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Sovereign Defaults Set to Fall Again in 2005

Publication date: 28-Sep-2004

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Defaults by sovereign governments on bonds and bank loans have continued to decline so far in 2004. Two sovereigns have emerged from default and resumed normal debt service, while no new sovereigns have entered default. Overall, Standard & Poor's estimates that the number of rated and unrated sovereigns in default on bonds and bank loans stands at 25, down from 27 at the end of last year (see chart 1). By region, the number of governments in default remains highest in Sub-Saharan Africa (11), followed by Latin America and the Caribbean (8), Asia-Pacific (4), Central and Eastern Europe (1), and the Middle East and North Africa (1). The issuer default rate, at 12.4%, has fallen for the third year in a row, and remains well below its peak of nearly 31% in 1990 (see chart 2).

The value of sovereign debt in default has also fallen, to about US\$135 billion from US\$139 billion in 2003, but, thanks to Argentina's ongoing default, remains close to its highest level since 1994 (see chart 3).

Looking ahead to 2005, Standard & Poor's expects both the number of sovereign issuers in default and the value of defaulted debt to fall again, reflecting the following factors:

- A relatively benign international economic environment. After slowing in the first half of 2004, global output looks set to grow about 3.25% annually through next year, despite high oil prices and tighter monetary conditions in the U.S. and Europe. This prospect should support continued expansion in exports, domestic business activity, and cross-border capital inflows in many emerging market countries.
- Completions of debt workouts in the pipeline are likely to outweigh the impact on the numbers of new sovereign defaults that occur. Paraguay (B-/Stable/C) concluded a distressed debt exchange in July, the restructuring of Dominica's local and foreign currency debt is nearly complete, and Serbia is expected to close its deal with London Club bank creditors before the end of 2004. A few other governments in Sub-Saharan Africa and the Pacific are also likely to resume normal debt service by next year.
- At least a partial resumption of debt service on Argentina's defaulted bonds. The Kirchner administration is expected to launch a debt exchange to cure Argentina's default--the world's biggest at about US\$100 billion--before the end of 2004, in the belief that a majority of bondholders will accept its terms. Yet a sizable gap remains in the perceptions of the government and investors about Argentina's future debt-servicing capacity. If a debt exchange results in a large number of holdouts, Argentina may resume only partial debt service next year, while holders of bonds still in default pursue legal and political remedies in an attempt to secure better terms.
- Among sovereigns rated by Standard & Poor's, the Dominican Republic (CC/Negative/C) remains at highest risk of default. The new government of President Leonel Fernandez has signaled that it will restructure its foreign currency bonds later this year or by early 2005. Overall, however, average credit quality of speculative-grade rated emerging market sovereigns is on an improving trend, with rating upgrades outpacing downgrades by a large margin this year.

Standard & Poor's expects the default rate in the sovereign sector to rise again later this decade. This conclusion is based on the speculative-grade credit quality of many newly rated issuers, together with the low credit standing of the majority of unrated governments. Defaults on foreign currency bonds, which are still less common than defaults on bank loans, should increase in frequency. Defaults on local currency debt, while relatively rare, may also be trending higher. Efforts by official creditors to impose "burden sharing" on private creditors will affect the timing of some defaults, although the economic and political fundamentals in each country will be more decisive factors. On balance, however, for some years to come, the default rate in the sovereign sector likely will remain more muted than in the 1980s and early 1990s. This environment, combined with less investor uncertainty about how defaults are resolved, should make for less volatile financial conditions in emerging markets than seen in the 1990s.

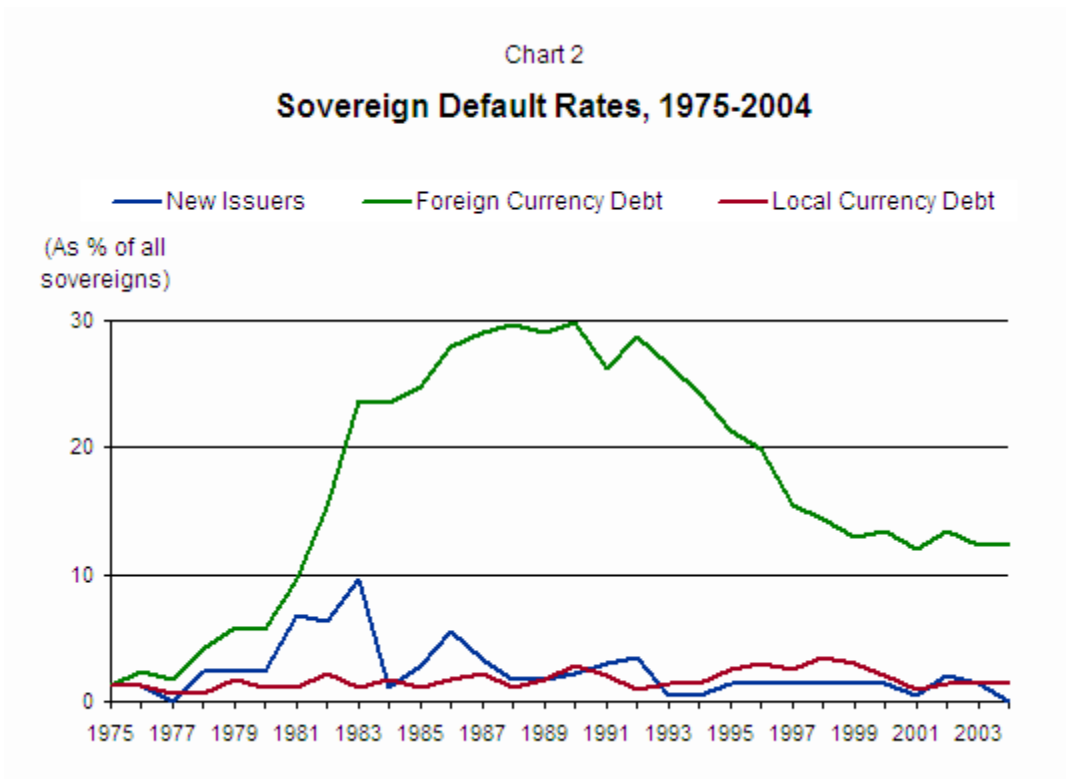
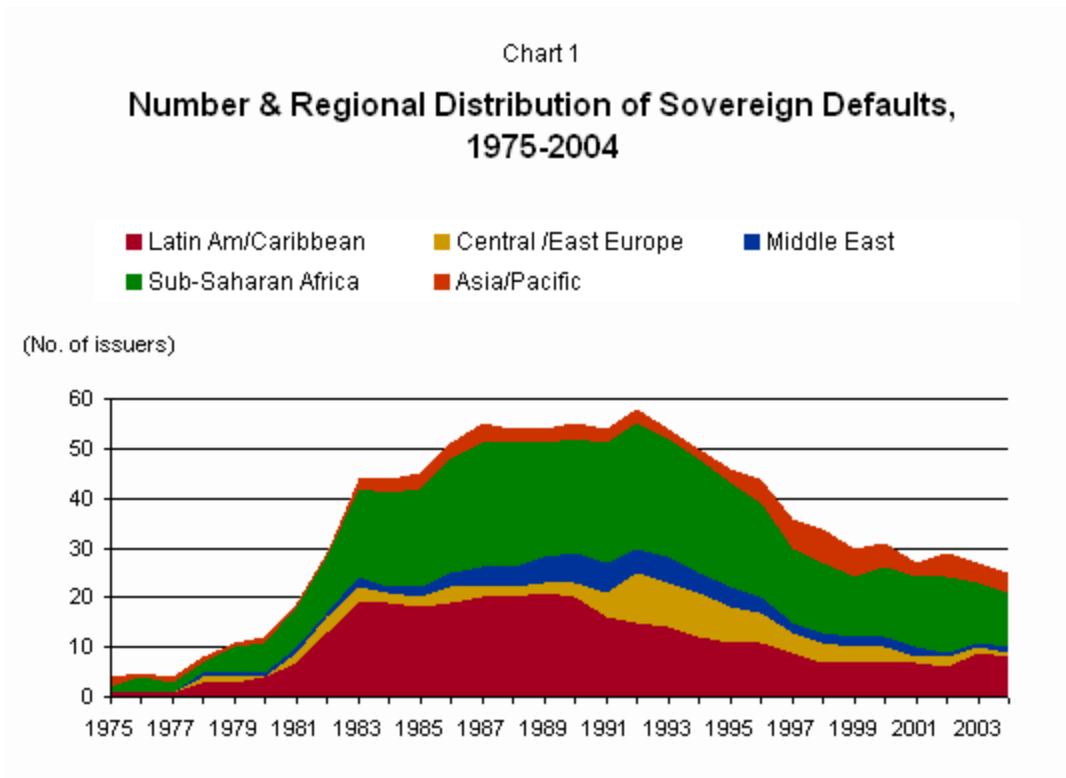
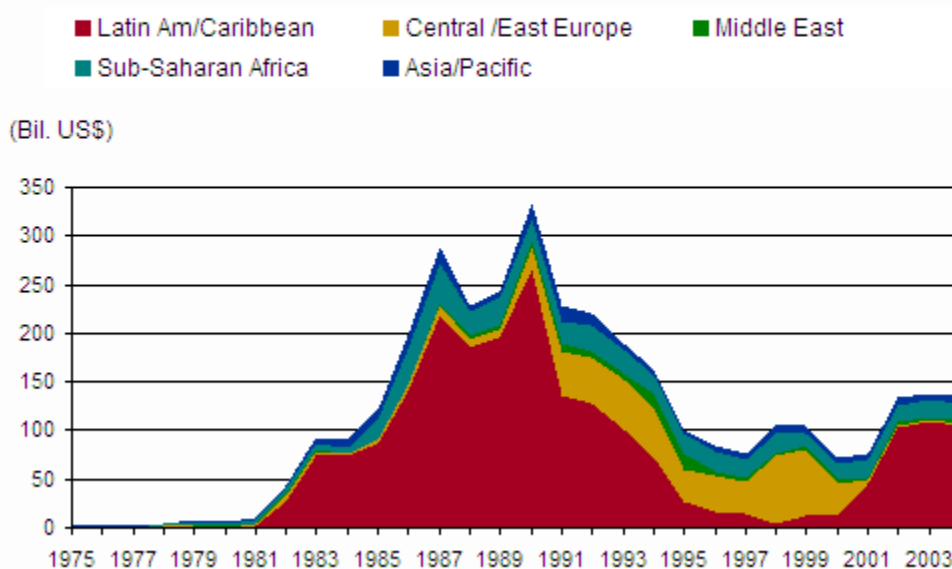


Chart 3
Sovereign Debt in Default, 1975-2004



■ Sovereign Default Survey Complements Corporate Default Study

This report updates Standard & Poor's annual survey of sovereign governments with debt in default (see "Defining Sovereign Defaults" at the end of the article). The survey, launched in 1994 and last updated in September 2003, tracks the default frequency of 202 rated and unrated sovereign issuers between 1975 and 2004. This year's survey is similar to earlier surveys in terms of coverage, and includes comprehensive data on local currency and foreign currency bond and bank loan defaults since 1975, as well as data on foreign currency bond defaults back to 1824.

Ongoing improvements in Standard & Poor's proprietary database, on which the survey is based, have led to revisions in the historical data. Consequently, the outcomes shown in the 2004 survey differ from those published in previous years. The underlying trends are much the same, however, and each survey is self-contained, effectively superseding previous versions.

The survey complements Standard & Poor's annual study of corporate defaults (see "Corporate Defaults in 2003 Recede From Recent Highs," RatingsDirect, Jan. 4, 2004), which last year covered 10,438 rated obligors, excluding sovereigns, that sell debt in the U.S., Europe, Japan, and other markets.

The sovereign default survey differs from the corporate default study in a number of ways. First, it covers both rated and unrated issuers. The survey tracks defaults on unrated governments because they have been so numerous over the past three decades. By contrast, for most of the 1975-2004 survey period, defaults by rated governments have been relatively few. However, judging from the volume of bond issuance by emerging market sovereigns, a growing proportion of which are rated in the speculative-grade category (see chart 4), Standard & Poor's believes defaults by rated sovereigns will become more commonplace.

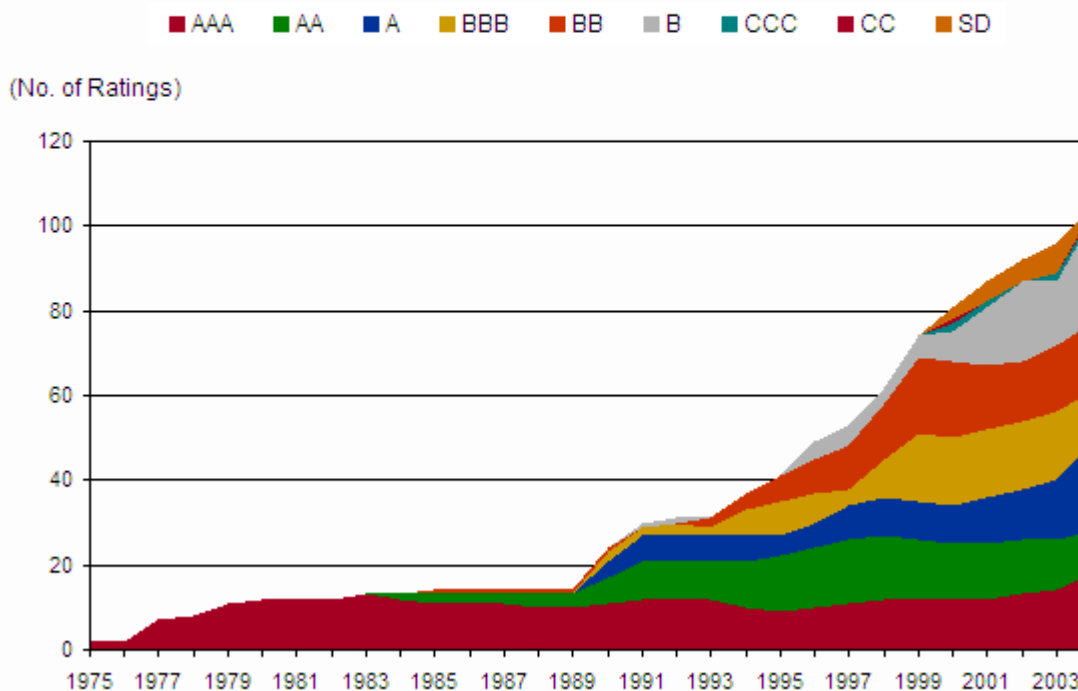
Table 1 compares default rates of sovereign and corporate issuers rated by Standard & Poor's over one-, three-, and five-year periods through to year-end 2003. The data show some differences in sovereign and corporate default rates, but Standard & Poor's does not view these as statistically significant because of the small number of rated sovereigns that have defaulted to date. As more rated sovereigns default, the default rate should, over time, broadly parallel the default rates for similarly rated corporate issuers (see also "2003 Transition Data Update for Rated Sovereigns," RatingsDirect, Jan. 30, 2004).

Table 1 Sovereign Vs Corporate Default Rates						
	One-Year		Three-Year		Five-Year	
(%)	Sov.	Corp.	Sov.	Corp.	Sov.	Corp.
AAA	0.0	0.0	0.0	0.0	0.0	0.1
AA	0.0	0.0	0.0	0.1	0.0	0.3
A	0.0	0.1	0.0	0.3	0.0	0.7
BBB	0.0	0.4	2.7	1.7	7.4	3.4
BB	0.7	1.4	4.8	7.1	8.1	12.4
B	4.3	6.1	12.7	19.2	20.8	26.8
CCC/CC	50.0	30.9	50.0	45.5	50.0	53.0

Implied senior ratings through 1995; issuer credit ratings thereafter. Sovereign foreign currency ratings for 1975-2003; Corporate local currency ratings for 1981-2003.

Chart 4

Evolution of Sovereign Foreign Currency Ratings, 1975-2004



■ Default History

Defaults on foreign currency bonds took place repeatedly, and on a substantial scale, throughout the 19th century and as recently as the 1940s. Sovereign defaults fell to low levels only in the first four decades after the World War II (see chart 5), when cross-border bond issuance was also minimal.

Past defaults reflected a variety of factors, including wars, revolutions, lax fiscal and monetary policies, and external economic shocks. Today, fiscal discipline, debt management, and the contingent liabilities arising from weak banking systems represent significant policy challenges for many sovereigns. The associated credit risks, which for a time may seem manageable, can mushroom quickly--as events in a number of emerging market countries illustrated in the second half of the 1990s. Given these factors, it would be surprising if a new sovereign bond default cycle did not become firmly established during this decade.

This survey also differs from the corporate default study because it covers sovereign defaults on unrated short- and long-term bank loans and privately placed debt issues, in addition to unrated public bonds. Sovereign defaults on foreign currency bonds were rare in the 1970s and 1980s mainly because bond issuance by governments of lower credit quality was itself rare. Defaults on bank loans happened more frequently because, starting in the 1970s, many governments relied on them for the lion's share of their cross-border borrowing. For speculative-grade-rated sovereigns in particular, foreign currency bond issuance only took off after 1990, when Mexico issued the first Brady bonds in exchange for defaulted bank debt.

While the incentives for timely payment of bank loans may have been weaker than for bonds over the past three decades, defaults on bank debt have predictive value in an era dominated increasingly by concern over the default risk on bonds. Consequently, Standard & Poor's includes bank loans, as well as local and foreign currency bonds, in the default survey to gauge historical sovereign default trends more accurately.

One other difference between the sovereign default survey and the corporate default study is that they cover different time periods. Standard & Poor's corporate default study includes detailed statistics on the number of rated issuers and the value of debt in default for period 1981-2004. The sovereign default survey tracks the far smaller number of rated and unrated government issuers that have defaulted on foreign currency bonds back to 1824--when sizable cross-border sovereign bond issuance began--and the annual U.S. dollar value of local and foreign currency debt in default back to 1975 (see table 2).

Finally, the sovereign default survey departs from the corporate default study in its focus on both local and foreign currency debt. Local currency debt is debt denominated in the legal tender of an issuer's country of domicile. Compared with foreign currency debt, the frequency of default on local currency sovereign debt is low. Thanks to their taxation powers and control of the domestic financial system, sovereign governments generally have a stronger capacity and willingness to service local currency than foreign currency debt.

For this reason, Standard & Poor's assigns ratings to sovereigns' local currency debt that in many instances are higher than for their foreign currency debt. In the survey, therefore, defaults on local currency debt are tracked independently from defaults on foreign currency debt and are counted as separate events in the annual totals.

Year	Number of Issuers					(Bil. US\$)	
	All Issuers	New Issuers	Local Currency Debt	Foreign Currency Debt*	Foreign Currency Bonds	Total Debt	Avg. Debt per User
1975	4	2	2	2	1	2.4	0.6
1976	5	2	2	4	1	1.6	0.3
1977	4	0	1	3	1	1.6	0.4
1978	8	4	1	7	1	4.5	0.6
1979	11	4	3	10	1	7.7	0.7
1980	12	4	2	10	1	5.6	0.5
1981	19	12	2	17	0	9.4	0.5
1982	29	11	4	27	0	43.6	1.5
1983	44	17	2	42	0	93.0	2.1
1984	44	2	3	42	1	90.7	2.1
1985	45	5	2	44	1	120.9	2.7
1986	51	10	3	50	1	199.1	3.9
1987	55	6	4	52	2	288.4	5.2
1988	54	3	2	53	2	229.2	4.2
1989	54	3	3	52	4	244.6	4.5
1990	55	4	5	53	2	335.6	6.1
1991	54	6	4	52	2	227.8	4.2
1992	58	7	2	57	3	221.0	3.8

1993	54	1	3	53	2	188.5	3.5
1994	50	1	3	49	2	161.7	3.2
1995	47	3	5	44	2	101.9	2.2
1996	46	3	6	40	2	83.6	1.8
1997	36	3	5	31	2	77.2	2.1
1998	34	3	7	30	4	104.1	3.1
1999	30	3	7	27	4	104.9	3.5
2000	31	3	5	28	4	72.4	2.3
2001	27	1	3	25	2	75.9	2.8
2002	29	4	4	28	4	134.6	4.6
2003	27	3	4	26	4	138.6	5.1
2004†	25	0	4	24	3	135.0	5.4

Source: Standard & Poor's. *Bank debt & bonds. †Through third quarter.

■ 2004 Highlights

Through the third quarter of 2004, Standard & Poor's has identified 25 sovereign issuers in default on various types of bond and bank debt, down from 27 in 2003. Since last year, no new sovereigns have defaulted, while Cameroon and Uruguay have resumed normal debt service. By contrast, defaults by 23 sovereigns originated in earlier years and were carried over into 2004. As a result, the total value of defaulted debt fell slightly, to an estimated US\$135 billion, from nearly US\$139 billion last year.

In May 2003, Uruguay completed a distressed debt exchange affecting US\$5 billion of foreign currency bonds. In response, Standard & Poor's raised Uruguay's credit rating to 'B-' on June 2, 2003. Uruguay's rating was raised again, to 'B', on July 21, 2004, reflecting ongoing restraint in public expenditures, and improved prospects that the government's high debt burden will gradually decline medium term.

In August 2003, Cameroon cured a default on its commercial bank debt dating back to 1984. The government bought back eligible debt amounting to US\$953 million, including interest arrears, at a price equal to 14.5% of principal. The transaction was financed by the International Development Association (IDA), the soft lending arm of the World Bank, under a debt reduction facility created in 1989 to help governments in low-income countries reduce their external debt owed to commercial creditors. Subsequently, on Nov. 26, 2003, Standard & Poor's assigned Cameroon its 'B' credit rating.

Looking at this year's regional totals, the number of sovereigns in default remains highest in Sub-Saharan Africa (11); followed by Latin America and the Caribbean (8), Asia-Pacific (4), Central and Eastern Europe (1), and the Middle East and North Africa (1). In terms of the U.S. dollar value of debt in default, the picture changes, however. Thanks to Argentina, Latin America and the Caribbean leads with US\$105 billion, while Sub-Saharan Africa accounts for US\$16.6 billion. Asia Pacific, the Middle East, and Central and Eastern Europe clock in with US\$7.2 billion, US\$3.3 billion, and US\$2.7 billion, respectively.

The pipeline of debt workouts by unrated sovereigns will continue to be a key driver affecting the number of sovereigns in default moving into 2005. The government of Serbia and Montenegro is expected to conclude by the end of this year a debt exchange on commercial bank debt in default since 1992. Meanwhile, Dominica looks close to completing the restructuring of both its local and foreign currency debt. The Solomon Islands also is set to resume servicing local currency debt in default since 1996. Other pending workouts include London Club bank debt restructurings by Kenya and Gabon, and a debt buyback by Tanzania.

As noted earlier, prospects for an early agreement to restructure Argentina's obligations remain mixed. With some US\$100 billion in defaulted debt outstanding, even a partial resumption of debt service next year on its own could lead to a substantial decline in the global amount of bonds and bank loans in default in 2005. Much more than the near-term default numbers hinge on the extent of bondholder acceptance of the Argentine government's exchange offer slated for the fourth quarter of 2004, as this debt workout is certain to influence the conduct of future bond restructurings.

■ Long-Term Trends

For more than a decade, sovereign credit quality at the bottom end of the credit spectrum has shown sustained improvement, judging from the number of rated and unrated issuers that have cured bond and bank debt defaults. Beginning in the late 1970s, the issuer default rate rose steadily, from about 2%, even before the Latin American bank debt crisis began in 1982. As sovereigns from other regions (mainly in Sub-Saharan Africa and Central and Eastern Europe) became involved, the default rate rose sharply and peaked at 31% in 1990. Since then, however, the issuer default rate has trended downward to 12.4% through the third quarter of 2004 (see chart 2).

The total value of sovereign bonds and bank loans in default is an estimated US\$135 billion so far this year, down from US\$138.6 billion in 2003, and about 60% below the peak of US\$335.6 billion in default in 1990. A related indicator, the average amount of debt in default per issuer (see table 2), shows a much smaller decline of 12%, to US\$5.4 billion this year from US\$6.1 billion in 1990. This reflects the impact of Argentina's default, the largest by a single issuer since Brazil's in 1990.

Apart from more conservative economic policy-making by many sovereigns, two factors largely explain developments over the past decade. First, the settlements between bank creditors and a number of the largest sovereign borrowers since the beginning of the 1990s were important because they cured some of the largest individual defaults and set the pattern for the debt restructuring agreements with other sovereigns that followed. Another factor, with echoes from the more distant past, is the recurring nature of defaults by individual issuers. Ecuador and Ivory Coast, to take two examples, completed Brady-style deals on their bank debt, in 1995 and 1997, only to default again in 1999 and 2000, respectively. In the sovereign sector, successful debt restructurings do not necessarily signal lasting improvements in creditworthiness.

■ Default Rates Since 1824

Seen from an even longer historical perspective, the past decade was still a period of high sovereign defaults. By Standard & Poor's estimates, the issuer default rate on foreign currency bond and bank debt averaged about 16.5%. Only in the 1830s did a much higher proportion of governments, 31% of the total, default on their foreign currency obligations. By comparison, default rates in the 1980s and, more surprisingly still, during the worldwide depression of the 1930s, were only a little higher, at 22% and 21%, respectively (see chart 5).

Chart 5

Sovereign Default Rates, 1824-2004



In comparing historical episodes of high sovereign defaults, two caveats are worth bearing in mind. One is that the rate of issuer defaults in the 1980s mainly reflected defaults on bank loans, not bonds. The default rate for bonds, while increasing since the 1970s, so far have reached no higher than 2% since

the late 1990s and has declined to just 1.5% thus far in 2004, a much lower level than during previous periods of high sovereign default activity (see table 3). The other concerns the economic importance of such defaults. Those in the 1930s and 1940s--featuring sovereigns like Germany, Italy, and Japan, alongside other issuers--clearly had greater financial impact than the defaults of the 1980s and of today.

While comprehensive data on the value of sovereign bonds outstanding are not available for the whole of the 1824-2004 period, it is certain that the share of debt in default has not only varied substantially, but also has been less than issuer default rates over time. This reflects the dominant share of the global bond market long held by 'AAA' sovereign issuers--the U.K. in the 19th century and, more recently, the U.S. and a number of European issuers. The value of their outstanding bonds, together with those of other investment-grade sovereigns, is such that the amount of debt in default in U.S. dollar terms amounts to less than 1% of the sector as a whole. Nevertheless, as in the past, a key driver of default rates is the rapid growth in the number of sovereign governments, albeit ones of lesser credit quality and of comparatively limited global financial importance. By Standard & Poor's count, the number of sovereign issuers has doubled since 1950, to 202, and has risen fivefold since the early part of the 19th century.

Table 3 Sovereign Default Rates						
Year	Number of Issuers	(% of all sovereign issuers)				
		All Issuers in Default	New Issuers in Default	All Foreign Currency Debt*	Foreign Currency Bonds	Local Currency
1975	164	2.4	1.2	1.2	0.6	1.2
1976	165	3.0	1.2	2.4	0.6	1.2
1977	166	2.4	0.0	1.8	0.6	0.6
1978	169	4.7	2.4	4.1	0.6	0.6
1979	173	6.4	2.3	5.8	0.6	1.7
1980	174	6.9	2.3	5.7	0.6	1.1
1981	176	10.8	6.8	9.7	0.0	1.1
1982	176	16.5	6.3	15.3	0.0	2.3
1983	177	24.9	9.6	23.7	0.0	1.1
1984	178	24.7	1.1	23.6	0.6	1.7
1985	178	25.3	2.8	24.7	0.6	1.1
1986	179	28.5	5.6	27.9	0.6	1.7
1987	179	30.7	3.4	29.1	1.1	2.2
1988	179	30.2	1.7	29.6	1.1	1.1
1989	179	30.2	1.7	29.1	2.2	1.7
1990	178	30.9	2.2	29.8	1.1	2.8
1991	198	27.3	3.0	26.3	1.0	2.0
1992	198	29.3	3.5	28.8	1.5	1.0
1993	200	27.0	0.5	26.5	1.0	1.5
1994	201	24.9	0.5	24.4	1.0	1.5
1995	201	23.4	1.5	21.9	1.0	2.5
1996	201	22.9	1.5	19.9	1.0	3.0
1997	201	17.9	1.5	15.4	1.0	2.5
1998	201	16.9	1.5	14.9	2.0	3.5
1999	201	14.9	1.5	13.4	2.0	3.5
2000	201	15.4	1.5	13.9	2.0	2.5
2001	201	13.4	0.5	12.4	1.0	1.5
2002	202	14.4	2.0	13.9	2.0	2.0
2003	202	13.4	1.5	12.9	2.0	2.0
2004¶	202	12.4	0.0	11.9	1.5	2.0

Source: Standard & Poor's. *Bank debt & bonds. ¶Through third quarter.

■ Prospects in Sub-Saharan Africa

Sovereign defaults in Sub-Saharan Africa have attracted renewed attention in recent years because of the debate about the role that debt relief might play, along with other measures, in helping spur stronger economic performance in the region. In fact, defaults have declined markedly over the past decade, broadly in line with trends globally. Standard & Poor's estimates that the number of sovereigns in default on bank loans and bonds now stands at 11 (see chart 1), well below the 25 Sub-Saharan governments in default as recently as 1992. The dollar amount of debt in default has also fallen substantially, to about US\$17 billion this year from a peak of US\$41 billion in 1989 (see chart 3).

Standard & Poor's expects sovereign defaults in Sub-Saharan Africa to decline again in 2005 and over the next couple of years. As already noted, a number of debt workouts and buybacks are pending and their completion should offset the impact on the numbers of any new defaults that occur. Other factors contributing to the improved credit standing of sovereigns in the region include greater political stability, official debt relief, and the embrace by a growing number of governments of fiscal discipline, structural economic reforms, and better debt management practices.

Still, compared with other regions, there are differences in the dynamics of sovereign defaults in Sub-Saharan Africa that are likely to persist for some years:

- The number of Sub-Saharan governments in default, while declining, continues to account for some 40% of the global total, and therefore is still out of line with the region's relative economic standing. While average credit quality is weaker than in other regions, Standard & Poor's recent assignment of credit ratings in the 'B' category to seven sovereigns, and our expectation of a further decline in the default rate, underscore that the region's credit standing is on an improving trend.
- Commercial sovereign debt workouts in Sub-Saharan Africa are driven more heavily by creditor government policies than elsewhere. With the notable exceptions of Botswana (foreign currency A/Stable/A-1) and South Africa (foreign currency BBB/Stable/A-3), public sector external debt in the region largely consists of lending by the IMF, the multilateral development banks, and non-regional governments. Bank loans and bonds, by contrast, account for a low and declining share of the total. As a result, the resolution of commercial defaults in the region is usually linked with workouts of the debt of official creditors. Furthermore, Paris Club "comparability of treatment" principles, which require that commercial creditors accept similar debt workout terms, are more strictly enforced, particularly on the debt relief granted under the Highly Indebted Poor Country (HIPC) initiative. So long as official lenders remain the region's largest creditors, they will heavily influence the terms under which commercial defaults are resolved.
- Historically, bank loans, not bonds, have been the predominant form of cross-border commercial lending in Sub-Saharan Africa. With few exceptions, commercial bank lending to sovereigns in the region is still on a declining trend. In at least 11 cases, defaults on bank loans have been cured through debt buybacks financed by IDA and by creditor governments. The number of commercial debt restructurings has also declined in recent years, in part because such lending has been discouraged by the IMF and official creditors, and, in certain countries, because commercial banks have chosen to exit sovereign lending. IDA-financed buybacks of defaulted commercial bank debt have featured deep discounts, at prices ranging between eight and 14.5 cents per U.S. dollar face value of principal. Over the medium term, IMF- and HIPC-related restrictions on cross-border borrowings are likely to slow the recovery of bank lending to sovereigns in the region and thereby contain the number of new defaults on commercial bank debt.
- The time it takes to resolve sovereign bank debt defaults in Sub-Saharan Africa is longer than the global norm, mainly because of the intractable political and security problems that some governments face. Defaults on commercial bank loans by Sudan and the Democratic Republic of the Congo, for example, date as far back as the 1970s. On average, Sub-Saharan sovereigns in default have remained in default for 14 of the past 30 years, compared with an average of less than 10 years for sovereigns in other regions. Progress in the completion of commercial debt workouts, lower levels of new bank lending, and, most importantly, a greater willingness and ability by governments to negotiate with commercial creditors will be key to reducing the time it takes to resolve new commercial sovereign defaults in the region in future.
- South Africa is the only sovereign in the region that has regularly accessed the cross-border bond markets in recent years. Nigeria and the Ivory Coast both issued Brady bonds in exchange for restructured bank loans in the 1990s, but Nigeria has avoided fresh issuance since then and the market has been closed to the Ivory Coast since it defaulted on its bonds in 2000. As with

bank lending, IMF- and HIPC-related restrictions on cross-border borrowings are likely to restrict the number of new sovereign bond issuers in the region for some years yet, and, in turn, the number of new foreign currency bond defaults.

- Sovereign defaults on local currency debt in Sub-Saharan Africa have been fewer than expected, given the high default rate on foreign currency debt. This appears to be mainly due to policies that resulted in low levels of domestic financial intermediation. Now, a growing number of Sub-Saharan African sovereigns are giving renewed attention to developing their domestic debt markets as part of broader economic reform programs. Their success in meeting this objective will depend on (i) securing an extended period of macroeconomic stability, including low inflation, and (ii) implementing a variety of legal and institutional measures that help stimulate long-term savings and investment (see commentary article titled "HIPC Doesn't Preclude Domestic Capital Market Development," published on RatingsDirect, April 26, 2004). If such reforms lead to higher local currency debt issuance by sovereigns in the region, local currency defaults could feature more prominently in future episodes of financial distress.

■ Bank Debt Default

As already noted, the tide of sovereign defaults recorded over the past 30 years was mainly one of default on foreign currency bank debt. Until recently, sovereigns have been less prone to default on their foreign currency bonds. A total of 82 sovereigns have defaulted on bank debt since 1975--the vast majority since 1982--including 20 issuers with bonds outstanding during the period their bank loans were in default. Yet, only nine sovereigns in this category defaulted on their bonds, while the others serviced them in full.

Why did this happen? In most cases the value of bonds outstanding was small relative to bank debt. The majority of governments treated bonds as being effectively senior to bank loans, and they did so with the tacit consent of bank creditors. However, Standard & Poor's has long argued that this behavior will not continue. Repayment of large amounts of bank debt through Brady bond exchanges and buybacks, the low volume of new cross-border bank lending to governments, and increasing new bond issuance by sovereigns of lesser credit quality, strongly suggest that the default rates of bank and bond debt will tend to converge.

Looking at the current decade, Standard & Poor's expects sovereign default rates gradually to rise again. The number of speculative-grade ratings assigned over the past decade, together with the below-average credit quality of most unrated sovereigns, points clearly in this direction.

Less clear, however, is the impact on debtor behavior of efforts by the IMF and G7 governments to create a more formalized framework for managing sovereign defaults. Many emerging market investors remain concerned that they will increase the risk of sovereign defaults in the future.

By contrast, Standard & Poor's believes that the impact of institutional changes in the debt workout process on default frequency is likely to be muted. The most comprehensive recent proposal, the IMF's sovereign default restructuring mechanism, or SDRM, has been sidelined, thanks to determined opposition from bond investors and, more importantly, the U.S. Treasury. On the other hand, the Paris Club's determination to "bail in" private creditors, and the gradual adoption by emerging market governments of collective action clauses in bonds, will, to a small degree, influence the time it takes to resolve defaults. Marketplace concerns that all these factors will also increase the number of sovereign defaults, though, are probably exaggerated. They overlook the fact that financial distress is a fundamental precondition for rescheduling both official and commercial debt, and that local political and economic conditions remain the most important influence affecting the willingness and ability of governments to service debt. When default occurs, it is the capacity of governments to negotiate with creditors, more than the framework in which negotiations occur, that remains key to determining the time it takes to resolve defaults.

On balance, therefore, for a number of years to come, the most likely outcome is that the number of issuers and the total amount of debt in default will grow--but to levels well short of those in the early 1990s. Bond markets are receptive to issuance by speculative-grade rated sovereigns, but barriers to entry by governments with the weakest credit quality remain high. The number of foreign currency bond issuers, although growing, is still smaller than the number of governments that had access to cross-border bank finance in the run-up to the 1980s debt crisis. And market appetite for speculative-grade debt will continue to be tested, as more sovereign bond defaults occur. Continued global economic growth, a relatively benign interest rate environment, and, in some cases, timely IMF financial support, should also make the current round of sovereign defaults more muted than the last.

As sovereign defaults continue to grow, how will investors react? Standard & Poor's believes that the market is resilient enough to go on absorbing them. The experience since 1998, which has featured bond defaults by a number of sovereigns, is already suggestive. A key reason that market sentiment toward emerging market sovereigns has fluctuated sharply since the early 1990s is investor uncertainty about credit risk and the process of resolving defaulted debt. The time it takes to resolve defaults, and the recovery value of defaulted bonds, are pertinent information in the pricing of securities in any market. Until recently, however, such information was absent in emerging markets because the bonds of sovereigns (and other issuers) were still performing. Yet despite the unprecedented nature of defaults on Brady and Eurobonds by Argentina and others, the market-risk premium on emerging market sovereign bonds has tended to be lower in the past couple of years than during earlier periods of financial stress. This is an encouraging development in Standard & Poor's view, suggesting less investor uncertainty about how defaults will be resolved in future. Financial conditions in emerging markets should be less volatile than in the 1990s as a result.

■ Local Currency Debt

Of the 202 sovereigns covered in the survey, Standard & Poor's has identified 23 issuers, 11.4% of the total, which have defaulted on their local currency obligations since 1975 (see tables 4 and 5). Recent defaulters include Argentina (2002-2004), Madagascar (2002), Dominica (2003-2004), Mongolia (1997-2000), Ukraine (1998-2000), and Russia (1998-1999). Russia's default on US\$39 billion of Russian ruble debt stands out because of its size: It was the largest local currency default by a sovereign since Brazil's default on US\$62 billion of local currency debt in 1990. Apart from Argentina's, defaults that have continued so far in 2004 include the Solomon Islands (1996-2004) and Dominica (2003-2004). Brazil, Ghana, and Venezuela defaulted at least twice on their local currency debt over the survey period, and Argentina three times.

As in previous years, the 2004 survey illustrates clearly the lower frequency of sovereign default on local currency than on foreign currency debt. The number of issuer defaults on local currency debt has increased over the past decade, reaching a peak of seven in 1998 before declining to four so far this year. Nevertheless, the issuer default rate on local currency debt has averaged just 2.5% per year over this time frame, compared with an average default rate of 15.1% for issuers of foreign currency debt. For the whole of the survey period, the ratio of issuer defaults on the two types of debt is 1 to 9.

Default on central bank notes took the form of partial conversion into new currency (as in Ghana in 1979 and 1982). In the case of bonds, default usually reflected either the unilateral extension of maturities (as in Russia and Ukraine), arrears on debt service (Gabon), the redenomination of foreign currency debt into local currency debt (as in Argentina in 2002), or the abrogation of inflation-linked indexes embedded in the terms of the issues (as in Brazil in 1986-1987 and 1990).

Of the 23 sovereigns defaulting on their local currency debt, ten--Argentina, Brazil, Congo (Kinshasa), Croatia, Ecuador, Gabon, Madagascar, Sierra Leone, Sudan, and Venezuela--previously defaulted on their foreign currency debt. On the other hand, a substantial majority of sovereigns (69) continued servicing local currency debt without interruption after defaulting on foreign currency debt.

■ Foreign Currency Debt

Standard & Poor's has identified 84 issuers, 41.5% of all sovereigns, which have defaulted on their foreign currency bond and bank debt since 1975 (see tables 4 and 5). Many governments defaulted more than once during the period. Default usually took the form of late payments of principal and/or interest on bank debt. In most instances, exchange offers (such as by the majority of the 22 sovereigns that have issued Brady-type securities) or debt buybacks cured the defaults, but impaired the value of the original debt.

A total of 17 issuers defaulted on foreign currency bonds, while issuers defaulting on both bank debt and bonds featured in 15 cases. Among the sovereigns that have defaulted on foreign currency bonds, Argentina's 2001-2004 default stands out because of its size--currently about US\$100 billion. Zimbabwe, Panama, and Bolivia stand out because their defaults lasted for relatively long periods. Zimbabwe's occurred initially in 1965, when Southern Rhodesia (as the state was then known) unilaterally ended its colonial links with the U.K. After its independence was legally recognized, Zimbabwe's new government settled with its creditors in 1980. Bolivia defaulted on its bonds in 1989 and settled with its creditors in 1997. Panama's bond default began in 1987, a few years after its bank debt went into default, and was cured through an exchange offer in 1994. By contrast, a number of recent bond defaults (Ecuador, Moldova, Pakistan, Paraguay, Russia, and Uruguay) have been cured

relatively quickly. In Standard & Poor's view, this demonstrates the capacity of financial markets to adapt to sovereign defaults, even without a more formalized framework for managing debt workouts.

■ Rated and Unrated Issuers

Seven sovereigns rated by Standard & Poor's--Argentina, Indonesia, Pakistan, Paraguay, the Russian Federation, Uruguay, and Venezuela--defaulted on part of their local and/or foreign currency debt after ratings were initially assigned. In 2003, Paraguay defaulted on domestically issued dollar bonds, while Uruguay restructured both domestically and internationally issued foreign currency bond issues. In 2001-2002, Argentina defaulted on both its local and foreign currency debt. Indonesia restructured syndicated bank loans in 1998-1999 and again in 2002, while maintaining debt service on its foreign currency bonds. Pakistan defaulted on its commercial bank debt in 1998, and in 1999 completed a distressed exchange affecting three Eurobond issues. In 1999, Russia restructured the ruble debt it defaulted on in 1998, and in 2000 restructured some categories of foreign currency debt, while remaining current on its Eurobonds. Similarly, Venezuela defaulted on portions of local and foreign currency debt in 1995-1998, while maintaining debt service on its Eurobonds. Throughout most of 1983-1990, Venezuela was in default on its bank debt, but maintained timely debt service on its rated foreign currency bonds.

Since 1992, Standard & Poor's has assigned credit ratings to 35 sovereign issuers that defaulted in previous years (see table 4). Two sovereigns, El Salvador and Kuwait, had previously defaulted on part of their local currency debt. Nine issuers (Argentina, Brazil, Croatia, Dominican Republic, Ecuador, Ghana, Madagascar, Ukraine, and Vietnam) had previously defaulted on both their local and foreign currency debt, while 24 others had defaulted on their foreign currency debt at various points during the 1975-2004 survey period. Altogether, 53 of the sovereigns currently rated by Standard & Poor's had defaulted on foreign currency bonds and bank loans at various times between 1824 and 2004 (see table 6).

The remaining local and foreign currency debt defaults identified between 1975 and 2003 were by 48 sovereigns not rated by Standard & Poor's (see table 5). This group includes five issuers that defaulted on foreign currency bonds, 44 that defaulted on foreign currency bank loans, and nine that defaulted on local currency debt. From 1824 through 2004, a total of 45 unrated sovereigns defaulted on foreign currency bonds and bank loans (see table 7).

Issuer	LC/FC Ratings	Local Currency Debt	Foreign Currency Bond Debt	Foreign Currency Bank Debt
Slovenia	AA/AA-			1992-96
Kuwait	A+/A+	1990-91		
Chile	AA/A			1983-90
Trinidad & Tobago	A/BBB+			1988-89
Poland	A-/BBB+			1981-94
South Africa	A/BBB			1985-87,89,93
Mexico	A-/BBB-			1982-90
Croatia	BBB+/BBB-	1993-96		1992-96
Bulgaria	BBB/BBB-			1990-94
Romania	BBB-/BB+			1981-83,86
Russia	BBB-/BB+	1998-99	1998-2000	1991-97
El Salvador	BB+/BB+	1981-96		
Jordan	BBB/BB			1989-93
Morocco	BBB/BB			1983,86-90
Philippines	BBB-/BB			1983-92
Costa Rica	BB+/BB		1984-85	1981-90
Macedonia	BB+/BB			1992-97
Peru	BB+/BB			1976,78,80,83-97
Panama	BB/BB		1987-94	1983-96
Brazil	BB/BB-	1986-87,90		1983-94

Guatemala	BB/BB-		1989	1986
Turkey	BB/BB-			1978-79,82
Vietnam	BB/BB-	1975		1985-98
Burkina Faso	B+/B+			1983-96
Cook Islands	B+/B+			1995-98
Ghana	B+/B+	1979, 1982		1987
Senegal	B+/B+			1981-85,90,92-96
Ukraine	B+/B+	1998-2000	1998-2000	
Pakistan	BB-/B		1999	1998-99
Indonesia	B+/B			1998-99, 2000, 02
Bolivia	B/B		1989-97	1980-84,86-93
Cameroon	B/B			1985-2003
Jamaica	B/B			1978-79,81-85,87-93
Madagascar	B/B	2002		1981-2002
Mongolia	B/B	1997-2000		
Mozambique	B/B			1980,83-92
Uruguay	B/B		2003	1983-85,87,90-91
Venezuela	B/B	1995-97,98	1995-97	1983-88,90
Paraguay	B-/B-		2003-04	1986-92
Ecuador	CCC+/CCC+	1999	1999-2000	1982-95
Dominican Republic	CC/CC	1975-2001		1982-94
Argentina	SD/SD	1982,89-90,2002-04	1989,2001-04	1982-93,2001-04

Source: Standard & Poor's. Ratings as of 9/20/04. LC -- Local currency, FC -- Foreign currency.

Table 5 Unrated Issuers: Years In Default, 1975-2004			
Issuer	Local Currency Debt	Foreign Currency Bond Debt	Foreign Currency Bank Debt
Albania			1991-95
Algeria			1991-96
Angola	1976		1985-2004
Antigua & Barbuda			1996-2004
Bosnia & Herzegovina			1992-97
Cape Verde			1981-96
Central African Republic			1981,83-2004
Congo (Brazzaville)			1983-2004
Congo (Kinshasa)	1979		1976-2004
Cuba			1982-2004
Dominica	2003-04		2003-04
Ethiopia			1991-99
Gabon	1999-2004		1986-94,1999-2004
Gambia			1986-90
Guinea			1986-88,91-98
Guinea-Bissau			1983-96
Guyana			1979,1982-2004
Haiti			1982-94
Honduras			1981-2004
Iran			1978-95
Iraq			1987-2004
Ivory Coast		2000-04	1983-98
Kenya			1994-2004

North Korea			1975-2004¶
Liberia			1981-2004
Malawi			1982-88
Mauritania			1992-96
Moldova		1998, 2002	
Myanmar	1984,87		1997-2004
Nauru			2002-04
Nicaragua			1979-2004
Niger			1983-91
Nigeria		1986-88,92,2002	1982-92
Rwanda	1995		
Sao Tome & Principe			1987-94
Serbia & Montenegro			1992-2004
Seychelles			2000-02
Sierra Leone	1997-98		1983-84,86-95
Solomon Islands	1996-2004		
Sri Lanka	1996		
Sudan	1991		1979-2004
Tanzania			1984-2004
Togo			1979-80,82-84,88,91-97
Uganda			1980-93
Yemen			1985-2001
Former Yugoslavia		1992	1983-91
Zambia			1983-94
Zimbabwe		1975-80*	2000-04

Source: Standard & Poor's. *Bonds initially defaulted in 1965. ¶Debt initially defaulted in 1974.

Table 6 Rated Sovereigns: Foreign Currency Debt In Default, 1824-2004			
Issuer	LC/FC Ratings	Foreign Currency Bond Debt	Foreign Currency Bank Debt
Austria	AAA/AAA	1868-70, 1914-15, 1932-33, 1938, 1940-52	
Germany	AAA/AAA	1932-38, 1939-53	
Spain	AA+/AA+	1824-34, 1837-67, 1827-82	
Portugal	AA/AA	1837-41, 1850-56, 1892-1901	
Italy	AA-/AA-	1940-46	
Japan	AA-/AA-	1942-52	
Slovenia	AA/AA-		1992-96
Greece	A+/A+	1826-78, 1894-97, 1932-64	
Chile	AA/A	1826-42, 1880-83, 1931-47	1983-90
Czech Republic*	A/A-	1938-46, 1959-60	
Hungary	A/A-	1932-37, 1941-67	
Trinidad & Tobago	A/BBB+		1988-89
Poland	A-/BBB+	1936-37, 1940-52	1981-94
China	BBB+/BBB+	1921-36, 1939-49	
South Africa	A/BBB		1985-87,89,93
Tunisia	A/BBB	1867-70	
Mexico	A-/BBB-	1828-30, 1833-41, 1844-50, 1854-64, 1866-85, 1914-22, 1928-42	1982-90
Croatia	BBB+/BBB-		1992-96
Bulgaria	BBB/BBB-	1916-20, 1932	1990-94

Egypt	BBB-/BB+	1876-80	
Romania	BBB-/BB+	1933-58	1981-83,86
Russia/USSR	BBB-/BB+	1918,1998-2000	1991-97
El Salvador	BB+/BB+	1828-60, 1898, 1921-22, 1932-35, 1938-46	
Colombia	BBB/BB	1826-45, 1850-61, 1873, 1880-96, 1900-04, 1932-34, 1935-44	
Jordan	BBB/BB		1989-93
Morocco	BBB/BB	1903-04	1983,86-90
Philippines	BBB/BB		1983-92
Costa Rica	BB+/BB	1828-40, 1874-85, 1895-97, 1901-11, 1932-52, 1962, 1984-85	1981,83-90
Macedonia	BB+/BB		1992-97
Peru	BB+/BB	1826-48, 1876-89, 1931-51	1976,78,80,84-97
Panama	BB/BB	1932-46, 1987-94	1983-96
Brazil	BB/BB-	1826-29, 1898-1901, 1902-10, 1914-19, 1931-33, 1937-43	1983-94
Guatemala	BB/BB-	1828-56,1876-88,1894,1899-1913,1933-36,1989	
Turkey/Otto. Empire	BB/BB-	1876-81, 1915-28, 1931-32, 1940-43	1978-79,82
Vietnam	BB/BB-		1985-98
Burkina Faso	B+/B+		1983-96
Cook Islands	B+/B+		1995-97
Ghana	B+/B+		1987
Senegal	B+/B+		1981-85,90,92-96
Ukraine	B+/B+	1998-2000	
Pakistan	BB-/B	1999	1998-99
Indonesia	B+/B		1998-99, 2000, 02
Bolivia	B/B	1875-79, 1931-48, 1989-97	1980-84,86-93
Cameroon	B/B		1985-2003
Jamaica	B/B		1978-79,81-85,87-93
Madagascar	B/B		1981-2002
Mozambique	B/B		1980,83-92
Uruguay	B/B	1876-78, 1891, 1915-21, 1933-38, 2003	1983-85,87,90-91
Venezuela	B/B	1826-40, 1848-59, 1860-62, 1865-81, 1892, 1898-1905, 1995-97	1983-88,90
Paraguay	B-/B-	1874-85, 1892-95, 1920-24, 1932-44, 2003-04	1986-92
Ecuador	CCC+/CCC+	1826-55,1868-90,1894-98,1906-08,1909-11,1914-24,1929-54,1999-2000	1982-95
Dominican Republic	CC/CC	1872-88, 1892-93, 1897, 1899-1907, 1931-34	1982-94
Argentina	SD/SD	1828-57, 1890-93, 1989, 2001-04	1982-93,2001-04
Ratings as of 9/20/04			
LC--Local currency. FC--Foreign currency. SD--Selective default. *Former Czechoslovakia. Sources: Standard & Poors and Debt Cycles in the World Economy, Westview Press, 1992.			

Table 7 Unrated Sovereigns: Foreign Currency In Default, 1824-2004		
Issuer	Foreign currency bond debt	Foreign currency bank debt
Albania		1991-95
Algeria		1991-96
Angola		1985-2003
Antigua & Barbuda		1996-2003
Bosnia & Herzegovina		1992-97
Cape Verde		1981-96
Central African Republic		1981,83-2003

Congo (Brazzaville)		1983-2003
Congo (Kinshasa)		1976-2003
Cuba	1933-34, 1960	1982-2003
Dominica		2003-04
Ethiopia		1991-99
Gabon		1986-94,1999-2004
Gambia		1986-90
Guinea		1986-88,91-98
Guinea-Bissau		1983-96
Guyana		1979,1982-2004
Haiti		1982-94
Honduras	1828-67, 1873-1925	1981-2004
Iran		1978-95
Iraq		1987-2004
Ivory Coast	2000-04	1983-98
Kenya		1994-2004
North Korea		1974-2004
Liberia	1875-98, 1912, 1914-15, 1917-18, 1919-23, 1932-35	1987-2004
Malawi		1982,88
Mauritania		1992-96
Moldova	1998, 2002	
Myanmar		1997-2003
Nauru		2002-04
Nicaragua	1828-74, 1894-95, 1911-12, 1915-17, 1932-37	1979-2003
Niger		1983-91
Nigeria	1986-88,92,2002	1982-92
Sao Tome & Principe		1987-94
Serbia & Montenegro		1992-2004
Seychelles		2000-02
Sierra Leone		1983-84,86-95
Sudan		1979-2004
Tanzania		1984-2004
Togo		1979-80,82-84,88,91-97
Uganda		1980-93
Yemen		1985-2001
Former Yugoslavia	1895, 1933-50, 1992	1983-91
Zambia		1983-94
Zimbabwe	1965-80	2000-04
Sources: Standard & Poor's and Debt Cycles in the World Economy, Westview Press, 1992.		

■ Scope of the Survey

Standard & Poor's based its survey on proprietary data compiled from a variety of sources believed to be reliable. The 2004 survey covers rated and unrated local and foreign currency debt issued by sovereign governments and territories between 1975 and 2004, and for foreign currency bonds between 1824 and 2004. By Standard & Poor's count, the number of sovereign governments has increased to 202 in 2003 from 39 in 1824.

Local currency obligations include government and central bank securities, as well as bank loans and central bank currency. Foreign currency debt includes bank loans and all capital market issues sold in cross-border and local markets.

The 104 rated sovereigns include all issuers with public local and foreign currency credit ratings as of Sept. 20, 2004, (see table 8). The 98 unrated issuers include 48 sovereigns with default histories identified since 1975.

Table 8 Standard & Poor's Sovereign Credit Ratings					
Issuer	Local Currency	Foreign Currency	Issuer	Local Currency	Foreign Currency
Australia	AAA	AAA	Slovak Rep.	A-	BBB+
Austria	AAA	AAA	China	BBB+	BBB+
Canada	AAA	AAA	Tunisia	A	BBB
Denmark	AAA	AAA	South Africa	A	BBB
Finland	AAA	AAA	Oman	BBB+	BBB
France	AAA	AAA	Mexico	A-	BBB-
Germany	AAA	AAA	Croatia	BBB+	BBB-
Ireland	AAA	AAA	Bulgaria	BBB	BBB-
Isle of Man	AAA	AAA	Kazakhstan	BBB	BBB-
Liechtenstein	AAA	AAA			
Luxembourg	AAA	AAA	Egypt	BBB-	BB+
Netherlands	AAA	AAA	Romania	BBB-	BB+
Norway	AAA	AAA	Russia	BBB-	BB+
Singapore	AAA	AAA	El Salvador	BB+	BB+
Sweden	AAA	AAA	Colombia	BBB	BB
Switzerland	AAA	AAA	Jordan	BBB	BB
United Kingdom	AAA	AAA	Morocco	BBB	BB
United States	AAA	AAA	Philippines	BBB-	BB
			Costa Rica	BB+	BB
New Zealand	AAA	AA+	India	BB+	BB
Belgium	AA+	AA+	Macedonia	BB+	BB
Spain	AA+	AA+	Peru	BB+	BB
Andorra	AA	AA	Panama	BB	BB
Bermuda	AA	AA	Brazil	BB	BB-
Portugal	AA	AA	Guatemala	BB	BB-
Slovenia	AA	AA-	Turkey	BB	BB-
Italy	AA-	AA-	Vietnam	BB	BB-
Japan	AA-	AA-	Grenada	BB-	BB-
Taiwan	AA-	AA-			
			Benin	B+	B+
Iceland	AA+	A+	Burkina Faso	B+	B+
Hong Kong	AA-	A+	Cook Islands	B+	B+
Greece	A+	A+	Ghana	B+	B+
Kuwait	A+	A+	Senegal	B+	B+
Qatar	A+	A+	Ukraine	B+	B+
Chile	AA	A	Pakistan	BB-	B
Botswana	A+	A	Indonesia	B+	B
Cyprus	A+	A	Papua New Guinea	B+	B
Malta	A+	A	Madagascar	B	B
Saudi Arabia	A+	A	Mozambique	B	B
Israel	A+	A-	Bolivia	B	B
Korea	A+	A-	Cameroon	B	B
Malaysia	A+	A-	Jamaica	B	B
Czech Republic	A	A-	Mali	B	B

Bahrain	A	A-	Mongolia	B	B
Hungary	A	A-	Uruguay	B	B
The Bahamas	A-	A-	Venezuela	B	B
Estonia	A-	A-	Belize	B	B-
Latvia	A-	A-	Lebanon	B-	B-
Lithuania	A-	A-	Suriname	B	B-
			Paraguay	B-	B-
Thailand	A	BBB+			
Trinidad & Tobago	A	BBB+	Ecuador	CCC+	CCC+
Barbados	A-	BBB+	Dominican Republic	CC	CC
Poland	A-	BBB+			
			Argentina	SD	SD
Ratings as of Sept. 20, 2004. SD--Selective default.					

Defaults by sovereigns on loans from other governments and their agencies are not tracked in the survey. Such obligations typically are made on concessional terms and are restructured more frequently than either bonds or commercial bank loans. Sovereign loans in arrears from multilateral lending institutions (such as the World Bank) are also not included in the survey. The default rate on loans by multilateral institutions is significantly lower than that for either bonds or bank loans, reflecting their "preferred creditor" status. Willingness to pay is an issue distinguishing sovereigns from most types of issuers and is reflected in the different default rates observed on various classes of rated and unrated sovereign debt. Partly because creditors have limited legal redress, governments can (and sometimes do) default selectively on their obligations, even when they possess the financial capacity for timely debt service.

Standard & Poor's gathers its historical sovereign default data from many sources and, not infrequently, information on some aspects, including the value of affected debt, is sketchy. Consequently, with the possible exception of foreign currency bonds, this compilation of sovereign defaults might not be exhaustive. Local and foreign currency debt defaults in a few countries and territories may have passed unnoticed (except by creditors). Additional information on such defaults, as it becomes available, will be incorporated into future surveys.

■ Defining Sovereign Defaults

Standard & Poor's generally defines default as the failure to meet a principal or interest payment on the due date (or within the specified grace period) contained in the original terms of the debt issue. Questions can arise, however, when applying this definition in different situations and to different types of sovereign obligations. In the sovereign default survey, each issuer's debt is considered in default in any of the following circumstances:

- For local and foreign currency bonds, notes, and bills, when either scheduled debt service is not paid on the due date, or an exchange offer of new debt contains terms less favorable than the original issue;
- For central bank currency, when notes are converted into new currency of less than equivalent face value; and
- For bank loans, when either scheduled debt service is not paid on the due date, or a rescheduling of principal and/or interest is agreed to by creditors at less favorable terms than the original loan. Such rescheduling agreements covering short- and long-term bank debt are considered defaults even where, for legal or regulatory reasons, creditors deem forced rollover of principal to be voluntary.

In addition, many rescheduled sovereign bank loans are ultimately extinguished at a discount from their original face value. Typical deals have included exchange offers (such as those linked to the issuance of Brady bonds), debt/equity swaps related to government privatization programs, and/or buybacks for cash. Standard & Poor's considers such transactions as defaults when they feature terms less favorable than the original obligation.

Each sovereign in default at any point during the year is included (along with the U.S. dollar equivalent

of its debt then in default) in the annual issuer totals. For example, in July 2004, Paraguay completed a distressed debt exchange on foreign currency bonds. As a result, Paraguay is counted in the 2004 issuer default totals, but--assuming the government maintains normal debt service going forward--it will not be counted among sovereign issuers in default in 2005.

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