Country Ceiling Criteria

Cross-Sector

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This report replaces the Country Ceiling Criteria dated 1 July 2020 and the Exposure draft: Country Ceiling Criteria dated 15 June 2023.

Scope

This report describes Fitch Ratings' criteria for assigning new and reviewing existing Country Ceilings, and applies to all Fitch-rated sovereign issuers.

Country Ceilings measure Transfer and Convertibility (T&C) risk, which is the risk of capital and/or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments. We consider that T&C risk has materialised when it affects all or the vast majority of economic sectors and asset classes.

Country Ceilings are not ratings, but rather a key analytical input that may constrain the foreign-currency ratings of entities and transactions originated in the sovereign's jurisdiction.

Key Analytical Drivers

The relative weight of the key analytical drivers depends on each case.

Close Link to IDR: Country Ceilings are notched upwards from the sovereign's Long Term Foreign-Currency Issuer Default Rating (LT FC IDR), indicating the generally strong correlation between T&C and sovereign risk. In exceptional circumstances, if T&C risks have materialised, Country Ceilings could be below the LT FC IDR.

Analytical Framework: Fitch determines the notching from the LT FC IDR using its Country Ceiling Model (CCM) as the starting point, and then adjusting the CCM output using Qualitative Adjustments (QAs). Both parts of the framework are based on the same three pillars:

- **Balance of Payments Restrictions:** Measures current and capital account restrictions in each market, their severity and the sovereign's record of imposing them.
- **Long-Term Institutional Characteristics:** Measures long-term characteristics that provide constraints and/or incentives to impose capital or exchange controls.
- **Near-Term Macro-Financial Stability Risks and Exchange-Rate Risks:** Measures the near-term risks that could trigger the imposition of capital and/or exchange controls.

Maximum Notching Distance: The combined maximum notch uplift of the CCM and QA is three notches above the LT FC IDR for most sovereigns. It can be up to six notches for sovereigns in economies with no separated legal tender (dollarised economies), sovereigns with reserve currency status, and sovereigns with currency union membership.

T&C Risk Materialisation: When T&C risks have materialised Fitch will place Country Ceilings at 'CCC+' bypassing the CCM + QA framework. Governments can alternatively default or be in distress (i.e. where the sovereign's LT FC IDR is 'CCC+' or below) without impeding the private sector's capacity to service its own foreign-currency obligations. In such cases, Fitch's framework of using the CCM plus QA will be applied and the minimum Country Ceiling will be 'B-' to reflect that T&C risk has not materialised.

Related Criteria

Sovereign Rating Criteria (April 2023)

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Country Ceiling Criteria – Summary

Starting point:
Higher of LT FC IDR and 'CCC+'

+

Country Ceiling Model (CCM) result:
0 to +3 notches

+/-

Qualitative Adjustments (QA)

-3 to +6 notches for Currency Union Members; Reserve Currencies; or Dollarized Economies (such that CCM + QA is 0 to +6 notches)	-3 to +3 notches, for all other sovereigns (such that CCM + QA is 0 to +3 notches)

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Country Ceiling[a]

[a] When T&C risk materialises, Country Ceilings are placed at 'CCC+', otherwise the Country Ceiling is floored at 'B-'. Accordingly, for distressed sovereigns for which T&C risk has not materialized, there is a minimum of +1 for the combined CCM and QA outcome.
Source: Fitch Ratings

Definitions and Concepts

Country Ceilings measure T&C risk, which is the risk of capital and/or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments. We consider that T&C risk has materialised when it affects all or the vast majority of economic sectors and asset classes. In those cases, Fitch will place Country Ceilings at 'CCC+' to signal the materialisation of T&C risk.

Country Ceilings do not address the risk of imposition of a wide range of less restrictive measures that governments more commonly use to control capital account transactions, for example, to regulate foreign direct investment or cross-border portfolio investment flows, although these inform our assessment of T&C risk (see Pillar 1 in the CCM and QA sections).

Relationship with Sovereign Ratings

Sovereign ratings and T&C risks are highly correlated. For that reason, Fitch's Country Ceiling is derived from the LT FC IDR of the sovereign.

A Country Ceiling above the sovereign rating indicates that we expect some entities may be able to continue to service their foreign debt even when the sovereign is unable or unwilling to service its foreign-currency debt.

The notching distance between the Country Ceilings and the LT FC IDR reflects Fitch's view on incentives against the imposition of capital controls when compared to the credit worthiness of the sovereign.

In broad terms, notch distance to the IDR for non-distressed sovereigns indicates the following:

- +3 or more = very strong incentives against the imposition of capital and/or exchange controls relative to the IDR.
- +2 = strong incentives against the imposition of capital and/or exchange controls relative to the IDR.
- +1 = moderate incentives against the imposition of capital and/or exchange controls relative to the IDR.

- 0 = no material incentives against the imposition of capital and/or exchange controls relative to the IDR.
- <0 T&C risks have materialised, in which case the Country Ceiling is 'CCC+'. Fitch considers that this outcome will only arise in absolutely exceptional circumstances.

Outlooks and watches are not assigned to Country Ceilings because Country Ceilings are not ratings. Nonetheless, due to the notching approach, it is likely (but not certain) that if the LT FC IDR is upgraded (or downgraded), the Country Ceiling would also be raised (or lowered).

General Approach

Provided T&C risks have not materialised, the Country Ceiling will be in the range 'AAA' to 'B-'.

Fitch assesses the likelihood of the imposition of capital and/or exchange controls relative to the IDR by evaluating the constraints and/or incentives faced by the sovereign authorities for and against imposing such controls. The assessment involves in a two-step approach:

- The CCM output provides a starting point of 0 to +3 notches above the LT FC IDR;
- Fitch's rating committee will then determine QAs on the range -3 to +3, such that the net total CCM + QA is constrained to 0 to +3 for most sovereigns. For sovereigns in currency unions, with reserve currencies or with no separate legal tender, there is an extension of the constraints in this approach. QAs are permitted in the range -3 to +6, such that the net total CCM + QA is constrained to 0 to +6; and
- For distressed sovereigns the starting point for the application of the CCM + QA uplift is 'CCC+'. This means that committees can assign Country Ceilings up to 'BB+'. The Country Ceiling has a floor of 'B-', unless T&C has materialised.

Materialisation of T&C Risks

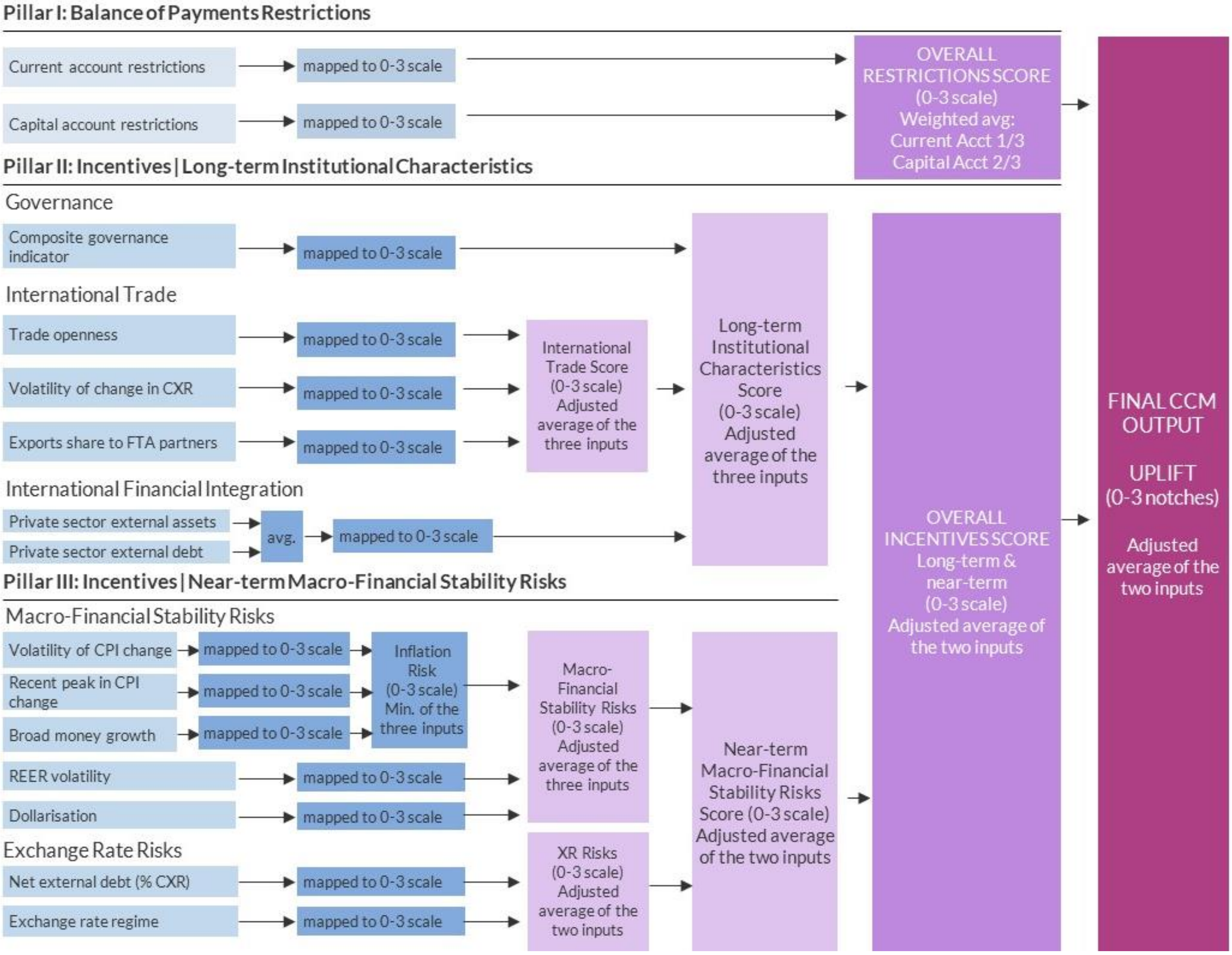
Notwithstanding the above general approach, when T&C risk has materialised the Country Ceiling is placed at 'CCC+'.

Country Ceilings below the established threshold (CCC+) could undesirably constrain ratings in sectors where payments are taking place. The Country Ceiling at 'CCC+' constitutes a signal for other sectors that the T&C risk has materialised. The effect in a particular sector and for each individual issuer/transaction will be determined by the application of the relevant rating criteria.

Country Ceiling Model

Fitch employs its CCM in assigning Country Ceilings. The CCM produces an output of 0 to +3 notches above the LT FC IDR, which provides the starting point for the derivation of the QA described in the next section.

Country Ceiling Model Framework



Source: Fitch Ratings

The CCM assesses the propensity of authorities to impose capital and/or exchange controls. It does not represent, for example, probability of default or probability of T&C risks materialising. The CCM comprises 15 input variables, that are organised across three pillars:

I. Balance of Payments Restrictions

II. Incentives: Long-term Institutional Characteristics

III. Incentives: Near-term Macro-Financial Stability Risks

The first pillar covers existing restrictions. The second and third pillars of the model collectively capture incentives (costs and benefits) for the sovereign to impose controls.

For the purposes of determining the model output, pillar II and III are combined to give a consolidated incentives score, which then has an equal weight as the current restrictions in the model output (see diagrammatic representation above). In certain parts of the model, the variables are condensed into analytical sub-factors within the pillars (for example, 'international trade'), such that the analytical sub-factors have an equal weight in the pillar. The model uses a combination of recent actual data and, at certain times of the year, forecasts/estimates.

The analytical rationale for the inclusion of the variables in the CCM is outlined in the following sections. Each variable is mapped to a 0 to 3 score, in line with the scale of the model output. Mapping tables are provided in the margin. See Appendices 1 and 2 for a more detailed description of the variable specifications and model structure.

I. Balance of Payments Restrictions

Data in this pillar are sourced from the IMF AREAER online database and provides a direct indication of current restrictions. This in turn provides a gauge of the propensity of authorities to use the types of measures that we aim to capture through the Country Ceilings. If authorities are used to imposing mild capital controls and have the institutional set-up in place to do so, they could also be more likely to impose stricter T&C-related controls.

However, the data are a proxy only of the strict T&C-related controls Country Ceilings represent. They represent the *volume* of certain types of control but they are not indicative of the actual restrictiveness of the individual controls. For example, they do not differentiate between more stringent requirements, such as for "authorisation", and lighter requirements for "notification".

The pillar is comprised of the following two ratios, both of which include inflow and outflow controls across a range of transaction types. Reflecting that the capital account restrictions are more closely aligned with T&C-related controls, that ratio has a two-third weight in the pillar. Current account restrictions have a one-third weight in the pillar.

- **Current Account Restrictions:** Percentage of 40 possible current account restrictions identified by Fitch that have been adopted in a given jurisdiction.
- **Capital Account Restrictions:** Percentage of 69 possible capital account restrictions identified by Fitch that have been adopted in a given jurisdiction.

II. Incentives: Long-Term Institutional Characteristics

This pillar is organised across three analytical factors that represent long-term characteristics that affect incentives (cost and benefits) faced by the sovereign to impose capital controls:

- **Composite Governance Indicator:** This indicator is a proxy for many intangible and difficult-to-measure factors that could exacerbate the need for capital controls and/or the likelihood of authorities adopting them in certain circumstances. For example, governments and institutions may be less effective in managing economic activity and absorbing adverse shocks in jurisdictions with weak civil institutions and rule of law, or that may be disrupted by civil unrest, political instability or conflict. The composite governance indicator is the simple average of the percentile ranks for the six World Bank Worldwide Governance Indicators: "rule of law"; "government effectiveness"; "control of corruption" and "voice & accountability"; "regulatory quality"; "political stability & absence of violence".

Pillar I Mapping Table

Current and Capital Account Restrictions (% Adopted)

Threshold	Score
<20	3
>=20	2
>=35	1
>=50	0

Source: Fitch Ratings

Pillar II Mapping Tables

Composite Governance Indicator (Percentile Rank)

Threshold	Score
>=65	3
>=50	2
>=35	1
<35	0

Trade Openness (% of GDP)

Threshold	Score
>=60	3
>=40	2
>=20	1
<20	0

Volatility of Change in CXR (%)

Threshold	Score
<7.5	3
>=7.5	2
>=10	1
>=15.0	0

Export Share to FTA Partners (% of Total Goods Exports)

Threshold	Score
>=75	3
>=50	2
>=25	1
<25	0

International Financial Integration: Private-Sector External Assets (% of GDP) and Private-Sector External Debt (% of GDP)

Threshold	Score
>=60	3
>=40	2
>=20	1
<20	0

Source: Fitch Ratings

- **International Trade:**
  - **Trade Openness (% of GDP):** Economies that are more open to international trade and integrated into global production networks risk greater damage to the economy from imposing exchange and capital controls that prevent the private sector honouring debt contracts. Consequences could include reputational damage, trade and investment losses, commercial and sanctions that impede or affect the ability to convert or transfer payments in certain foreign currencies, and lack of international credit.
  - **Volatility of Change in Current External Receipts (CXR):** This captures the propensity for fluctuations in foreign-exchange (FX) inflows into the economy. Countries facing more volatile external receipts, for example due to high commodity dependence, may have greater incentive to adopt foreign-currency-related controls as a policy response to the reduction in the FX supply to the economy. As inflows decline, and in the absence of strong buffers or alternative sources of financing (which may also be constrained when commodity prices are lower), measures to preserve or ration foreign currency may be tightened.
  - **Export Share to Free-Trade Agreement (FTA) Partners:** This variable captures the share of goods exports that are to recipients with whom the country has some form of free trade agreement. This share of trade may face “institutional” constraints against introducing capital controls.

International Financial Integration: Fitch measures this using private-sector external assets and debt, expressed as a share of GDP. The greater the degree of financial integration and openness to international capital, the greater the costs of imposing exchange controls in terms of possible damage to the economy (as well as the greater the difficulty in enforcing such controls). As with trade openness, consequences of imposing exchange and capital controls that prevent the private sector honouring debt contracts could include reputational damage, trade and investment losses, commercial sanctions, and lack of international credit.

III. Incentives: Near-Term Macro-Financial Stability Risks and Exchange-Rate Risks

Variables in this pillar identify certain near-term macro-financial risks that could precipitate the imposition of capital controls, in particular in the event of those positions deteriorating further.

Macro-Financial Stability Risks

- **Inflation:** The CCM takes the weakest measure across the following three variables to identify inflation-related risks. The respective rationales are closely aligned. Taking the weakest measure here allows the CCM to be more sensitive to possible signals, as each variable may in isolation flag inflation-related risks that may be masked by one or both of the other variables.
  - **Volatility of Consumer Price Index (CPI) Change:** Economies that have a relatively poor record on inflation often exhibit high degrees of indexation and dollarisation, as foreign currency becomes the chief store of value and the exchange rate the key reference price for the economy. In such cases, the incentive to impose controls on capital flows during a sovereign crisis can be strong.
  - **Recent Peak in CPI Change:** The rationale is as with the volatility measure, above. This variable specification – the highest annual change in CPI across the past five years – more directly measures recent record. The longer the period that low-to-moderate inflation is sustained in an economy, the greater the confidence that it will remain so.
  - **Broad Money Growth:** A rapid cumulative increase in broad money can reflect any of: large capital inflows; loose monetary/fiscal policy stance; or monetary deficit financing. These in turn could result in currency pressures, inflation and demand of foreign currency or capital flight that increase the likelihood of capital controls.

Pillar III Mapping Tables

Volatility of CPI Change (%)

Threshold	Score
<1.5	3
>=1.5	2
>=3.0	1
>=4.5	0

Recent peak in CPI Change (%)

Threshold	Score
<10	3
>=10	2
>=15	1
>=20	0

Broad Money Growth (%, 5-Year Cumulative)

Threshold	Score
<30	3
>=30	2
>=60	1
>=100	0

Note: This is approximately equivalent to, for example, five years of 5/10/15% annual growth rates, respectively.

REER Volatility (%)

Threshold	Score
<2.5	3
>=2.5	2
>=5	1
>=7.5	0

Dollarisation (%)

Threshold	Score
Fully dollarised[a]	3
<10	3
>=10	2
>=30	1
>=50	0

[a] Defined as jurisdictions with no separate legal tender for the exchange-rate regime variable.

Net External Debt (% of CXR)

Threshold	Score
<0	3
>=0	2
>=30	1
>=60	0

- **REER Volatility:** High real effective exchange-rate (REER) volatility is a negative factor in the model for the rationale that it can reflect volatile capital inflows, build-up of eventually unsustainable macroeconomic imbalances or a track record of instability that increase the incentives to impose capital control.
- **Dollarisation:** Except for long-standing and fully dollarised economies (i.e. jurisdictions with 'no separate legal tender' according to the exchange-rate regime variable, below), high financial dollarisation may reflect low confidence in the domestic currency/policies, represent contingent liability on international reserves (in the event of deposit withdrawals) and increase the likelihood of authorities implementing policies, such as deposit withdrawal limitations and exchange controls.

Exchange Rate Risks

- **Net External Debt/CXR:** Higher net external indebtedness will mean a greater outflow of capital to service and repay external debt, especially during a crisis when international creditors are less willing to roll over maturing claims. This can also imply a greater exposure to exchange-rate depreciation risks. The incentive to adopt restrictive measures will often, but not always, depend primarily on private-sector external debt stocks.
- **Exchange-Rate Regime:** In Fitch's view, sovereigns that maintain a flexible exchange-rate regime are less prone to adopt exchange-rate and capital controls to defend it. This does not mean that flexible exchange rates may not have other side effects on the economy, but those, when relevant for the assessment of T&C risk, are captured in other parts of this criteria.

Qualitative Adjustment Framework

The agency employs a QA framework to capture key factors that are not reflected or not fully reflected in the CCM output.

QA notch adjustments are made predominantly for relevant qualitative factors not captured in the CCM or recent developments and forward-looking aspects not yet reflected in the data in the model. It also serves to capture data non-linearities. QAs can also be assigned where, due to country-specific factors, an individual pillar needs to have a higher weight in the assessment.

As a secondary consideration, any QA notching takes account of the relative qualities of the issuer compared with a peer group of issuers with a similar LT FC IDR.

The QA notch adjustments are assigned using the three analytical pillars. The combined total QA is subject to the following rules:

- The rating committee decides on notch adjustments in the range +3/-3 for each pillar. The total QA summed across the three pillars is constrained to +3/-3 and the total QA plus CCM result is constrained to +3/0.
- When the long-term institutional characteristics of a sovereign include currency union membership, reserve currency status or fully dollarised economies, the QA uplift of the second pillar can be up to six notches, and the total CCM + QA can be up to six notches.
- For Sovereigns rated 'CCC+' or below, if T&C risks have not materialised, the CCM + QA approach will be used. However 'CCC+' will be used as the starting point, instead of the LT FC IDR, and with a floor at 'B-' for the Country Ceiling.
- When T&C risks have materialised, the Country Ceiling will be lowered to 'CCC+', bypassing the CCM + QA framework.

Aside from currency union membership, reserve currency status or fully dollarised economies, Fitch expects total QA outcomes beyond +/-1 to be rare.

Temporary migrations can take place when the CCM output migrates from notch uplift to another – either up or down – but the migration is deemed likely to be a temporary deterioration or improvement the committee can decide not to adopt the new CCM output as the starting point on which to apply the QA.

Exchange-Rate Regime

Regime type	Regime detail	Score
Hard Peg	No separate legal tender	3
Floating	Free floating	3
Floating	Floating	3
Soft Peg	Crawling peg	2
Soft Peg	Crawl-like arrangement	2
Soft Peg	Stabilised arrangement	1
Soft Peg	Pegged exchange rate within horizontal bands	1
Soft Peg	Other managed arrangement	1
Soft Peg	Conventional peg	1
Hard Peg	Currency board	0

Source: Fitch Ratings

The section below summarises the factors that Fitch considers to determine the QAs for each pillar.

I. Balance of Payments Restrictions

QA factors – relative to CCM
• Track record
• Stringency of controls
• Other factors

Source: Fitch Ratings

- **Track Record:** The committee may consider that a country's record of introducing capital controls warrants a negative adjustment independently of the *current* level of restrictions (i.e. to account for possible propensity to revert back to restrictions during periods of lower restrictions). Similarly, a sovereign with a long tradition of liberalised capital account movements may be over penalised by the amount of restrictions in place. The ability to adjust this pillar irrespective of the current level of restrictions would provide the necessary flexibility to committees to capture forward-looking expectations. A negative QA could be used in those cases in which the recently introduced restrictions are not yet reflected in the IMF AREAER dataset.
- **Stringency of Controls:** The IMF AREAER dataset represents the volume of certain types of control but it is not indicative of the true restrictiveness of those individual controls. It is therefore a proxy only of what Country Ceilings truly represent. QAs can therefore be made where we believe capital accounts are open and the large volume of controls are minor in nature (and/or not truly indicative of the likelihood of strict T&C-related controls), and vice-versa (i.e. only small number of absolute controls, but very stringent ones). Similarly, QAs should be used where necessary to lower the actual Country Ceiling notching from the IDR to 0 if serious controls are now in place, but they do not meet the threshold for materialisation of T&C risks. This could apply even if the CCM pillar I score is +0 notches, but other parts of the model are holding the overall CCM result up, i.e. we can use the QA to give outsize weight to this pillar.
- **Other Factors:** Any factors that are relevant and material to the imposition of BOP restrictions but which are not fully captured by the CCM. These factors can include a +1 notch for sovereigns rated 'CCC+' or below, when the combination of the CCM + the QA will otherwise be 0, but T&C has not materialised, to ensure that the assigned Country Ceiling is at the 'B-' floor.

II. Incentives: Long-Term Institutional Characteristics

QA factors – relative to CCM
• Currency unions and dollarised economies
• Reserve currencies
• International financial centres, supranational membership, sanctions and other factors

Source: Fitch Ratings

- **Currency Unions and Dollarised Economies:** Currency unions or supranational currency arrangements introduce institutional, political and practical constraints that can considerably reduce the risk of exchange and capital controls being imposed, but do not wholly eliminate them.

  For member countries of a currency union or supranational currency arrangement, Fitch allows a maximum Country Ceiling uplift of six notches above the FC IDR. Examples of currency unions to be considered under this methodology include the eurozone, the Central African Economic and Monetary Community (CEMAC), the West African Economic and Monetary Union (WAEMU) the Common Monetary Area (CMA), or the Eastern Caribbean Currency Authority (ECCA).

  Fitch considers some currency unions to have stronger institutions than others. Specifics of the monetary arrangement play an important role in determining the uplift, and can include institutional provisions restricting the imposition of capital controls at the country level or the strength of support provided by the monetary arrangement in the case of stress.

The full six-notch uplift is meant for common currencies that are combined with strong institutions, far-reaching economic integration, and based on a reserve currency. A smaller uplift is assigned to currency unions with weaker institutions, and even less to fairly loose monetary arrangements without much institutional integration.

In determining the uplift for individual member countries, rating committees consider the risks related to the country leaving the arrangement or imposing controls in times of stress. Deviations in notching for a currency union member from the level typically applied for members of the same arrangement often occurs in times of crisis or depending on historical precedents.

The risks of an exit from the currency union or arrangement, or the imposition of capital controls would generally be expected to be higher for lower-rated sovereigns, and the notching is therefore reviewed whenever a country is downgraded, especially to low sub-investment grade.

Fully dollarised economies with no separated legal tender and a stable record of maintaining a foreign currency as their domestic one, by definition cannot impose exchange rate controls. In Fitch's view, dollarisation also reduces the risk of capital controls being imposed, although it does not wholly eliminate them. Up to six notches will be assigned for countries with a long tradition of dollarisation and no indication of any potential change in monetary system.

In determining the uplift, rating committees consider the risks and incentives related to the country retaining the arrangement vis-à-vis changing it, and the need to impose controls in times of stress, for example in scenarios of low levels of international reserves or incapacity to access international capital markets.

Deviations in notching for a dollarised economy from the maximum level typically applied often occur in times of crisis. The risks of imposing capital controls would generally be expected to be higher for lower-rated sovereigns, especially to low to sub-investment grade.

- **Sovereigns with Reserve Currencies:** A government can be considered to have weaker incentives to impose exchange and capital controls if its currency is widely held and traded internationally. Such governments can easily borrow abroad in their own currency, which confers major benefits to the sovereign and therefore potential cost if lost. Fitch considers the following currencies, which are included in the IMF's COFER publications, as reserve currencies: Australian dollar, Canadian dollar, Chinese renminbi, euro, Japanese yen, Swiss franc, UK pound and US dollar.

  Fitch allows a maximum Country Ceiling uplift of six notches above the LT FC IDR for sovereigns with a reserve currency. To determine the uplift, rating committees will consider how well the relevant currency in practice functions internationally as a store of value and to what extent it is fully convertible.

  When a sovereign with a reserve currency is also part of a currency union a combined assessment of both factors is taken into consideration in determining the QA.

- **International Financial Centres (IFCs), Membership of Supranational Institutions, Sanctions and Other Factors**

  - **IFC:** Generally, we would expect a major IFC to reach the maximum overall (i.e. combining the CCM and the QA) three notch uplift over the LT FC IDR. However, there is no binary classification of sovereign IFCs. A sovereign can share some characteristics of an IFC but not others. For example, the role of an economy as IFCs can be guided by the size of the International Investment Position (IIP) to GDP, but also by other intangible characteristics. The determination of whether a sovereign can share characteristics of an IFC or not will be derived by credit committees based on expert judgement and peer comparison.

- **Supranational Membership:** Membership of established supranational institutions such as EU, EU candidacy, the Association of Southeast Nations (ASEAN), Mercosur, Gulf Cooperation Council (GCC), but excluding 'currency unions', may be relevant for the determination of the notch uplift where benefits of supranational membership of broader and deeper economic integration are understated by the international trade parts of the model. This could warrant a positive QA if the potential benefits of imposing severe exchange and capital controls in a crisis situation would be at least partially offset by the costs incurred in violating the letter or spirit of treaty commitments and membership of supranational institutions. Absence of membership of the WTO could warrant a negative QA.
- **Sanctions:** Sanctions or the risk of sanctions can lead to a lower degree of external financial integration and create risks that countries have to implement more interventionist measures in response, leading to a negative QA.
- **Other Factors:** Any other factors that are relevant and material to the long-term incentives to impose capital controls, but which are not fully captured by the CCM.

III. Incentives: Near-Term Macro-Financial Stability Risks and Exchange-Rate Risks

QA factors – relative to CCM
• Domestic macro-financial imbalances
• External financing vulnerabilities
• Other factors

Source: Fitch Ratings

- **Domestic Macro-Financial Imbalances:** This adjustment takes into consideration any macro-economic or financial factors that have a propensity for generating instability that might in-turn increase the likelihood of demand for FC, capital flight and, ultimately, increased likelihood of capital controls. The Sovereign Rating Criteria (SRC) Qualitative Overlay (QO) Macroeconomic Policies and Performance assessment for a given sovereign can give an indication of domestic macro-financial imbalances. Financial sector risks (in particular where Fitch's Banking Sector Indicator (BSI) is a category or more below the sovereign LT FC IDR) could be another relevant area to consider a negative QA.
- **External Financing Vulnerabilities:** This adjustment takes into consideration factors that may put pressure on external financing sources and/or vulnerability of the external balance sheets to shocks. The SRC external finances QO assessment for a given sovereign can give an indication of the presence of external financial vulnerabilities. The NXD variable (which is part of the CCM) by itself does not capture risks related to the available liquidity and the structure of external debt and the sovereign access to external financing. Other factors may guide this assessment including diversity of external financing sources; if the IMF de facto exchange-rate classification does not reflect our assessment of the actual policy implementation; history of volatile capital inflows are not completely captured by the REER in the model; or factors that provide mitigations such as the level of foreign exchange reserves.
- **Other Factors:** Any factors that are relevant and material to the near-term incentives to impose capital controls but which are not fully captured by the CCM.

Data Sources

The sources used for the development of the criteria and for its application are the same.

- Current account and capital account restrictions and the exchange rate regime data, are retrieved from the IMF AREAER online database.

- The share of exports to FTA partners are calculated by Fitch combining information on goods trade agreements provided by the WTO Regional Trade Agreement database with bilateral trade flows sourced from the IMF Direction of Trade Statistics.
- The rest of the data used are derived in line with Fitch's Sovereign Data Comparator:
  - World Bank (WB) Worldwide Governance Indicators are retrieved from the WB Governance dataset; and
  - Other indicators are sourced from a combination of national sources, the IMF, World Bank and others (e.g. BIS and Bruegel in some cases for REER).

Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgement exercised through a committee process. The combination of transparent criteria, analytical judgement applied on a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the country ceiling when appropriate.

A variation can be approved by a ratings committee when the risk, feature, or other factor relevant to the assignment of a country ceiling and the methodology applied to it are both included within the scope of the criteria, but when the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Criteria Disclosure

In rating action commentaries for assigning new and reviewing existing Country Ceilings, Fitch would typically disclose the Country Ceiling level resulting from the application of the CCM and the QA adjustment applied, if any.

Limitations

Ratings assigned by Fitch, including Rating Watches and Outlooks, are subject to limitations specified in Fitch's Ratings Definitions.

Appendix 1: CCM Variables

Variable	Data point[a], description and sources
I. Balance of Payments Restrictions	
Current account restrictions (% adopted)	Single year datapoint (most recent outturn) derived from the IMF AREAER online database. Percentage of 40 possible current account restrictions identified by Fitch that have been employed in the jurisdiction.
Capital account restrictions (% adopted)	Single year datapoint (most recent) derived from the IMF AREAER online database. Percentage of 69 possible current account restrictions identified by Fitch that have been employed in the jurisdiction.
II. Incentives: Long-Term Institutional Characteristics	
Governance | composite governance indicator (percentile rank)	Single year datapoint (most recent outturn) derived from the World Bank Worldwide Governance Indicators. Simple average of the percentile ranks for "rule of law"; "government effectiveness"; "control of corruption" and "voice & accountability"; "regulatory quality"; "political stability & absence of violence".
International trade | trade openness (% of GDP)	Five-year average, up to and including the CCM year, of trade openness (% of GDP).
International trade | volatility of change in CXR (%)	Standard deviation across 10 years, up to and including the CCM year, of the year-on-year change (%) in current external receipts (CXR, USDm).
International trade | export share to FTA partners (% of total goods exports)	Five-year average, up to and including the CCM year, of export share to FTA partners.
International financial integration | private-sector external assets (% of GDP)	Five-year average, up to and including the CCM year, of private-sector external assets (% of GDP).
International financial integration | private-sector external debt (% of GDP)	Five-year average, up to and including the CCM year, of private-sector external debt (% of GDP).
III. Incentives: Near-Term Macro-Financial Stability Risks and Exchange-Rate Risks	
Macro-financial stability risks | inflation | volatility of CPI change (%)	Standard deviation across 10 years, up to and including the CCM year, of the annual average percentage change in CPI.
Macro-financial stability risks | inflation | recent peak in CPI change (%)	Maximum across five years, up to and including the CCM year, of the annual average percentage change in CPI.
Macro-financial stability risks | inflation | broad money growth (%)	Percentage change in broad money (LCUbn) between the CCM year and five years prior.
Macro-financial stability risks | REER volatility (%)	Standard deviation across 10 years, up-to and the including the CCM year, of the annual percent change in the average annual index of the REER.
Macro-financial stability risks | dollarisation (%)	Single year datapoint (most recent outturn, estimate or forecast) across three years, up to and including the CCM year.
Exchange-rate risks | net external debt (% of CXR)	Three-year average, up to and including the CCM year, of net external debt (% of CXR).
Exchange-rate risks | exchange-rate regime	Single year classification (most recent) of the de-facto exchange-rate arrangement from the IMF AREAER online database (or, occasionally, from other more timely reports).

Note: For expanded definitions of sovereign indicators, please refer to the "Definitions and Sources" section of Fitch's *Sovereign Data Comparator*.
[a] CCM year is the previous year for rating committees in January-June, and the current year for rating committees in July-December.
Source: Fitch Ratings

Appendix 2: CCM Model Definition

The derivation of the CCM result for each sovereign comprises five broad steps, represented by the different coloured columns in the diagrammatic representation (see *Country Ceiling Model* section). These are broadly as follows:

- **Step 1 – Raw Input Data:** Data are collated for the 15 input variables, set across the three analytical pillars. See *Appendix 1* for variable descriptions and data points referenced.
    - NB: Exclusively in the *International Financial Integration* section, there is an additional intermediate step. The CCM takes the average of the data across both variables, private-sector external assets (% of GDP) and private-sector external debt (% of GDP).
- **Step 2 – Indicator Level Scores:** For each variable, the raw data are calibrated to a 0–3 scale using the mapping tables provided in the sidebar in the main body of this report. There are two exceptions to the general approach:
    - Exclusively in the *Macro-Financial Stability Risks | Inflation* section, there is an additional intermediate step. The CCM takes the minimum score across the three input variables to determine the final Inflation score.
    - Exclusively in the dollarisation score, the score is set to 3 for fully dollarised economies. These are identified as those with 'No Separate Legal Tender' under the exchange-rate regime variable.
- **Step 3 – Pillar II and III Scores:** Indicator level scores are combined using the 'adjusted average' method (defined below) in a two-step process to determine the composite Pillar II and III scores:
    - First, indicator level scores are combined into analytical sub-factor scores where applicable as per the diagrammatic representation. For example, scores for trade openness, volatility of CXR change, and export share to FTA partners are combined using the 'adjusted average' method to determine the International Trade score; the same approach applies for macro-financial stability and exchange-rate risks as these also comprise more than indicator level score.
    - Second, the analytical sub-factors are combined using the 'adjusted average' method to determine the final Pillar II and Pillar III scores. For example, for Pillar II, we take the 'adjusted average' of the governance, international trade and international financial integration scores.
- **Step 4 – Final Component Scores**
    - The overall restrictions score is determined by taking a weighted average of the current account restrictions (one-third weight) and capital account restrictions (two-third weight) indictor level scores. This weighted average is then rounded to the nearest integer.
    - The overall incentives score is determined by taking the 'adjusted average' of the Pillar II and III scores.
- **Step 5 – Final CCM Output:** The final model output is determined by taking the 'adjusted average' of the overall restrictions score and the overall incentives score.

Adjusted Average Method: This method takes the simple average of the component scores and then:

- If the simple average is greater than or equal to 2.5, assign a 3.
- If the simple average is less than 2.5, round down to the nearest integer (i.e. 0, 1 or 2).

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