# Fixed Income

# Credit Analysis for Government Issuers

## Exam Focus

- Sovereign government debt
- Nonsovereign government debt

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## Sovereign vs. Nonsovereign

**Reminder:**

**Sovereign:** national government issues bonds to raise funds for public goods and services, and investment into public infrastructure

**Nonsovereign:** issued by states, provinces, counties, and entities created to fund and provide services (e.g., construction of hospitals and airports)

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## Sovereign Government Debt

***Qualitative* factors affecting creditworthiness**

- Institutions and policy
- Fiscal flexibility
- Monetary effectiveness
- Economic flexibility
- External status
- Willingness to pay

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## Sovereign Government Debt

***Quantitative* factors affecting creditworthiness**

- Fiscal strength
- Economic growth and stability
- External stability

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## Government of Romania's Improved Ratings Outlook

- In October 2021, Moody's Investors Service changed its ratings outlook on the Government of Romania from negative to stable with a Baa3 issuer and senior unsecured debt rating.
- In addition to solid economic growth prospects, Moody's cited an expectation of consistent and sustained fiscal consolidation as a reason for the improved outlook.
- As part of Romania's goal to become a full-fledged member state after joining the EU in 2007, the government was expected to prepare and implement fiscal reforms to reduce its annual deficit to below 3% of GDP within three years.
- The incentive to reduce the deficit was strengthened by the possible suspension of EU structural and investment grants in the case of non-compliance.

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## Zambia's Default in 2020 (1 of 2)

- The Republic of Zambia defaulted on a USD42.5 million Eurobond payment in November 2020, the first sovereign default following the COVID-19 pandemic. Zambia is Africa's second-largest producer of copper, which comprises 60% of its exports.
- An economic slowdown due to COVID-19 accelerated a decline in copper prices beginning in 2014.
- By November 2020, Zambia's annual inflation rate climbed to 17.4%, its highest level in four years. Additionally, the national currency, the kwacha (ZMK), depreciated 33% against the US dollar in 2020, creating more pain for Zambian consumers.

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## Zambia's Default in 2020 (2 of 2)

- Zambia's total external debt had more than doubled in just five years, increasing from USD4.8 billion, or 18% of gross domestic product, at the end of 2014 to USD11.2 billion, or 48% of GDP, in 2019.
- At the same time, external reserves fell from over 50% of external debt to just 5% due to falling prices for its copper exports.
- This led to the inevitable default on external debt and the consequent restructuring.



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## Debt Burden: Example

Which of the following statements *best* describes debt burden versus debt affordability measures?

A. Debt burden measures are similar to leverage, indicating a government's relative solvency, while debt affordability measures provide a measure of debt coverage.

B. A higher interest-to-GDP measure is associated with higher credit quality, while a lower debt-to-GDP ratio signals less credit risk.

C. Higher debt to revenue is associated with greater credit risk, while a higher interest-to-revenue ratio signals higher credit quality.



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## Nonsovereign Government Debt

- Issuers include the following:
  - Agencies
  - Government sector banks/financing institutions
  - Supranational issuers
  - Regional governments

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## Creditworthiness: Example

Which of the following statements *best* describes the relationship between local government and sovereign creditworthiness?

A. Local governments have limited jurisdictional powers and no control over economic and monetary institutions.

B. All sovereign governments use a tax revenue sharing system across sovereign and local governments to ensure that local authorities are able to meet their obligations.

C. Local governments with the power to attract and retain major industries and employers are often more creditworthy than their sovereign government.

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## Types of Bonds: Example

Ile-de-France, the regional government of Paris, issued a green bond, the proceeds of which are to be used for investments including ecofriendly construction and renovation of buildings, public transport to support sustainable mobility, and renewable energy projects. The bond is backed by the tax and other revenue of Ile-de-France. This bond is an example of:

A. a general obligation (GO) bond.

B. a revenue bond.

C. an agency bond.

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## Types of Bonds: Example

Danainfra Nasional Berhad, a special purpose vehicle of the Government of Malaysia, issued retail bonds for the purpose of financing mass rapid transport infrastructure in Kuala Lumpur. Interest and principal payments are supported by the cash flows of the mass rapid transport system and a credit guarantee of the Government of Malaysia. This bond is an example of:

A. a general obligation (GO) bond.

B. a revenue bond.

C. an agency bond.

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## Solutions

## Debt Burden: Example

Which of the following statements *best* describes debt burden versus debt affordability measures?

A. Debt burden measures are similar to leverage, indicating a government's relative solvency, while debt affordability measures provide a measure of debt coverage.

B. A higher interest-to-GDP measure is associated with higher credit quality, while a lower debt-to-GDP ratio signals less credit risk. *A higher interest-to-GDP measure is associated with lower credit quality, while a lower debt-to-GDP ratio signals less credit risk.*

C. Higher debt to revenue is associated with greater credit risk, while a higher interest-to-revenue ratio signals higher credit quality.
*A higher interest-to-GDP measure is associated with lower credit quality, while a lower debt-to-GDP ratio signals less credit risk.*

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## Creditworthiness: Example

Which of the following statements *best* describes the relationship between local government and sovereign creditworthiness?

A. Local governments have limited jurisdictional powers and no control over economic and monetary institutions.

B. All sovereign governments use a tax revenue sharing system across sovereign and local governments to ensure that local authorities are able to meet their obligations. *Some, not all, sovereign governments use tax revenue sharing.*

C. Local governments with the power to attract and retain major industries and employers are often more creditworthy than their sovereign government. *Because local governments are subject to the economic and monetary policy of the sovereign, their rating is typically equal or below that of the sovereign government.*

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## Types of Bonds: Example

Ile-de-France, the regional government of Paris, issued a green bond, the proceeds of which are to be used for investments including ecofriendly construction and renovation of buildings, public transport to support sustainable mobility, and renewable energy projects. The bond is backed by the tax and other revenue of Ile-de-France. This bond is an example of:

A. a general obligation (GO) bond.

B. a revenue bond.

C. an agency bond.

Though the proceeds of the bond are used for specific green infrastructure development, interest and principal payments are backed by the tax and other revenue of the local government rather than any specific project revenue.

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# Types of Bonds: Example

Danainfra Nasional Berhad, a special purpose vehicle of the Government of Malaysia, issued retail bonds for the purpose of financing mass rapid transport infrastructure in Kuala Lumpur. Interest and principal payments are supported by the cash flows of the mass rapid transport system and a credit guarantee of the Government of Malaysia. This bond is an example of:

A. a general obligation (GO) bond.

B. a revenue bond.

C. an agency bond.

The funding is for the development of a specific mass rapid project for Kuala Lumpur, and the repayment is supported by the revenue of the mass rapid transport line. While the bonds also have a sovereign guarantee to provide credit enhancement, the primary source of repayment is mass transit revenue.



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