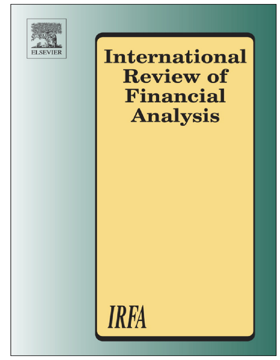

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New Evidence on Sovereign to Corporate Credit Rating Spill-overs

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Abstract

We explore what happens to domestic firm-level ratings around the time of a sovereign-rating action on a day-by-day and country-by-country basis. Our granular approach provides banks and investors with a fuller picture of their sovereign credit risk exposure and, as such, our analysis might feed into banks' internal modelling of their credit risk exposure for the purpose of determining regulatory capital, introduced under Basel II. We also provide a novel analysis of any bias in spill-over and we show that, inter alia, the tendency for greater spill-over of negative sovereign-rating actions can largely be accounted for by firm- and sovereign-level factors. However, even after allowing for these factors, some countries suffer from negative bias. The implied higher correlation between sovereign and firm-level ratings in times when countries are in crisis versus when they are in recovery may contribute to quicker and/or deeper crises versus slower and/or longer recoveries.

JEL classification: G15, G24

Keywords: Credit risk, sovereign ratings, firm ratings, rating spill-over effects.

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