3. Ratings Agency

Prelims Syllabus: Economy

Mains Syllabus: GS-III Economy

Why in News?

- Finance Secretary has accused rating agencies of "Double Standards" when assessing Emerging Markets and Developing Economies.

What is the News?

- Fitch, a rating agency, has termed India as the most indebted emerging market.
- It claimed that the latest budget did not provide clarity on fiscal consolidation plans.

What is a Rating Agency?

- Rating agencies assess the creditworthiness or potential of an equity, debt or country.
- Their reports are read by investors to make an informed decision on whether or not to invest in a particular country or companies in that geography.
- They assess if a country, equity or debt is financially stable and whether it at a low/high default risk.
- In simpler terms, these reports help investors gauge if they would get a return on their Investment.

What do they do?

- The agencies periodically re-evaluate Previously assigned ratings after new developments Geopolitical Events or a significant Economic Announcement by the concerned entity.
- Their reports are sold and published in Financial and Daily Newspapers.

What Grading Pattern do they follow?

- The three prominent ratings agencies, viz., Standard & Poor's, Moody's and Fitch subscribe to largely similar grading patterns.
- Standard & Poor's accord their highest grade, that is, AAA, to countries, equity or debt with the Exceedingly high capacity to meet their financial commitments.
- Its grading slab includes letters A, B and C with an addition a single or double letter denoting a higher grade.
- Moody's separates ratings into short and long-term definitions. Its longer-term grading ranges from Aaa to C, with Aaa being the highest.

- Fitch, too, rates from AAA to D, with D being the lowest. It follows the same succession scheme as Moody's and Fitch.

Criticism of Rating Agencies

- Popular ratings agencies publicly reveal their methodology, which is based on macroeconomic data publicly made available by a country, to lend credibility to their inferences.
- However, credit rating agencies were subjected to severe criticism for allegedly spurring the financial crisis in the United States, which began in 2017.
- The agencies underestimated the credit risk associated with structured credit products and failed to adjust their ratings quickly enough to deteriorating market conditions.
- They were charged for methodological errors and conflict of interest on multiple counts.

Do countries Pay Attention to Ratings Agencies?

- Lowered rating of a country can potentially cause panic selling or offloading of investment by a foreign investor.
- In 2013, the European Union opted for regulating the agencies.
- Over reliance on credit ratings may reduce incentives for investor to develop their own capacity for credit risk assessment.
- Ratings Agencies in the EU are now permitted to issue ratings for a country only thrice a year, and after close of trade in the entire Union.