S&P Global Ratings

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How We Rate Sovereigns

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This article provides a summary of each key stage of S&P Global Ratings' "Sovereign Rating Methodology," published Dec. 18, 2017.

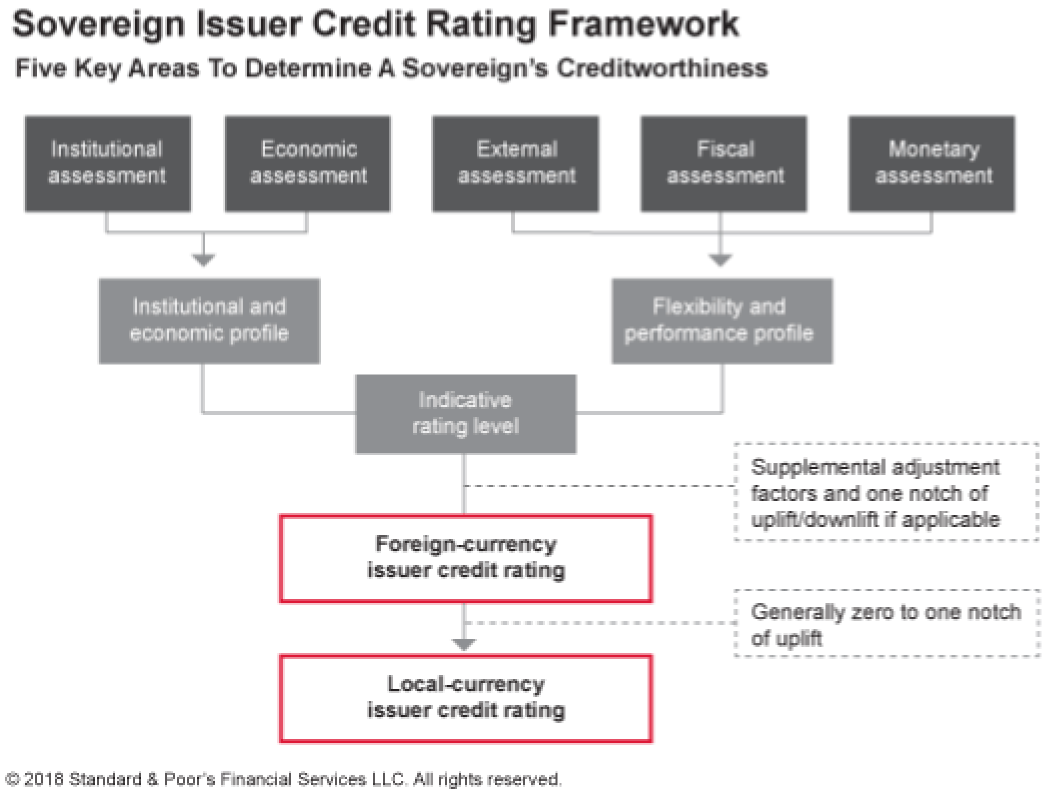
S&P Global Ratings' global methodology applies to sovereign governments and monetary authorities and aims to give market participants a clear picture of how we rate both types of entities. The criteria apply to issuer credit and issue ratings. For the purpose of the criteria, we define a sovereign as 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.

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:

- 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.

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.

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).



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.

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.

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.

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."

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.

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.

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 policymaking. 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.

We then use the flexibility and performance profile and institutional and economic profile to determine an "indicative rating level" (see table). 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-'.

Indicative Rating Levels

From The Combination Of The Institutional And Economic Profile With The Flexibility And Performance Profile

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	Assess-ment	1	1.5	2	2.5	3	3.5	4	4.5	5	5.5	6
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-

Assigning 'CCC+', 'CCC', 'CCC-', and 'CC' ratings is based on "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings," Oct. 1, 2012.

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. 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.

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). 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.

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.

Related Criteria

- Sovereign Rating Methodology, Dec. 18, 2017