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Subjectivity in sovereign credit ratings

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Abstract

A sovereign credit rating is a function of hard and soft information that should reflect the creditworthiness and the probability of default of a country. We propose an alternative characterisation for the subjective component of a sovereign credit rating — the parts related to the ratee's lobbying effort or its familiarity from a United States point of view — and apply it to S&P, Moody's and Fitch ratings, using both traditional ordered-logit panel models and machine learning techniques. This subjective component turns out to be large, especially for the low-rated countries. Countries that are rated as investment grade tend to be positively influenced by it, and *vice versa*. Subjective judgment in credit ratings does have predictive value: it helps in identifying chances of sovereign defaults in the short-term. Still, the impact of subjectivity in sovereign ratings on borrowing costs is very limited on average.

JEL Classification: G24, G15, O16
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