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The Information Effect of Sovereign Credit Ratings

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A B S T R A C T

This paper examines the quality of sovereign credit ratings of the Big Three rating agencies, including S&P, Moody's and Fitch and checks whether the information effect of sovereign credit ratings has improved after ESMA's regulatory reforms and increased competition. When considering the whole sample, the results show sovereign ratings of Big Three rating agencies can explain default probability and default amounts and bond yield spreads. However, the information effect of sovereign ratings of Big Three rating agencies does not change after regulatory reforms and increased competition from non-Big Three rating agencies. Second, when considering high-income countries sample, part of the results shows the information effect of sovereign ratings of Big Three rating agencies worsens after regulatory reforms and when facing the competition from non-Big Three rating agencies. Third, there is no significant information effect in middle-income countries. Our results echo some recent reports from the European Union, which found that the quality of credit ratings has not significantly improved following various reform measures and increased competition among credit rating agencies (ESMA, 2021; Karimov et al., 2024).

Keywords: sovereign credit rating; regulatory reform; competition; information effect

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