

# KINGDOM OF SPAIN

\*EJR Sen Rating(Curr/Prj) BBB/ BBB-

\*EJR CP Rating: A2

Rating Analysis - 8/19/20

\*EJR's 3 yr. Default Probability: 2.0%

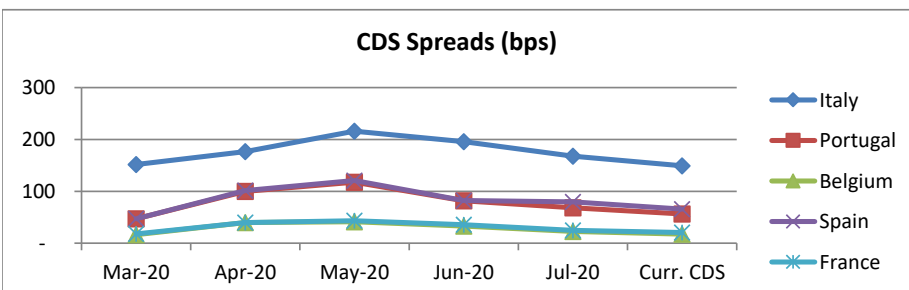
The Spanish economy, according to OECD, is projected to contract by 14.4% in 2020 in a scenario with a second virus outbreak later in the year, and by 11.1% in a scenario assuming that the pandemic subsides by the summer. The subsequent recovery in 2021 will be slower in the former case, at 5%, compared to the rebound of 7.5% in the single-hit scenario. In both scenarios, the fall in domestic demand, due to job destruction and the shutdown of activity, is the key driver of the contraction.

EJR believes, as the recovery commences, the use of short-time work schemes will need to become well-targeted and gradually be replaced with labor market policies to help firms and workers in sectors with persistent negative effects shift into activities with better medium-term prospects. The budget deficit and the public debt-to-GDP ratio are projected to rise sharply, with the latter (Maastricht definition) reaching 117.8% in the single-hit and 129.5% in the double-hit scenario in 2020A slower-than-assumed recovery in tourism and trading partner growth could limit the pace of recovery. Conditions in Spain continue to deteriorate as COVID grows to the most affected country in the region. We are affirming with a negative watch. Other raters might take positive actions.

CREDIT POSITION	Annual Ratios (source for past results: IMF, CountryEconomy)					
	2017	2018	2019	P2020	P2021	P2022
Debt/ GDP (%)	98.2	97.1	95.5	101.6	108.3	115.4
Govt. Sur/Def to GDP (%)	-3.4	-2.7	-3.1	-3.7	-4.3	-5.0
Adjusted Debt/GDP (%)	98.2	97.1	95.5	101.6	108.3	115.4
Interest Expense/ Taxes (%)	11.3	10.7	10.3	10.4	10.5	10.6
GDP Growth (%)	4.3	3.6	2.8	2.3	2.3	2.5
Foreign Reserves/Debt (%)	3.8	3.8	4.1	3.8	3.4	3.2
Implied Sen. Rating	A	A	A-	A-	BBB+	BBB+

INDICATIVE CREDIT RATIOS	AA	A	BBB	BB	B	CCC
Debt/ GDP (%)	100.0	115.0	130.0	145.0	170.0	200.0
Govt. Sur/Def to GDP (%)	2.5	0.5	-2.0	-5.0	-8.0	-10.0
Adjusted Debt/GDP (%)	95.0	110.0	125.0	140.0	160.0	190.0
Interest Expense/ Taxes (%)	9.0	12.0	15.0	22.0	26.0	35.0
GDP Growth (%)	3.5	3.0	2.0	1.0	-1.0	-5.0
Foreign Reserves/Debt (%)	3.0	2.5	2.0	1.5	1.0	0.5

PEER RATIOS	Other NRSROs	Debt as a % GDP	Govt. Surp. Def to GDP (%)	Adjusted Debt/ GDP	Interest Expense/ Taxes %	GDP Growth (%)	Ratio-Implied Rating*
Federal Republic of Germany	AAA	59.8	1.6	59.8	3.3	2.5	AA
French Republic	AA	98.1	-2.5	98.1	4.7	2.9	A+
Kingdom of Belgium	AA	98.7	-1.5	98.7	6.6	4.8	AA+
Republic of Italy	BBB-	134.8	-2.1	134.8	11.7	1.6	BBB
Portugal Republic	BB+	117.7	-0.7	117.7	12.0	3.9	A+

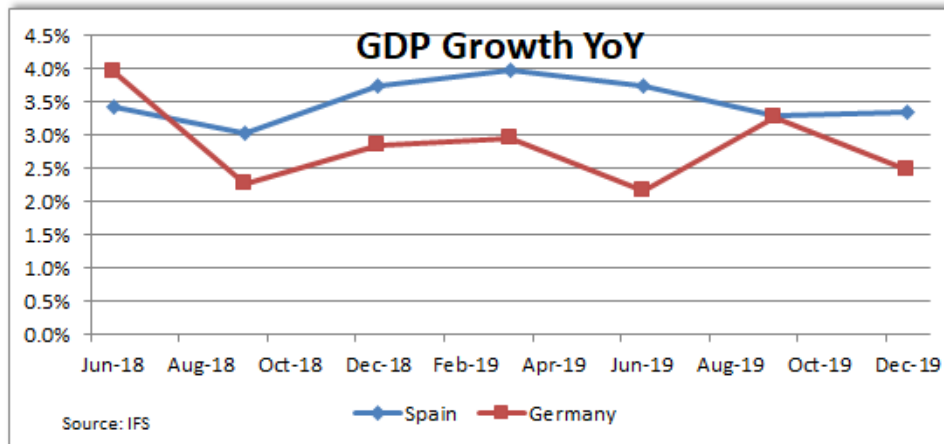


(Source: Thomson Reuters)

Country	EJR Rtg.	CDS
Italy	BBB-	149
Portugal	BBB-	56
Belgium	BBB	18
Spain	BBB	65
France	A+	21

**Economic Growth**

Spain's Q2 GDP shrank by 18.5% - this is the largest quarterly drop since the days of the Spanish Civil War (1936-1939), and it comes on top of a 5.2% contraction in the first three months of the year, reflecting the fact that the country went into lockdown in mid-March. The lost production amounts to around €300 billion, a figure that would be enough to cover pension payments for Spain's 10 million retirees for two years. According to the Spain's statistical office INE, on an annual basis Spain's GDP shrank by 22.1%. The numbers show that the coronavirus crisis has ended six years of steady growth that followed a prolonged recession triggered by the 2008 financial crisis.



**Fiscal Policy**

The government's caution even in the face of such dire predictions is largely because of the uncertain state of its public finances. The country's budget was structurally out of balance before the crisis and those imbalances are getting worse. Previously the country had a structural deficit of about 3 per cent of GDP and was only reducing its debt because interest rates were less than growth. Government agency estimates a government deficit of between 11.1% and 13.9% of GDP this year, and between 7.7% and 9.7% in 2021 — depending on the severity and duration of the pandemic. Government agency expects the Spanish government's debt burden to jump from 95% of GDP just before the crisis to about 120% this year and a couple of points higher in 2021.

	Surplus-to-GDP (%)	Debt-to-GDP (%)	5 Yr. CDS Spreads
Spain	-3.06	95.51	65.47
Germany	1.58	59.76	12.34
France	-2.53	98.12	20.78
Belgium	-1.52	98.75	17.67
Italy	-2.09	134.80	149.17
Portugal	-0.69	117.74	56.08

Sources: Thomson Reuters, IFS and CountryEconomy

**Unemployment**

Spain's unemployment rate rose to 15.33% in the second quarter of 2020, the highest since the first quarter of 2018, but below market expectations of 16.70 percent with the extent of the coronavirus crisis being masked by leaving out people on furlough and those not meeting technical jobless criteria. The number of unemployed increased by 55 thousand to 3.368 million, while employment declined by a record 1.074 million to 18.607 million. In addition, 1.019 million people dropped out of the labor force.

	Unemployment (%)	
	2018	2019
Spain	15.26	13.96
Germany	3.40	3.20
France	9.11	8.43
Belgium	5.98	5.44
Italy	10.62	9.90
Portugal	7.05	6.33

Source: Intl. Finance Statistics

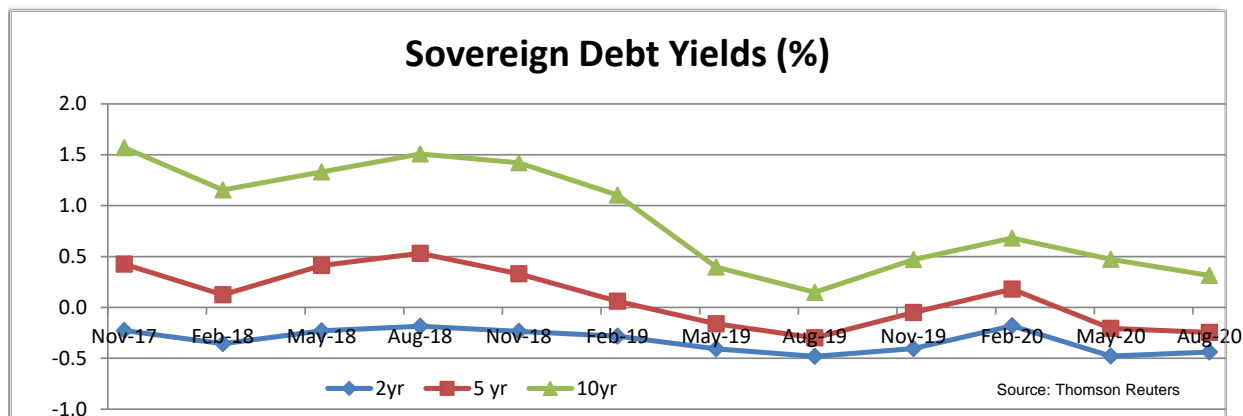
## Banking Sector

Spain risks becoming another sick man of Europe. Not only has Spain been among COVID-19's biggest victims in Western Europe. Its tourist-dependent economy has proved to be particularly vulnerable to the pandemic's ravages. No. of companies filing for bankruptcies in Spain stood at 1,111 in Q2 and this is over and above the 1,501 companies that filed for bankruptcy in Q1'20. Spain's industrial confidence indicator increased to -11.5 in July 2020. The pandemic that has forced lenders to set aside billions of euros to cover bad loans, write down the value of assets and eradicate dividends under pressure from regulators. Spain's Non-Performing Loans Ratio stood at 4.7 % in May 2020, compared with the ratio of 4.7 % in the previous month.

Bank Assets (billions of local currency)		
	Assets	Mkt Cap/ Assets %
BANCO SANTANDER	1,522.7	2.26
BBVA	698.7	2.87
CaixaBank	391.4	3.09
Bankia	208.5	1.59
Banko de Sabadell	<u>223.75</u>	<u>0.78</u>
Total	3,045.0	
EJR's est. of cap shortfall at 10% of assets less market cap		232.8
Spain's GDP		1,244.2

## Funding Costs

Spain's 5 Years CDS value is at 60.7 which reveals a 1.01% implied probability of default, on a supposed 40% recovery rate. Spanish officials boosted net debt issuance for this year to €130 billion, a fourfold increase from a target set in January. That exceeds a previous record set in 2009, in the depths of the region's last major economic contraction.



## Ease of Doing Business

Major factors for growing the economy are the ease of doing business and the economic freedom; although not the sole factor for determining economic growth, a country which makes it easy for businesses to operate and provides a reasonably free environment to conduct business has a good chance for growth. The chart on the right indicates that with an overall rank of 30 (1 is best, 189 worst) is strong.

The World Bank's Doing Business Survey*			
	2019	2018	Change in
	Rank	Rank	Rank
<b>Overall Country Rank:</b>	<b>30</b>	<b>28</b>	<b>-2</b>
<b>Scores:</b>			
Starting a Business	97	86	-11
Construction Permits	79	123	44
Getting Electricity	55	42	-13
Registering Property	59	53	-6
Getting Credit	80	68	-12
Protecting Investors	28	24	-4
Paying Taxes	35	34	-1
Trading Across Borders	1	1	0
Enforcing Contracts	26	26	0
Resolving Insolvency	18	19	1

\* Based on a scale of 1 to 189 with 1 being the highest ranking.

**Economic Freedom**

As can be seen below, Spain is above average in its overall rank of 66.9 for Economic Freedom with 100 being best.

<b>Heritage Foundation 2020 Index of Economic Freedom</b>				
<b>World Rank 66.9*</b>				
	<b>2020</b>	<b>2019</b>	<b>Change in</b>	<b>World</b>
	<b>Rank**</b>	<b>Rank</b>	<b>Rank</b>	<b>Avg.</b>
<b>Property Rights</b>	<b>74.9</b>	<b>72.9</b>	<b>2.0</b>	<b>56.6</b>
<b>Government Integrity</b>	<b>55.1</b>	<b>51.4</b>	<b>3.7</b>	<b>43.8</b>
<b>Judicial Effectiveness</b>	<b>51.8</b>	<b>51.9</b>	<b>-0.1</b>	<b>45.1</b>
<b>Tax Burden</b>	<b>62.1</b>	<b>62.3</b>	<b>-0.2</b>	<b>77.3</b>
<b>Gov't Spending</b>	<b>48.3</b>	<b>46.2</b>	<b>2.1</b>	<b>66.0</b>
<b>Fiscal Health</b>	<b>62.6</b>	<b>51.1</b>	<b>11.5</b>	<b>69.1</b>
<b>Business Freedom</b>	<b>66.8</b>	<b>66.8</b>	<b>0.0</b>	<b>63.3</b>
<b>Labor Freedom</b>	<b>57.7</b>	<b>57.8</b>	<b>-0.1</b>	<b>59.4</b>
<b>Monetary Freedom</b>	<b>82.0</b>	<b>87.5</b>	<b>-5.5</b>	<b>74.6</b>
<b>Trade Freedom</b>	<b>86.4</b>	<b>86.0</b>	<b>0.4</b>	<b>73.8</b>

\*Based on a scale of 1-100 with 100 being the highest ranking.  
 \*\*The ten economic freedoms are based on a scale of 0 (least free) to 100 (most free).  
 Source: The Heritage Foundation

**Credit Quality Driver: Taxes Growth:**

KINGDOM OF SPAIN has grown its taxes of 1.3% per annum in the last fiscal year which is disappointing. We expect tax revenues will grow approximately 1.3% per annum over the next couple of years and 1.3% per annum for the next couple of years thereafter.

**Credit Quality Driver: Total Revenue Growth:**

KINGDOM OF SPAIN's total revenue growth has been more than its peers and we assumed a 2.3% growth in total revenue over the next two years.

Income Statement	Peer Median	Issuer Avg.	Assumptions	
			Yr. 1&2	Yr. 3,4,5
Taxes Growth%	2.7	1.3	1.3	1.3
Social Contributions Growth %	3.2	7.5	7.0	7.0
Grant Revenue Growth %	0.0	NMF		
Other Revenue Growth %	0.0	NMF		
Other Operating Income Growth%	0.0	2.2	2.6	2.6
Total Revenue Growth%	2.8	3.3	2.3	2.1
Compensation of Employees Growth%	3.1	5.0	5.0	5.0
Use of Goods & Services Growth%	2.3	3.5	3.5	3.5
Social Benefits Growth%	3.8	6.1	6.1	6.1
Subsidies Growth%	7.3	5.0		
Other Expenses Growth%	0.0			
Interest Expense	1.8	2.4	2.4	2.4
Currency and Deposits (asset) Growth%	(2.3)	0.0		
Securities other than Shares LT (asset) Growth%	8.9	0.0		
Loans (asset) Growth%	0.8	(2.1)	(2.1)	(2.1)
Shares and Other Equity (asset) Growth%	9.7	(2.3)	2.0	2.0
Insurance Technical Reserves (asset) Growth%	1.6	0.0		
Financial Derivatives (asset) Growth%	11.4	23.3	1.3	1.3
Other Accounts Receivable LT Growth%	1.8	1.7	1.3	1.3
Monetary Gold and SDR's Growth %	0.0	0.0	5.0	5.0
Other Assets Growth%	0.0	0.0		
Other Accounts Payable Growth%	(1.4)	6.9	3.0	3.0
Currency & Deposits (liability) Growth%	1.0	3.6	3.6	3.6
Securities Other than Shares (liability) Growth%	6.8	6.8	4.7	4.7
Loans (liability) Growth%	(2.4)	(1.5)	0.5	0.5
Insurance Technical Reserves (liability) Growth%	0.0	0.0		
Financial Derivatives (liability) Growth%	5.9	(28.0)	(10.0)	(10.0)
Additional ST debt (1st year)(millions EUR)	0.0	0.0		

**ANNUAL OPERATING STATEMENTS**

Below are KINGDOM OF SPAIN's annual income statements with the projected years based on the assumptions listed on page 5.

	ANNUAL REVENUE AND EXPENSE STATEMENT (MILLIONS EUR)					
	2016	2017	2018	2019	P2020	P2021
Taxes	245,312	257,722	273,771	277,317	280,922	284,574
Social Contributions	135,573	142,430	149,382	160,533	171,770	183,794
Grant Revenue						
Other Revenue						
Other Operating Income	43,895	43,379	47,849	48,904	48,904	48,904
Total Revenue	424,780	443,531	471,002	486,754	501,596	517,272
Compensation of Employees	121,506	123,460	127,644	134,063	140,805	147,886
Use of Goods & Services	58,229	59,386	61,547	63,671	65,868	68,141
Social Benefits	202,982	207,420	216,305	229,594	243,699	258,671
Subsidies	11,227	12,126	12,104	12,706	12,707	12,709
Other Expenses				27,725	27,725	27,725
Grant Expense						
Depreciation	27,760	28,177	28,578	28,676	28,676	28,676
Total Expenses excluding interest	447,248	453,753	474,810	496,435	519,481	543,808
Operating Surplus/Shortfall	-22,468	-10,222	-3,808	-9,681	-17,884	-26,536
Interest Expense	<u>30,657</u>	<u>29,251</u>	<u>29,301</u>	<u>28,450</u>	<u>29,131</u>	<u>29,829</u>
Net Operating Balance	-53,125	-39,473	-33,109	-38,131	-47,015	-56,364

**ANNUAL BALANCE SHEETS**

Below are KINGDOM OF SPAIN's balance sheets with the projected years based on the assumptions listed on page 5.

<b>Base Case</b>	<b>ANNUAL BALANCE SHEETS</b>					
<b>ASSETS</b>	<b>(MILLIONS EUR)</b>					
	2016	2017	2018	2019	P2020	P2021
Currency and Deposits (asset)	79,287	92,939	102,891	95,737	105,500	105,500
Securities other than Shares LT (asset)	3,743	3,595	3,971	11,355	11,355	11,355
Loans (asset)	62,159	60,112	59,972	58,728	57,510	56,317
Shares and Other Equity (asset)	183,127	184,358	189,149	184,718	188,412	192,181
Insurance Technical Reserves (asset)					0	0
Financial Derivatives (asset)	670	333	133	164	166	168
Other Accounts Receivable LT	70,488	75,853	76,785	78,056	79,071	80,099
Monetary Gold and SDR's						
<b>Other Assets</b>						
Additional Assets	<u>1</u>	<u>1</u>				
<b>Total Financial Assets</b>	399,475	417,191	432,901	428,758	442,014	445,620
<b>LIABILITIES</b>						
Other Accounts Payable	59,758	65,837	76,307	81,594	84,042	86,563
Currency & Deposits (liability)	4,247	4,462	4,707	4,876	4,876	4,876
Securities Other than Shares (liability)	1,059,234	1,104,787	1,142,798	1,220,180	1,278,015	1,338,592
Loans (liability)	183,635	170,089	155,256	152,961	199,976	256,341
Insurance Technical Reserves (liability)				1,227	1,227	1,227
Financial Derivatives (liability)	228	208	157	113	102	92
Other Liabilities				<u>1</u>	<u>1</u>	<u>1</u>
<b>Liabilities</b>	1,307,102	1,345,383	1,379,225	1,460,952	1,521,224	1,581,193
<b>Net Financial Worth</b>	<u>-907,627</u>	<u>-928,192</u>	<u>-946,324</u>	<u>-1,032,194</u>	<u>-1,079,209</u>	<u>-1,135,574</u>
<b>Total Liabilities &amp; Equity</b>	399,475	417,191	432,901	428,758	442,014	445,620

Copyright © 2020, Egan-Jones Ratings Company, Inc. ("Egan-Jones"). All rights reserved. The information upon which Egan-Jones ratings and reports are based is obtained by Egan-Jones from sources Egan-Jones believes to be accurate and reliable. Egan-Jones relies on third party reports and information and data provided and Egan-Jones has not, unless required by law or internal policies/procedures, independently verified or performed due diligence related to the accuracy of information, data or reports. Egan-Jones has not consented to, nor will consent to, being named an "expert" under federal securities laws, including without limitation, Section 7 of the Securities Act of 1933. Please note that expected or final ratings are not recommendations to buy, hold or sell the securities. Egan-Jones is not an advisor and is not providing investment advice, strategy, or related services. Egan-Jones and its third-party suppliers ("Suppliers") hereby disclaim any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, and fitness for any particular purpose or non-infringement of any of such information. In no event shall Egan-Jones or its directors, officers, employees, independent contractors, agents, representatives, or Suppliers (collectively, Egan-Jones Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error. (negligent or otherwise) or other circumstance or contingency within or outside the control of Egan-Jones or any Egan-Jones Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. Ratings and other opinions issued by Egan-Jones are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness or recommendations to purchase, sell or hold any securities. A report providing an Egan-Jones rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Egan-Jones is not responsible for the content or operation of third-party websites accessed through hypertext or other computer links and Egan-Jones shall have no liability to any person or entity for the use of such third-party websites. This publication may not be reproduced, retransmitted, or distributed in any form without the prior written consent of Egan-Jones. Egan-Jones ratings are subject to disclaimers.

**Egan-Jones is not an NRSRO (as defined by the SEC) for sovereign/municipal issuers and structured finance/ABS issuers.**

#### **Comments on the Difference between the Model and Assigned Rating**

In this case, there has been little change in the recent results and therefore we have used our best judgement in making adjustments which are reflected in the results for the projected ratings. We have assigned a rating of "BBB" whereas the ratio-implied rating for the most recent period is "A-"; the median rating for the peers is significantly higher than the issuer's rating.

#### **Changes in Indicative Ratios**

We have not made any adjustment in the indicative ratios at this time.



**SEC Rule 17g-7(a) Disclosure (Non-NRSRO)**

Below are the disclosures as required by Paragraph (a) of Rule 17g-7.

**1. The symbol in the rating scale used to denote the credit rating categories and notches within categories and the identity of the obligor, security, or money market instrument as required by Paragraph (a)(1)(ii)(A) of Rule 17g-7:**

For the issuer KINGDOM OF SPAIN with the ticker of 1841z SM we have assigned the senior unsecured rating of BBB. There are three notches in our rating categories (e.g., A-, A, and A+) other than those deep into speculative grade; for CC, C, and D there are no notches.

**2. The version of the procedure or methodology used to determine the credit rating as required by Paragraph (a)(1)(ii)(B) of Rule 17g-7:**

We are using the Methodologies for Determining Credit Ratings (Main Methodology) version #15 available via [egan-jones.com](http://egan-jones.com) under the tab at the bottom of the page "Methodologies".

**3. The main assumptions and principles used in constructing the procedures and methodologies used to determine the credit rating as required by Paragraph (a)(1)(ii)(C) of Rule 17g-7:**

The credit rating assigned reflects our judgement regarding the future credit quality of the issuer. Regarding the specific assumptions used, please refer to projections on pages 1, 6, and 7 of this Rating Analysis Report.

**4. The potential limitations of the credit rating as required by Paragraph (a)(1)(ii)(D) of Rule 17g-7:**

Our rating pertains solely to our view of current and prospective credit quality. Our rating does not address pricing, liquidity, or other risks associated with holding investments in the issuer.

**5. Information on the uncertainty of the credit rating as required by Paragraph (a)(1)(ii)(E) of Rule 17g-7:**

Our rating is dependent on numerous factors including the reliability, accuracy, and quality of the data relied used in determining the credit rating. The data is sourced from publicly available information from the IMF and other similar sources. In some cases, the information is limited because of issues such as the lack of reported data, a delay in reporting data, restatements, inaccurate accounting, and other issues. Such issues are not always readily apparent. EJR aims to identify such shortcomings and make adjustments using its best judgement.

**6. Whether and to what extent third-party due diligence services have been used in taking the rating action as required by Paragraph (a)(1)(ii)(F) of Rule 17g-7:**

EJR does not utilize third-party due diligence services.

**7. How servicer or remittance reports were used, and with what frequency, to conduct surveillance of the credit rating as required by Paragraph (a)(1)(ii)(G) of Rule 17g-7:**

Servicer or remittance reports normally pertain to structured finance issuers; this report does not pertain to a structured finance issuer (EJR is not an NRSRO for structured finance or sovereigns/ municipal issuers). Regarding surveillance, the minimum time period for corporation issuers is normally one year.

**8. A description of the data that were relied upon for the purpose of determining the credit rating as required by Paragraph (a)(1)(ii)(H) of Rule 17g-7:**

EJR uses publicly available information from the IMF, governmental filings, and other similar sources for ratings on sovereign issuers.

**9. A statement containing an overall assessment of the quality of information available and considered in the credit rating as required by Paragraph (a)(1)(ii)(I) of Rule 17g-7:**

The information is generally adequate and acceptable.

**10. Information relating to conflicts of interest as required by Paragraph (a)(1)(ii)(J) of Rule 17g-7:**

This rating is unsolicited.

**11. An explanation or measure of the potential volatility of the credit rating as required by Paragraph (a)(1)(ii)(K) of Rule 17g-7:**

Our rating aims to assess the probability of the payment of obligations in full and on-time. Factors which affect such probability, and in turn our rating include changes in the operating performance of the issuer, changes in capital structure, and merger and acquisition events.

**12. Information on the content of the credit rating as required by Paragraph (a)(1)(ii)(L) of Rule 17g-7:**

Regarding the historical performance of the credit rating, our rating transition matrix is available in our Form NRSRO, exhibit 1. The expected probability of default and the expected loss in the event of default is listed on the first page of this report.

**13. Information on the sensitivity of the credit rating to assumptions as required by Paragraph (a)(1)(ii)(M) of Rule 17g-7:**

Below is a summary of the impact of the 5 assumptions which independently would have the greatest impact on our "ratio-implied rating":

	Assumptions			Resulting Ratio-Implied Rating		
	Base	Optimistic	Pessimistic	Base	Optimistic	Pessimistic
Taxes Growth%	1.3	5.3	(2.7)	BBB+	A-	BBB+
Social Contributions Growth %Other	7.0	10.0	4.0	BBB+	A-	BBB+
Revenue Growth %	0.0	3.0	(3.0)	BBB+	BBB+	BBB+
Total Revenue Growth%	2.3	4.3	0.3	BBB+	BBB+	BBB+
Monetary Gold and SDR's Growth %	5.0	7.0	3.0	BBB+	BBB+	BBB+

**14. If the credit rating is assigned to an asset-backed security, a description of: (i) the representations, warranties, and enforcement mechanisms available to investors; and (ii) how they differ from the representations, warranties, and enforcement mechanisms in issuances of similar securities, as required by Paragraph (a)(1)(ii)(N) of Rule 17g-7:**

This credit rating is not assigned to an asset-backed security.

**ATTESTATION FORM**

In compliance with the US Securities and Exchange Commission (SEC) Rule 17g-7(a), the Egan-Jones analyst who published the report is responsible for the rating action and to the best knowledge of the person:

- 1) No part of the credit rating was influenced by any other business activities,
- 2) The credit rating was based solely upon the merits of the obligor, security, or money market instrument being rated, and
- 3) The credit rating was an independent evaluation of the credit risk of the obligor, security, or money market instrument.

**Analyst Signature:**

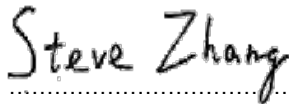


.....  
Subramanian NG  
Senior Rating Analyst

**Today's Date**

August 19, 2020  
.....

**Reviewer Signature:**



.....  
Steve Zhang  
Senior Rating Analyst

**Today's Date**

August 19, 2020  
.....

## **Sovereign Rating Methodology (Non-NRSRO)**

**Scope and Limitations:** Sovereign Issuer Credit Quality Ratings (CQR) are a forward-looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and on time. Sovereigns are assigned two CQRs: a Local-Currency CQR, which reflects the likelihood of default on debt issued and payable in the currency of the sovereign, and a Foreign-Currency CQR, which is an assessment of the credit risk associated with debt issued and payable in foreign currencies.

**Key Rating Drivers:** EJR's approach to sovereign risk analysis is a synthesis of quantitative and qualitative judgments. The quantitative factors EJR uses are:

- Debt in relation to GDP.
- Surplus or deficit in relation to GDP.
- Debt plus potential under-funding of major banks in relation to GDP.
- Interest expense in relation to taxes.
- GDP growth.
- Foreign reserves in relation to debt.

Debt levels for many sovereign issuers have increased at an accelerating rate over the past decade, affecting implied ratings. EJR also considers unemployment levels and funding costs. EJR recognizes that no model can fully capture all the relevant influences on sovereign creditworthiness, meaning that its sovereign ratings can and do differ from those implied by the rating model. Some of the qualitative factors that impact its ultimate assessment of credit quality include the flexibility, stability and overall strength of the economy, efficiency of tax collection, acceptance of contract law, ease of doing business, trade balances, prospects for future growth and health and monetary policy, and economic freedom. These subjective and dynamic qualitative issues are not captured by the model but affect sovereign ratings.

*For additional information, please see Exhibit 2: Methodologies in EJR's Form NRSRO.*