Fitch Ratings

Criteria Essentials – Sovereign Ratings (1/2)

Scan QR code or visit https://www.fitchratings.com/criteria/sovereigns to view detailed **Sovereign Rating Criteria**

	Structural Features	Macro Performance, Policies, Prospects	Public Finances	External Finances
Sovereign Rating Model (SRM)	• Governance indicators • GDP per capita • Share in world GDP • Years since default or restructuring • Broad money supply to GDP	• Real GDP growth • Real GDP growth volatility • Consumer price inflation	• Gross general government (GG) debt to GDP • GG interest to revenue • GG fiscal balance to GDP • Foreign currency GG debt to gross GG debt	• Reserve-currency flexibility • Sovereign net foreign assets to GDP • Commodity dependence • FX reserves (months of CXP[a]) • External interest service to CXR[b] • CAB[c] plus net FDI[d] to GDP
Qualitative Overlay (QO)	• Political stability and capacity • Financial sector risks • Other structural factors -2 to +2 notch adjustment	• Macroeconomic policy credibility & flexibility • GDP growth outlook (medium term) • Macroeconomic stability -2 to +2 notch adjustment	• Fiscal financing flexibility • Public debt sustainability • Fiscal structure -2 to +2 notch adjustment	• External financing flexibility • External debt sustainability • Vulnerability to shocks -2 to +2 notch adjustment

Predicted Rating
AAA to CCC+

Notch Adjustment*
-3 to +3

Long-Term Foreign Currency Issuer Default Rating (LT FC IDR)
AAA to B-

Where LT FC IDR is 'CCC+' or below

Fitch does not utilise the SRM and QO. Instead, ratings are directly based on the Fitch's Ratings Definitions: CCC: Substantial credit risk; CC: Very high levels of credit risk; C: Near default; RD: Restricted default

*The overall notching adjustment relative to the SRM output is generally capped at +3/−3, meaning that the maximum notching adjustments for each of the 4 analytical pillars cannot be applied simultaneously. In certain circumstances (e.g. a crisis), Fitch's sovereign rating committee may extend the range of overall notching to address the inability of the SRM to adjust rapidly to or deal with such circumstances.

a: CXP current external payments; b: CXR current external receipts; c: CAB current account balance; d: FDI Foreign direct investment

FitchRatings

Criteria Essentials – Sovereign Ratings (2/2)

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Rating Types Overview

SOVEREIGN ISSUER | **INSTRUMENTS**

Long-Term Foreign Currency (FC) IDR
Likelihood of default on debt obligations in foreign currencies to private-sector creditors and public debt securities

→ **Short-Term FC IDR**

→ **Senior Unsecured FC Instrument Ratings**
typically aligned with applicable IDR

Long-Term Local Currency (LC) IDR
Likelihood of default on debt obligations in the currency of the sovereign to private-sector creditors and public debt securities

→ **Short-Term LC IDR**

→ **Senior Unsecured LC Instrument Ratings**
typically aligned with applicable IDR

Sovereign Default Events

Sovereign Default events that would result in the sovereign's IDR being lowered to 'RD':

- Missed coupon or principal repayment on public debt security issued by the sovereign or guaranteed by the sovereign
- Failure to pay debt obligations owed to private creditors by the sovereign or by third parties with a guarantee from the sovereign
- On execution of a distressed debt exchange (DDE)
- Forced redenomination of sovereign debt into a different currency, unless the old currency ceased to exist
- Unilateral or forced change of debt terms initiated by the sovereign on a public debt security that constitutes a material reduction in terms

Not sovereign default events:

Reported failure to repay debt owed to official creditors, other than public debt securities, eg World Bank Group, IMF, bilateral development agencies, export credit agencies, publicly-owned development banks, although this could adversely affect ratings

Derivation of Long-Term Local Currency (LC) IDR

1. **For investment grade sovereigns, typically LC = FC ratings** since LC and FC credit profiles are typically indistinguishable
2. **For non-investment grade sovereigns**, greater potential for divergent LC and FC credit profiles, particularly for sovereigns that are in or approaching distress:

FC and LC Sovereigns Ratings Relationships

Key Factors	Existing and expected future public finance fundamentals relative to external finance fundamentals	Average/Weak	Strong	Exceptionally weak
Key Factors	Expectations about different treatment of LC and FC creditors	No expectation of LC preferential treatment	Expectation of LC preferential treatment	Expectation of FC preferential treatment
Supporting Factors	Domestic capital market/banking sector	Shallow, illiquid, short maturities, expensive	Deep, liquid, long maturities, affordable	Shallow, illiquid
Supporting Factors	Inflation	Volatile, indexation	Low, stable	High, volatile
Supporting Factors	Foreign-exchange regime	Currency board, peg, currency union, dollarised	Free float, own currency	n.a.
Supporting Factors	LC vs FC debt burdens	n.a.	Low or neutral LC burden vs FC debt	Heavy LC debt burden vs FC debt
		↓ Baseline LC = FC IDR	↓ 1 or 2 key factors LC = FC IDR + 1 notch can rarely be 2 notches or more	↓ Rarely LC = FC IDR – 1 notch

Derivation of Short-Term IDRs (typically applicable for instruments with initial maturity ≤13 months)

Correspondence table between Long- and Short-Term Ratings

Long-Term Rating		AAA to AA-	A+	A	A-	BBB+	BBB	BBB-	BB+ to B-	CCC+ to C	RD/D
ST Rating	Lower option	F1+	F1	F1	F2	F2	F3	F3	B	C	C/RD/D
	Higher option		F1+	F1+	F1	F1	F2				

1. **For ST Local-Currency ratings:** The higher of the 2 options is applied
2. **For ST Foreign-Currency ratings** The higher of the 2 options is applied if either
   - Reserve-currency flexibility score > 0
   - Fitch assesses that the sovereign has a robust international liquidity position

   Otherwise, lower option applied

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