LM15 · FIXED INCOME · CFA LEVEL I

Credit Analysis for Government Issuers

Sovereign, non-sovereign (general-obligation & revenue), and quasi-government & supranational credit analysis.

Learning Outcomes

LOS a Explain the qualitative and quantitative factors used to evaluate a sovereign issuer

LOS b Describe the credit analysis required for non-sovereign government bonds

Exam Tip: Know the **5 qualitative pillars** (institutions & policy, fiscal flexibility, monetary effectiveness, economic flexibility, external status) and **3 quantitative pillars** (fiscal strength, economic growth/stability, external stability) for sovereigns. Know GO vs revenue bonds for non-sovereigns.

LOS A · 5 QUALITATIVE PILLARS

Sovereign Credit Analysis — Qualitative Pillars

1. **Institutions & policy:** political stability, property rights, culture of debt repayment, transparency, pro-business policies.
2. **Fiscal flexibility:** ability to raise taxes or cut spending to fund debt service.
3. **Monetary effectiveness:** independence of the central bank and its ability to manage inflation and money supply.
4. **Economic flexibility:** real GDP growth, per-capita income, diversity of economic drivers.
5. **External status:** currency standing in international markets, geopolitical risks.

LOS A · 3 QUANTITATIVE PILLARS

Sovereign Credit Analysis — Quantitative Pillars

Fiscal strength

Low debt-to-GDP; low interest expense relative to revenue.

Economic growth & stability

High real GDP growth; large real GDP; high per-capita GDP; low volatility of GDP growth.

External stability

High FX reserves; low long-term and near-term external debt; high FX reserves relative to external debt.

Local currency vs. foreign currency debt

Sovereigns can "print" local currency to service local-currency debt (at the cost of inflation and currency depreciation). **Foreign-currency sovereign debt** is therefore riskier — it typically carries a lower rating than the same sovereign's local-currency debt.

CHECKPOINT 1

Quiz 1: Sovereigns

Answer all questions to test your understanding. Your score updates on the final step.

Q1. A sovereign issuer’s **local currency** debt typically carries:

Q2. Fiscal strength is *best* assessed through:

Q3. “Monetary effectiveness” primarily addresses:

Q4. Emerging-market sovereign debt is *most likely* issued in:

Q5. “Institutions and policy” in sovereign analysis refers to:

LOS B · NON-SOVEREIGN GOVERNMENT BONDS

Non-sovereign Government Bonds

Non-sovereign government bonds are issued by states, provinces, counties, cities, and special-purpose entities (e.g., airports, toll roads). Two main types:

General obligation (GO) bonds

Unsecured bonds backed by the issuer's **full faith and credit** and taxing power. Repayment depends on the strength of the local economy.

Revenue bonds

Issued to finance a **specific project** (airport, toll road, hospital). Repayment comes from project cash flows only. Higher credit risk than GO bonds — the project is the sole source of repayment.

$$Debt service coverage ratio (DSCR) = Net operating income / Debt service$$

Analysts evaluate revenue bonds **like a corporate bond** — focus on cash flows, DSCR, and the project's commercial viability. GO bonds are analyzed via tax capacity and demographic trends.

LOS B · AGENCY AND SUPRANATIONAL DEBT

Quasi-Government and Supranational Debt

- **Quasi-government (agency) bonds** — issued by entities created by national governments for specific purposes (e.g., infrastructure, mortgage finance). Where sovereign-backed, credit ratings track the sovereign closely.
- **Supranational bonds** — issued by international institutions (World Bank, IMF, ADB). Backed by member-sovereign support. Typically **high credit quality** and some issues are highly liquid.

CHECKPOINT 2

Quiz 2: Non-sovereign

Answer all questions to test your understanding. Your score updates on the final step.

Q6. General obligation municipal bonds are backed by:

Q7. Credit risk of a **revenue bond** relative to a GO bond is *most likely*:

Q8. A supranational issuer’s credit rating *most closely* reflects:

Q9. When analyzing a revenue bond, the *most important* metric is usually:

Q10. Quasi-government agency bonds backed by a sovereign typically have:

REVIEW · SUMMARY TABLE

Side-by-side Summary

ISSUER TYPE	REPAYMENT SOURCE	KEY RISK FACTORS
Sovereign (local currency)	Taxes, central-bank currency creation	Institutions, policy, fiscal & monetary
Sovereign (foreign currency)	Taxes, FX reserves	FX reserves, external debt, currency risk
GO municipal	Issuer’s taxing power	Local economy, demographics
Revenue municipal	Project cash flows	Project commercial viability, DSCR
Quasi-government agency	Sovereign backing plus specific revenue	Degree of sovereign support
Supranational	Member-sovereign support	Member-country ratings; capital structure

CHECKPOINT 3 · SYNTHESIS

Quiz 3: Synthesis

Answer all questions to test your understanding. Your score updates on the final step.

Q11. External-stability analysis for a sovereign emphasizes:

Q12. A revenue bond with a DSCR of 1.05 is *most likely*:

Q13. Sovereign issuers can service local-currency debt through:

Q14. Which is a **qualitative** pillar of sovereign credit analysis?

Q15. The default risk of a high-grade supranational bond is typically:

MODULE COMPLETE

Your Scorecard

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LM15 Key Takeaways — Exam-Ready Cheat Sheet

Sovereign pillars

Qualitative (5): Institutions & policy, Fiscal flexibility, Monetary effectiveness, Economic flexibility, External status. **Quantitative (3):** Fiscal strength, Economic growth & stability, External stability.

Non-sovereign

GO bonds: taxing power; depend on local economy. **Revenue bonds:** project cash flows; evaluated like a corporate; focus on DSCR.

Ratings hierarchy

Supranationals (AAA-typical) → sovereign (local-currency rating ≥ foreign-currency rating) → quasi-gov agencies (track sovereign) → non-sovereign (GO > revenue typically).

Step 1 of 10