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Sovereign credit rating determinants: a comparison before and after the European debt crisis

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Abstract

This paper compares the importance of different sovereign credit rating determinants over time, using a sample of 90 countries for the years 2002-2015. Applying the composite marginal likelihood approach, we estimate a multi-year ordered probit model for each of the three major credit rating agencies. After the start of the European debt crisis in 2009, the importance of the financial balance, the economic development and the external debt increased substantially and the effect of eurozone membership switched from positive to negative. In addition, GDP growth gained a lot of importance for highly indebted sovereigns and government debt became much more important for countries with a low GDP growth rate. These findings provide empirical evidence that the credit rating agencies changed their sovereign credit rating assessment after the start of the European debt crisis.

Keywords: Composite marginal likelihood, Credit rating agencies, European debt crisis, Multi-year ordered probit model, Sovereign credit rating determinants

JEL: C33, C35, F34, G24, H63

1. Introduction

A sovereign credit rating is a measure of the creditworthiness of a sovereign government assigned by a credit rating agency (CRA). Each sovereign credit rating is determined by a rating committee, which assesses the different factors that drive the sovereign's creditworthiness. Rather than computing a fixed weighted average of these factors, CRAs can vary the relative importance of the various factors over time, in response to changing macroeconomic circumstances (Kiff *et al.*, 2010). For instance, Fitch (2014) states they attach more importance to the sovereign public finance ratios and financing

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