

BLACKROCK SOVEREIGN RISK INDEX
TALES OF DETERIORATION AND BIG MOVERS
JULY 2012

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BlackRock Sovereign Risk Index

FIRST WORDS AND SUMMARY

The BlackRock Sovereign Risk Index (BSRI) provides investors with a framework for tracking sovereign credit risk. Drawing on a pool of financial data, surveys and political insights, the BSRI assesses the government debt of 48 countries. In this quarterly update, we highlight:

- ▶ **India** and **Spain** deteriorated due to increases in government debt and worsening economic growth forecasts. The countries retained their rankings but moved closer to **Argentina**.
- ▶ **Malaysia** and **South Africa** moved up three notches each, largely because of rosier GDP growth projections. **France** moved up two notches due to an increase in perceived government stability after the presidential elections.
- ▶ **Indonesia** dropped the most in the rankings (five spots), partly because of an increase in short-term debt and a decline in the ratio of domestically held debt. Other decliners were **Austria**, **China** and **Mexico**.

The BSRI 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 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'.

The BSRI's inputs are updated at irregular intervals, meaning some ratings changes may only reflect the timing of data releases. Small changes in ratings 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.

INDIA AND SPAIN: DIRE DETERIORATION

The debt profiles of India and Spain deteriorated markedly due to increased government debt loads (both in absolute terms and as a percentage of GDP) and worsening GDP growth forecasts. The countries kept their BSRI rankings at 39th and 40th places but are now buried deeper in the 5th quintile.

The opinions expressed are as of July 2012, and may change as subsequent conditions vary.

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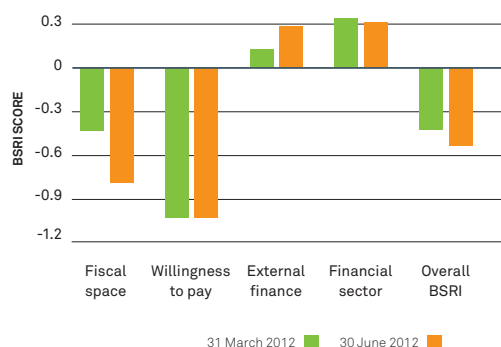
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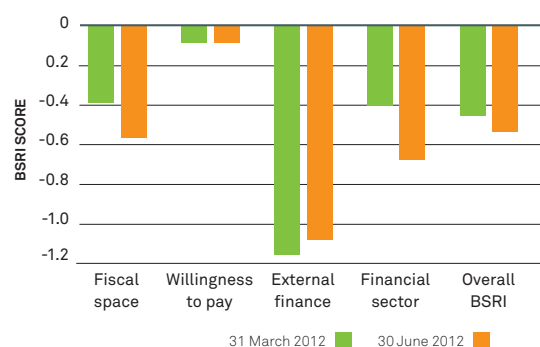
INDIA: THE ELEPHANT STUMBLES



Source: BlackRock

India faces declining growth, gaping fiscal deficits and capital flight, as we detailed in **'When the Elephant Gets Sick: India at a Crossroads'** in June 2012. This confluence of factors has hurt India's BSRI profile, with its Fiscal Space score suffering from increased general government debt, diminished access to capital markets and lower GDP growth forecasts. See the chart on the previous page. India has deteriorated steadily since the fourth quarter of 2011.

SPAIN: AFTER THE PROPERTY FIESTA



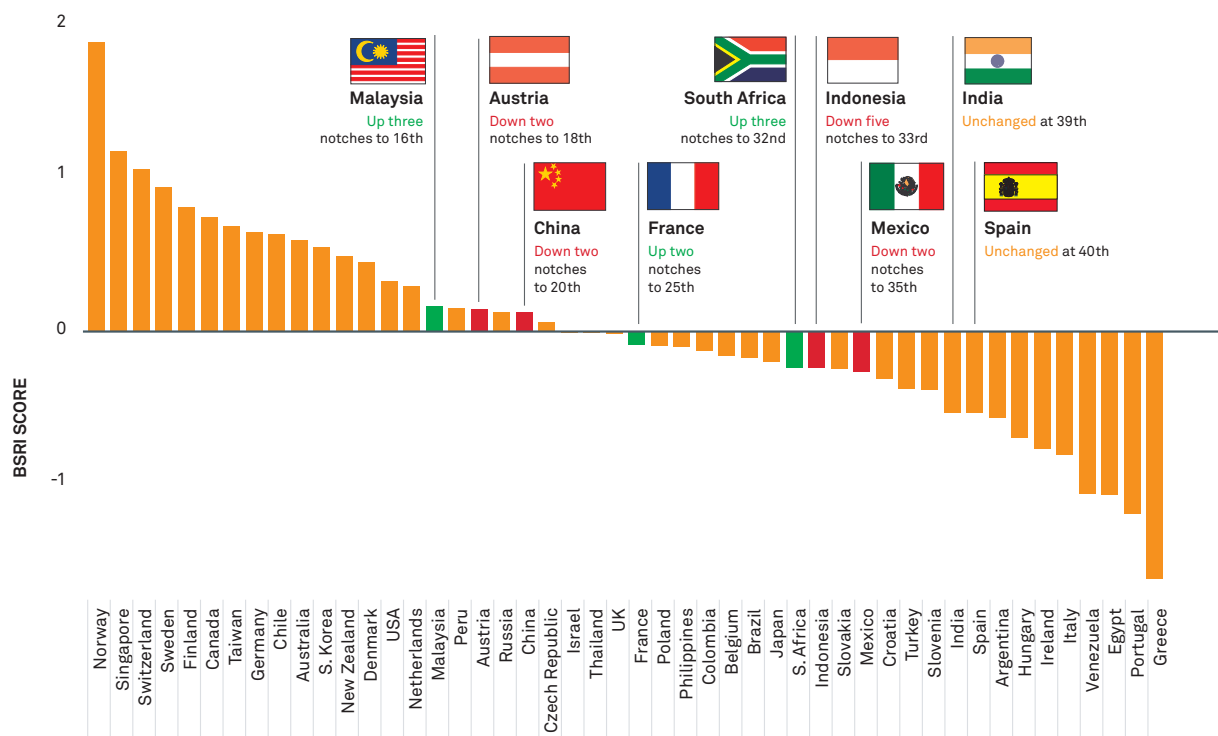
Source: BlackRock

Spain's debt profile also took a hit. Increased debt and lower GDP expectations hurt its Fiscal Space score. Spain's Financial Sector score fell sharply as it became clear many banks needed additional capital to reserve against bad construction and property loans. Spain's weak banking sector is the eurozone's Achilles' heel, as we discussed in **'Europe on a Tightrope'** in May 2012. European leaders recognised this by agreeing to recapitalise Spanish banks at their June summit.

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WHO'S UP AND WHO'S DOWN

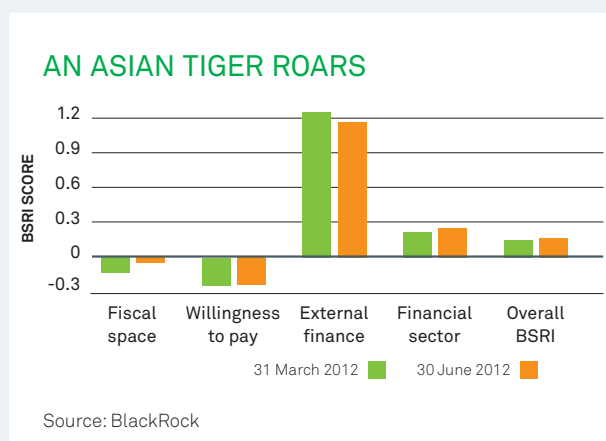
BlackRock Sovereign Risk Index Rankings, June 2012



Sources: BlackRock, Bloomberg, IMF, World Bank, central banks, Eurostat, BIS, Consensus Economics, UN, Moody's, Standard and Poor's, Fitch, PRS Group and www.euromoneycountryrisk.com. Note: Ranking changes based on movement from 31 March to 30 June 2012.

MOVING UP AND DOWN THE LADDER

Malaysia rose three notches to 16th place on strong momentum from late 2011, when GDP surprised to the upside. Net exports have struggled, but Malaysia benefits from strong private consumption and investment growth. Lower short-term debt levels and an upgrade of Malaysia's projected ability to service its debt improved its Fiscal Space score. See the chart below.



South Africa also benefited from rosier GDP projections. This drove improvement across the board and boosted its ranking by three notches to 32nd place. An increase in domestic debt ownership and the elimination of external debt also helped.

France rose two spots to 25th place on an upgrade of its perceived government stability with the election of president François Hollande. An improved primary budget deficit helped its Fiscal Space score.

Indonesia saw the biggest move, dropping five notches to 33rd place. Reasons included an increase in short-term debt; a lower ratio of domestically owned debt; a perceived worsening of the investment climate; and a drop in its bank capital-to-assets ratio. Indonesia's exports are sputtering, and its persistent current account deficit requires offsetting capital inflows. Caps on foreign investment and raw materials exports could hurt these.

Other decliners included **Austria** (down two spots to 18th place) and **China** (down two notches to 20th place). **Mexico's** overall debt profile improved slightly, but its BSRI ranking fell two notches to 35th place as other countries improved.

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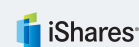
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