COLLEGE OF EUROPE
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RATING AGENCIES AND EUROZONE SOVEREIGN BONDS VOLATILITY:

Analysis and policy implications of the role of the sovereign rating assessments.

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ABSTRACT

In recent years, rating agencies have been very active in the issuance of sovereign rating assessments. In fact, there has been a very intense debate within the European Union about the role that rating agencies have played in the eurozone sovereign debt crisis. This has actually been one of our main motivations to pursue further research in this area.

Indeed, we wondered whether or not rating announcements can be drivers of market instability and in what circumstances this phenomenon may happen. In our study we have intended to measure the impact that Standard and Poor´s rating sovereign assessments have had on debt spreads volatility during last years. The study of volatility of sovereign spreads is important form a financial and macroeconomic point of view.

First, the high volatility that some eurozone sovereigns are experiencing question the consideration of the government bonds as a risk free asset and secondly high instability in the sovereign debt market may jeopardize austerity programs that have been put into place by some member states such as Portugal, Greece, Italy and Spain since it poses more difficulties to roll over their debt. For this purpose we have performed an event study for which we have used daily bond yields of eleven eurozone countries.

Our investigation suggests that Standard and Poor´s rating news may have some influence on spreads volatility. Negative news tend to trigger an excessive volatility in the sovereign market whereas positive news do not have a significant market impact and tend to reduce instability.

Additionally, we have evaluated some policy implications that our findings may entail for future policy developments in the European Union.