

Sovereign Risk Analysis

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THE CONTINENTAL ECONOMICS INSTITUTE RESEARCH PAPER SERIS 2011/1

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I. KEY VARIABLES OF SOVEREIGN RISK

Financial Position:

International reserves

Current account

Internal credit expansion, inflation rate

Debt Position:

Debt burden

Debt structure

Debt management

International environment:

U.S. interest rate

Economic growth in major export markets (for indebted country)

International currency movements (dollar, euro, yen)

Performance of the major bond and stock markets (as indicators of global liquidity)

Regional setting:

Portfolio characteristics (in terms of regional aspects)
Regional contagion

Economic Policy fundamentals:

Monetary policy (independence, stability, orientation, management quality)
Fiscal policy (tax efficiency, ability to generate revenues)

Long-term microeconomic fundamentals

Degree of export orientation (and import dependence)
International Competitiveness
Open Markets
Efficient market structures

Governance

Transparency and Validity of Rules
Democratic Political Participation
Popular wealth orientation

II. SOVEREIGN RISK ANALYSIS CHECKLIST

General economic policy

- a) Does the government have an integrative view of its economic policy measures, or does it practice ad hoc interventionism?
- b) Is there inherent coherency and internal consistency of government measures directed at national wealth creation?
- c) Is there constancy and reliability in government measures?

Markets

- a) Is there a predominance of competitive markets is there a tolerance of oligopolistic and monopolistic tendencies? What is the stance of the government? Are there effective means of anti-trust policies?
- b) Is the central bank reliable in guaranteeing stable monetary conditions (primacy of price stability, financial system stability, restrictions on government funding)?

Macroeconomic Policy

- a) Is there moderation in demand management policies or a practice of stop and go?
- b) Are there stable fiscal conditions (budget balance)
- c) Are fiscal burdens low and the tax-expenditure system transparent (tax structure, efficient government expenditure)?

Social Conditions

- a) Is there an active policy to curtail extremes in the distribution of income and wealth or is there a practice of favoritism with privileges for special groups?
- b) Are there orderly procedures of ‘voice’?
- c) Are the ways to private wealth acquisition open or limited by social prejudice, discrimination, and restrictions?

III. SOVEREIGN RISK ANALYSIS INDICATORS

1. External Debt Indicators

Indicator	Indicatum
R/STD	financial vulnerability
D/EX	financing the debt burden
CA/GDP	external sector position
D/GDP	overall debt burden
Inflation rate	degree of monetary stability
Deficit/Tax	internal fiscal position

2. A Weighting Scheme

Inflation rate	10		
Government budget deficit	10		
Asset prices (RER)	10	(+ real estate ROI)	
		30 %	
Current account	10		
U.S. interest rate	10		
International asset prices	10		
Export Markets growth	10	40 %	
R/STD	10		
D/EX	10		
D/GDP	10	30 %	
			100 %

3. A Benchmark System

Inflation rate: up to 4 % ok, over 5 % critical

Government budget deficit: up to - 4 % ok, over 5 % critical

Current account: up to -4 % ok, over 5 % critical

U.S. real interest rate: up to 3 %, over 4 % critical

R/STD: for ratio < 1 critical

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