Moody's Rating System

Moody's ratings provide the international capital markets with a globally consistent framework for comparing the credit quality of rated debt securities. The rating system permits a comparison of rated debt obligations regardless of the currency of the obligation, country of the issuer, or the industry in which the issuer operates. Moody's rates 70% of all Eurobonds and over 500 issuers of Euro-commercial paper and Euro certificates of deposit.

Moody's Long-Term Debt Ratings

Moody's long-term debt ratings are assigned to specific debt instruments (such as bonds and debentures) and reflect our assessment of:

1) Credit Risk - the future ability of an issuer to repay its long-term debt obligations; and
2) Indenture Protection - the level of legal protection afforded to the holder of a specific security based on that security's indenture provisions relating to senior/subordinate status, security, negative pledge clauses, guarantees, etc.

An issuer's senior, unsecured debt rating may be regarded as an indication of the issuer's overall credit quality, but investors are advised to confirm ratings of specific securities they consider purchasing, because securities issued by a single issuer may carry different ratings due to different indenture provisions. Precise definitions of each long-term rating category are provided at the end of this publication.

Moody's Short-Term Debt Ratings

Moody's short-term ratings, unlike our long-term ratings, apply to an individual issuer's capacity to repay all short-term obligations rather than to specific short-term borrowing programmes. Once assigned to an issuer, a short-term rating is global in scope; it applies to all the issuer's senior, unsecured obligations with an original maturity of less than one year regardless of the currency or market in which the obligations are issued. An exception to the global nature of these ratings occurs if an issuer's rating is supported by another entity through vehicles such as a letter of credit or guarantee. Precise definitions of each short-term rating category are provided at the end of this publication.

The following is a ranking (from highest to lowest) of Moody's long-term and short-term rating categories. The indicated relationship between long-term and short-term ratings is approximate and may not necessarily apply in all situations.
Transparency:
A Post-Asian Crisis Review

Based on Remarks at the
International Institute for Securities Market Development
Sponsored by the Securities and Exchange Commission
April 21, 1999

Summary Opinion

One of the most important elements of a well-functioning fixed-income market is the quality of the information that flows between companies that borrow and the financial markets. Equity and debt investors active in emerging markets are frequently operating under conditions that are less than ideal. They often have very little information on the companies they invest in, and communications are sometimes limited because of cultural or language barriers. However, the scarcity of information is changing in some countries.

- New rules for accounting standards and financial disclosure may be partially responsible for the relative stability of the banking sector in some countries in Latin America.
- Some self-regulation is occurring in Latin American countries, as new foreign participation brings global standards of information technology and financial transparency to domestic markets, and privatization results in more banks operating on a commercial basis.
- The South east Asia region has a more mixed record, with some countries pulling back from reforms after an initial move toward greater transparency, and others adopting fully a disclosure-based regulatory scheme.

continued on page 3
**Improvements to Local Securities and Financial Markets**

Out of the ashes of the Asian financial crises have evolved a significant improvement in their local securities and financial markets. Moody's analysts have been observing very positive trends in accounting standards and financial disclosure, both of which affect fixed-income capital markets and the banking sector. These reforms are often led by bank regulators, but they are also taking shape in debt and equity securities markets.

Additionally, our analysts are noticing that better disclosure may be a significant factor that is allowing some regions to survive economic turbulence, at least to date. That change, driven both by regulatory requirements and the demands of a global marketplace, is beginning to drive a more efficient allocation of capital.

In the past, New Zealand has been cited as an example of a securities and banking market where the regulators moved from rule-based regulation to a disclosure-based regime. They have been successful in generating discussion within the financial markets about the comparative quality of their banks. The recognition of the varying credit quality of market participants made its way even into the general press, and apparently this commentary has substantially improved the regulators' confidence in the stability of the financial system.

**How Latin America Differentiates Itself**

However, New Zealand's regulators are not the only ones who have made such a move. In our view, what distinguishes the Latin American region from various other emerging markets is the degree and extent of its governments' long-term commitment to improvements in prudential supervision and regulation.

This commitment has enhanced the transparency of the region's financial reporting in general. Banking regulators have led the effort in this regard, but securities regulators have been quick to see its benefits. They too have made significant efforts to create greater transparency in public debt and equity markets.

In this respect, Latin America is far ahead of many other regions of the world. Many challenges still face Latin American systems, but the region should continue to benefit from the process of financial sector liberalization, improvements on the regulatory front, and governments' willingness and determination to maintaining the overall health of their financial systems.

This discipline should help alleviate some of the pain of current global and internal economic conditions, at least relative to other emerging-market economies. Latin America started out in a significantly weaker position than most East Asian countries in 1997, burdened with heavy foreign currency debt, high debt-service ratios, low savings rates, and low growth rates—but it now appears in a better position to weather further currency and banking sector crises than the Asian regions.

**Banks as an Example**

From our perspective, the enhancement of financial reporting for financial institutions, including more timely and comprehensive financial disclosure, has improved investor confidence in the accuracy of disclosure and in their assessment of the relative risks present in specific Latin American banking systems. This process has been supported by three important factors:

1. the privatization process and the management of a greater portion of most banking sectors on a commercialized basis;
2. increased foreign ownership of banks (bringing in both information technology and capital); and
3. the ability and willingness of many private-sector banks to self-regulate, even in systems where overall weaknesses still exist.

All of these factors have begun to weed out the weaker players in these markets in a far less destabilizing way than in most other emerging-market systems — Brazil is most noteworthy — and thereby have induced banking sector consolidation throughout the region.

*Moody's Special Comment 3*
Specific Examples of Latin American Successes

In the case of Chile and Colombia, transparency is directly related to long-standing policies of open-market economics, bolstered by traditionally strong and capable management teams throughout the private-sector, all of which have been supported by relatively strong and independent regulatory bodies in both of these nations.

Argentina's track record is also particularly noteworthy. There have been vast improvements in its bank regulation, less-restricted ownership of the banking sector, and a clear determination on the part of the regulatory body to improve the implementation and enforcement of its regulatory regime. A more transparent picture of the health of the financial sector has been the result. Some notable examples are improvements in financial disclosure, including asset quality, regulations designed to account for restructured assets, and a more detailed disclosure regarding the sources of profitability and losses on a systemwide basis. So far, this development in the banking sector has enabled Argentina to weather the financial storm emanating from Brazil. This represents a very different experience from what happened following the Mexican crisis of 1994-1995; the Argentine banking system was put under enormous stress at that time.

Many challenges still face the Brazilian authorities, especially given the balance-of-payments and fiscal position of the government. Nevertheless, we note the ability of the private-sector banks to be self-regulating. Also, the relatively stronger technological expertise throughout the financial sector has enabled regulators to more efficiently and rapidly enforce many regulations; this includes recent improvements in the disclosure of asset quality to include an assessment of restructured assets, to name simply one important example.

Because of the regulatory environment, and because of the increased transparency seen throughout much of Latin America, the banking systems have provided a strength to the regional economy, and not a weakness. As a consequence, deeply based support for better regulation and greater systemic transparency is clearly evident across the region. Unfortunately there are still some exceptions.

East Asia's economic fundamentals have been (and continue to be) much stronger than those of Latin America. Nevertheless, one could easily imagine if East Asia's adoption of Latin America's approach to regulation and transparency would probably have greatly insulated the various nations from the collapse in investor confidence that began in 1997.

How Securities Markets Can Benefit From Transparency

A similar benefit can be achieved by securities markets regulation. The current Latin America trend toward greater corporate transparency for capital market issuers is a welcome one. We note the value that greater transparency brings in improving corporate governance. To provide greater transparency, clearly companies' management information systems often have to be substantially improved. That, in turn, often results in company managers finding things out about their companies of which they previously had no knowledge.

To borrow again from the example of the banking sector, once Japanese banks were required to make an honest measure of delinquencies on their loan portfolios, they had to centralize internally information previously available only to the branch managers. Senior bank officials had previously asserted they had no significant bad loan problems, but they suddenly realized that they indeed had major potential loan losses. At least in part, this regulatory pressure appears to have at last galvanized the Japanese banking system into finally addressing its huge, long-standing loan-quality problems.

In less extreme cases, the exposure of the economics of the companies to public view provokes a fruitful dialogue with the market—one that requires the company manager to understand the business in great detail, and be able to justify strategies and operations for each of its lines of business in the cold light of investors' examinations. Car manufacturers began to shed golf course subsidiaries, for instance, and oil companies began to exit the airline business.
Asia’s Recent Mixed Record

South east Asia has been progressing in terms of transparency, but the record here is mixed. In some countries, financial regulators have even begun to regress in the amount of disclosure that they are requiring from their banks. After initial market reforms that attempted—at least partially—to create a more open and transparent system, several countries, among them Malaysia, Korea, Indonesia, and Taiwan, have seemed to allow the banks’ financial information to become more cloudy. Those sovereigns and their institutions that issue securities into the cross-border markets or attempt to tap into the interbank markets, however, will find it very difficult to access European or US investors unless they present much more clarity about their financial conditions.

Not all of the region is regressing, however. Singapore has emphasized its intention to move from a rule-based regulatory scheme to a disclosure-based scheme. The Monetary Authority of Singapore wants to allow market participants to fully understand the particular risks of securities issuers and banks, and then to assume only those levels of risks with which they feel comfortable. At least that market regulator has come to recognize transparency as a preferred mechanism for improving corporate governance and fiscal responsibility.

Japan has also become increasingly aggressively in requiring banks to disclose their non-performing loan problems. New accounting standards for other types of companies came into effect in April. The stock exchange is seeking to enforce more stringently disclosure standards already required of listed companies.

In each of these situations, those countries that are improving their financial transparency are recognizing that issuers in their countries, including sovereigns, corporations, and banks, have lost the trust of many investors. They believe that issuers of equity and debt must expose their credit quality and business to the full light of day as part of the necessary improvements that must be made, in order to regain that trust.

Rating Agencies as Information Providers

Some regulators assume that rating agencies can be of greater service to financial markets when they serve as the conduit of information between issuers and investors. Based on its experience, Moody’s concludes the opposite is true. It is no accident that rating agencies’ opinions are the most trusted in countries where financial and markets transparency is greatest. Investors must have confidence in the quality of the information and opinions on credit they receive through the analysis provided by rating agencies. If they do not have access to the same information, they have no way of knowing whether we are right or wrong until a highly rated security defaults. If investors see the same information, and reach a similar conclusion, they are more likely to trust the next rating opinion from that rating agency.

We welcome recognition of another aspect of rating agencies. It has become increasingly apparent to securities regulators that it is important for rating agencies to voice their opinion notwithstanding the payment by issuers for those opinions. Each of the global rating agencies have built their reputations by issuing credit opinions whether or not they were asked to by the issuer. Moody’s credit decisions have never been dictated by whether or not the issuer would pay for that opinion, but whether investors were interested in ratings on that issuer’s securities. In the past several months, Moody’s has observed a few domestic rating agencies and regulators beginning to recognize the value of insulating rating agencies from the whims of issuers by promoting what some refer to as “unsolicited ratings,” or rather, ratings driven by investor rather than issuer needs. If that trend continues, we think domestic rating efforts will become much more credible with domestic investors.
To order reprints of this report (100 copies minimum), please call 800.811.6980 toll free in the USA.
Outside the US, please call 1.212.553.1658.
Report Number:
45531
Moody's Sovereign Ratings: A Ratings Guide

What Do We Mean By "Default"?

Moody's defines default as any missed or delayed disbursement of interest and/or principal. We include as defaults distressed exchanges where: (1) the issuer offers bondholders or depositors a new security or package of securities that amount to a diminished financial obligation (such as preferred or common stock, debt with a lower coupon or par amount, or a less liquid deposit either because of a change in maturity or currency of denomination, or required credit maintenance facilities) and (2) the exchange has the apparent purpose of helping the borrower avoid default.

Moody's also classifies as a default when an issuer delays payment for credit reasons even when payment is ultimately made within the grace period provided for in an indenture or deposit agreement. Our rationale for including grace period defaults is simply that a contractual payment was not made when due.

It is important to keep this definition in mind, because many commentators use "default" in a much narrower sense, that is, in the legal context of a creditor actually declaring a debtor in default on a particular obligation, resulting in a judgment by a court in favor of the creditor. Anyone who examines the post-World War II period will quickly recognize the significant practical difference between what we mean by default, and what a judge might determine to be a default in a legal proceeding.
Country Ceilings

Country ceiling for foreign currency bonds and notes: These represent the highest foreign currency rating an issuer might receive where the obligor is subject to the sovereignty of a particular government. The ceiling indicates the highest rating that can be assigned to the issuer with the lowest transfer risk, i.e., with the greatest claim on foreign exchange during a crisis. This is usually the sovereign itself, although in Euroland, the lowest risk would be associated with the European Central Bank. In cases where there is no particular debt obligation outstanding, a sovereign ceiling rating could still be issued based on an assessment of risk posed by a national government if it were to issue a foreign currency obligation. We consider such obligations to represent the lowest foreign currency default risk within a country. The reason: a national government, through its ability to mobilize foreign currency assets within its own domain, has almost by definition the best ability to obtain foreign exchange of any issuer within the country. For instance, governments may, and often have, imposed foreign exchange controls. Governments may, and often have, instituted foreign currency deposit regulations aimed at capturing foreign exchange within the country. The tools available to a government to gain access to foreign exchange are well established and clearly recognized under international law.

Private issuers often have argued that their obligations pose a lower risk than those of their own government in this regard because of their special circumstances. Although we always explore each case on an individual basis, in the end, if the issuer is subject to the law of its home government, even if its activities are mainly undertaken outside the home country, we have found that the issuer is in fact still subject to the foreign currency country ceiling. (The requirements for exceeding the foreign currency country ceiling are outlined below under the heading “Piercing the Country Ceiling.”) The foreign currency country ceiling does not necessarily represent the risk of the establishment of exchange controls per se, but rather the risk associated with exchange controls which could disrupt the timely repayment of debt securities. Nor does it necessarily represent the risk of rescheduling bank loans. The risk of a sovereign moratorium on bank loans is better represented by the foreign currency country ceiling for bank deposits described below.

COUNTRY CEILINGS FOR FOREIGN CURRENCY BANK DEPOSITS

These represent the default risk associated with: 1) foreign currency-denominated bank deposits held within a country; 2) deposits with a branch of a foreign bank located in the particular country; or 3) deposits with an overseas branch of a bank domiciled in that country.

A foreign currency bank deposit is any foreign-currency-denominated deposit (e.g., in Mexico, any deposit denominated in any currency except the peso) in any domestic bank or foreign bank branch located in the country (A foreign currency deposit held with Citibank's Mexico City branch office would be subject to the Mexican foreign currency bank deposit ceiling.) It also includes any foreign-currency denominated deposits in foreign branches of the country's banks. A Japanese yen deposit in the New York branch of a Mexican bank would be subject to default risk posed by either the U.S. or Mexican government. But since the bank is subject to the laws of its home country, in this case Mexico, any legal actions taken by the Mexican government may have an impact upon the bank’s ability to meet its foreign currency obligations anywhere in the world, despite the deposit being located in the United States. Therefore, the Mexican foreign currency bank deposit ceiling would apply, despite the deposit's U.S. location. Looked at from a different angle, since the Mexican bank's foreign currency deposit rating is limited by the Mexican sovereign ceiling for bank deposits, the ratings on deposits by Mexican financial institutions anywhere in the world are limited by the rating of foreign currency deposits of the bank in its home country.

A default on a foreign currency bank deposit would be judged to occur if the government mandated credit maintenance facilities, which means that if any depositor withdraws a deposit, the depositor must immediately redeposit/re lend the same amount as was withdrawn (e.g., a requirement whereby a maturing certificate of deposit or CD must be replaced by the purchase of a new CD or provide other credit equal to the amount of the maturing CD).
PIERCING THE COUNTRY CEILING

In order for a cross-border security issuance or a forward sale transaction to obtain a rating that exceeds the foreign-currency ceiling of the country in which the issuer or originator is domiciled, the transaction will be reviewed for its presence of certain conditions. In essence, the transaction will be evaluated as to the likelihood that it would continue to pay investors as specified in the original contract even in the event of a severe balance of payments or financial crisis in which the government has defaulted upon (by Moody’s definition) its own eurobonds and has imposed a general foreign exchange payments moratorium on entities within that country. It should be convincingly demonstrated that a transaction will generate (or otherwise have access to) ample foreign exchange revenues to pay all debt service and/or would not fall subject to foreign exchange controls if imposed. This exemption from controls could arise through the explicit permission of the monetary authorities, due to the commercial nature of the underlying transaction, or because of the high opportunity costs associated with interfering with the transaction. Except in special instances, the following factors are essential:

1) The credit quality of the entity which is to generate or deliver the necessary resources offshore should equal or exceed the rating of the transaction.

2) The originator should be a major exporter generating significant foreign exchange revenues and/or be involved in transactions that generate foreign exchange in a form that would be difficult for the government to divert or control (e.g., cross-border credit card receivables).

3) With some exceptions, such as transactions involving a strategic industry of national importance,
   (a) the debt service for the transaction should be low relative to its cash flow, and
   (b) total debt service for all transactions that are issued out of the same country and, for example, are backed by future export receivables, should be unlikely to become a significant portion of the country’s total foreign currency obligations.

4) The disruption or diversion of the delivery of the underlying commodity or service should be difficult, expensive and time consuming.

5) The political and/or financial incentives for the government to interfere with the transaction should be low.

6) Where applicable, sovereign immunity should be waived explicitly.

7) Payments of hard currency should be made to an entity or into an account outside the geographical boundaries of the country, and within a legal system with satisfactory risk.

8) Swaps associated with the transaction should not terminate upon the imposition of foreign exchange controls.

9) The legal structure of the transaction should be sound and enforcable, as of the closing date, under both the laws of the applicable local jurisdiction and the laws governing the transaction.

LOCAL CURRENCY GUIDELINES

A local currency guideline assesses the general country-level risks that need to be incorporated into the ratings of locally domiciled obligors or locally originated structured transactions denominated in local currency. In particular, while not acting as an absolutely rigid ceiling, it will indicate the highest rating level that might be assigned to the financially strongest transactions in the country, if they warrant that level on the basis of their stand-alone creditworthiness.

Local currency guidelines do not affect possible local currency ratings of genuinely foreign obligors. Foreign obligors are usually able to receive a rating similar to their local currency rating in their home country. They are not generally constrained by these guidelines. The reason for this is that we have not been able to find instances, even when countries were in severe financial distress, in which those countries were unwilling to accept foreign currency in exchange for local currency. Therefore, Moody’s believes
that a creditworthy foreign obligor which has to repay an obligation in local currency could always bring in an adequate amount of foreign currency to purchase local currency in order to meet its debt service obligations in local currency. For instance, Moody's has rated and will continue to rate local currency-denominated bonds of multilateral organizations such as the World Bank, the Asian Development Bank, etc., Aaa even when they have borrowed in exotic local currencies. However, local subsidiaries and/or local branches of foreign banks are subject to the guidelines unless there is an explicit guarantee, or similar assurance, from the home office.

It could be argued that the guideline for domestic obligors in local currency should be Aaa because there are always “premier” borrowers in every country. If a Aaa represented a simple ordinal ranking, that might be the case. However, since the ratings scale is associated with the risk of repayment on a scale which is comparable globally, the best credit within one country, even in local currency, might not be the equivalent of the best credit in another country. With this as background, it becomes important to assess whether there are any possible institutional, structural, political or other features of individual countries which might lead one to conclude that even the best credit in that country should be rated below Aaa.

In establishing this type of “country risk guideline”, both quantifiable and non-quantifiable criteria are relevant: 1) Is there a substantial risk of political regime change which could lead to a general repudiation of debts — or a risk of civil war/anarchy or foreign invasion? 2) Does the country have a well-established system of contract law, which allows for successful suits for collection of unpaid debts, seizure of collateral, etc.? 3) Does the country have a deep financial system which is effective in making payments and avoiding technical breakdowns? 4) Is the regulatory/legal environment malleable, corrupt, unpredictable, etc.? 5) Is there a tendency towards hyperinflation? (Concerning hyperinflation, what we are interested in is not so much the rate of inflation itself, but rather the possibility that the government of the country, in an attempt to avoid a descent into hyperinflation, might impose controls on the domestic payments system [e.g., a deposit freeze] which could jeopardize many obligors’ ability to repay debts on a timely basis).

Although the risk of a foreign-currency default is not a perfect predictor of possible local currency risks, many of the variables required to determine a foreign-currency ceiling are similar to those which would indicate the level of country risk measured in local currency. Nonetheless, since the risks posed by systemic default risks in local currency are generally, though not necessarily always, lower than the risk of a default in foreign currency, most local currency guidelines are significantly higher than the foreign-currency rating.

**GOVERNMENT BONDS DENOMINATED IN LOCAL CURRENCY**

Local currency guidelines are often higher even than the default risk of the national government’s local currency bonds, since even if a government reschedules its debt, this does not necessarily lead to large-scale disruption of the local currency payments system. At the same time, since any rescheduling of government securities would probably have a significant effect upon the banking system, a local currency bank deposit rating is probably more often closely related to the actual government bond rating in local currency than it would be to the local currency guideline for the country.

As noted above, Moody's does not accept the premise that all bonds issued by governments in their own currency should be rated Aaa. History proves that to be an erroneous assumption. In fact, in certain instances, Moody's has even rated local currency instruments of a government lower than bonds issued by that same government in foreign currency. Since a rating measures our assessment of default risk, we are simply stating in those exceptional cases that we perceive a higher risk on local versus foreign currency instruments of that particular government.

The rating of a government in local currency takes into account the government’s ability to mobilize currency to meet its domestic currency financial requirements. Most governments have a greater capacity to mobilize domestic rather than foreign resources. Therefore, the risk of a default on local currency instruments is usually lower than the risk of default on foreign currency instruments. However, risks still remain. A domestic currency government bond rating is related not only to the structure of the economy and its ability to generate resources, but also on the government’s ability to mobilize these resources. Different governments have different capacities to mobilize resources. A long-established democratic regime probably has a far greater capacity to mobilize domestic resources than a transition economy undergoing rapid political transformation. In addition, it is not so much the size of the public sector itself that is important, but its size relative to its usable resource base.
Another important constraint is political. Can the government of the day mobilize resources under a stress scenario? Although it might have the theoretical capacity to mobilize resources, such a mobilization might interfere with other important policy goals of the government of the day. As a result, under certain circumstances, a government might see a default on its local currency debt as less onerous than the maintenance of policies which would allow for a full and timely repayment of local currency debt.
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Report Number:
43788
Sovereign Credit Ratings: A Primer

Contents

- Behind the Ratings
- Local Currency Ratings Factors
- Foreign Currency Rating Factors
- Local and Foreign Currency Rating Distinctions
- Sovereign Rating Changes
- Sovereign Ratings and Corporate Credit Risk

(Editors' note: Some of the data presented in the criteria article “Sovereign Credit Ratings: A Primer,” published on Nov. 5, 1998, were incorrect. The complete, corrected article follows.)

Standard & Poor's sovereign credit ratings—which now cover local and foreign currency debt issued by governments in 77 countries and territories (see table 1)—are an assessment of each government’s capacity and willingness to repay debt according to its terms. Sovereign ratings are not “country ratings,” an important and often misunderstood distinction. Sovereign ratings address the credit risks of national governments, but not the specific default risks of other issuers. Ratings assigned to other public and private sector entities in each country can, and frequently do, vary. Ratings of some issuers may be the same as the sovereign's, while others are lower. In rare cases, the ratings of some issuers may be even higher. In all instances, however, the sovereign's ratings set the benchmark for the ratings assigned to other issuers under its jurisdiction.

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<td>AA</td>
<td>Morocco</td>
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<td>BB</td>
</tr>
<tr>
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<td>AA</td>
<td>AA</td>
<td>Argentina</td>
<td>BBB</td>
<td>BB</td>
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<td>AA</td>
<td>Peru</td>
<td>BBB</td>
<td>BB</td>
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<td>AA-</td>
<td>Costa Rica</td>
<td>BBB+</td>
<td>BB</td>
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<tr>
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<td>AA-</td>
<td>Jordan</td>
<td>BBB</td>
<td>BB-</td>
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<tr>
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<td>A+</td>
<td>Paraguay</td>
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<td>Bolivia</td>
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<td>Brazil</td>
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<td>A</td>
<td>Lebanon</td>
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<td>BB-</td>
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<td>A+</td>
<td>A</td>
<td></td>
<td></td>
<td></td>
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<td>Czech Republic</td>
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<td>Venezuela</td>
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<td>B-</td>
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<td>N.R.</td>
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<td>Indonesia</td>
<td>B-</td>
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<td>CCC-</td>
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<td></td>
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<td>Russia</td>
<td>N.R.</td>
<td>CCC-</td>
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Ratings as of 10/15/98. N.R.—Not rated.

Defaults by sovereign issuers of bank and bond debt—the risk the ratings address—have declined in recent years, at least until 1998. Since 1975 (and even earlier), in fact, no sovereign issuer has defaulted on local or foreign currency debt rated by Standard & Poor's. Will such defaults occur in the future? Judging from the volume of bond issuance by emerging market sovereigns in the 1990s, many with ratings in the speculative-grade ('BB+' ratings or lower) category (see table 1), Standard & Poor's believes that they will. The default rates for sovereign issuers, over time, should broadly parallel the default rates for similarly rated corporate issuers.

If defaults occur more frequently in the sovereign sector, as we expect, this will not be an unprecedented development. Defaults on foreign currency bonds took place repeatedly, and on a substantial scale, throughout the 19th century and as recently as the 1940s. Sovereign default rates fell to low levels only in the first three decades after the Second World War (see chart 1), when cross-border sovereign bond issuance also was minimal. Defaults on bank loans, the main vehicle for financing governments in the 1970s and 1980s, peaked in 1990 and have fallen steadily since then.

Past defaults reflected a variety of factors, including wars, revolutions, lax fiscal and monetary polices, and external economic shocks. As the 1990s draw to a close, fiscal discipline, debt management, and the contingent liabilities arising from weak banking systems, in particular, represent significant policy challenges for many sovereigns. The associated credit risks, which for a time may seem manageable, can mushroom quickly—as events in a number of emerging market countries since 1997 have shown. Given these factors, it...
would be surprising if a new sovereign default cycle did not emerge over the next decade. Standard & Poor's believes, therefore, that understanding sovereign ratings, what they mean, and the criteria behind them, is more relevant than ever.

Behind the Ratings

Standard & Poor's appraisal of each sovereign's overall creditworthiness is both quantitative and qualitative. The quantitative aspects of the analysis incorporate a number of measures of economic and financial performance as outlined below. The analysis is qualitative because Standard & Poor's ratings indicate future debt service capacity.

The ratings service uses both a "top down" and a "bottom up" analyses to determine sovereign ratings. "Top down" analyses consider global systemic factors, which past experience suggests influence both the timing and magnitude of sovereign defaults. Examples include quarterly analysis of default trends throughout the sector (see Sovereign Defaults in 1998: A Turning Point?, November 1998) and regular examination of global financial sector risks (see Global Financial System Stress: Leading Indicators Signal Pressure in 16 Countries, September 1998).

The "bottom up" analyses focus on the credit fundamentals affecting each government. It divides the analytical framework into eight categories so that all important factors that contribute to sovereign default are considered in turn (see box). Each category relates to both economic and political risk, the key determinants of credit risk. Economic risk addresses the government's ability to repay its obligations on time and is a function of both quantitative and qualitative factors. Political risk addresses the sovereign's willingness to repay debt.

Willingness to pay is a qualitative issue that distinguishes sovereigns from most other types of issuers. Partly because creditors have only limited legal redress, a government can (and sometimes does) default selectively on its obligations, even when it possesses the financial capacity for timely debt service. In practice, of course, political and economic risks are related. A government that is unwilling to repay debt usually is pursuing economic policies that weaken its ability to do so. Willingness to pay, therefore, encompasses the range of economic and political factors influencing government policy.

As part of the committee process that Standard & Poor's uses to assign credit ratings, each government is ranked on a scale of one (representing the highest score) to six (the lowest) for each analytical category in relation to the universe of rated and unrated sovereigns. There is, however, no exact formula combining the scores to determine ratings. The analytical variables are interrelated and the emphasis can change when, for example, differentiating the degree of credit risk between a sovereign's local and foreign currency debt.

Because the default frequency of sovereign local currency debt differs significantly from that of foreign currency debt, both types of debt are analyzed. While the same political, social, and economic factors affect the government's ability and willingness to honor local and foreign currency debt, they do so in varying degrees. A sovereign government's ability and willingness to service local currency debt is supported by its taxation power and its ability to control the domestic financial system, which gives it potentially unlimited access to local currency resources.

To service foreign currency debt, however, the sovereign must secure foreign exchange, usually by purchasing it in the currency markets. This can be a binding constraint, as reflected in the higher frequency of foreign than local currency debt default (see Sovereign Defaults Continue to Decline in 1998, September 1998). The primary focus of Standard & Poor's local currency credit analysis is on the fiscal, monetary, and inflation outcomes of government policies that support or erode incentives for timely debt service. When assessing the default risks on foreign currency debt, Standard & Poor's places more weight on the interaction between fiscal and monetary policies, the balance of payments and its impact on the growth of external debt, and the degree of each country's integration in the global financial system.

Local Currency Ratings Factors

Key economic and political risks that Standard & Poor's considers when rating sovereign debt include:
• Stability of political institutions and the degree of popular participation in the political process,
• Income and economic structure,
• Fiscal policy and budgetary flexibility,
• Monetary policy and inflation pressures, and
• Public and private sector debt burdens and debt service track record.

These factors, more than any others, directly affect the ability and willingness of governments to ensure timely local currency debt service. Further, because fiscal and monetary policies ultimately influence the country's external balance sheet, they also affect the ability and willingness of governments to service foreign currency debt.

The stability and perceived legitimacy of a country's political institutions are important considerations. They set the parameters for economic policymaking, including how quickly policy errors are identified and corrected. France's 'AAA' credit standing, for instance, in part reflects the country's democratic political framework. Policymaking is transparent and, as a result, the government's response to policy errors is predictable over time. Kazakhstan's evolving political institutions, by contrast, constrain its 'B+' foreign currency and 'BB-' local currency ratings; the future direction of economic policy is less predictable for this reason.

A country's economic structure also factors into the analytical process. Because of its decentralized decision-making process, a market economy, with legally enforceable property rights, is less prone to policy error and more respectful of the interests of creditors, than one where the state dominates. If market reforms succeed in the transition economies of Central and Eastern Europe, the credit standing of at least some of the region's sovereigns ultimately could converge with those of Western Europe, where market economies are well entrenched (see Rating the Transition Economies, February 1997).

A government in a country with a growing standard of living and income distribution regarded as broadly equitable can more readily support high public debt levels and withstand unexpected economic and political shocks, than can one with a poor or stagnant economy. But a sovereign with a recent history of default, generally, must manage with lower levels of leverage to rebuild its credibility than one that has maintained an unblemished debt record. The United Kingdom, rated 'AAA,' has a track record of honoring its obligations over centuries punctuated by war and financial distress. In contrast, Argentina's ('BB' foreign currency and 'BBB-' local currency) ratings still reflect the legacy of many years of economic mismanagement, including default. Its credit standing, while improving, is by no means as strong as Britain's, although the Argentine government now has less debt in relation to national income. These factors, in turn, influence the conduct of fiscal and monetary policies, and their impact on future changes in the public debt burden.

Fiscal Policy

When evaluating fiscal policy, Standard & Poor's focuses on three related issues:

• The purpose of public sector borrowing;
• Its impact on the growth of public debt; and
• Its implications for inflation.

Deficit financing can be an appropriate policy tool for any government. Public sector infrastructure projects, for example, can be prudently financed through borrowing when they generate revenues sufficient to cover future debt service. Singapore, rated 'AAA,' has transformed itself into a prosperous manufacturing- and service-based economy over the past 40 years partly by astute investment in its public infrastructure.

More typically, governments borrow to finance combinations of consumption and investment that increases public debt. Still, analysis of public finance is complicated by the fact that the taxation and monetary powers unique to sovereigns can permit them to manage widely varying debt levels over time. Depending on their political support, policymakers can raise taxes to meet their obligations. But a growing tax burden can adversely affect the economy's growth prospects. Moreover, public opinion often favors the lowest possible tax burden—so much so that proposals to raise taxes occasionally drive governments from office. Efforts to cut spending can be stymied by powerful interests that benefit from government programs. Absent a political consensus favoring conservative fiscal principles, sovereigns can succumb to the temptation to print money owing to their monopoly over the currency and control of the banking system.
Inflation and Public Debt

Standard & Poor's regards the rate of inflation as the single most important leading indicator of sovereign local currency credit trends. Significant monetization of budget deficits fuels price inflation, which can undermine popular support for governments. As a result, policymakers usually respond with measures to contain it. If they do not, and price increases accelerate, serious economic damage and an erosion of public trust in political institutions can result. These conditions are fertile ground for a sovereign default. Inflation benchmarks, and their relationship to different local currency rating categories, are shown in table 2.

<table>
<thead>
<tr>
<th>Local Currency Rating Category</th>
<th>Annual Inflation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>50-200</td>
</tr>
<tr>
<td>BB</td>
<td>25-100</td>
</tr>
<tr>
<td>BBB</td>
<td>10-50</td>
</tr>
<tr>
<td>A</td>
<td>7-25</td>
</tr>
<tr>
<td>AA</td>
<td>4-15</td>
</tr>
<tr>
<td>AAA</td>
<td>0-10</td>
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</tbody>
</table>

In evaluating price pressures in each country, Standard & Poor's considers their behavior in past economic cycles. The analysis is based, in part, on the level and maturity structure of the public debt burden—total borrowing of central, regional, and local governments in relation to GDP—together with the likely extent of future borrowing. Off balance sheet, public sector pensions, and contingent liability items—such as banks and other enterprises—are scrutinized for their possible contribution to inflation. Related indicators include rates of money and credit expansion. Taking all these factors into account, the rating service makes a conservative assessment of average inflation, as measured by the consumer price index, over the next cycle.

In addition, Standard & Poor's looks at institutional factors affecting inflation. For instance, an autonomous central bank with a public mandate to ensure price stability can be a strong check on fiscal imbalances; less so a central bank tied closely to the government. Among industrial countries, Germany (AAA) and the U.S. (AAA) provide excellent examples of central banks where strong traditions of independence have evolved over the years. Similar examples among emerging market issuers include the central banks of Chile ('A-' foreign currency and 'AA' local currency) and Israel ('A-' foreign currency and 'AA-' local currency). On the other hand, Mexico's credit standing ('BB' foreign currency and 'BBB+' local currency) does not benefit from the Banco de Mexico's formal autonomy, given the federal government's continued influence over the institution.

The depth and breadth of a country's capital markets also can act as an important discipline. The sovereign has fewer incentives to default on local currency obligations when they are held by a broad cross-section of investors, rather than concentrated in the hands of local banks. For this reason, the establishment of mandatory, privately funded pension funds in a number of countries—such as Chile and Argentina—helps bolster their credit standing by creating an influential new class of bondholders. The experience of many OECD countries suggests that, even when public debt is high, creditworthiness can be sustained over long periods when policymakers are responsive to constituencies with vested interests in safeguarding the value of money.

Foreign Currency Rating Factors

The same economic and political factors that affect a sovereign's local currency credit standing also impact its ability and willingness to honor foreign currency debt—often to a greater degree because of the binding constraints the balance of payments can impose. As a result, Standard & Poor's analysis of foreign currency debt focuses on how government economic policies influence trends in public and private external debt over time.

In addition, from a political risk perspective, the extent of each country's integration in the global trade and financial systems must be considered. A high degree of integration generally gives the government strong incentives to meet its external obligations because of the correspondingly high political and economic costs of default.
Sudan (N.R.), in default on its foreign currency bank loans since 1979, has struggled almost continuously in recent years with civil insurrection and the breakdown of effective administration—its political and economic links with the outside world are at a low ebb. By contrast, Luxembourg (AAA) is a small country that is highly integrated with Europe and the rest of the world. As a result, it has very strong incentives to play by the international financial rules of the game. All sovereigns fall somewhere between these two extremes in their integration in the global economy.

At the same time, relations with neighboring countries must be examined with an eye for potential security risks. National security is a concern when military threats place significant burdens on fiscal policy, reduce the flow of potential investment, and put the balance of payments under stress. As Iraq’s invasion of Kuwait (‘A’ foreign currency and ‘A+’ local currency) in 1990 demonstrated, the very existence of the sovereign can sometimes come into question. Lebanon (‘BB-’ foreign currency and ‘BB’ local currency) and Qatar (‘BBB’ foreign currency) are two other examples of sovereigns whose credit standing is constrained by their vulnerable geopolitical positions.

**Balance of Payments Flexibility**

Standard & Poor’s balance of payments analysis focuses on the impact of economic policy on the external sector, as well as its structural characteristics. In the short run, policymakers’ ability to manage financial pressures from abroad partly depends on the structure of merchandise trade, services, transfers, and the like. Yet, balance of payments pressures do not appear spontaneously or reach large magnitudes for structural reasons alone. In most cases, they can be traced back to flawed economic policies. The ratings service’s approach reflects the premise that the macro- and microeconomic policies discussed earlier affect balance of payments behavior.

For this reason, the size of a country’s current account deficit, even when very large, may not by itself be an important rating consideration. The tendency for some countries to run current account surpluses and others to run current account deficits is well documented. It is the product of many factors, not all of them negative, and not all related to government policies. Singapore ran very large current account deficits for much of its modern history, ones readily financed because they were not the by-product of fiscal mismanagement. However, Thailand’s (‘BBB-’ foreign currency and ‘A-’ local currency) foreign exchange crisis in 1997 is a sharp reminder that large current account deficits can also be a symptom of serious underlying weaknesses—in this case a financial sector whose asset quality had weakened dramatically after years of rapid domestic credit growth. And as Mexico’s debt servicing crisis in 1995 illustrated, current account deficits are a concern when government policies result in a public external debt structure that is vulnerable to sudden changes in investor sentiment.

**External Financial Position**

Consequently, Standard & Poor’s examines each sovereign’s external balance sheet alongside its analysis of balance of payments flows. The main focus is on trends in the public external debt position, the magnitude of contingent liabilities of the government, and the adequacy of foreign exchange reserves to service its and (especially in a crisis) the private sector’s foreign currency debt. To complete the picture, Standard & Poor’s calculates an international investment position. This is the broadest measure of a country’s external financial position. It adds the value of private sector debt and equity liabilities to public sector external indebtedness denominated in local and foreign currencies.

Four important variables are:

- Net public external debt,
- Net external debt of financial institutions,
- Net external debt of the nonbank private sector, and
- Total debt service.

Public external debt includes the direct and guaranteed debt of the central government, obligations of regional and local governments, and the nonguaranteed debt of other public sector entities. Net public external debt equals total public sector debt minus public financial assets, including central bank reserves. The debt of other levels of government are analyzed, and generally consolidated with those of the national government, if legal and political circumstances expose the sovereign to internal and external financial risks.
from this source.

To measure the magnitude of public debt, Standard & Poor's compares it with annual flows of exports of goods and services (along with net public and private transfers where they are positive). For the 77 sovereigns with public ratings in October 1998, the median net public external debt-to-export ratio is 60%. Sovereigns with this degree of leverage currently include Denmark ('AA+' foreign currency and 'AAA' local currency), Israel ('A-' foreign currency and 'AA-' local currency), and Egypt ('BBB-' foreign currency and 'A-' local currency).

Other sectors’ external debt also are measured in this way. Financial institutions’ net debt equals their total external liabilities minus total external assets. Net debt of the nonfinancial private sector equals their total debt minus loans abroad. Debt of the private sector is examined because, in some circumstances, it can become a liability of the state.

Problems in the financial sector, in particular, can impair the sovereign’s credit standing when they lead to official rescues of failing banks. Korea ('BBB' foreign currency) and Thailand are sovereigns whose foreign and local currency ratings were sharply downgraded in 1997-1998, in part because of the escalating cost of supporting their banking sectors. Currently, Malaysia’s banks weigh on the sovereign’s ('BBB-' foreign currency and 'A-' local currency) credit standing. Asset quality is rapidly deteriorating, and the system already relies on substantial official financial support. By contrast, New Zealand’s banking sector poses relatively little risk to the sovereign’s credit standing. Asset quality is generally sound and, importantly, the system’s largest institutions are owned by creditworthy foreign banks.

Sovereign external debt also is evaluated in terms of its maturity profile, currency composition, and sensitivity to changing interest rates. Along with new borrowings, these factors influence the size of future interest and amortization payments. Debt service—including interest and principal on both short- and long-term debt—therefore is compared with projected exports. Debt contracted on concessional terms, to some extent, can offset a high public debt burden. Poland, for instance, has relatively high public external debt, around 82% of exports in 1998. But favorable terms on restructured foreign currency debt mean that debt service is low at 10% of exports.

**International Liquidity**

Central bank reserves are another external indicator, one whose importance varies across the ratings spectrum. Reserves usually act as a financial buffer for the government during periods of balance of payments stress. They include foreign currency and gold holdings, with the latter valued at market prices. Reserve adequacy is measured in relation to imports, and to projected current account deficits and total debt service. Whether a given level of reserves is adequate or not is judged in relation to the government’s financial and exchange rate policies and, consequently, their vulnerability to changes in trade and capital flows.

Access to funding from the IMF and other multilateral and bilateral official sources is a related factor to consider. However, the mixed experience of recent Fund-led programs in Asia and Russia underscores the limited availability of official resources in relation to the funds deployed by banks and cross-border investors. Reserve levels, consequently, deserve particular scrutiny during periods of global financial volatility, as in the latter part of 1998, when bond markets effectively closed their doors to emerging market issuers.

The U.S. maintains very low reserves. It can do so because the U.S. dollar generally has floated against other currencies since 1971. The dollar's unique status as the key currency financing global trade and investment also reduces the need for gold and foreign exchange. Most other high investment-grade sovereigns with floating currencies and little foreign currency debt also require relatively modest reserves.

At lower rating levels, though, international liquidity is more critical when, as is often the case, government debt is denominated in foreign currencies and significant amounts of local currency debt are held by cross-border investors. Public finance setbacks and other economic or political shocks, consequently, can impair financial market access. Most Latin American sovereigns fall into this category and generally maintain above-average reserves as a result. Argentina and Hong Kong (foreign currency 'A' and local currency 'A+') also require above-average levels of international liquidity because their currency boards issue notes backed by foreign exchange. Lebanon, which maintains reserves equal to nearly a year's worth of imports, is something of a special case. It does so because the economy's highly dollarized nature is intertwined with the country's vulnerable geopolitical position, which creates the need for an especially large financial cushion to maintain investor confidence.
Local and Foreign Currency Rating Distinctions

Any divergence between a sovereign’s local and foreign currency ratings reflects the distinctive credit risks of each type of debt. For example, long-standing political stability, fiscal and monetary policies resulting in relatively low inflation, and a high degree of international economic integration are characteristics of sovereign issuers of ‘AAA’ rated local currency debt. The manageable public external debt burdens of these issuers, in turn, result in foreign currency debt ratings at the upper end of the investment-grade spectrum.

Differences between local and foreign currency debt ratings can widen to some degree with sovereigns that are further down the ratings scale. These sovereigns, typically, fall into one of two categories: Sovereigns in the first category have long records of timely service on both local currency and foreign currency debt. Inflationary pressures are moderate and public finances are relatively sound, but foreign currency indebtedness may be relatively high or is likely to become so over time. Sovereigns in the second category also have unblemished local currency debt servicing track records, but relatively recent histories of foreign currency default. The local and foreign currency debt ratings assigned to them balance often substantial improvements in inflation and public finances with the risks inherent to still-heavy foreign currency debt burdens.

At the lower end of the rating scale, however, such rating differences sometimes narrow. A number of sovereigns in this category have emerged from local or foreign currency debt default quite recently, and still carry the risk of policy reversals that can result in renewed default. Other sovereigns in this category may not have defaulted, but face high inflation and other forms of social and political stress that carry a material risk of local currency default after payment of foreign currency debt can no longer be assured.

Canada (‘AA+’ foreign currency and ‘AAA’ local currency) is a good example of a government shouldering a public debt burden on the order of 90% of GDP—well above the OECD country average—but where the political commitment to low or moderate rates of inflation seems well entrenched. Conversely, when public finances are weak and inflation is left unchecked, the stage can be set for an accelerating spiral that leads to default. Government-inspired indexation of debt and other contracts to price inflation often abets the process, as in the defaults of Brazil (‘BB-’ foreign currency and ‘BB’ local currency) earlier this decade. But not all countries that have experimented with indexation suffer hyperinflation and default. Chile and Israel have long records of timely local currency debt service. Relatively conservative fiscal policies have underpinned their general credit standing in recent years by helping to unwind inflation and to contain the external debt burden.

Ratings of EU states joining the EMU present a special case. Governments entering EMU, due to start in January 1999, will cede monetary and exchange rate responsibilities to the new European Central Bank. As a result, Standard & Poor’s now rates each government’s local currency, including euro-denominated, debt and foreign currency debt the same. Economic and fiscal factors, already important, will be the dominant criteria for differentiating credit quality of sovereigns inside EMU going forward (see Local and Foreign Currency Ratings Converge for EMU Issuers, June 1998). Local and foreign currency ratings for Liechtenstein (AAA), Panama (BB+), and the Cook Islands (B-) are the same because these countries, too, are part of monetary unions.

As these examples illustrate, a number of factors must be examined when considering whether distinctions between local and foreign currency ratings are appropriate. The default frequency of sovereign local currency debt, generally, is much lower than that of foreign currency debt, but local currency defaults do occur. Russia’s August 1998 default on its rouble-denominated debt is a particularly instructive case. Ironically, its experience shows why most sovereigns resist the temptation to take such a drastic step. Governments rarely default on local currency debt because control over the domestic banking system gives them access to some finance, even when foreign currency debt is in default. Russia defaulted on its rouble debt, in part, because a substantial portion was held by nonresidents seeking to reduce their holdings. (In such cases, Standard & Poor’s usually rates local currency debt the same as, or only slightly higher than, foreign currency debt.) As a result of its default, however, Russia suddenly cut itself off from all financial markets, both domestic and external. The government, therefore, crippled the real economy, generated intense inflationary pressures, and sharply raised the default risk on its foreign currency debt.

Sovereign Rating Changes

Until recently, rated sovereigns formed an exclusive club of the world’s most creditworthy governments. In
1980, Standard & Poor's rated just a dozen sovereign issuers—all at the 'AAA' level. Rating downgrades were relatively rare over the remainder of that decade and, when they occurred, usually were of modest dimensions. Today, the sovereign sector is far more heterogeneous. The 77 sovereigns Standard & Poor's monitors carry ratings between 'AAA' and 'CCC-.' Given this range of credit quality, rating changes occur more frequently.

Current economic and financial indicators alone do not determine ratings. Sovereign ratings measure future debt service capacity, and the future, of course, is uncertain. As a result, Standard & Poor's rating committees consider reasonable "worst-case" scenarios over a three- to five-year time horizon to gain a better understanding of future downside risks. The government's medium-term financial program, when available, is scrutinized alongside independent forecasts. The ratings service then looks at the interaction between public finances, external debt, and other variables, such as real export growth, asset quality trends affecting the local banking system, and changes in overseas interest rates.

Rating changes occur whenever new information significantly alters Standard & Poor's view of likely future developments. (Analysts generally meet with government officials at least once annually, but the timing of on-site meetings itself is not a factor determining when the agency raises or lowers ratings or changes rating outlooks.) For example, Ireland's foreign currency rating was upgraded to 'AA+' (and converged with its local currency rating) from 'AA' in May 1998, in light of its improved fiscal performance and declining public debt burden. By contrast, Kazakhstan's foreign and local currency ratings were downgraded to B+/BB- from BB-/BB+ in September 1998. These actions stemmed from the government's ineffective response to mounting fiscal and current account deficits at a time when, along with other emerging market issuers, its ability to attract capital inflows had greatly diminished.

As these examples illustrate, the impact of public finances on external debt usually is a key factor driving changes in foreign currency credit ratings. Similarly, significant changes in the inflation outlook figure in local currency rating changes. However, the implications of rating changes can vary across the credit spectrum. Fiscal pressures were behind the loss of New Zealand's 'AA' foreign currency rating in 1983 and subsequent downgrades to 'AA-' though 1991. Still, the erosion in its credit quality was neither sudden nor very great. This reflects an important characteristic of most high investment-grade sovereigns, namely their ability to correct financial imbalances and even to bounce back in credit terms over time. Following a sustained tightening of budgetary policy, New Zealand's foreign currency rating was upgraded to 'AA' in December 1994 and to 'AA+' in January 1996. (Renewed fiscal weakness resulted in a rating outlook change to negative from stable in September 1998.)

Again, Russia tells a rather different story. Currently, Standard & Poor's considers its foreign currency debt to have the highest default risk in the sovereign sector. The government's credit standing has fallen steeply since it was first assigned a 'BB-' foreign currency rating in October 1996. The rating was lowered in four steps to 'CCC-' this year and the outlook remains negative. If anything, since the onset of Russia's crisis in the summer of 1998, policymakers have embraced heterodox policies, which suggests that the country's economic troubles will persist for a long time to come. Often in such cases, a number of financial crises, and defaults, may occur before there is renewed support for genuine economic stabilization and reform.

**Sovereign Ratings and Corporate Credit Risk**

Sovereign credit risk is always a key consideration in the assessment of the credit standing of banks and corporates. Sovereign risk comes into play because the unique, wide-ranging powers and resources of each national government affect the financial and operating environments of entities under its jurisdiction. Past experience has shown that defaults by otherwise-creditworthy borrowers can stem directly from the imposition of exchange controls, often, though not always, linked to a sovereign default.

In the case of foreign currency debt, the sovereign has first claim on available foreign exchange and controls the ability of any resident to obtain funds to repay creditors. To service debt denominated in local currency, the sovereign can exercise its powers to tax, to control the domestic financial system, and even to issue local currency in potentially unlimited amounts. Given these considerations, the credit ratings of international borrowers most often are at, or below, the ratings of the relevant sovereign. When obligations of issuers are rated higher than the sovereign's, this reflects both their stand-alone credit characteristics and other factors mitigating sovereign credit risk. (See "Understanding Sovereign Risk," January 1997 and "Less Credit Risk for Borrowers in Dollarized Economies," May 1997.)
Dates are effective dates of ratings and publication in New York. Owing to the securities law regulations, there may be a delay in the updating of this page compared to the information on the What's New Page.

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