Reading 63

CREDIT ANALYSIS FOR GOVERNMENT ISSUERS

1. (A) **default rates on GOs are typically lower for same credit ratings.**

Explanation

Municipal bonds usually have lower default rates than corporate bonds of the same credit ratings. GO bonds' creditworthiness is affected by economic downturns. Sovereigns can print money to repay debt, but municipalities cannot.

(Module 63.1, LOS 63.a)

2. (B) **revenue bond.**

Explanation

Revenue bonds are issued by local or regional governments and backed by the revenue (e.g., tolls) of a specific project. Agency bonds are bonds issued by government agencies. GO bonds are (senior) unsecured bonds backed by unspecific revenues of the issuing government.

(Module 63.1, LOS 63.a)

3. (A) **weak fiscal strength and strong economic growth and stability factors.**

Explanation

A very high interest-to-GDP ratio indicates an unfavorable (weak) fiscal strength factor because it implies weaker debt affordability by the sovereign. Low real GDP growth volatility indicates more favorable economic conditions and therefore stronger economic growth and stability factors.

(Module 63.1, LOS 63.a)

4. (C) **Revenue bonds have lower yields than general obligation bonds because they are backed by specific projects.**

Explanation

General obligation bonds are backed by the full faith, credit, and taxing power of the issuer and thus tend to have lower yields than revenue bonds.

(Module 63.1, LOS 63.a)

5. (C) **have higher yields.**

Explanation

Revenue bonds typically have higher credit risk than GO bonds because the only source of revenue for payment on the bonds is the revenue from the projects being financed. As a result, revenue bonds typically have higher yields than GO bonds. Only GO bonds are backed by the full faith and credit of the issuing government.

(Module 63.1, LOS 63.a)

6. (B) **institutions and policy factors.**

Explanation

Because the investor would have no recourse to the issuing government, it should evaluate the government's willingness to repay its obligations. This assessment is incorporated under institutions and policy factors. Fiscal flexibility factors (like capacity to collect taxes) and monetary effectiveness factors (like central bank actions) measure the sovereign government's ability to repay its obligations.

(Module 63.1, LOS 63.a)

7. (B) **Only GO bonds are effectively funded by taxpayers.**

Explanation

GO bonds are supported by the full taxing power of the issuing government. In other words, GO bonds are effectively funded by taxpayers (individual and corporate). In contrast, revenue bonds are only backed by revenues from the specific projects funded by these bonds (for example, tolls from a toll road or bridge).

(Module 63.1, LOS 63.a)