The Effects of Change in Credit Rating to the Returns of Banking Industry of Different Emerging Countries

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Abstract: While sovereign credit rating upgrades affect the whole economy, one of the first sectors affected is the banking sector. Typically, sovereign credit rating upgrades would bring about optimism that would improve investments in the economy. Since banks serve as the forerunner of this whole development, it is expected that they would achieve abnormal returns. This study aims to test the immediate significant effect of sovereign credit rating upgrades on the banking sector listed in the stock market and to see whether these upgrades could be used to accurately measure the performance of this sector. To have a more accurate gauge on its short-term effect, only the top bank stock prices of Philippines, Indonesia, Turkey and Mexico were used to represent the banking sector of each country across the time period of 60 days before and 60 days after the credit rating upgrades. A regression analysis of the dataset, comprised of daily movements of the cumulative abnormal return, percent change of stock prices, volume of trades, policy rate, exchange rates and the sovereign credit rating upgrade dummy variable, were used. The study showed that the exchange rate was the only significant variable proven in having a cumulative abnormal return. But the result was contrary to a-priori expectations; the exchange rate of these emerging economies did not appreciate much after the credit rating upgrade. However, it was proven that the domestic currency of these emerging economies if pegged to US dollar had been depreciating at a much slower rate after the upgrade. As for their stock prices, it turned out that though it had increased during the first few days after the upgrade, it was not sustained in the 60 day period. Thus, it relatively turned out that it was not able to affect the stock prices in the given time period.

Key Words: sovereign credit rating; banking; emerging countries; abnormal return; stock price