ANALYSIS OF WEAKNESSES IN EVALUATION METHODOLOGY OF SOVEREIGN CREDIT RATING AGENCIES.

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Key words

Credit rating, financial market, S&P, Moody's, Fitch Ratings, GDP, global financial crisis, finance.

Abstract

The purpose of this article is "One of the goals set by our President Sh.M. Mirziyoyev in the 2030 strategy of the new Uzbekistan" is the issues that are an obstacle to the transfer of the sovereign credit rating from BB to BBB and the neighboring the path of the countries in this regard and the evaluation criteria of the rating agencies, which are at the top of the world rating agencies, are discussed.

Introdustion

As the world economy has become more integrated, sovereign credit ratings have become one of the most important elements determining the direction of global capital flows. The influence of credit rating agencies on both national and global economies has increased. On the other hand, credit rating agencies have been heavily criticized for their failure to predict and assess the global financial crises of the 1990s and the 2008 financial crisis in a timely manner.

Credit rating agencies, which have been operating in the financial markets for more than 100 years, have been criticized for shortcomings in their rating assessment methodology. The global financial crisis that occurred in 2008 led to an increase in these criticisms. Although it was clear that the bonds of companies and countries with high credit ratings were high-risk, the reliability of the ratings that credit rating agencies assigned to them with high ratings was questioned. These criticisms can be summarized as follows;

- The assessment method of credit rating agencies is not perfect enough;
- Lack of competition in the credit rating market;
- Conflict of interest due to the revenue model of credit rating agencies;
- Credit rating agencies' inability to foresee the crisis and their overly negative assessment of the current situation:

Analysis of literature on the topic.

Rating agencies take many factors into account when assigning a country's sovereign credit rating. The reports published by credit rating agencies cite many economic, political, and social factors as the basis for their sovereign credit ratings. In 2015, Fatih Bahadir Haspolat published an article in the journal Procedia Economics and Finance titled "Analyzing Moody's Sovereign Credit Ratings: Are Criticisms Against Rating Agencies Now Losing Their Force?" [1] In his article, Analysis of Moody's Sovereign Credit Ratings: Criticisms Towards Rating Agencies Are Still Valid?, he draws on previous research and Moody's rating methodology, using thirteen economic and five corporate governance indicators and three models to predict sovereign credit ratings, to identify which factors have the greatest influence on ratings and to point out shortcomings in the rating methodology. [2] European scholars Periklis Boumparis, Costas Milas, Theodore Panagiotidis, Cecilia Téllez Valle, José Luis Martín Marín, Michael Kisser, and Turkish scholar Fatih Bahadir Haspolat have stated that the most effective way to improve a sovereign credit rating is to reform the tax system. [3]. Economists from the University of Arizona in America, João C.A. Teixeira, Francisco J.F. Silva, Manuel B.S. Ferreira, and José A.C. Vieira, argue that sovereign ratings play a key role in boosting a country's economy. [4]. In addition, Indian scientists such as Masood O, Bashir F and Sahi AI have extensively researched sovereign ratings and their evaluation methodology in their scientific works and articles. [5].

Methods used in conducting the research

In order to achieve the goals set in the research, the methods of logical and structural analysis, grouping, economic and statistical analysis, and mutual and comparative comparison were effectively used.

Analysis

As a result of analyzing the data of Moody's rating agency methodology; average GDP per capita, quality of governance, balance of payments, macroeconomic growth indicators and growth forecasts, industrialization of the country and possession of reserve currency were identified as factors that positively affect the sovereign credit rating. On the other hand; exchange rate volatility, interest payments, debt volumes and loan origination are factors that negatively affect the credit rating.

The results of the analysis have criticized credit rating agencies for their failure to predict economic crises and for their sharply negative assessment of current crises. Analyzing the history of Greece's ratings, one can understand why credit rating agencies are criticized. Analyzing the economic and social data of Greece and many other countries, it is observed that Moody's does not always give ratings according to the rating guidelines. The ratings do not reflect the real economic and social situation of the countries. Given that Moody's ratings and rating criteria are similar to those of other large credit rating agencies such as S&P and Fitch Ratings, the assessment methodologies of credit rating agencies are close to each other.

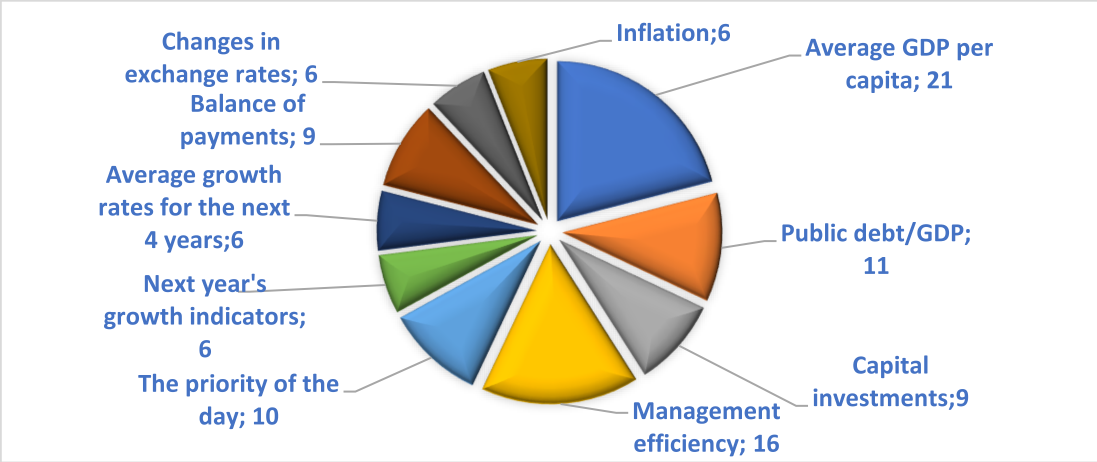

Diagram 1. The main factors influencing the rating assessment in Moody's rating methodology, in percent [6]

Although the indicators used by rating agencies such as S&P, Moody’s and Fitch in their sovereign credit rating methodologies are based on realistic statistical and other analyses, country ratings, in our opinion, are relative indicators. Because during the global financial crisis of 2008, countries such as Greece, Italy and Spain, which had high ratings, fell into a deep financial crisis and were unable to fulfill their financial obligations. For example, in 2007, Moody’s rated Greece at “A1” negative, in 2011 it was “Ca” negative, and in 2012 it was “C” negative. If we look at the rating scales presented in Table 1, “A1” is an investment grade upper middle class scale, and “C” is a rating scale that indicates a default situation. The fact that a country rated investment grade in 2007 declared itself in default in 2012 undermines confidence in the rating agencies' assessment methodology.

As a logical continuation of our idea, we will analyze the ratings of 5 voluntary countries that have been rated almost equally by the rating agencies S&P, Fitch, and Moody's since 2021.

Table 1

Optional 5 country rankings with almost the same level of rating [3]

T/r	Italy	Kazakhstan	Russia	India	Portugal
S&P	BBB (stable)	BBB- (stable)	BBB (stable)	BBB- (stable)	BBB- (stable)
Moody’s	Baa3 (stable	Baa3 (stable)	Baa3 (stable)	Baa3 (stable)	Baa3 (stable)
Fitch	BBB (stable)	BBB (stable)	BBB (stable)	BBB- (stable)	BBB (stable)

In this table, 5 countries with similar ratings were selected: Italy, Kazakhstan, Russia, India and Portugal. The three rating agencies listed above have given almost the same rating to these countries. From Table 1, we can see that the BBB rating scale is an investment grade rating scale. In Table 2, we compare some macroeconomic indicators of these countries.

Table 2

Some macroeconomic indicators of Italy, Kazakhstan, Russia, India and Portugal [7,8,9,10,11]

T/r	Indicators	Italy	Kazakhstan	Russia	India	Portugal
1	**Average GDP per capita (thousands of $)**	33 228,24	9 812,39	11 513.3	2 099.6	23 252,06
2	**Average annual GDP growth**	0.3	4.1	1.3	6.1	1.7
3	**Consumer Price Index Growth**	0.6	5.6	4.5	3.4	1.1
4	**Public debt / GDP**	124.6	91.2	29.1	69.1	118.8
5	**Balance of Payments / GDP**	3.3	-2.8	3.8	-2.1	-0.6
6	**Fiscal balance / GDP**	-3	-0.2	1.9	-3.3	-3.7
7	**GDP ($ billion)**	2 004	176.6	1 689	2 935.6	238.8
8	**Population (million)**	60,36	18.5	146.7	1 330.1	60.36

We discussed in detail in the first chapter of our scientific work that the average GDP per capita is the indicator that has the greatest impact on the evaluation of ratings. Because the higher this indicator, the greater the state tax revenues. In Italy, this indicator is the highest among our selected countries at $ 33,228.24, while in India it is the lowest at $ 2,099.6. The difference between them is almost 16 times. However, the average annual GDP growth rate is the highest in India at 6.1%, while in Italy it is the lowest at 0.3%. At the same time, the consumer price index, which reflects inflationary processes in the country, was 5.6% in Kazakhstan, while in Italy it was 0.6%. This is a very good indicator. Among the countries of the eurozone, Italy has one of the largest public debt. In 2019, Italy's public debt was $2.457 trillion, or 124.6% of GDP. Among the countries in the table, we can see that Russia's public debt was 29.1% of GDP. Considering that international financial organizations consider it normal for public debt to be 50% of GDP, this is a very good indicator.

Table 2. The ratio of the balance of payments to GDP, the ratio of the fiscal balance to GDP, the size of the GDP of the countries, and the population size are also presented, although they are not considered as one of the main indicators in the assessment of sovereign credit rating agencies' ratings. Because the large population is a key indicator indicating the size of the potential labor force and the size of the market.

Conclusion and suggestions on the article.

In conclusion, the following can be stated. Credit ratings affect the market in three ways:

- "information services", according to which, regardless of the initial level of the rating, there is a significant market reaction to rating actions (rating changes or credit terms);

- changes in the investment grade threshold, either upwards or downwards, affect the volume of debt funds attracted from financial markets and their interest rates.

- changes in sovereign debt affect domestic interest rates;

- sovereign rating dynamics are less developed compared to government bond dynamics, which exacerbates the cycle (decline or rise) in the debt markets of developing countries.

The formation of independent rating agencies in the Republic of Uzbekistan, the ability of existing rating agencies (for example, Axbor Rating) to independently calculate, publish sovereign ratings and carry out monitoring, will allow the development of the rating market, improve relations with external agencies, and take measures to determine and strengthen ratings in advance. The following requirements can be imposed on the activities of these agencies: the agency cannot be based on principles that may lead to a conflict of interest, conduct constant research to improve the quality of the existing methodology, and ensure transparency of its activities.

The following rules can be proposed:

- prohibit the provision of consulting services;
- not issue ratings when there is insufficient information to make a decision;
- maintain and publish the rating model and methodology, as well as its history;
- differentiate rating products based on the level of complexity;
- provide an annual report;
- prevent employee remuneration from being tied to performance.

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