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Impact of Wage Rigidity on Sovereign Credit Rating

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Abstract

Sovereign credit rating is a condensed assessment of a country's ability to repay its public debt in a timely fashion. Downward wage rigidity has been considered a critical determinant of various macroeconomic and financial phenomena. This study examines the effect of a country's wage rigidity on its sovereign credit rating by directly measuring downward wage rigidities based on a regime-switching model. The results indicate that greater wage rigidity induces lower credit rating. We find that wage rigidity amplifies cash flow fluctuations and magnified cash flow volatility subsequently negatively affects the sovereign credit rating.

Keywords: wage rigidity, sovereign credit rating, regime switching, cash flow volatility

JEL classifications: E24, J31, G32, M41

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