SIDE – NOTE

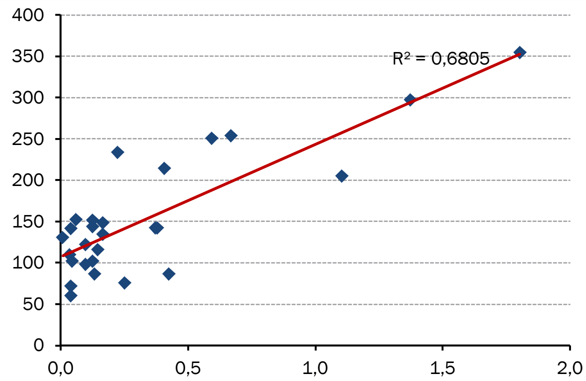
Sovereign default risk determinants

Typically, sovereign defaults occur during times of economic trouble, often triggered by large exogenous shocks. However, they are more than simply economic events, since honoring debt obligations by a borrowing government is often a matter of political will. The literature on sovereign debt suggests that defaulting governments have the technical ability to repay debts in most cases – what they often seem to lack is the incentive to do so. Thus, a solid part of our macroresearch contains a scenario analysis of Ukraine's political framework. Empirical studies suggest that the significant variables for sovereign default probability estimation are the following:

1. Political regime
2. Debt/GDP ratio
3. Trade openness, Current account balance/GDP
4. Income inequality and heterogeneities

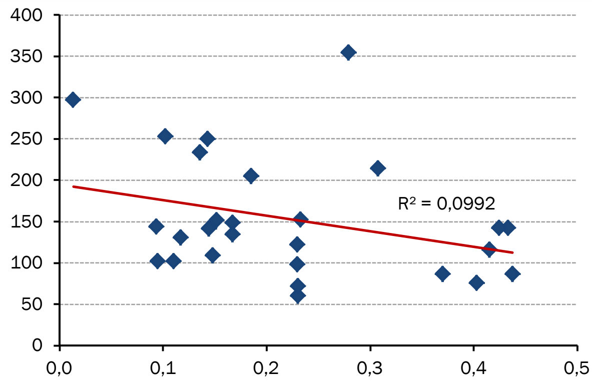
The simple charts below depict the correlation between sovereign credit spreads and several of the aforementioned factors. As long as the determination coefficient is quite low in most cases, further investigation beyond the scope of this side-note is needed, in order to determine their significance. We will be follow that in our upcoming issues.

Public debt/GDP ratio of EM countries vs 5Yr sovereign CDS



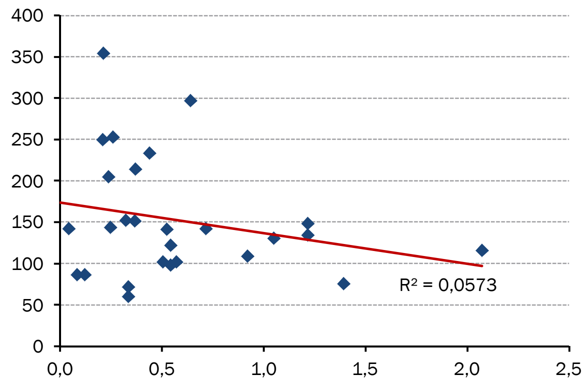
Source: Bloomberg, IMF, AYA calculations

Short term public debt/Public debt of EM countries vs 5Yr sovereign CDS



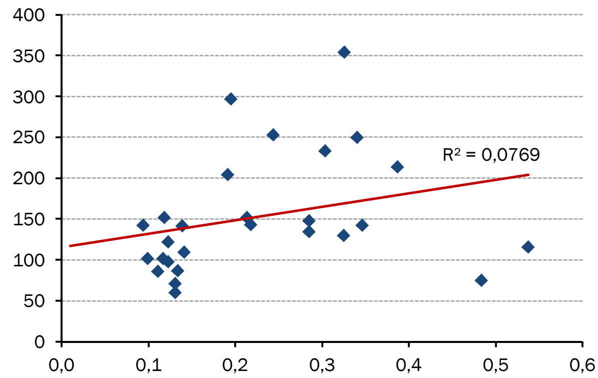
Source: Bloomberg, IMF, AYA calculations

International reserves / Gross Ext.Debt ratio of EM countries vs 5Yr sovereign CDS



Source: Bloomberg, IMF, AYA calculations

International reserves/GDP ratio of EM countries vs 5Yr sovereign CDS

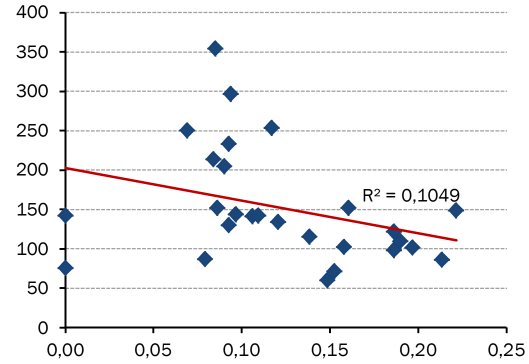


Source: Bloomberg, IMF, AYA calculations

SEE THE LAST PAGE FOR IMPORTANT DISCLOSURES & ANALYST CERTIFICATION

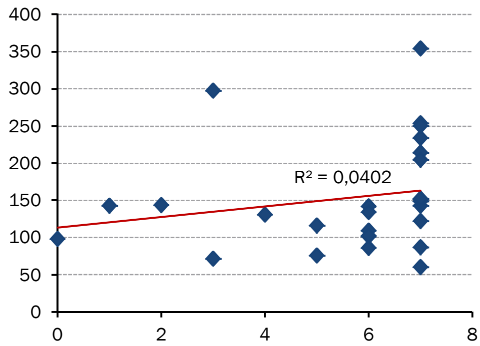
Alexander Vedeneyev
Head of Research
tel: +38 044 392 2030
E-mail: a.vedeneyev@ayacapital.com

Income Inequality of EM countries vs 5Yr sovereign CDS



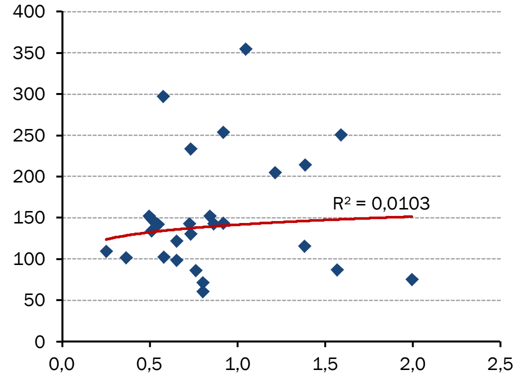
Source: Bloomberg, UN Human Development Report 2010. AYA calculations

Executive constraints of EM countries vs 5Yr sovereign CDS



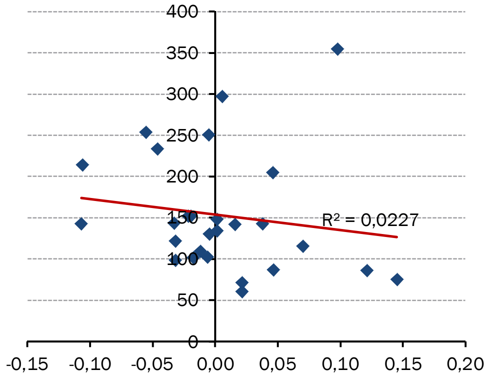
Source: Bloomberg, Polity IV, AYA calculations

(Export+Import)/GDP ratio of EM countries vs 5Yr sovereign CDS



Source: Bloomberg, IMF, AYA calculations

Current account balance/GDP ratio of EM countries vs 5Yr sovereign CDS



Source: Bloomberg, IMF, AYA calculations

Notably, the determination of the sovereign yield does not depend exclusively on a borrowing country's economic and political characteristics. Among other factors commonly referred to as borrowing conditions are, for example, loan currency, maturity of debt instrument, etc. International conditions also play a role, with liquidity in international capital markets acting as a benefit to countries across the board with lower interest rates. Conversely, when there is no liquidity in international markets, "cheap" loans will be difficult to secure for almost any country.

.

Disclaimer

The research analyst(s) denoted on the cover of this report certifies that:

1) all views expressed in this report accurately reflect their personal views on any and all of the subject securities/issuers/industries/topics;

2) no part of any of the research analysts' compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

This issue was prepared by AYA Capital solely for information purposes and is furnished through AYA Capital solely for information purposes. This document does not constitute an offer or invitation to the sale or purchase of securities or any assets; businesses or undertakings described herein shall not form the basis of any contract. AYA Capital did not independently verify any of the information and does not make any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein and it (including any of its respective directors, partners, employees or advisers or any other person) shall not have, to the extent permitted by law, any liability for the information contained herein or any omissions therefrom or for any reliance that any party may seek to place upon such information. In furnishing this information, AYA Capital undertakes no obligation to provide the recipient with access to any additional information or to update or correct the information. This information may not be excerpted from, summarised, distributed, reproduced or used without the consent of AYA Capital. Neither the receipt of this information by any person, nor any information contained herein constitutes, or shall be relied upon as constituting, the giving of investment advice by AYA Capital to any such person. All pricing is as of the close of market for the securities discussed, unless otherwise stated. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Past performance is not indicative of future results. The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients. The recipients of this report should make their own independent decisions regarding any securities or financial instruments mentioned herein. Periodic updates may be provided on companies/industries based on company specific developments or announcements, market conditions or any other publicly available information.

For information requests please contact Alexander Vedeneyev, Head of Research,
e-mail: a.vedeneyev@ayacapital.com, tel: +38 044 392 2030