RatingsDirect®

How We Rate Sovereigns

Criteria Officer, Global Sovereigns:
Olga I Kalinina, CFA, New York (1) 212-438-7350; olga.kalinina@standardandpoors.com

Primary Credit Analysts:
John B Chambers, CFA, New York (1) 212-438-7344; john.chambers@standardandpoors.com
Moritz Kraemer, Frankfurt (49) 69-33-999-249; moritz.kraemer@standardandpoors.com

Media Contact:
Mark Tierney, London (44) 20-7176-3504; mark.tierney@standardandpoors.com

Table Of Contents

Sovereign Rating Criteria

Rating Sovereign Issuers

Publication

Related Criteria And Research

How We Rate Sovereigns

*(**Editor's Note:** We originally published this article on Nov. 12, 2013. We've since republished it to reflect our updated sovereign criteria, "Sovereign Rating Methodology," Dec. 23, 2014.)*

The events of the last several years highlighted the role of credit rating agencies in assessing sovereign creditworthiness. We are publishing this article to explain the basics of Standard & Poor's Ratings Services' sovereign rating methodology, and our sovereign rating process in general.

Sovereign government bonds, which represent more than 40% of the stock of bonds issued globally, are a significant asset class for investors. We believe it is important that investors have globally recognized and consistent benchmarks to help them make investment decisions. In this context, credit rating agencies can play an essential role in providing investors with independent, globally comparable, and consistent ratings.

Here, in the first section, we explain how we apply our sovereign rating methodology by assessing five key credit factors and combining those assessments to arrive at a sovereign rating. The latter section addresses frequently asked questions about our rating process, from the rating request to research publication.

For a more detailed overview of Standard & Poor's sovereign credit rating methodology, see "Sovereign Rating Methodology," published Dec. 23, 2014.

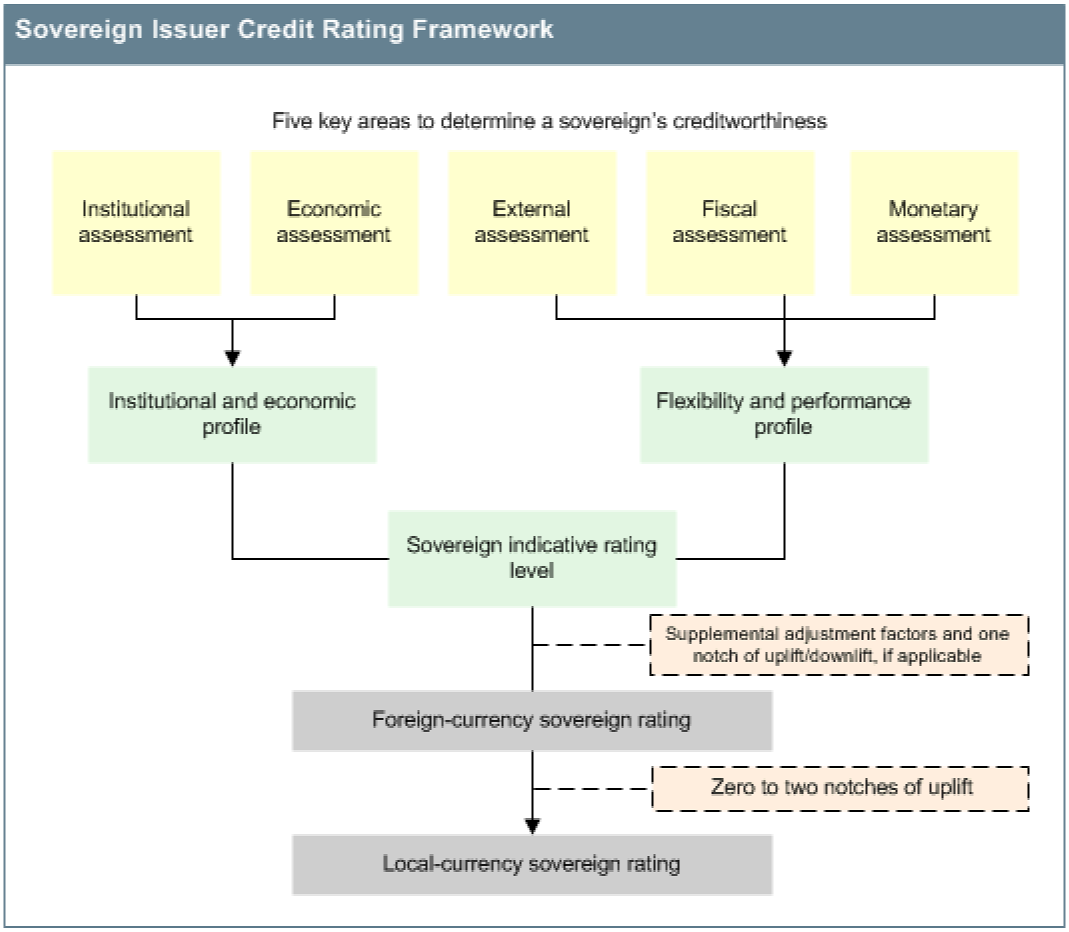
Sovereign Rating Criteria

Our sovereign rating criteria aim to give market participants a clear picture of how we rate sovereigns and to build on the robust long-term track record of our sovereign ratings. Since 1975, an average of 3.9% of investment-grade sovereigns have defaulted on their foreign-currency debt within 15 years, compared with 22.6% of those in the speculative-grade category (see "Sovereign Defaults And Rating Transition Data, 2013 Update," published Sept. 17, 2014).

Our sovereign rating criteria address the factors that we believe affect a sovereign government's willingness and ability to service its debt on time and in full. Our analysis focuses on a sovereign's performance over past economic and political cycles, as well as on factors that suggest to us greater or lesser economic policy flexibility in future economic cycles.

The five factors that form the foundation of our sovereign credit analysis are (see chart):

- Institutional and governance effectiveness and security risks, reflected in the institutional assessment.
- Economic structure and growth prospects, reflected in the economic assessment.
- External liquidity and international investment position, reflected in the external assessment.
- Fiscal performance and flexibility, as well as debt burden, reflected in the fiscal assessment.
- Monetary flexibility, reflected in the monetary assessment.



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 three factors that are the key drivers of a sovereign's economic assessment are our view of the country's income levels, growth prospects, and its economic diversity and volatility.

Three factors also drive a country's external assessment, namely our view of the status of a sovereign's currency in international transactions; the country's external liquidity; and its external indebtedness, which shows residents' assets and liabilities 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 main drivers of the monetary assessment are 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 sovereign's ability to coordinate monetary policy with fiscal and other economic policies to support sustainable economic growth; 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 five factors is assessed on a six-point numerical scale from '1' (the strongest) to '6' (the weakest). A series of quantitative factors and qualitative considerations form the basis for these forward-looking assessments. The criteria then call for those five assessments to be combined to form a sovereign's institutional and economic profile (the average of the institutional assessment and the economic assessment) and its flexibility and performance profile (the average of the external assessment, the fiscal assessment, and the monetary assessment).

These two profiles are then used 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

		Institutional and economic profile										
Flexibility and performance 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
Extremely strong	1 to 1.7	aaa	aaa	aaa	aa+	aa	a+	a	a-	bbb+	N/A	N/A
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	N/A	bbb	bbb-	bb+	bb	bb-	b+	b	b	b-	b-
Extremely weak	5.3 to 6	N/A	bb+	bb	bb-	b+	b	b	b-	b-	'b-' and below	'b-' and below

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

In rare 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. 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 our "Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC'," published Oct. 1, 2012, or "Rating Implications Of Exchange Offers And Similar Restructurings, Update," May 12, 2009.

Separately, a sovereign local currency rating is determined by applying up to two notches 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.

Rating Sovereign Issuers

Standard & Poor's rating process for sovereigns is typically initiated when the sovereign or its representative requests a rating. This request may lead to the sovereign engaging Standard & Poor's to provide rating services. Such ratings are termed "solicited." Other sovereign ratings are termed "unsolicited" and indicated as such in Standard & Poor's publications because we do not have a rating agreement with the sovereigns in question. We rate these sovereigns on an unsolicited basis when we believe there is significant market interest in them and there is also sufficient public information of reliable quality to support our analysis and ongoing surveillance.

In rating a sovereign, Standard & Poor's generally assigns an analyst, often in conjunction with a team of specialists, to take the lead in evaluating the sovereign's creditworthiness. Typically, analysts obtain information from published reports, as well as from interviews and discussions with representatives of the sovereign. The analysts use that information to assess the sovereign's financial condition, operating performance, policies, and risk-management strategies. The formulation of our ratings opinions is a well-documented process that is based on a thorough analysis according to the relevant criteria and, we believe, is enhanced by the knowledge, experience, and judgment of our credit analysts and other credit professionals.

In applying criteria during the ratings process, analysts undertake analysis and prepare ratings-related documentation that is then presented to a rating committee. The large amount of analytical work that informs the ratings process is packaged in the form of a Ratings Analysis Methodology Profile (RAMP). The RAMP covers the rating factors prescribed by the applicable criteria. Based on the outcome of the quantitative and qualitative analyses performed by the analytic team, the lead analyst presents his or her view with respect to each of these ratings factors, which are then considered by the voting members of the rating committee. At the rating committee meeting, the RAMP is reviewed and discussed and a vote is taken to arrive at the assigned rating.

Publication

For public ratings, in most cases, Standard & Poor's publishes a press release announcing the final rating along with the rationale, distributes it to the media, and posts it on www.standardandpoors.com. To verify that the factual information is correct and that no confidential information has inadvertently been disclosed, Standard & Poor's may provide the issuer with a copy of its report for a review prior to releasing it to the public. The information in the draft is confidential and should not be disclosed or released prior to its publication by Standard & Poor's. The advance copy time period is based upon the domicile of the lead analyst as follows: one full (eight-hour) working day in the EU, and two hours in all other regions. When the lead analyst is based in the EU, the one full working day period may not be shortened (and must be one full working day in the country where the issuer is based). However, if the rating is provided on a confidential basis, the rating is not published and Standard & Poor's disseminates the rating only to the rated entity.

Related Criteria And Research

- Sovereign Rating Methodology, Dec. 23, 2014
- Sovereign Defaults And Rating Transition Data, 2013 Update, Sept. 17, 2014