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Reactions of Japanese markets to changes in credit ratings by global and local agencies

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Abstract

We examine data from the mid-1980s to 2003 to investigate whether stock prices set on the Tokyo Stock Exchange for Japanese firms react more strongly to changes in credit ratings of global rating agencies than of local agencies. This offers a strong test of relative influence of the two groups of rating agencies. We hypothesize that global raters will have more influence, but given that the two global agencies, Moody's and Standard and Poors, are headquartered in the United States, analysis of stocks of Japanese firms listed on US exchanges would confound the results to the extent there is a home bias for raters. We find that global agencies are more influential than the two major local raters, Japan Rating and Investment Information and Japan Credit Rating Agency, for rating downgrades. Thus for credit downgrades, global raters are more influential than local ones even in the local market. Consistent with previous research, we find that upgrades are benign events, and this holds true for global as well as local agencies.

JEL classification: G14; G15

Keywords: Credit ratings; Rating agencies

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1. Introduction and background

Our principal task is to determine the influence of global credit rating agencies relative to local agencies using data from the mid-1980s to 2003. According to the Bank for International Settlements (2000), there are three global credit rating agencies headquartered in the US. They are Moody's Investors Service, Standard and Poor's (S&P), and A.M. Best Co. Global rating agencies in foreign countries are Fitch, which is owned by French conglomerate FIMALAC, Japan Rating and Investment Information (R&I), and Japan Credit Rating Agency (JCR). Although Fitch is owned by a French conglomerate, it has major operations in the US. There is no pan-European rating agency. BIS classifies other rating agencies around the world as regional rating agencies. We define Moody's and S&P as global agencies and R&I and JCR as local agencies for comparison purposes. This inquiry is guided by economic arguments that the larger and more established agencies should have more credibility.

We investigate stock price reactions in the Japanese market to counter a possible home bias for raters; i.e., if global raters are shown to be more influential even in local markets, their dominance will have been convincingly demonstrated. Moreover, we investigate whether Moody's is more influential than S&P in light of mixed survey evidence that Moody's ratings may receive greater emphasis among managers of Japanese financial and industrial firms. We re-visit earlier findings regarding differential reactions to rating changes for *keiretsu* versus other firms, and we determine whether rating changes are more influential for speculative versus investment grade issues. We also examine price reactions to rating refinements announced by S&P.

According to the Wall Street Journal (2003a), S&P and Moody's dominate the world credit services market with 79% of combined market share in 2001, followed by Fitch (14%) and other rating agencies (6%). Moreover, the global reach of the two US agencies has expanded rapidly. Moody's annual report shows that its non-US revenue has grown much faster than US revenue, increasing from 18% of total revenue in 1997 to 36% in 2003, with a compound annual growth rate of more than 30%. Although the bulk of the increase has come from western European countries, the revenues of Moody's and S&P in Japan have increased rapidly due to the dis-intermediation of the banking industry and the strong growth of structured finance ratings despite the lingering recession in that country. The Japanese bond market is a natural subject of credit rating influence because of its size alone – second only to that of the United States (Hattori et al., 2001).

Previous evidence on the comparison of the influence of rating agencies is limited.[1] Kish et al. (1999) investigate the impact of credit ratings on bond yields. Comparing 1607 US industrial bonds rated by Moody's to the same bonds rated by S&P over the period 1986–1996, Kish et al. (1999) find no evidence that Moody's ratings deliver stronger information content than S&P's ratings, or vice versa. Shin and Moore (2003) find that the ratings of US agencies for Japanese corporate bonds are systematically lower than those of local counterparts. They also report that the differences are not due to *keiretsu* affiliation. The systematic

[1] In a study related to ours, Mollemans (2003) compares the stock price reactions of rating changes between Moody's and S&P and Japanese raters (R&I and JCR) and finds significant price reactions following the announcements of rating downgrades only by S&P and JCR, but not by Moody's and R&I. Some of his results are contradictory to ours and other studies (see Fairchild and Shin (2004, 1999) and Wall Street Journal (2002, 2003b)).