Sovereign Credit Ratings and their Role in Development Financing

To what extent do credit ratings influence sovereign bond investor decision-making?

Why might similarly rated countries be priced differently in the international capital markets?

What can countries do to reduce their cost of borrowing on the margin despite assigned credit ratings?

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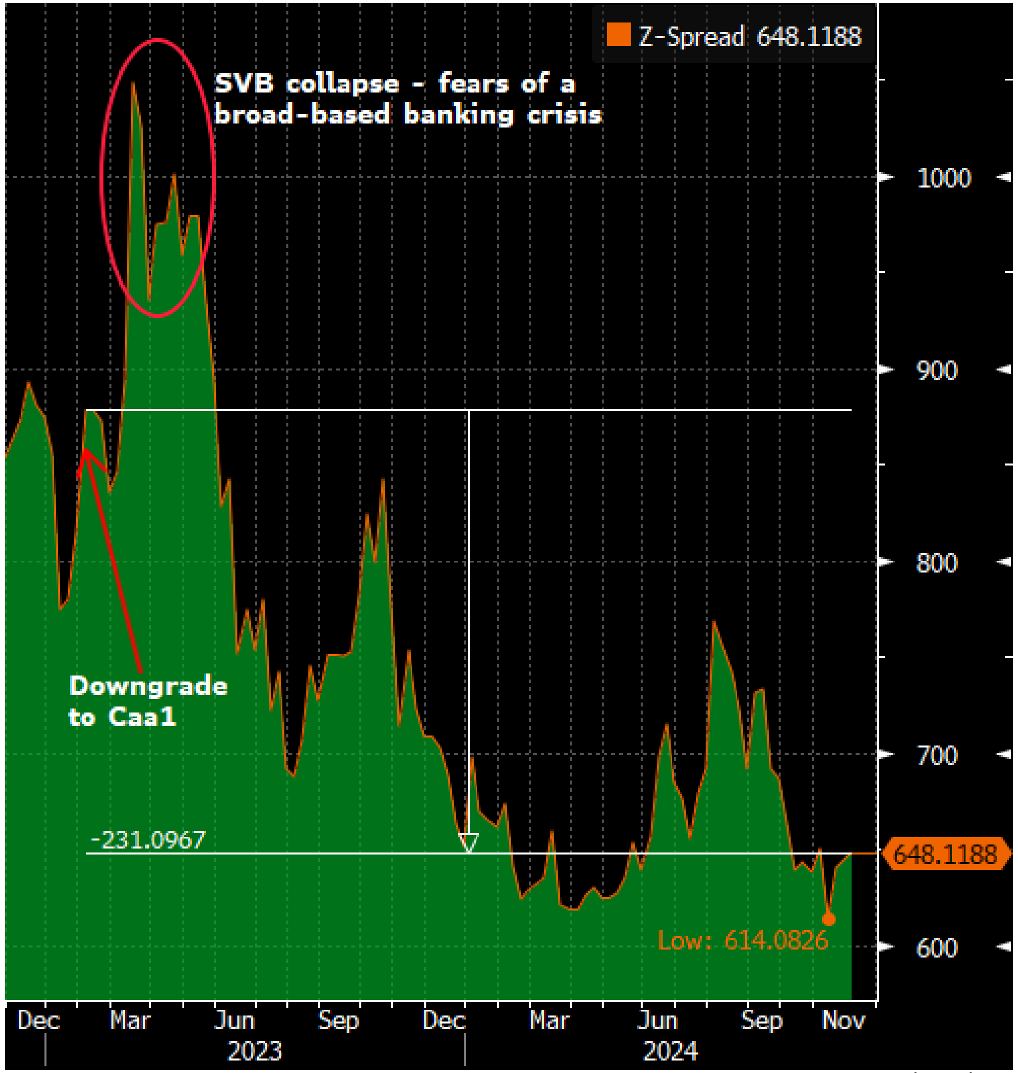
To what extent do credit ratings influence investment decisions?

- Influence of a credit rating on an investment decision tends to be overstated.
- Many investment teams conduct their own research.
- Credit ratings provide a rough signaling of credit quality, but do not necessarily determine whether a bond is a good or bad investment.
- Investment decisions more often driven by:
  - View that markets are not appropriately pricing-in the risk profile of a country
  - Macroeconomic/political outlook
- Credit rating actions may lag the market's repricing of risk.

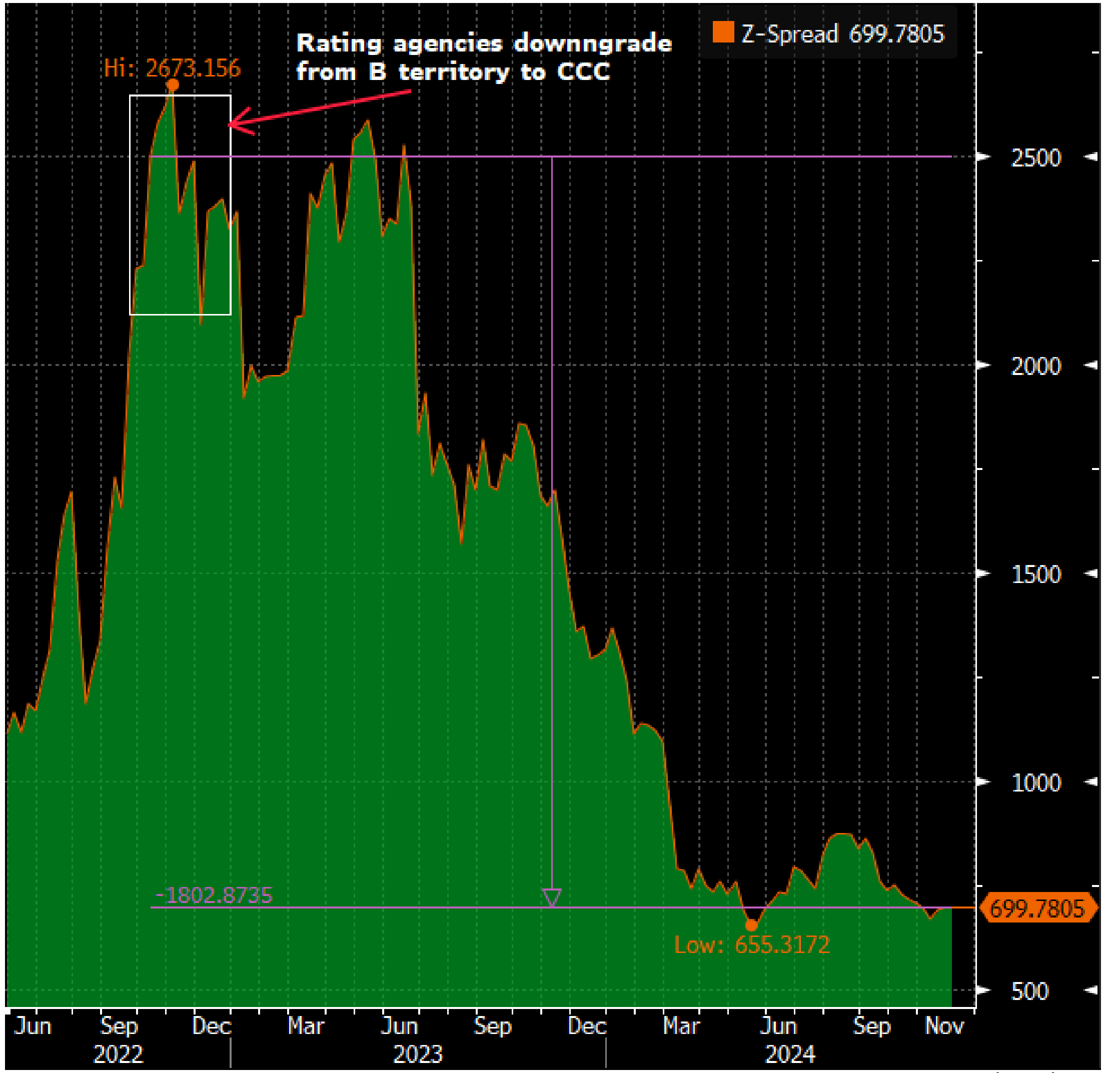
Credit rating actions can lag the market's repricing of sovereign risk

<u>NIGERIA 2038 bond</u>: Spreads have declined 230bps since downgrade to CCC-territory in Q1 2023.



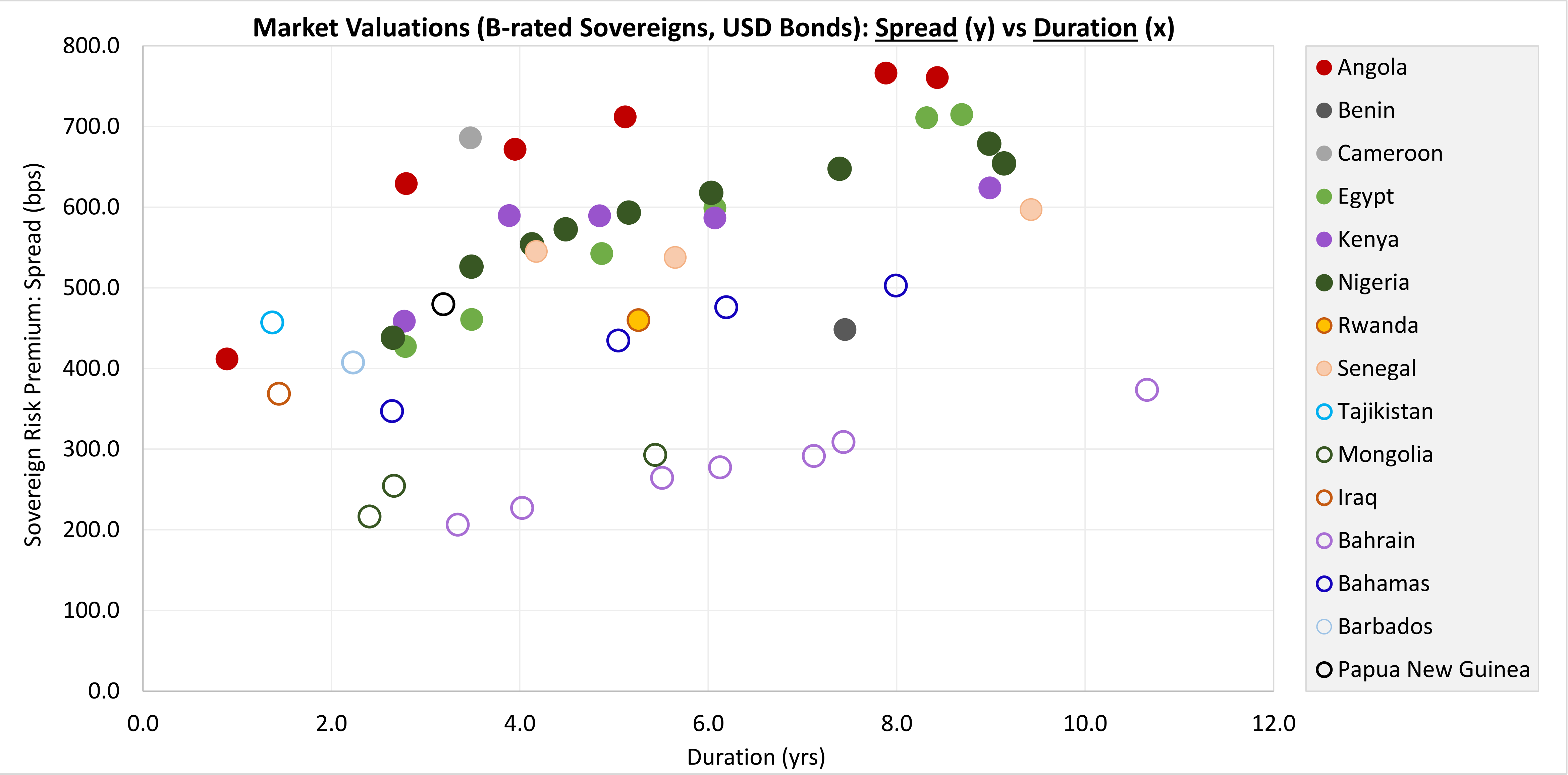
Source: Bloomberg

<u>PAKISTAN 2031 bond</u>: Spreads have declined 1,800bps since downgrade into CCC-territory in Q4 2022.



Source: Bloomberg

Why similarly-rated sovereigns may be priced differently? Varying risk perception across B-rated issuers



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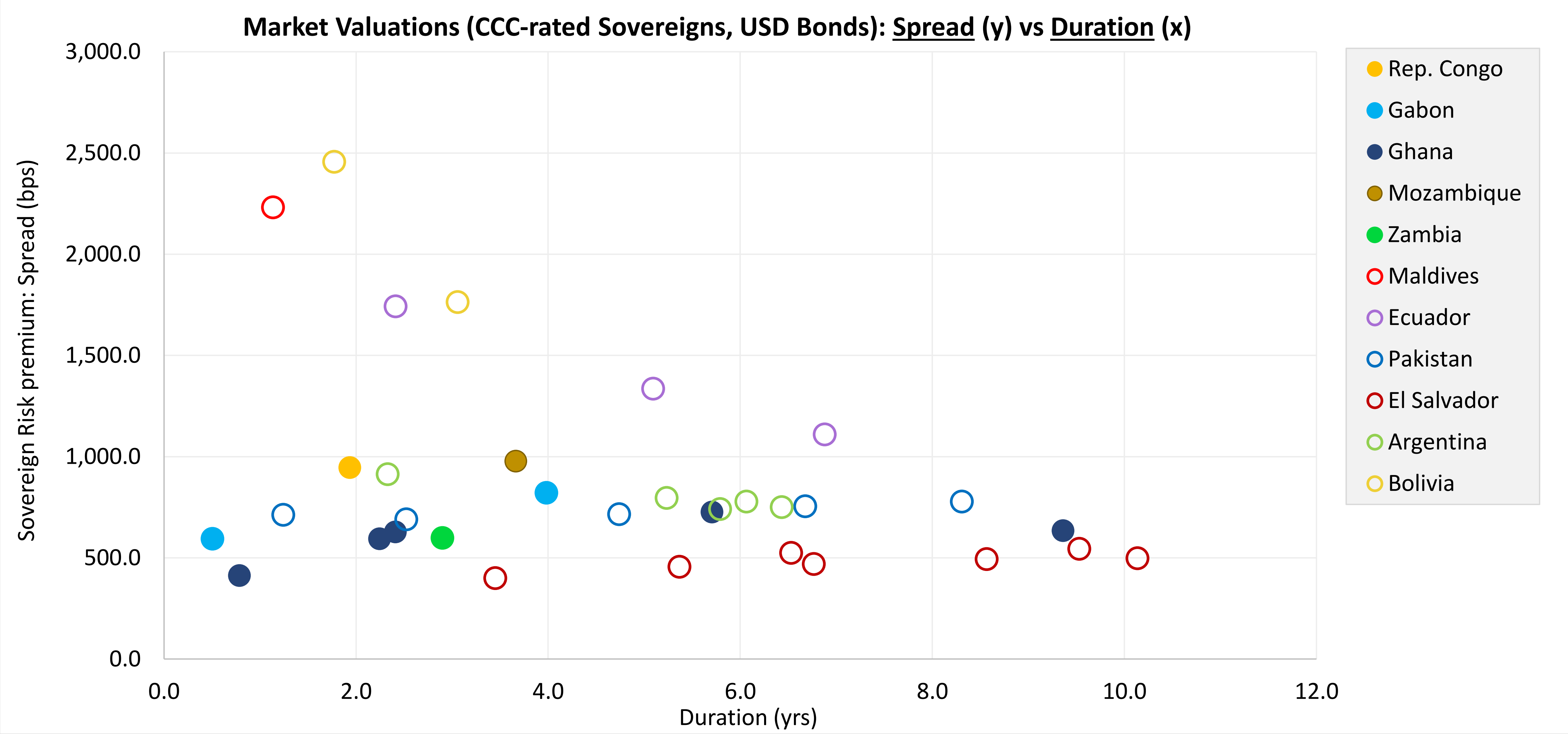

Source: Bloomberg

How can sovereigns lower their cost of borrowing?

- No substitute for a coherent macroeconomic framework.
- Strategy to improve external/fiscal buffers.
- Improve transparency (data availability) – investor relations unit.
- Investor engagement