public-private partnerships.

5. Monetary assessment

110. A sovereign's monetary assessment results from the analysis of:
- The exchange rate regime, which influences a sovereign's ability to have an independent monetary policy tailored to the needs of its domestic economy; and
 - The credibility of its monetary policy, as measured, among other factors, by inflation trends over an economic cycle or by the impact of market-oriented monetary mechanisms on the real economy, which is largely a function of the depth and diversification of the resident financial system and capital markets.
111. Tables 8A and 8B present the factors that we generally analyze for our assessments of the exchange rate regime and monetary policy credibility. A sovereign's initial monetary assessment is derived by combining our assessments of:
- The exchange-rate regime (weighted 40%), and
 - The monetary policy credibility (weighted 60%).
112. The initial assessment for sovereigns not part of a monetary union can be adjusted down by up to two categories (see "Negative adjustments to the initial monetary assessment").
113. The assessment for sovereigns that are part of the monetary union can be adjusted down by up to two additional categories (see "Sovereigns in monetary unions").

Table 8A

A Sovereign's Monetary Assessment: The Exchange-Rate Regime

On a scale from '1' to '6', strongest to weakest

1	Reserve currency
2	Actively traded or free-floating currency
3	i) Managed float, crawling pegs, crawl-like arrangements, floating with a short track record or challenged by the effect of interest rates on capital flows, soft pegs other than conventional pegs ii) Intermittent intervention in foreign exchange market
4	i) Conventional pegged arrangement; or ii) Heavy intervention in the foreign exchange market
5	Hard peg (currency board)
6	No local currency (the sovereign uses the currency of another country)

Exchange-rate regime definition from the IMF System Annual Report on Exchange Arrangements And Exchange Restrictions. While using these definitions, our classification of countries may differ from that of the IMF.

Sovereign Rating Methodology

Table 8B

A Sovereign's Monetary Assessment: the Monetary Policy Credibility

On a scale from '1' to '6', strongest to weakest

	Monetary authority independence	Monetary policy tools and effectiveness	Price stability	Lender of last resort	Development level of local financial system and capital markets
1	All or most of all the following factors apply: Strong and long-established track record (more than 10 years) of full independence with clear objectives	Wide array of monetary instruments	Sovereign's CPI is low and in line with that of its trading partners, leading to stable REER over the economic cycle. Broad price stability by other measures	Ability to act as a lender of last resort for the financial system	Depository corporation claims on residents in local currency and nonsovereign local currency bond market capitalization combined amount to over 50% of GDP
2	All or most of all the following factors apply: Track record of independence	Market-based monetary instruments	Sovereign's CPI is low and in line with that of its trading partners, leading to fairly stable REER over the economic cycle. Broad price stability by other measures	Ability to act as a lender of last resort for the financial system	Depository corporation claims on residents in local currency and nonsovereign local currency bond market capitalization combined amount to over 50% of GDP
3	All or most of all the following factors apply: Independence, although shorter track record or less secure	Market-based monetary instruments, but heavy reliance on reserve requirements	Sovereign's CPI is broadly in line with that of its trading partners over the economic cycle. Somewhat volatile REER over the economic cycle	Ability to act as a lender of last resort for the financial system	Depository corporation claims on residents in local currency and the nonsovereign local currency bond market capitalization plus the equity market capitalization combined amount to over 50% of GDP
4	All or most of all the following factors apply: Operational independence, but shorter or less secure than at better assessments	Market-based monetary instruments, but effectiveness may be untested in downside scenario	Annual CPI is less than 10%. Somewhat volatile REER over the economic cycle	Ability to act as a lender of last resort for the financial system	Depository corporation claims on residents in local currency and the nonsovereign local currency bond market capitalization plus the equity market capitalization combined amount to less than 50% of GDP
5	Any of the following factors apply: Independence is limited by perceived political interference	Monetary statistics are not viewed as credible	Average CPI typically exceeds 10%. Volatile REER over the economic cycle	Limited ability to act as a lender of last resort for the financial system	Depository corporation claims on residents in local currency and the nonsovereign local currency bond market capitalization plus the equity market capitalization combined amount to significantly less than 50% of GDP
6	Any of the following factors apply:		Average CPI typically exceeds 20%. Volatile REER over the economic cycle	No ability to act as a lender of last resort for the financial system	Depository corporation claims on residents in local currency and the nonsovereign local currency bond market capitalization plus the equity market capitalization combined amount to significantly less than 50% of GDP

A sovereign's ability to use monetary policy and the exchange-rate regime

114. A sovereign can use monetary policy to address imbalances or shocks in the domestic economy only when it controls the dominant currency used for domestic economic and financial transactions. The exchange-rate regime influences the monetary authority's ability to conduct monetary policy. Monetary objectives may conflict with objectives to sustain a certain exchange rate. The more rigid the exchange-rate regime, the more likely this disconnect impedes the conduct of monetary policy. Sovereigns with reserve currencies have the most flexibility. For sovereigns with an actively traded currency but that operate under a fixed or currency board exchange regime, we assign an assessment of '2' if there is a long history (in general of at least two decades) of the regime successfully withstanding severe financial and economic pressures, supported by structural changes to adapt to these shocks. Such regimes are likely found in economies that are highly flexible and have significant net external asset positions.

Monetary policy's credibility and effectiveness, and inflation trends

115. Effective monetary policy requires credible institutions conducting it. Although "credibility" cannot be objectively measured, certain factors generally make a central bank more

Sovereign Rating Methodology

credible and, therefore, effective in its conduct of monetary policies. These factors include the following:

- Operational independence. We define this as the ability of the monetary authority to determine freely the best way of achieving policy goals, including the types of instruments used and the timing of their use.
 - Management and legal independence. It usually goes hand in hand with institutional settings, such as the nomination of monetary policy decision-makers for defined terms, their protection from political interference, and the independence of central banks' budgets within the confines of applicable public-sector guidelines.
116. The length of the period of independence is relevant because reversing independent monetary policy conduct may become harder the more entrenched it has become.
117. Effective monetary policy is another important foundation for confidence in monetary authorities. Confidence is crucial in a period of stress because it enables policymakers to resort temporarily to unconventional tools to counter the effect of economic shocks. A chief measure of the monetary policy's effectiveness is broad price stability, including low inflation over the economic cycle, absent the use of administrative controls. Inflation in line with that of the sovereign's trading partners creates an important foundation for confidence in local currencies as a store of value, and for the development of the financial sector. For sovereigns with the highest level of monetary flexibility, we typically expect:
- Asset prices to move in line with fundamentals, including well-contained consumer price inflation; and
 - The real effective exchange rate (REER) to typically not be subject to wide swings over an economic cycle.
118. Operating losses that central banks incur, often as a result of actions unrelated to monetary policy, such as bailouts of barely solvent (or insolvent) banks or cost of excess reserve accumulation and reserve sterilization, are also generally viewed as impairing monetary effectiveness. Similarly, the monetary policy's credibility and effectiveness assessment is typically weakest in the sovereigns with persistently high consumer price inflation. Doubtful monetary statistics also impair monetary policy's credibility.
119. The ability to be a lender of last resort to the financial sector enhances financial stability. A lender of last resort, typically a central bank, provides solvent financial institutions liquidity against good collateral when market conditions impair traditional channels. This ability is viewed as a source of monetary flexibility, but extensive use of such a role can also signal rising systemic problems.
120. The development of the financial system and debt markets is important for monetary credibility analysis because these are the channels through which monetary policy decisions are transmitted to the real economy. Monetary policy tools--such as the discount rate, reserve requirements, or open market operations--work by influencing the funding costs and conditions that households and businesses face. This influence is often weak when the financial sector is in its early stages of development, when lending conditions are set by administrative means, or when the use of foreign currency is prevalent. By contrast, a developed capital market allows for open market operations and a financial system in which local-currency transactions facilitate a central bank's conduct of monetary policy.

Negative adjustments to the initial monetary assessment

121. The following negative factors can generally lower the initial assessment by one category each, for a maximum of two categories of adjustment:

Sovereign Rating Methodology

- A country's transmission mechanisms are weak or are significantly weakening, thereby impeding monetary flexibility. Transmission mechanisms may weaken as a result of a lasting dislocation in the domestic capital markets or a significant stress in the resident financial system. The symptoms of such deterioration could include a substantial deterioration in the market capitalization of the country's largest domestically incorporated banks or a rapid widening of their funding costs. The causes of such deterioration could be sharply higher credit costs in the financial system, other losses unexpected by creditors in the financial system, or structural shifts in the wholesale funding market. These risks can be further exacerbated if public financial and nonfinancial enterprises are dominant participants in the domestic capital markets;
- Resident deposits or loans in foreign currency (dollarization) exceed roughly 50% of total; and
- Extensive exchange restrictions are applied (as informed by compliance with IMF Article VIII obligations).

Sovereigns in monetary unions

122. The monetary assessment for sovereigns in monetary unions results from a two-step process. The first step assigns an initial assessment (per tables 8A and 8B) for the monetary union as a whole. The second step of the monetary assessment can lower the initial assessment by one category to reflect if members of monetary unions generally have less flexibility, other things being equal, relative to sovereigns with their own central banks.
123. The central bank of the monetary union applies its monetary flexibility to the intended benefit of the zone as a whole and not to individual member states. Then, the assessment can weaken by another category if an economy of a monetary union member is unsynchronized with the zone at large—for instance if it displays prolonged price and wage trends diverging strongly from the monetary union average. In other words, the union's monetary policy stance could be inappropriate for a particular sovereign's economic conditions. We do not apply either of these adjustments to members with economies that account for more than 50% of the zone's GDP. This is because such economic significance usually means a better alignment of monetary policy objectives with economic circumstances.
124. Negative adjustments cited in paragraph 121 could also apply to members of the monetary union. Therefore, a final assessment of a monetary union member can be up to four categories away from an initial assessment of the monetary zone.

B. Supplemental Adjustment Factors And Caps

125. Supplemental adjustment factors are important because certain components of credit risk can, at times, dominate overall creditworthiness, even if the other factors remain stable. The dominance of negative supplemental adjustment factors is based on our judgment that the supplemental risks can jeopardize debt-service capacity more than positive developments can improve them.
126. A sovereign could receive a foreign-currency rating below the indicative rating because of:
- Extremely weak external liquidity. The country's external liquidity is, or we expect it to deteriorate to, a level substantially worse than the benchmark for the weakest levels of external liquidity, as defined in table 4. An exception is when these levels are a reflection of the sovereign's strengths (for instance, reserve currency position). We could also apply the supplemental adjustment factor if we see, or expect to see, a country's access to external liquidity to deteriorate sharply and suddenly.

Sovereign Rating Methodology

- Extremely high fiscal debt burden. A government debt burden presents characteristics significantly worse (especially, if the debt dynamic is deteriorating) than the benchmark for the weakest levels defined in table 6. Similarly, the rating would be one notch lower if the debt assessment (before the contingent liabilities adjustment but after all other adjustments as described in table 6) is '6' and contingent liabilities are high or very high in accordance with table 7.
 - Very high institutional risk and high debt burden. A sovereign with an institutional assessment of '6' cannot be rated higher than 'BB+', regardless of any potential upward adjustment for a large asset position. The track record of sovereign defaults suggests that institutional risks are among the main causes of the poor economic policies leading to default, which is why the institutional assessment receives this particular weight. A sovereign with an institutional assessment of '6' and a debt assessment of '5' or '6' cannot be rated higher than 'B+', given the heightened risks such a combination entails.
 - Event risk. In cases of imminent or rapidly rising external or internal political risk (such as war, escalating domestic conflict, or acute and growing risk to institutional stability), a sovereign rating could differ from the indicative rating, depending on the conflict's expected magnitude and effect on the sovereign's credit characteristics. In the other cases, when the risk of conflict is long-standing but not imminent, it affects the sovereign rating through an adjustment to the institutional assessment. Furthermore, the occurrence of a rare but severe natural catastrophe or the existence of exceptionally material geopolitical risk could lead to a rating that is more than one notch below the indicative rating.
127. If a foreign-currency indicative rating is already at 'b-', these supplemental adjustments would not apply unless the sovereign meets the conditions listed in ["Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings."](#) published Oct. 1, 2012.
128. A sovereign could receive a foreign-currency rating one notch above the indicative rating because of:
- Very large liquid financial government assets. General government is in a net asset position and has exceptionally large liquid financial assets (as defined in Appendix C), typically equivalent to more than 100% of GDP (based on the current year and the expected trend for the next two to three years unless historical data are more relevant). This provides the government with an exceptional buffer during periods of economic or financial shocks.

C. Determining A Sovereign Local-Currency Rating

129. Historically, we have observed lower default rates on local-currency debt than on foreign-currency debt. Any divergence between sovereign local- and foreign-currency ratings reflects the distinctive credit risks of each debt type.
130. In most cases, the sovereign local-currency rating and the sovereign foreign-currency rating are the same. The sovereign local-currency rating is one notch above the sovereign foreign-currency rating if we believe that the default risks (even if remote) apply differently to foreign- and local-currency debt and if all the characteristics below apply:
- Independent monetary policy. A government has greater capacity to pay its local-currency debt than its foreign-currency debt only if it can manage its local currency independently. Absent exchange controls, it can do this if it can set interest rates without regard to the currency's external value. For that, we typically expect a track record of a free floating or floating exchange rate (including sovereigns that have committed to join a monetary union with a free floating or floating exchange rate) or with a managed exchange-rate regime demonstrably transitioning toward a more flexible regime. We exclude countries where dollarization of deposits or claims exceeds 50% for sovereigns, imposing exchange-rate restrictions on payments and transfers for current international transactions or engaging in discriminatory currency

Sovereign Rating Methodology

arrangements, or sovereigns with a track record of default on their local-currency debt.

- Depth of the local-currency capital markets. A sovereign has greater ability to conduct monetary policy the deeper its capital markets and the broader its ancillary markets, including active secondary market trading. An important incentive in continuing to service local-currency debt, when not servicing foreign-currency debt, is that the local-currency debt may be a significant portion of the assets of local pension funds, banks, and other private-sector entities, which represent not only voters but also important elements of the local economy. We then typically expect to observe an active local-currency fixed income and money market with a capitalization typically above 20% of GDP and some secondary market trading.
- Institutional and fiscal flexibility. If institutional, political, or fiscal concerns are the dominant constraint on the rating, the sovereign is generally less likely to have sufficient flexibility to accord a higher priority to servicing local-currency obligations. We typically expect the fiscal and institutional assessments are not a dominant constraint compared with the other four assessments.

131. The sovereign local-currency rating can be several notches above the sovereign foreign-currency rating when the latter moves to the 'CCC' range, indicating a near-term risk of default; there is greater visibility on potential differences in default scenarios between a sovereign's foreign-currency and local-currency obligations. In this case, if S&P Global Ratings expects the sovereign not to default on local-currency obligations, the local-currency rating will stay in the 'B' category, thereby increasing the amount of notches between the ratings.

D. Issue-Specific Considerations

132. The rating on an unguaranteed senior unsecured sovereign foreign-currency issue is the same as the sovereign foreign-currency ICR. Subordination is uncommon in this sector. We do not assign recovery ratings to sovereign obligations.

133. The rating on an unguaranteed senior unsecured sovereign local-currency issue is generally the same as the sovereign local-currency ICR, except when a government issues:

- A local-currency-payable debt instrument, for which debt service is linked to another currency. This issue receives the same rating as the sovereign's foreign-currency debt because in a stress scenario, we expect this debt type to behave much like foreign-currency debt, with debtholders exchanging the local-currency debt service proceeds into foreign currency.
- Local-currency debt in the global capital markets and the debt documentation states that the obligations rank equally with foreign-currency obligations. This issue receives the same rating as the sovereign's foreign-currency debt.

134. The approach does not reverse, however, for foreign-currency-denominated debt issued in domestic markets. Such debt always receives a foreign-currency rating. Foreign-currency debt issuance generally diminishes the buffer that a domestic capital market can provide against economic and political shocks. We observe that such issuance often indicates domestic investors' lack of confidence in the local currency.

135. We rate fully guaranteed debt meeting our guarantee criteria (see [“Guarantee Criteria.”](#) Oct. 21, 2016) at the same level as the guarantor. Partially guaranteed debt is rated the same as unguaranteed debt.

136. Sovereigns occasionally issue commercial paper programs in foreign currency to which we may assign a short-term rating. To derive the short-term rating, we apply the standard mapping as described in [“Methodology For Linking Long-Term And Short-Term Ratings.”](#) published on April 7, 2017.

Appendixes

A. Monetary Authorities

137. Monetary authorities are unique among rated institutions in that they provide liquidity to all economic sectors. Their primary responsibilities include conducting monetary policy. They also generally serve as lender of last resort to a given financial system, which is critical to a country's well-being, and potentially an influence on several factors we take into account when rating sovereigns.
138. The ratings on monetary authorities outside of monetary and currency unions are at the same level as their respective sovereign because we consider that they are analytically inseparable from one another.
139. We apply a different approach in rating monetary authorities of monetary and currency unions, such as the European Central Bank, and the central banks of the Central African Economic and Monetary Community, West African Economic and Monetary Union, and the Eastern Caribbean Currency Union. These institutions generally have a greater degree of independence from their sovereigns' creditworthiness because they manage the monetary policies of several nations.
140. We rate these institutions based on our assessment of their monetary policy and flexibility, as defined in our sovereign rating methodology, and on the ratings on the members of the monetary or currency union. Under our sovereign rating methodology, the assessment of a monetary authority's policy and flexibility is based on these main factors:
 - The exchange rate regime, which determines in part the flexibility of the monetary policy; and
 - The credibility of the monetary policy, as measured by inflation trends and by the effectiveness of mechanisms for transmitting the effect of monetary policy decisions to the real economy, which is largely a function of the depth and diversification of the financial system and capital markets.
141. The ratings on sovereign members in a monetary or currency union will ultimately influence the factors underpinning the monetary authority's monetary flexibility and credibility. These factors include, for instance, the use of its currency as a reserve currency.
142. If a single nation dominates the monetary union (for instance, accounting for more than 50% of the union's GDP), we rate the monetary authority at the same level as the relevant sovereign.
143. For monetary authorities of unions with no dominant sovereign member, we determine ratings based on the combination of their monetary flexibility and the average rating on the sovereign members of the union, weighted by their respective shares in the monetary union's GDP.
144. We factor between zero and four notches of uplift from the weighted average rating on the sovereign members of a monetary or currency union into the rating on the monetary authority. For sovereigns that are not rated, we will use our own confidential credit estimates to assess their credit quality. The number of notches of uplift hinges on the monetary assessment we assign to the monetary authority. These assessments range from '1' to '6', with the greatest uplift applied to those monetary authorities with an assessment of '1' and the least to those with an assessment of '6' (see table 9).
145. Within the scoring categories in the table, we determine the number of notches of uplift based on our view of the most creditworthy sovereign members' ability and willingness to

Sovereign Rating Methodology

take action to support confidence in the union's currency, and the monetary authority's balance sheet.

146. We may factor in uplift in excess of four notches in some cases when rating government-related entities (see "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015). This could occur in instances where we believe that the monetary authority would likely benefit from extraordinary external support from a third party (such as another monetary authority), if needed.

Table 9

Determining The Rating On The Monetary Authority Of A Monetary Or Currency Union

Monetary assessment for the monetary authority*	Rating on the monetary authority of a monetary and currency union
1	Up to four notches uplift above the weighted average rating of the sovereign members§
2	Up to three notches uplift above the weighted average rating of the sovereign members
3 and 4	Up to two notches uplift above the weighted average rating of the sovereign members
5	Up to one notch uplift above the weighted average rating of the sovereign members
6	Equivalent to the weighted average rating of the sovereign members

*Initial monetary assessment as defined in tables above. §Weighted by share in the monetary union's GDP. For sovereigns that aren't rated, we will use our own confidential credit estimates to assess their credit quality.

B. Sovereign Obligations With Contingent Risks

147. In some cases, sovereign obligations may be exposed to contingent risks, where our view of the likelihood of payment may be somewhat weaker than that indicated by the sovereign ICR. One example is where long-term sovereign payment certificates are issued to a third party upon completion of specified milestones in connection with a project. In determining the likelihood of payment of such sovereign obligations, we may notch down, generally one to three notches, from the sovereign ICR based on our analysis of the degree of the following strengths and weaknesses. The decision of whether to notch, and if so, the number of notches, is based on the relative preponderance of positive versus negative attributes. Such attributes generally include consideration of whether:

- The obligation provides funding for projects that exhibit significant importance to the basic function and purpose of government, versus funding for projects that only serve an auxiliary function;
- The sovereign issuer, central bank, or ministry of finance (or equivalent) is responsible for payment, versus an entity one step removed from the sovereign (another governmental department or agency);
- The obligation is included in reported debt and budget for the sovereign, there is clear intent by the ministry of finance (or equivalent) or contractual language to annually budget for the required payments, versus off-balance sheet and off budget, or there are administrative risks that could delay or impede debt service payment;
- There is no evidence of political or community resistance to the related project, versus there is evidence of such resistance;
- Nonpayment of the obligation would constitute a cross-default under other sovereign debt obligations, versus nonpayment would not constitute a cross-default under other sovereign debt obligations;
- There are standard mechanisms for contract enforcement, versus domestic arbitration proceedings; and

Sovereign Rating Methodology

- Regardless of whether we notch down our rating on such contingent obligations from the ICR, we also include such obligations in our sovereign rating analysis, either in the debt metrics or contingent liabilities.

C. Glossary

Economic and monetary assessments key indicators

148. **GDP per capita (USD)**. Total U.S. dollar market value of goods and services produced by resident factors of production, divided by population.
149. **Real GDP per capita (% change)**. Percent change in constant-price per capita GDP.
150. **Consumer price index (% change)**. Average percent change in index of prices of a representative set of consumer goods bought by a typical household on a regular basis.
151. **Depository corporation claims (% change)**. Percent change in year-end resident depository corporation claims (excluding claims of the central bank) on the resident nongovernment sector. May include claims by resident nondepository financial corporations, where these institutions are of systemic importance.
152. **Monetary base**. Local currency in circulation plus the monetary authority's local-currency liabilities to other depository corporations. The latter normally consists of these depository institutions' deposits at the central bank plus central bank securities that can be used in satisfying reserve requirements, though there are national differences in definitions.

External assessment key indicators

153. **Current account receipts (CAR)**. Proceeds from exports of goods and services plus factor income earned by residents from nonresidents plus official and private transfers to residents from nonresidents. In which factor income = compensation of employees + investment income earned by residents from nonresidents. For situations where we have no detailed information on the assets of sovereign wealth funds, we estimate the respective projected investment income by applying 10-year average of nominal U.S. dollar-returns of FTSE World Index (equity) and the JP Morgan Global bond index with a weight of two-thirds and one-third, respectively.
154. **Current account payments (CAP)**. Payments for imports of goods and services plus factor income earned by nonresidents from residents plus official and private transfers to nonresidents from residents. In which factor income = compensation of employees + investment income earned by nonresidents from residents.
155. **Official reserves**. Monetary authority liquid claims in foreign currency (including gold) on nonresidents.
156. **Usable reserves**. Official reserves minus items not readily available for foreign exchange operations and repayment of external debt. In which items not readily available for foreign exchange operations and repayment of external debt = reserves pledged as security for any loan, including gold repos + reserves sold forward + reserves deposited in domestic financial institutions, including their offshore branches + required bank reserves on resident foreign-currency deposits (required reserves on nonresident deposits are included in reserves because the nonresident deposits are included in the short-term external debt measure in the calculation) + monetary base for sovereigns that have adopted a currency board or have a long-standing fixed peg with another currency if we consider the reserve coverage of the base is critical to maintaining confidence in the exchange-rate link).

Sovereign Rating Methodology

157. **Narrow net external debt/CAR or CAP (%).** Stock of foreign- and local-currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities, as a percent of CAR or CAP. The calculation of the narrow net external debt may exclude the external debt of foreign banks that do not have domestic financial assets, when material.
158. **Gross external financing needs (% of CAR plus usable reserves).** CAP plus short-term external debt at the end of the prior year, including nonresident deposits at the end of the prior year plus long-term external debt maturing within the year, as a percent of CAR plus usable reserves.
159. **Current account balance/CAR (%).** Exports of goods and services minus imports of the same plus net factor income plus official and private net transfers, as a percentage of CAR.
160. **Net foreign direct investment (FDI)/GDP (%).** Direct investment by nonresidents minus residents' direct investment abroad, as a percent of GDP.
161. **Net external liabilities/CAR (%).** Total public- and private-sector liabilities to nonresidents minus total external assets, as a percent of CAR in which total external assets = official reserves + resident public-sector external assets + resident financial institutions' external assets + resident nonfinancial sector external assets + the stock of direct and portfolio equity investment placed abroad.
162. **Terms of trade.** Price of goods exports relative to price of goods imports.

Fiscal assessment key indicators

163. **General government.** Aggregate of the national, regional, and local government sectors, including social security and other defined benefit public-sector pension systems, and excluding intergovernmental transactions. We may also include some GREs depending on information availability, our assessment of materiality, and proximity to the government sphere.
164. **Change in net general government debt as a percentage of GDP.** Net general government debt at year-end minus general government debt at prior year-end, as a percent of GDP. This measure is compared with the headline deficit, which typically ignores the impact of exchange rate movements and off-budget factors on the debt burden. Among the one-off items for which we would adjust in our analysis are changes in debt related to shifts in prefunding practices, proceeds from the privatization of government assets, shifts in exchange rates that are not expected to persist, and bank and other bailouts that are not expected to be repeated. In cases where the period average is distorted by one-off items, the assessment is based on the level of change in net general government debt that excludes them.
165. **Net general government debt/GDP (%).** General government debt minus general government liquid financial assets, as a percent of GDP. Gross general government debt includes the debt of government's asset management companies used for the resolution of banks or other private-sector bailouts.
166. **General government liquid financial assets.** General government deposits in financial institutions (unless the deposits are a source of support to the recipient institution), widely traded securities, plus minority arms-length holdings of incorporated enterprises that are widely traded plus balances of defined-benefit government-run pension plans or social security funds (or stabilization or other freely available funds) that are held in bank deposits, widely traded securities, or other liquid forms. Where government external assets

Sovereign Rating Methodology

are sufficiently large, we believe that the sovereign will be able to utilize a significant portion of them in the event of financial distress to support its creditworthiness and prevent default. As a result, general government external assets over 100% of GDP are also considered liquid financial assets for the purpose of calculating narrow net external debt, net general government debt, and the first potential adjustment to the initial institutional assessment related to debt payment culture. Defined-benefit government-run pension fund balances invested in government debt are usually excluded from gross debt if the government controls the fund, and thus are not included in assets except in exceptional cases.

167. ***Gross general government debt/GDP (%)***. Debt incurred by national, regional, and local governments and central bank debt (if applicable), as a percent of GDP. Internal holdings, including social security and defined benefit public-sector pension fund investments in government debt, are netted out.
168. ***General government interest/general government revenues (%)***. Interest payments on general government debt, as a percent of general government revenues.

Impact on outstanding ratings

We expect marginal rating impact resulting from the changes in these criteria.

Related criteria and research

Retired criteria

- [Sovereign Rating Methodology, Dec. 23, 2014](#)
- [Monetary Authorities Rating Methodology, Sept. 11, 2013](#)
- [Methodology: Rating Partially Guaranteed Sovereign Debt, May 6, 2013](#)
- [Sovereigns And Equalized GRES Commercial Paper Rating Methodology, March 29, 2012](#)

Related criteria

- [Methodology For Linking Short-Term And Long-Term Ratings, April 7, 2017](#)
- [Guarantee Criteria, Oct. 21, 2016](#)
- [Rating Government-Related Entities: Methodology and Assumptions, March 25, 2015](#)
- [Group Rating Methodology, published Nov. 19, 2013](#)
- [Criteria for Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012](#)
- [Banking Industry Country Risk Assessment Methodology and Assumptions, Nov. 9, 2011](#)
- [Principles of Credit Ratings, Feb. 16, 2011](#)
- [Stand-Alone Credit Profiles: One Component of a Rating, Oct. 1, 2010](#)
- [Credit Stability Criteria, May 3, 2010](#)
- [The Time Dimension of Standard & Poor's Credit Ratings, Sept. 22, 2010](#)
- [Understanding Standard & Poor's Rating Definitions, June 3, 2009](#)
- [Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009](#)

Related research

- [What's New In S&P Global Ratings' Updated Sovereign Rating Methodology?, Dec. 18, 2017](#)
- [GDP Per Capita Thresholds For Sovereign Rating Criteria, Dec. 18, 2017 \(updates semiannually\)](#)
- [Sovereign Ratings Score Snapshot, Dec. 18, 2017](#)
- [What Does S&P Global Ratings Consider A Default For Sovereign And Non-U.S. Local And Regional Governments?, April 13, 2017](#)
- [Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017](#)
- [Common Characteristics Of Rated Sovereigns Prior To Default, Jan. 28, 2013](#)

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Sovereign Rating Methodology

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