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Worse ratings by U.S. rating agencies for European sovereigns no argument for European rating agency

A new study by the Halle Institute for Economic Research (IWH) – Member of the Leibniz Association shows that the major U.S. rating agencies rated European sovereigns significantly worse than Fitch, which is more "Europe oriented". Although the findings in part support the claim of some European politicians during the recent debt crisis that there was an "anti-Europe" bias of the U.S. agencies, the study shows that a new European agency would not address this problem. The reason: Market participants would not listen to the new agency.

Moody's, Standard & Poor's (S&P) and Fitch Ratings (Fitch) are the so called "Big Three", controlling 95% of the credit rating market worldwide. During the sovereign debt crisis between 2010 and 2012, the agencies received a lot of public attention when they downgraded several Eurozone member states. Policy makers, especially the European Leaders, started criticising their dominant position. The former president of the European Commission Jose Manuel Barroso claimed in July 2011, following the downgrading of Portugal, that Moody's, S&P and Fitch were anti-Europe biased and fueled the speculations against the Eurozone member states. In December 2011, S&P announced to consider downgrading 15 of 17 Eurozone countries which provoked additional public outrage. Besides the general dominance of the US-based rating agencies and the conjectured discrimination, European politicians particularly criticised the timing of the announcement as it put additional pressure on EU leaders to come up with a convincing strategy to consolidate fiscal balances. As a response, politicians floated the idea of launching a globally active European rating agency to challenge the Anglo-Saxon dominance.

A new IWH study establishes that there is indeed a difference between the U.S. ratings and Fitch, which is presumed to be more "Europe-oriented": Fitch assigned on average more favourable ratings than his peers. "Fitch rated Eurozone crisis countries on average between 0.25 and 0.59 rating notches more favourable than Moody's and S&P" says Andre Güttler, one of the authors of the study. "This fact may be explained by Fitch's stronger ties to Europe. It is dual headquartered in New York and London which connects the agency geographically to the continent. Moody's as well as S&P's head offices are in contrast located exclusively in New York. In addition, Fitch is owned by the French Firmalac group and is hence the only player that was not solely owned by US entities." Previous studies indicated that geographical and cultural distance can affect financial decisions. The study leaves open, however, whether Fitch's ratings were "too positive" or the ratings of the two other U.S. agencies "too negative". Further, the

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authors analyse how investors reacted to the more favourable Fitch ratings and found that Fitch's ratings had no significant impact on investor's behaviour. Investors rather followed the rating actions of Moody's and S&P. "Our results thus doubt the often proposed need for an independent European credit rating agency since it is likely that it would not influence investors' behaviour", IWH President Reint E. Gropp concludes. "Fitch speaks out more positively to the Eurozone countries but this did not change the investor's perception of the creditworthiness of the member states."

One might counter that Fitch's significant lower market share of 17% compared to S&P (40%) and Moody's (35%) could lead to the lower impact. "But a European rating agency would find itself in a "new kid on the block" position in the market", Gropp says. "The likelihood that a new agency would significantly affect the perception of the Eurozone countries by market participants seems very low."

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