

THE INFLUENCE OF RATING INDICATORS IN MACROECONOMIC DECISIONS

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Abstract

On the basis of major macroeconomic decisions are the internal indicators calculated by different institutions and also the rating indicators calculated by the foreign rating institutions. Based on these indicators a country has a lower or a greater level of risk for future investments. Not always a higher risk level corresponds to a higher level of income. There are many situations when we have to know the potential risks in order to take a wise decision. In the paper I presented the calculation methodologies of the country rating for the main agencies and I made a comparison between various levels of sovereign ratings for European Union countries.

Keywords: rating methodologies, Fitch, Moody's, Standard & Poors, Coface, risk, decision

Introduction

The sovereign risk is defined by the probability that the government of a country (or an agency backed by the government) will refuse to comply with the terms of a loan agreement during economically difficult or politically volatile times. Although sovereign nations don't "go broke," they can assert their independence in any manner they choose, and cannot be sued without their assent. Sovereign risk was a significant factor during 1970s after the oil shock when Argentina and Mexico almost defaulted on their loans which had to be rescheduled [1].

The big three rating agencies are Fitch, Moody's and Standard & Poors. What they do is assess how likely a borrower is to be able to repay its debts and help those trading debt contracts in the secondary market.

That means for those trading debt contracts such as treasury gilts after they've been issued, ratings agencies help assess a fair price to charge. Ratings agencies have been criticized for having too much clout in jittery markets during the financial crisis. They were widely attacked for failing to warn of the risks posed by certain securities, in particular mortgage-backed securities [2].

Fitch ratings methodology

Fitch Ratings is a global rating agency dedicated to providing value beyond the rating through objective and balanced credit opinions, research and data. Offering a world of knowledge and experience behind every rating, it transforms information to deliver meaning and utility to investors, issuers and other market participants. The additional

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context, perspective and insights it provides help financial professionals make important business decisions [3].

Fitch Solutions offers a range of comprehensive data, analytical tools and risk services, and is the distribution channel for Fitch Ratings content.

In the case of countries with foreign and local currency sovereign ratings significantly below 'AAA', Fitch Ratings may provide National Fund Credit Ratings. Such ratings are based on the same scale as that applicable to national long term credit ratings, which results in the assignment of an 'AAA' long-term credit rating to the lowest default risk relative to all the issuers or issues in the same country [4].

The National Rating scale provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, an 'AAA' Long-Term National Rating will be assigned to the lowest relative risk within that country, which, in most but not all cases, will be the sovereign state.

The National Rating scale merely ranks the degree of perceived risk relative to the lowest default risk in that same country. Like local currency ratings, National Ratings exclude the effects of sovereign and transfer risk and exclude the possibility that investors may be unable to repatriate any due interest and principal repayments. It is not related to the rating scale of any other national market. Other levels of risk are presented in table 1.

AAA	Denote the highest rating and it is assigned to issuers or obligations with the lowest expectation of default risk relative to all other issuers or obligations in the same country.
AA	Denote expectations of very low default risk relative to other issuers or obligations in the same country. The default risk inherent differs only slightly from that of the country's highest rated issuers or obligations.
A	Denote expectations of low default risk relative to other issuers or obligations in the same country. Changes in circumstances or economic conditions may affect the capacity for timely repayment to a greater degree than is the case for financial commitments denoted by a higher rated category.
BBB	Denote a moderate default risk relative to other issuers or obligations in the same country.
BB	Denote an elevated default risk relative to other issuers or obligations in the same country. Within the context of the country, payment is uncertain to some degree and capacity for timely repayment remains more vulnerable to adverse economic change over time.
B	Denote a significantly elevated default risk relative to other issuers or obligations in the same country. Financial commitments are currently being met but a limited margin of safety remains and capacity for continued timely payments is contingent upon a sustained, favorable business and economic environment.
C	Risk is imminent

RD	Indicate an issuer that in Fitch Ratings' opinion has experienced an uncured payment default on a bond, liquidation or other formal winding-up procedure, and which has not otherwise ceased business. This would include: the selective payment default on a specific class or currency of debt; the uncured expiry of any applicable grace period, cure period or default forbearance period following a payment default on a bank loan, capital markets security or other material financial obligation; the extension of multiple waivers or forbearance periods upon a payment default on one or more material financial obligations, either in series or in parallel; or execution of a coercive debt exchange on one or more material financial obligations.
D	Denote an issuer or instrument that is currently in default

Table 1. The risk levels established by Fitch agency

Moody's rating methodology

The system of rating securities was originated by John Moody in 1909. The purpose of Moody's ratings is to provide investors with a simple system of gradation by which relative creditworthiness of securities may be noted.

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country [6]. National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings.

Gradations of creditworthiness are indicated by rating symbols, with each symbol representing a group in which the credit characteristics are broadly the same. There are nine symbols from that used to designate least credit risk to that denoting greatest credit risk: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C [5] (Table 2).

Aaa	Issuers or issues rated Aaa.n demonstrate the strongest creditworthiness relative to other domestic issuers.
Aa	Issuers or issues rated Aa.n demonstrate very strong creditworthiness relative to other domestic issuers.
A	Issuers or issues rated A.n present above-average creditworthiness relative to other domestic issuers.
Baa	Issuers or issues rated Baa.n represent average creditworthiness relative to other domestic issuers.
Ba	Issuers or issues rated Ba.n demonstrate below-average creditworthiness relative to other domestic issuers.
B	Issuers or issues rated B.n demonstrate weak creditworthiness relative to other domestic issuers.

Caa	Issuers or issues rated Caa.n are speculative and demonstrate very weak creditworthiness relative to other domestic issuers.
Ca	Issuers or issues rated Ca.n are highly speculative and demonstrate extremely weak creditworthiness relative to other domestic issuers.
C	Issuers or issues rated C.n are extremely speculative and demonstrate the weakest creditworthiness relative to other domestic issuers.

Table 2. National Scale Long-Term Ratings [6]

Standard & Poors rating methodology

Standard & Poor's traces its history back to 1860, with the publication by Henry Varnum Poor of History of Railroads and Canals in the United States. This book was an attempt to compile comprehensive information about the financial and operational state of U.S. railroad companies. Henry Varnum went on to establish H.V. and H.W. Poor Co with his son, Henry William, and published updated versions of this book on an annual basis.

In 1906 Luther Lee Blake founded the Standard Statistics Bureau, with the view to providing financial information on non-railroad companies. Instead of an annually published book Standard Statistics would use 5" x 7" cards, allowing for more frequent updates.

In 1941, Poor and Standard Statistics merged to become Standard & Poor's Corp. Then in 1966 S&P was acquired by The McGraw-Hill Companies, and now encompasses the Financial Services division [7].

S&P rates borrowers on a scale from AAA to D. Intermediate ratings are offered at each level between AA and CCC (e.g., BBB+, BBB and BBB-). For some borrowers, S&P may also offer guidance (termed a "credit watch") as to whether it is likely to be upgraded (positive), downgraded (negative) or uncertain (neutral).

Investment Grades are [8]:

AAA: the best quality borrowers, reliable and stable

AA: quality borrowers, a bit higher risk than AAA. Includes:

AA+: equivalent to Moody's and Fitch Aa1

AA: equivalent to Aa2

AA-: equivalent to Aa3

A: quality borrowers whose financial stability could be affected by certain economic situations

A+: equivalent to A1

A: equivalent to A2

BBB: medium class borrowers, which are satisfactory at the moment

The Coface rating methodology

The country rating assigned by Coface [10] reflects the average level of short-term non-payment risk associated with companies in a particular country. It reflects the extent to which a country's economic, financial, and political outlook influences financial commitments of local companies. However, international trade actors know that sound

companies can operate in risky countries and unsound companies in less-risky countries and that overall risk will depend not only on a company's qualities but also on those of the country in which it operates. In assessing overall risk associated with a particular operation, Country ratings are thus complementary to rating Credit Opinions on companies.

Ratings are based on threefold expertise developed by Coface (figure 1):

- macroeconomic expertise in assessing country risk based on a battery of macroeconomic financial and political indicators
- the business environment expertise. The score is based on internal and external sources
- microeconomic expertise that draws on Coface databases covering 50 million companies worldwide and 50 years experience with payment in trade flows it guarantees.

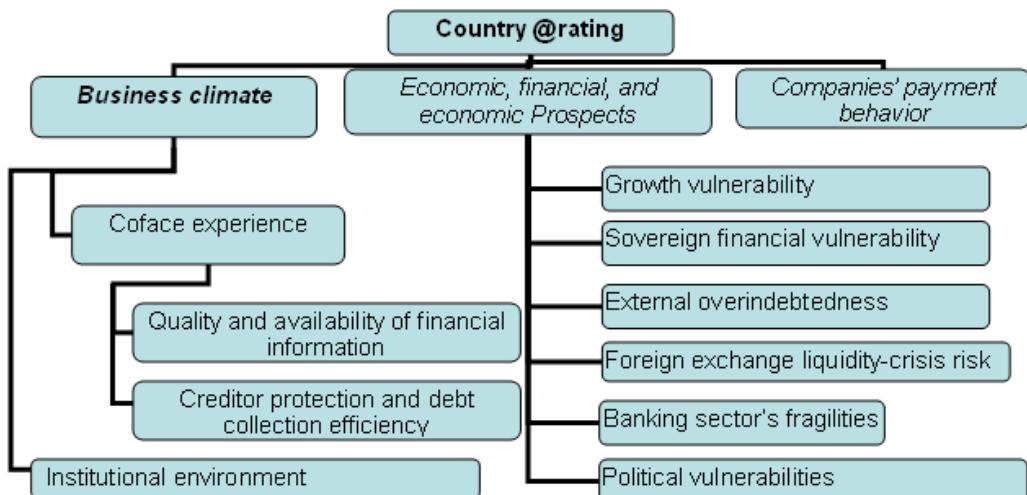


Figure 1. Calculation of the country rating

A1	The political and economic situation is very good. A quality business environment has a positive influence on corporate payment behavior. Corporate default probability is very low on average.
A2	The political and economic situation is good. A basically stable and efficient business environment nonetheless leaves room for improvement. Corporate default probability is low on average.
A3	Changes in generally good but somewhat volatile political and economic environment can affect corporate payment behavior. A basically secure business environment can nonetheless give rise to occasional difficulties for companies. Corporate default probability is quite acceptable on average.
A4	A somewhat shaky political and economic outlook and a relatively volatile business environment can affect corporate payment behavior. Corporate default probability is still acceptable on average.
B	Political and economic uncertainties and an occasionally difficult business environment can affect corporate payment behavior. Corporate default probability is appreciable.

C	A very uncertain political and economic outlook and a business environment with many troublesome weaknesses can have a significant impact on corporate payment behavior. Corporate default probability is high.
D	A high-risk political and economic situation and an often very difficult business environment can have a very significant impact on corporate payment behavior. Corporate default probability is very high.

Table 3. The levels of risk and their qualifications

Comparison between the sovereign ratings given by each agency for European countries

Every rating agency gives a qualify to the level of risk for every country, as it is shown in table 4.

Country	MOODYS RATING	MOODYS OUTLOOK	Fitch RATING	FITCH OUTLOOK	S and P RATING	S and P OUTLOOK
Austria	Aaa	STABLE	AAA	STABLE	AAA	STABLE
Belgium	Aa1	STABLE	AA+	STABLE	AA+	NEGATIVE
Bulgaria	Baa3	POSITIVE	BBB-	NEGATIVE	BBB	STABLE
Cyprus	A2	STABLE	AA-	NEGATIVE/WATCH	A	NEGATIVE
Czech Republic	A1	STABLE	A+	POSITIVE	A	POSITIVE
Denmark	Aaa	STABLE	AAA	STABLE	AAA	STABLE
Estonia	A1	STABLE	A	STABLE	A	STABLE
Finland	Aaa	STABLE	AAA	STABLE	AAA	STABLE
France	Aaa	STABLE	AAA	STABLE	AAA	STABLE
Germany	Aaa	STABLE	AAA	STABLE	AAA	STABLE
Greece	B1	NEGATIVE	BB+	NEGATIVE	BB+	NEGATIVE
Hungary	Baa3	NEGATIVE	BBB-	NEGATIVE	BBB-	NEGATIVE
Ireland	Baa3	NEGATIVE	BBB+	STABLE	A-	NEGATIVE
Italy	Aa2	STABLE	AA-	STABLE	A+	STABLE
Latvia (Republic of)	Baa3	STABLE	BBB-	POSITIVE	BB+	STABLE
Lithuania	Baa1	STABLE	BBB	STABLE	BBB	STABLE
Luxembourg	Aaa	STABLE	AAA	STABLE	AAA	STABLE
Malta	A1	STABLE	A+	STABLE	A	STABLE
Netherlands	Aaa	STABLE	AAA	STABLE	AAA	STABLE
Poland	A2	STABLE	A-	STABLE	A-	STABLE
Portugal	A1	RUR-	A-	NEGATIVE/WATCH	A-	NEGATIVE
Romania	Baa3	STABLE	BB+	STABLE	BB+	STABLE
Slovak Republic	A1	STABLE	A+	STABLE	A+	STABLE
Slovenia	Aa2	STABLE	AA	STABLE	AA	NEGATIVE
Spain	Aa1	RUR-	AA+	NEGATIVE	AA	NEGATIVE
Sweden	Aaa	STABLE	AAA	STABLE	AAA	STABLE
United Kingdom	Aaa	STABLE	AAA	STABLE	AAA	NEGATIVE

Table 4 The values of sovereign risk indicator for European Union Countries in 2010 [9]

It is observed that for a certain country the results of the three rating companies are different. For example, Bulgaria has the outlook of Moody's company positive, of Fitch negative and Standard and Poor it is stable. That it is possible because the three companies have different of calculation methodologies. For Romania, from the three agencies point of view, the outlook is stable.

Conclusion

Country risk is the probability of losses from the international activities, due of economic, social and political events for every country. Country risk includes two components which are interrelated: political component resulting from measures taken by local or central public authorities of a country or through the manifestation of some causes such as riots, strikes, wars, embargoes; and economic and financial component resulting from the exaggerated inflation, lack of foreign reserves and not the last phase inability of payment.

Rating agencies are the main but also the most objective source of information for investors and governments. The credibility of agencies is related with the quality of given information on the clients (investors and borrowers). The information contained in the note given to a country help investors to guide in an unknown environment - especially the external- offering an image closer to reality of the potential risk on which they assume it.

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