

WELCOME TO THE CLUB

BSRI QUARTERLY UPDATE

JANUARY 2014

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INSTITUTE



Benjamin Brodsky
Global Head of BlackRock
Fixed Income Asset Allocation

Sami Mesrour
Member of BlackRock
Model-Based Fixed Income Team



Ewen Cameron Watt
Chief Investment Strategist,
BlackRock Investment Institute

Garth Flannery
Member of BlackRock
Model-Based Fixed Income Team

Welcome to the club

The latest quarterly update of the BlackRock Sovereign Risk Index (BSRI) highlights the addition of two emerging economies to our index:

Nigeria and Ukraine. Try our [interactive BSRI](#) to view individual country scores, compare two countries and sort rankings by index components.

Our main headlines for the quarter ended 31 December:

- ▶ **Nigeria and Ukraine** are large emerging economies with growing weights in emerging market debt indices. They debut at 39th and 45th place, respectively, out of 50 countries in our index. Willingness to Pay, or a government's perceived effectiveness, is their Achilles' heel (like many emerging markets).
- ▶ **Nigeria** has strong fundamentals, including rapid economic growth, low debt levels and a current account surplus. Yet its Willingness to Pay is the second-worst in our index. Rising political unrest is pressuring **Ukraine's** Willingness to Pay, too. Budget and current account deficits add to the country's vulnerabilities.

Drawing on a pool of financial data, surveys and political insights, the BSRI provides investors with a framework for tracking sovereign credit risk. The index uses more than 30 quantitative measures, complemented by qualitative insights from third-party sources.

The index breaks down the data into four main categories that each count toward a country's final BSRI score and ranking: Fiscal Space (40%), Willingness to Pay (30%), External Finance Position (20%) and Financial Sector Health (10%).

- **Fiscal Space** includes metrics such as debt to gross domestic product (GDP), the debt's term structure, tax revenues and dependency ratios.
- **Willingness to Pay** measures a government's perceived effectiveness and stability, and factors such as perceived corruption.
- **External Finance Position** includes exposure to foreign currency debt and the state of the current account balance.
- **Financial Sector Health** gauges the banking system's strength.

For full descriptions, see [Introducing the BlackRock Sovereign Risk Index](#) of June 2011. The BSRI's inputs are updated at irregular intervals, meaning some changes may only reflect the timing of data releases. Small changes in scores can spur big changes in rankings, as many issuers are bunched together in the index. The BSRI is not meant to forecast the creditworthiness of countries.

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EXECUTIVE DIRECTOR
Lee Kempler

CHIEF STRATEGIST
Ewen Cameron Watt

EXECUTIVE EDITOR
Jack Reerink

The opinions expressed are as of January 2014 and may change as subsequent conditions vary.

NEW ENTRANTS

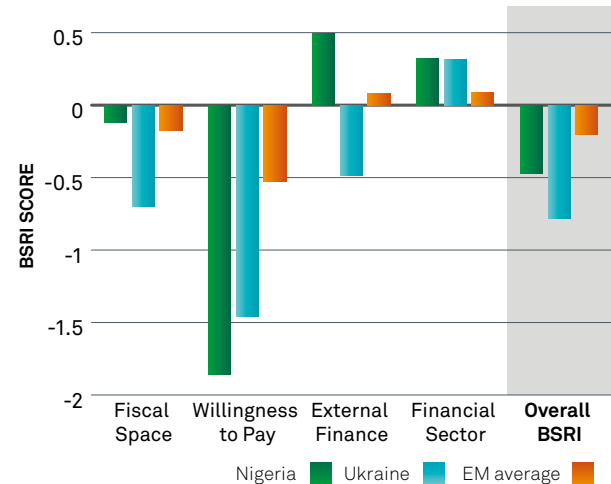
This quarter we introduce two large emerging markets to our BSRI: **Nigeria** and **Ukraine**. Why do these countries matter to investors?

- ▶ Nigeria is Africa's third-largest economy and most populous nation with 169 million people. Its population is expected to overtake that of the United States by 2050, according to United Nations projections.
- ▶ Ukraine has 45 million people. The country's position between the European Union and the former Soviet states makes it geopolitically important.
- ▶ Both countries have small but growing weights in emerging market debt indices. See the table on the following page for details. Nigeria's weight, in particular, looks likely to increase. The IMF expects Nigeria's economy to grow at a 7% annual pace from 2014 to 2018.

Nigeria debuts at 39th place in our 50-country index, and Ukraine at 45th. Our Willingness to Pay factor drags both down. See the chart on the right.

A SHARED WEAKNESSES

Nigeria and Ukraine, BSRI breakdown

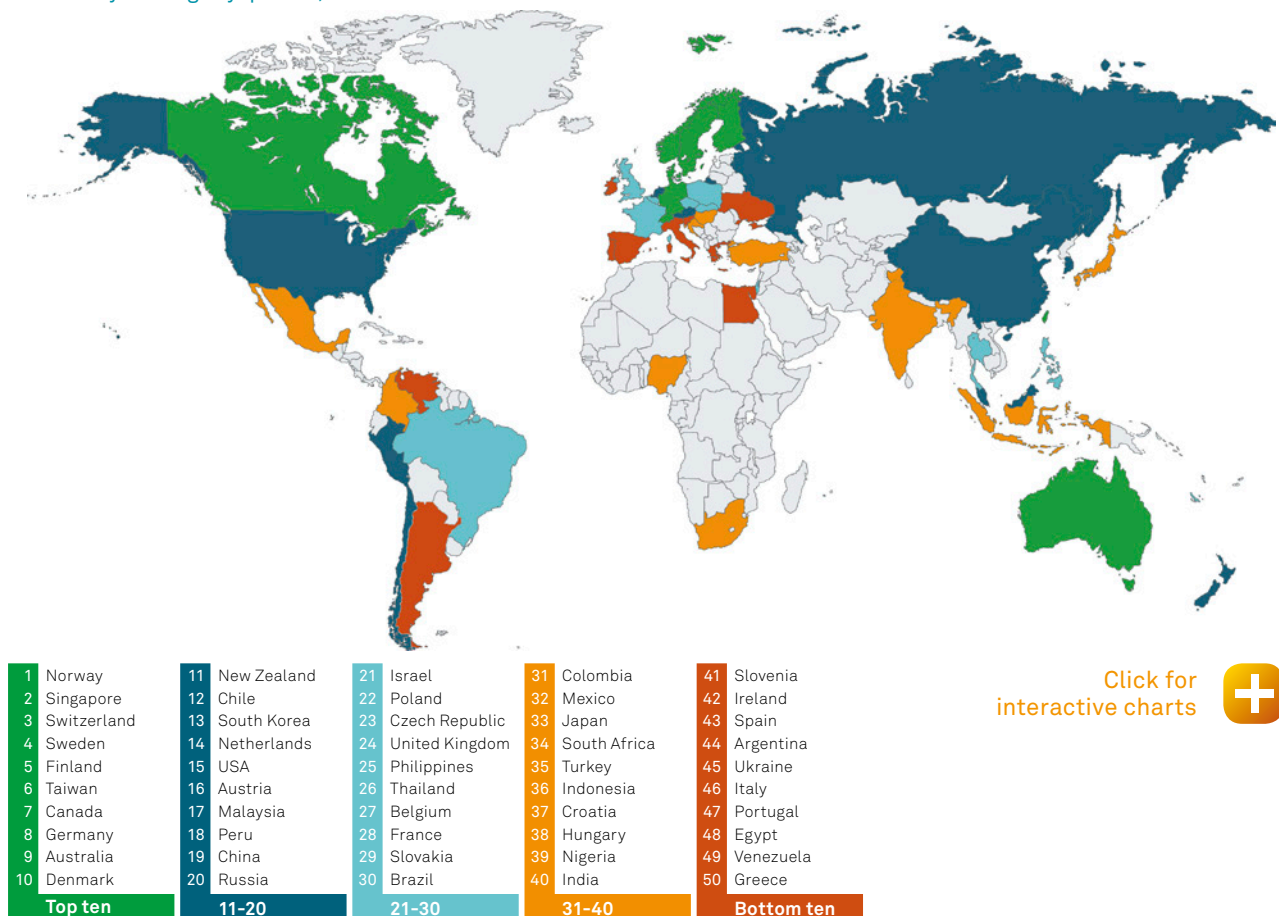


Source: BlackRock Investment Institute, December 2013.

Only **Venezuela** has a worse score on this measure than Nigeria. It is a common affliction among emerging markets, as detailed in *Maturities Matter* of April 2013.

A WORLD OF SOVEREIGN RISK

BSRI country rankings by quintile, December 2013



Source: BlackRock Investment Institute, January 2014.

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interactive charts



POLITICAL FRAGILITY

Nigeria has strong economic fundamentals but weak institutions. Its economy has grown at a 7% annual real pace over the past decade, while its gross debt amounts to just 19.6% of GDP (less than one-fourth the Eurozone average). See the table on the right.

The country runs a current account surplus, mostly thanks to oil exports, and 87% of its debt is in domestic currency, Bloomberg data show.

The problem? Nigeria's low tax revenues limit its ability to service government debt. And a history of debt defaults and restructuring (five times since 1980) has left it with limited access to global capital markets.

The country returned to democracy in 1999 after decades of military rule – but still ranks poorly on measures such as perceived corruption.

Ukraine has stronger institutions than Nigeria – but faces rising political instability. Demonstrators in December occupied the streets of Kiev, protesting President Viktor Yanukovich's decision to back away from stronger relations with the European Union.

Ukraine also has a poor Fiscal Space score. Weaknesses include budget deficits, a history of volatile economic growth and inflation. External Finance is also a drag: Ukraine runs a large current account deficit.

EMERGING GIANTS?

Nigeria and Ukraine: select statistics



NIGERIA



UKRAINE

Country Basics		
Population (world rank)	169m (7th)	45m (30th)
Population growth (next 5 years)	15%	0%
Urban population (% of total)	50%	69%
Economy		
GDP per capita (nominal)	\$1,725	\$3,862
Real GDP growth (10-year average)	7%	2.7%
Inflation (10-year average)	11.9%	9.9%
Unemployment rate	23.9%	8%
Fiscal balance (% of GDP)	-2.2%	-4.3%
Gross public debt (% of GDP)	19.6%	42.8%
Current account (% of GDP)	2.9%	-6.2%
Currency	Naira	Hryvnia
Foreign reserves	\$45.1b	\$18.8b
Debt Markets		
EM index weight	2%	3%
S&P sovereign rating	BB-	B-
Other		
Capital city	Abuja	Kiev
Corruption rank (177 = most corrupt)	144	144
Life expectancy (years)	57	71
World football ranking	36th	18th

Notes: Indices used are JPMorgan EMBI Diversified for Ukraine and JPMorgan GBI-EM Global Diversified for Nigeria. Current account and fiscal balances are 12-month forward forecasts. Data is for the most recent period available. Unemployment rate for Nigeria is based on a 2011 estimate. Sources: Thomson Reuters, IMF, World Bank, Consensus Economics, Bloomberg, Transparency International, FIFA, Central Bank of Nigeria, National Bank of Ukraine and BlackRock Investment Institute, December 2013.

KEEPING UP WITH THE TIMES

Forecasting fiscal trends has become a minor industry. The breadth (and timeliness) of data sources available has improved since we launched the BSRI in 2011. We have tweaked our methodology in response.

- ▶ Monthly updates of budget balance forecasts are available for a rising number of countries. We are increasing the weight we allocate to monthly updates versus less frequently updated data.
- ▶ We are boosting the breadth of our primary budget balance projections by adding Standard and Poor's to our sources (previously IMF and Moody's only).

- ▶ We are strengthening our political risk ratings by adding an additional source for our Willingness to Pay category. This is a small but important change. Recent unrest in **Ukraine** and **Thailand** underscores the importance of having a fundamental scorecard to gauge political fragility.

An important note: The weights we assign to our key categories and subcategories remain unchanged.

Bottom line: The changes should help ensure real world developments are more rapidly (and smoothly) reflected in our index.

ON THE MOVE

The addition of Nigeria and Ukraine has resulted in a minor reshuffle of the BSRI rankings. This is a one-off change.

We will not focus on rankings changes this quarter as a result. We highlight three key movers instead:

The **United States'** BSRI score edged up thanks to an improvement in its Fiscal Space. Projected U.S. budget deficits and net debt levels are falling.

The economic recovery has boosted tax revenues, while spending has been falling as stimulus measures fade and mandatory (sequester) spending cuts kick in.

The country faces another potential flashpoint. The statutory debt ceiling is set to expire on 7 February.

Rising political dysfunction has fed into a decline in the U.S. Willingness to Pay score over the past year. See [Willingness to Pay](#) of October 2013 for details.

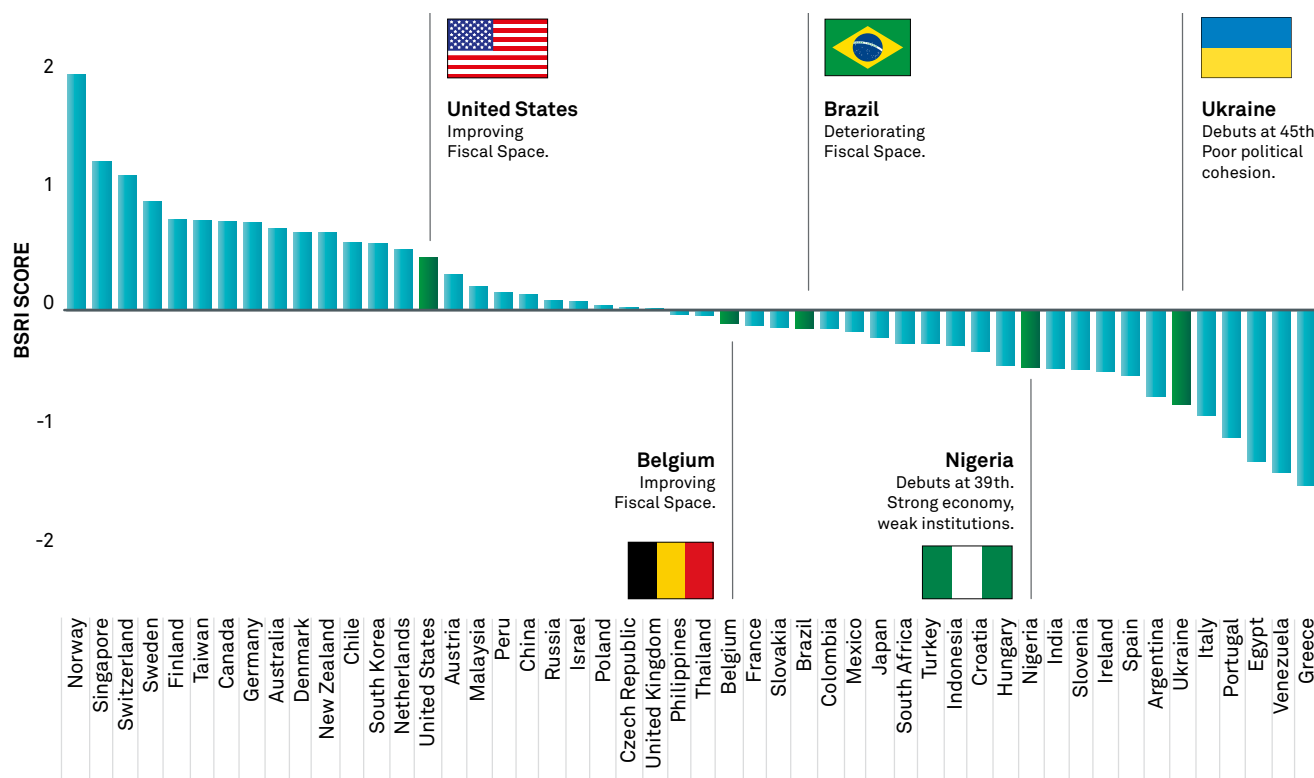
Brazil's BSRI score declined due to a deteriorating Fiscal Space rating. Projected budget deficits and debt levels are on the rise as sluggish economic growth and tax cuts have reduced revenues.

Belgium's BSRI score ticked higher thanks to an increase in its projected primary fiscal balance.

IN THE SPOTLIGHT

BlackRock Sovereign Risk Index rankings, December 2013

[Click for interactive charts](#)



Sources: Bloomberg, IMF, World Bank, central banks, Eurostat, BIS, Consensus Economics, UN, Moody's, Standard and Poor's, Fitch, PRS Group, Economist Intelligence Unit, www.euromoneycountryrisk.com and Blackrock Investment Institute.

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