Abstract

This paper looks into the contagion dynamics of sovereign credit rating changes with regards to bond yields in the period before and during the sovereign debt crisis in Europe. Our sample included European Union member countries, as well as a Eurozone subsample and a subsample excluding highly indebted countries. Events and outlooks from all three major rating agencies were considered. Our findings for the pre-crisis period are consistent with existing research, indicating an increase in borrowing costs by approximately five basis points in the case of a one-notch negative event, and insignificant effects in the case of positive events. During the crisis period, we observed a reversal of this effect, associating negative ratings with lower spreads on the entire sample. However, the effect was no longer significant when highly indebted countries were excluded from the sample, indicating that this effect may be tied to overly negative expectations. Lastly, we investigated the persistence of results, with only full-sample crisis period data displaying persistent effects.

JEL Classification	F01, F34, F42
Keywords	credit rating, sovereign debt, default, debt crisis, European debt, sustainability

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