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AFDB SOVEREIGN CREDIT RATING INITIATIVE



Monthly Brief 3 : **ESG Factors in Sovereign Ratings**

This is the third in the series of briefs published ahead of the launch, this November, of the AfDB Sovereign Credit Rating Initiative, implemented by the ALSF. Brief 1 considered the role of credit rating agencies in Africa, while Brief 2 examined the importance of effective sovereign investor relations. This brief turns to another increasingly visible feature of sovereign credit analysis: environmental, social and governance ("ESG") factors.

The first point is one of definition. Credit rating agencies do not generally ask whether a sovereign is "good" on ESG in the abstract. Their concern is narrower: whether an environmental, social or governance consideration is sufficiently material to affect the sovereign's capacity or willingness to service its debt. S&P Global Ratings, for example, incorporates ESG factors where it considers them material to creditworthiness and sufficiently visible; Fitch similarly considers ESG issues where they are credit-relevant and material to the rating decision. Moody's likewise incorporates ESG considerations into its credit analysis, using Issuer Profile Scores and Credit Impact Scores to assess their relevance and credit impact, while making clear that these measures are distinct from the credit rating itself and do not constitute separate ESG ratings.[1]

ESG is Already Embedded in Sovereign Credit Analysis

The ESG terminology may be relatively recent, but many of the underlying considerations are not. Governance quality, institutional effectiveness, demographic pressures, social stability, exposure to natural disasters and dependence on environmentally vulnerable sectors have long influenced assessments of sovereign creditworthiness. What has changed is that rating agencies increasingly identify, categorise and disclose these considerations expressly as ESG-related credit factors.[2]

The transmission mechanism matters more than the label. An environmental shock becomes relevant to a sovereign rating where, for example, it weakens economic growth, damages exports, increases public expenditure or contingent liabilities, erodes the external position or similar. A social pressure becomes credit-relevant where it constrains growth, increases demands on the budget, undermines social cohesion or affects political and policy stability. Governance affects creditworthiness through the quality and predictability of institutions and policy, the credibility of fiscal and monetary management, transparency, and the government's capacity to respond effectively to shocks[3]

This distinction is important. ESG considerations are therefore not necessarily additional factors sitting beside the traditional sovereign-rating framework. Frequently, they operate through the economic, fiscal, institutional and external variables that already determine creditworthiness.

The Three Pillars

- **Environmental factors**: For sovereigns, environmental considerations include both physical risks and transition risks. Physical risks may include exposure to floods, droughts, extreme weather, rising temperatures or other climate-related hazards.[4] Their credit significance depends on how those risks transmit into economic activity and the sovereign balance sheet: through weaker output, damaged infrastructure, lower fiscal revenue, higher reconstruction expenditure, pressures on food or energy security, or deterioration in the external accounts.[5] Transition risks may arise where an economy, its exports or its public revenues are materially dependent on activities that could be affected by changes in technology, regulation or global demand associated with the transition to a lower-carbon economy.

  Rating agencies nevertheless remain cautious about converting long-dated climate projections directly into present-day rating outcomes. Fitch, for example, uses Climate Vulnerability Signals as a screening mechanism to identify sovereigns requiring additional analysis rather than as a mechanical rating input. The agency has

1 - See S&P Global Ratings, "ESG in Credit Ratings," accessed August 26 2026, https://www.spglobal.com/ratings/en/research/esg-in-credit-ratings. S&P Global; Moody's Ratings, "Credit Ratings," accessed August 26, 2026, https://www.moodys.com/web/en/us/solutions/ratings.html. Moody's; Fitch Ratings, "Fitch's General ESG Approach: Fitch's Approach to Addressing Environmental, Social and Governance Considerations in Credit Ratings," January 29, 2026, https://assets.fitchratings.com/downloadFile?reportType=report&sfReport=false&slug=banks%2Ffitch-general-esg-approach-29-01-2026.

2 - S&P Global Ratings, "ESG in Credit Ratings"; Fitch Ratings, "What Investors Want to Know: ESG Relevance Scores for Sovereigns," April 8, 2019, https://assets.fitchratings.com/downloadFile?reportType=report&sfReport=false&slug=sovereigns%2Fwhat-investors-want-to-know-esg-relevance-scores-for-sovereigns-08-04-2019.

3 - S&P Global Ratings, "Weather Warning: Assessing Countries' Vulnerability to Economic Losses from Physical Climate Risks," April 27, 2022, https://www.spglobal.com/sustainable1/en/insights/weather-warning-assessing-countries-vulnerability-to-economic-losses-from-physical-climate-risks; Fitch Ratings, "Sovereign Rating Criteria," April 27, 2026, https://assets.fitchratings.com/downloadFile?reportType=report&sfReport=false&slug=sovereigns%2Fsovereign-rating-criteria-27-04-2026; Moody's Ratings, "Outlooks 2026: Global Sovereigns Are Negative but Emerging Markets Hold Stable," November 13, 2025, https://www.moodys.com/web/en/us/insights/credit-risk/outlooks/global-sovereigns-2026.html.

4 - Fitch Ratings, "Sovereign Rating Criteria", Appendix 4.

5 - S&P Global Ratings, "Weather Warning".

emphasised both the long-term horizon over which some climate effects may materialise and the substantial uncertainty surrounding their eventual scale, policy response and credit transmission[6]

- **Social factors**: Social considerations may become credit-relevant where demographic trends, employment and income conditions, public safety or broader social pressures affect economic performance, fiscal demands or political stability.[7] Demographic change may alter the size and productivity of the workforce or increase pension and other social expenditure. Employment and income conditions, human-development outcomes and access to basic services may also affect economic performance and social stability, with potential consequences for fiscal policy and institutional effectiveness.[8]

  The relevant question, again, is not whether a social indicator is desirable or undesirable in isolation. It is whether the condition is sufficiently material to affect the sovereign's economic or fiscal position, institutional resilience or, ultimately, its creditworthiness.

- **Governance factors**: Of the three pillars, governance is generally the most deeply embedded in conventional sovereign credit analysis. Fitch's sovereign framework treats political risk and governance as part of the structural features of the economy, with governance indicators capturing, among other things, institutional effectiveness, political stability and the authorities' capacity and willingness to mobilise resources for debt service.[9] S&P similarly places institutional effectiveness at the core of its sovereign methodology, with the institutional assessment forming one of the five principal factors underpinning its sovereign credit analysis.[10]

  The reason is straightforward. Sovereign creditworthiness depends not only on the resources available to a state, but also on the institutions through which those resources are governed. Effective institutions and credible policy frameworks can strengthen a sovereign's capacity to manage economic activity, mobilise resources for debt service and absorb adverse shocks. Conversely, weak institutions and political instability can compound underlying economic or fiscal vulnerabilities and reduce the sovereign's resilience.[11]

Why This Matters for African Sovereigns

For African sovereigns, the practical lesson is not to treat ESG as a separate communications exercise undertaken only when issuing a green or sustainability-labelled bond. ESG-related considerations may already be present in the ordinary sovereign rating through the assessment of institutions, growth, public finances, external resilience and event risk.

This is particularly relevant where structural exposure and fiscal capacity interact. A sovereign may face material climate or social vulnerabilities but retain resilience because of strong institutions, fiscal buffers, economic diversification or effective adaptation. Conversely, the same underlying exposure can have a larger credit effect where fiscal space is limited, institutions are weaker or the economy is highly concentrated. Moody's expressly recognises this interaction between ESG exposure and sovereign resilience, including income, fiscal capacity and governance.[12]

There is also reason for care in interpreting sovereign ESG measures themselves. World Bank and IMF research has highlighted an important methodological problem: sovereign ESG scores can be strongly correlated with countries' levels of income, particularly under the social and governance pillars. That can make it difficult to distinguish sustainability performance from the accumulated advantages of economic development.[13] The IMF's 2024 review of sovereign ESG methodologies similarly found that important methodological challenges remain, including income bias and differing approaches to environmental performance.[14] These observations concern ESG scoring and investment methodologies rather than the mechanics of an individual sovereign credit rating, but they reinforce the need to understand precisely what a particular metric measures before relying upon it.

6 - Fitch Ratings, "Sovereign Rating Criteria," 31–32.
7 - Fitch Ratings, "What Investors Want to Know".
8 - Moody's Ratings, "Outlooks 2026".
9 - Fitch Ratings, "Sovereign Rating Criteria".
10 - S&P Global Ratings, "Sovereign Ratings Score Snapshot," April 2, 2024, https://www.spglobal.com/ratings/en/regulatory/article/240402-sovereign-ratings-score-snapshot-s13059555.
11 - Fitch Ratings, "Sovereign Rating Criteria," 8–9.
12 - Moody's Ratings, "Outlooks 2026"; Fitch Ratings, "Sovereign Rating Criteria," Appendix 4.
13 - Ekaterina Gratcheva, Teal Emery, and Dieter Wang, Demystifying Sovereign ESG (Washington, DC: World Bank, 2020), https://documents1.worldbank.org/curated/en/842671621238316887/pdf/Demystifying-Sovereign-ESG.pdf.
14 - Ekaterina Gratcheva and Bryan Gurhy, "Sovereign Environmental, Social, and Governance (ESG) Investing: Chasing Elusive Sustainability," IMF Working Paper No. 2024/102 (Washington, DC: International Monetary Fund, May 17, 2024), https://www.imf.org/en/publications/wp/issues/2024/05/17/sovereign-environmental-social-and-governance-esg-investing-chasing-elusive-sustainability-549165.

For a debt management office, therefore, the objective should not be to pursue a better "ESG score" in the abstract. It should be to understand which environmental, social and governance factors the rating agencies consider materially relevant to the country's own credit profile; identify the channels through which those factors affect growth, public finances, external resilience or institutional strength; and ensure that the sovereign can demonstrate both the underlying risk and the policies, buffers and institutional arrangements available to manage it.



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