CREDIT RATING DOWNGRADES AND ITS IMPACT ON A STATES NATIONAL ECONOMIC SECURITY

by

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DECLARATION

I declare that this Research Report is my own, unaided work. It is being submitted for the Degree of Masters of Arts by Coursework and Research Report in International Relations at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination at any other University.

_________D.C_______________

(Signature of candidate)

___5th_______day of____October_______20_20_______

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Dominique Correia

ABSTRACT

In the last 35 years, all three major credit rating agencies (Moody's, Standard & Poor and Fitch), have downgraded over 17 states to 'junk status' from an investment grading, with only 8 states recovering back to an investment grade, which has taken between a 1 to 16 years. Hence, the dreaded rating of 'junk status' continues to spark fear, dictating news headlines across the globe, as it is said to have a huge implications on national economy and investment in the country, thus, creating a cycle of high economic insecurity which is challenging to overcome. Therefore, my research aimed to investigate: *what ways credit rating downgrades impact upon a state's national economic security*. While there is various research on the impact of credit rating agencies, particularly on emerging economies, there remains a gap in literature drawing on the debate on whether downgrades to junk status by all three major credit rating agencies (Moody's, S&P, and Fitch), impact upon a state's national economic security, particularly using a qualitative case study analysis. Hence, my study aimed to investigate and draw the causal pathway between the implementation of 'junk status', and a state's national economic security, which focus on economic indicators of: exchange rate, inflation, FDI, debt and government bonds as a measure. I used 3 case studies: Greece, Brazil, and Azerbaijan, providing an in-depth analysis on the impact of a downgrade to 'junk status', using a before and after logic restricted within a 6 month time frame.

Keywords: Credit Ratings agencies; junk status; national economic security; Moody's; Standard &Poor; Fitch

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LIST OF ABBREVIATIONS

BRICS	Brazil, Russia, India, China, South African (organisation)
CDS	Credit default swaps
CRA	Credit rating agencies
EU	European Union
EMU	European Monetary Union
GDP	Gross Domestic Product
IMF	International Monetary finance
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organisation
S&P	Standard & Poor
USA	United States of America
WB	World Bank
WTO	World Trade Organisation

1. Chapter 1: INTRODUCTION

1.1 Introduction

On the 27th March 2020, Moody's was the final dominant credit agency to place South Africa's sovereign credit rating to 'junk,' with a negative outlook, adding prevailing financial market stress to the South African economy, which is already in a recession (Winning, 2020). Hence, it is important to understand what impact this will have on the country, both in the immediate and long term. As credit rating agencies (CRAs) have become an essential factor in the global financial market, emerging from relative obscurity in the 1990s, to the monopolisation of market in the post-Cold War era, by three major agencies: Moody's s Services, Standard & Poor's (S&P) and Fitch, controlling 95% of the market. These agencies play a vital role in the financial market, rating sovereigns which voluntarily signup to be rated, and providing a standardised level of data transparency for potential and existing investors to assess their credit risk. Thus, great significance is placed on decisions to downgrade a state to the dreaded *junk status* from an investment grading, which dictates news headlines worldwide. As seen with all three major agencies downgrading over 17 countries to *junk status*, from an investment grading, with only eight states recovering back taking between 1 to 16 years. Hence, downgrades by CRAs are said to have huge implications on the national economy and investment in the country. Thus, creating a cycle of high economic insecurity which is challenging to overcome due to the predicted direct impact on the development of a state, particularly an emerging market, further aiding human insecurity. Therefore, this research seeks to assess what the causal mechanisms are between downgrades to 'junk status' and economic insecurity.

However, debates (Krantz, 2013; Cantor and Packer, 1996; Reisen and von Maztlan, 1999 Kaminsky and Schmukler, 2002; Slabbert, 2016) continue to spark around the impact and accuracy of CRAs, as illustrated with the events of the 1990s, namely, the Asian, Russian and Latin crisis, and the global crisis of 2007. These events were ultimately representing some of the shortfalls of CRAs prognosis on investment gradings, as well as critiques of bias and under-rated rating as national security has evolved in the post-Cold War era. And with security shifting from traditional threats of military and a bipolar global order, to focus on the safety of all human beings, from both quantitative, income poverty and qualitative threats, lack of human dignity (Thomas, 2001). The dangers of insecurity have further broadened to include internal individuals daily life stresses, encompassing issues such as job security, income security, health security and environmental security, the financial sector has a larger role in a state's national security. For this paper, the focus will be placed precisely on the economic security of a country, which largely contributes to state's relations and cooperation, and in realist terms, state survival. And as CRA's contribute to overall recognition of a state's ability to attract and keep investment, furthering economic security. Therefore, this study aims to build on from current debates to investigate the causal mechanisms between a downgrade to junk status and economic insecurity.

1.2. Background Study

The creation of CRA’s dates back to the end of 1800s in the United States, as a response to "market turbulence created by failed railroads, dubious Florida land schemes, and other property deals in the newly opened lands of the Western United States" (Beaulieu, Cox, Saiegh, 2012). As demand increased for information regarding potential investments, Henry Varnum Poor published a series of journals and manuals on U.S. railroads, such as the "history of Railroads and Canals in the United States" in 1860, which formed as the forerunner of securities analysis, with the creation of Standard Statistics in 1906. Thus, resulting in the product of the published corporate bond, sovereign debt and municipal bond ratings (Alsakka and Gwilym, 2010). In 1941, Standard Statistics merged with Poor's publishing to form Standard and Poor's Corporation, known for its stock market index (Alsakka and Gwilym, 2010). Following in suit, John Moody and Company first published "Moody's Manual" in 1900, the manual published basic statistics and general information about stocks and bonds of various industries. By 1914, the creation of Moody's Investors Services, went on to provide ratings for almost all government bond markets. By 1970, Moody's began rating commercial paper and bank deposits, becoming the full-scale rating agency it is today (Alsakka and Gwilym, 2010). While John Knowles Fitch, founded Fitch Publishing Company in 1913, providing financial statistics for use in the investment industry via "The Fitch Stock and Bond Manual" and "The Fitch Bond Book" (Alsakka and Gwilym, 2010). By 1924, Fitch introduced the AAA to the D rating system, which continues to be of use as a basis for ratings around the globe (Alsakka and Gwilym, 2010). However, the demand for credit ratings lessened after the Great Depression, and Second World War, but by 1990s, revitalised, and started to gain a global reach from there U.S. home-base (Sinclair, 2003). Currently, Moody's and S&P account for 80% of the market, while Fitch holds 15% (Alsakka and Gwilym, 2010).

The primary function of rating agencies is to facilitate the efficient allocation of credit between lenders and borrowers by increasing the level of transparency and information available in a particular capital market (Thompson, 2013). Hence, CRAs facilitate the flow of information by analysing all available data, presented more simply to each investor, and increasing efficiency in capital markets by reducing the asymmetry in public information, and thus publish opinions about a debtor's credit risk (Thompson, 2013). Investors continue to appear as risk-averse, yet profit-seeking, the demand for CRAs remains high.

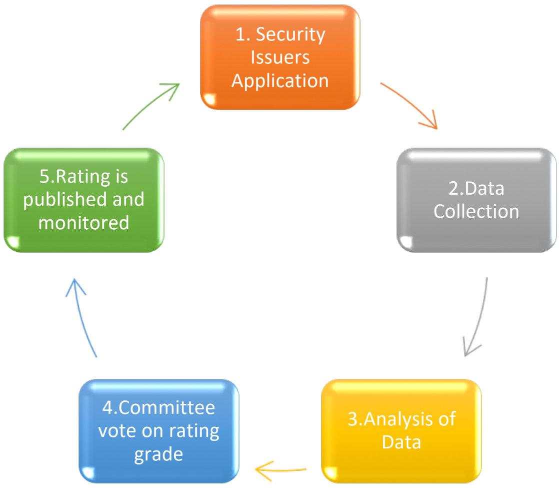
While the process of CRA's decision-making can be divided into two broad categories: economic and political risk (Kraussl, 2003). When deciding a country's rating, CRAs consider various factors. Although an explicit criterion for each agency is not apparent, David Levey, managing director for Moody's from 1985 to 2004, illustrated that assessments were "always a political analysis as much as an economic analysis" (Host et al., 2012, 22). The economic risk covers the government's ability to repay its obligations on time. It is a function of both qualitative and quantitative factors, whilst political risk covers the sovereigns willingness to repay its outstanding debt on time. For example, S&P (1997) (with Moody's and Fitch following similar criteria) "divides the factors which influence the determination of the overall sovereign credit rating into eight categories: political risk, income and economic structure, economic growth prospects, fiscal flexibility, public debt burden, price stability, the balance of payments flexibility, and external debt and liquidity" (S&P, 1997), as illustrated in *Figure 1*.

Figure 1: S&P Credit Rating Categories of Criteria

Copied from: S&P (1997).

Nonetheless, the process and methodology of all three ratings have five steps (illustrated in *Figure 2)*: firstly, security issuers application, secondly data collection, next, the analysis of data through quantitative and qualitative according to agency-specific methods, after that, agency's committee vote on credit rating grade, lastly, the rating is published, and the agency continues to monitor the issuer (Host et al., 2012).

Figure 2: 5-Step Process of issuing a sovereign rating by all three agencies



Host et al (2012).

Countries that are issued sovereign credit ratings by agencies reflect the country's overall economic conditions, such as foreign currency reserves, capital market reserves, and private and public investment (Chen, Chen, Chang, Yang, 2016). While also taking into account the social and political factors, such as political stability, to assess a state's capacity and willingness to honour its current and future debt obligations both in full and on time (Chen, Chen, Chang, Yang, 2016). Hence, institutional investors rely on sovereign ratings to both quantify and qualify the general atmosphere of a particular country, as the primary function of rating agencies is to reduce the asymmetry in available information (Host et al., 2012).

CRA's provide sovereigns with standardised evaluations of potential risks and returns associated with investments, according to specific standardised creditworthiness categories. However, the investment decision itself remains with the investor (Thompson, 2013). The CRA's rate a state's debt, in which they attach a 'grade' value, that represents the state's creditworthiness. The grading system increments differ amongst the three major agencies, yet, all CRA's maintain ratings along a scale of 16 points which ranges from AAA to C, with any rating above the seven lowest positions is considered an investment grade. Ratings in the range of BB+ to C represent, speculative or 'junk' (Host et al., 2012). The CRAs continuously monitored the creditworthiness and adjust their rates accordingly, following the motto, 'once rated, always rated' (Host et al., 2012), which provides potential investors with information about the probability about loans pay-outs. Hence, credit ratings have two categories: investment- grade and a speculative/ non-investment-grade, which *Figure 3* clearly illustrates.

<u>Figure 3: Grading System of Top 3 Credit Rating Agencies</u>

S&P		Moody's		Fitch		Meaning
Long term grade	Short term	Long term grade	Short term	Long term grade	Short term	
Investment grade						
AAA	A1+	Aaa		AAA	F1+	Highest rating
AA+ AA AA-	A1	Aa1 Aa2 Aa3	P1	AA+ AA AA-	F1	High rating
A+ A A-	A2	A1 A2 A3	P2	A+ A A-	F2	High capabilities of debt repayment
BBB+ BBB BBB-	A3	Baa1 Baa2 Baa3	P3	BBB+ BBB BBB-	F3	Sufficient capabilities of debt repayment
Speculative grade						
BB+ BB BB-	B	Ba1 Ba2 Ba3		BB+ BB BB-	B	Speculative, credit risk rises
B+ B B-		B1 B2 B3	Second-class	B+ B B-		Highly speculative, low possibilities of protection
CCC+, CCC, CCC-, CC, C	C	Caa, Ca,		CCC, CC, C	C	High risk of default
D	D	C		RD/D	RD/D	Default

Copied from Host et al. (2012).

As illustrated in the figure above, it is essential to note the process taken by CRAs in deciding whether to downgrade a state to junk status, with two distinct types of credit ratings, issuer ratings and debt ratings. For this study, the focus is solely on "issuer ratings- sovereign ratings whereby the issuer is a national government, and it provides a general credit standing of the rated entity" (Bhatia, 2002, 8). Countries that are issued sovereign credit ratings take into account the country's overall economic conditions, such as foreign currency reserves, capital market reserves, and private and public investment. While also taking into account the social and political factors, such as political stability, to assess a state's capacity and willingness to honour its current and future debt obligations both in full and on time (Chen, Chen, Chang, Yang, 2016). Hence, institutional investors rely on sovereign ratings to both quantify and qualify the general atmosphere of a particular country, as the primary function of rating agencies is to reduce the asymmetry in available information (Host et al., 2012).

After a relatively limited activity in financial markets for most of the 20th century, the globalisation of financial markets in the 1990s, with the triumph of capitalism, saw new opportunities for CRAs in the global financial sector with greater public awareness of their existence (Kerwer, 2002, 40). As illustrated by Olegario (2000), who states, "the very authority that Moody's and S&P have managed to construct in… nearly a century, and which is now upheld by powerful bodies such as international banks, the International Monetary Fund (IMF), other transnational organisations, and governments, has effectively shut out all competition in the credit-rating industry". Thus the monopolisation credit rating industry, with three US-based bond rating firms: Moody's; Standard & Poor's; Fitch, continue to dictate the financial sector. This is important to note, as it has previously been argued that the three central credit rating played a significant role in ensuring a state's national economic security.

Furthermore, CRAs have also been critiqued by state's, arguing that they are anti-development, and more so anti-African, as several African countries continue to speak out about the agencies, and their decisions to downgrade African economies. For example, in 2015, the Zambian government urged investors to ignore unsolicited credit downgrade, while in 2017, Namibia rejected Moody's decision to downgrade the country's credit rating to junk status, stating the downgrade was contrary to its generally stable economic outlook (Mutize, 2019). Similarly, last year, Tanzania criticised and rejected Moody's decision to assign a low credit rating with a negative outlook on the country's first international credit rating, as they stated that they had not been thoroughly consulted (Mutize, 2019). Nigeria, similarly disagreed with its downgrading, with the government saying that its economy had successfully emerged from a recession and recorded significant improvements across a broad range of sectors (Mutize, 2019). Thus, illustrating the consensus among various African states against the monopolisation of CRAs, as a gap remains in ensuring just and fairness in grading emerging markets, to foster greater growth, rather than hindering development.

In addition to the critiques from states, studies (Fuschs and Gehring, 2013) have illustrated the biased nature of CRAs, assigning a higher rating to their home country, favouring countries that are close to them, and ultimately under-rating emerging economies which results in a foreign bias. This is illustrated by the difference in rating by US-based agencies (Moody's, S&P, Fitch) and the Chinese-based agency (Dagong), with the U.S. agencies rating the United States as AAA, whilst Dagong rating is four notches below, at A+ (Luitel, Vanpee, Moor, 2016). Dagong uses a similar methodology to that of the Big Three, however, aims to focus on 'wealth creation capacity', instead of default risks, claiming to provide more timely credit information due to forward-looking approach (Joffe 2015). For example, Dagong rates China AAA, due to economic performance (wealth creation), whilst Fitch rates A and Moody's rates A3, differing six notches. Important to note, the major rating agencies have never downgraded their home country, besides S&P in 2011, which followed S&P receiving threats from the U.S. Treasury, to be held accountable for the "enormous disservice" to their country (Luitel, Vanpee, Moor, 2016). Hence, illustrating the bias in ratings, and thus a need for alternatives, that better reflect reality and lessen the tendency.

While the background study of economic security as a concept is not a new phenomenon, the outcome of recent strides of neoliberal globalisation, insecurity has increased within financial markets, ranging from labour to finance sectors. As this study focuses on economic security, it is crucial to understand the concept of security. As Baldwin (1997) argued, security is a confusing concept, that requires further clarification, a complex socio-economic category, influenced by continuously changing environment, of external and internal threats to the economy (Grigoreva and Garifova, 2015). Hence, for this study, I will be defining national economic security as one of the most critical components of national security, containing a combination of factors, which ensure national financial independence, stability and sustainability. Economic security forms part of human security, as illustrated in *Figure 4.* This focuses on security at the individual level, as many people continue to be threatened by economic insecurity such as unemployment, lack of social and economic opportunities, food inflation, job insecurity, lack of resources and poverty, impacts on an individual's opportunity, health and wellbeing (Yang, 2014).

FIGURE 4: 7 Types of Human Security

Cited: Gomez, Oscar and Gasper, Des. 2013. "Human Security: A thematic guidance note for regional and national human development report teams". *UNDP*.

The post-Cold War era saw a change from welfare capitalism to neoliberal globalisation, which has created a new precarious class, filled with job insecurity, due to the deregulation of the labour market (Yang, 2014). However, it must be noted this occurred despite CRA's, and instead, CRA's are merely a part of the neoliberal governance framework. As CRAs are voluntarily invited to rate sovereign's credit, they exercise agency within the neoliberal framework. This saw the contrasting of the promise of peace, stability and prosperity, in the post-Cold War, with the triumph of democratic values. Therefore, economic security is meant to protect the national interests of the state, the individual, and society (Jankovska, Tylchyk, Khomyshyn, 2018). However, negative consequences arise from neoliberal globalisation which continues to plague the global financial sector. For instance, currency depreciation, the numerous financial crisis worldwide, growing inequality, which is partly as a result of trade shocks, and the vulnerability of market, as seen with the Asian and Latin American financial crisis of the 1990s (UN DESA, 2008). Whilst these purported linkages are evident; a direct causal chain is not yet transparent within the academic literature, which is where my research aims to fulfil the gap, investigating the causal mechanism between CRAs and economic security. Hence, for this study, the focus will be placed upon national economic security, which is intrinsically links with individual economic security, as state's, due to increasingly integrated financial sector, continue to be vulnerable to external shocks, such as CRA's.

1.3. Problem Statement

While various research exists on the impact of CRA's, particularly on emerging economies; there remains a gap in literature drawing on the debate on whether downgrades to junk status by all three major CRA's (Moody's, S&P, and Fitch), impact upon a state's national economic security. Hence, my study aims to investigate and draw the causal pathway between the implementation of 'junk status', and a state's national financial security, which focuses on economic indicators of currency depreciation, inflation, foreign direct investment (FDI), debt and government bonds as a measure, using a qualitative case study analysis,

1.4. Research Question

My primary research question is examining *what ways credit rating downgrades impact upon a state's national economic security.* The extent of the effects of CRA's downgrades to a non-investment grade needs to be examined. This is necessary to answer whether impacts are more dependent on state policies, rather than 'junk status', as illustrated with some recovering within a year, whilst others take more than 16 years to reobtain an investment rating.

1.5. Research Aims

This research aims to investigate: how CRA's downgrades impact upon a state. My study attempts to answer this question by examining the causal pathways between all three agencies decision to downgrade a state to junk status, and the direct impact upon the state's national economic security. Thus, as existing causes are prevalent before downgrades to non-investment rating, how much of a role do CRA's exactly play? I aim to answer this by comparing the impact of junk status by all significant agencies on 3 case studies.

1.6. Rationale

CRA's have become an essential factor in the global financial market, emerging from relative obscurity before the 1990s, to the monopolisation of the market by three major agencies: Moody's Investors Services, Standard & Poor's (S&P) and Fitch, controlling 95% of the market. As the post-Cold War era has seen the triumph of capitalism, and the globalisation of financial markets, there is an increasing demand for CRAs. However, the events of 1990s, namely, the Asian, Russian and Latin crisis, and the global financial crisis of 2008, illustrate that CRAs are not always a reliable and realistic prognosis on risk investment trends. In addition, critiques of bias and under-rated rating, which cause severe consequences for the countries involved. This study is crucial as it aims to investigate the ongoing debate about whether CRAs downgrades have an impact on state, with particular focus on a state's national economic security, using an in-depth case-study to trace the causal effect, which is lacking in the existing literature. The sheer importance of this study is highlighted in fear of downgrade to 'junk status', which looms large in most states, due to the expected implications, hindering prosperity and places a negative outlook throughout the country. This illustrates the sheer importance of CRAs within global markets, with the need for immense academic literature investigating the power and implications of the external financial sector.

While various studies (such as Cantor and Packer (1996), Reisen and von Maltzan (1999), Kraussl (2003), Jaramillo and Tejada (2011), Tichy (2011), Boninghausen and Zabel (2015), Slabbert (2016)), have analysed the influence of CRA's on market economies, there remains a gap in analysing the impact of all 3 CRA's downgrades to junk on a state's national economic security. In addition, most of the studies provide a quantitative, large-n based approach, with numerous case studies, providing an overview of a strategy focused on the immediate impact upon a downgrade by all three agencies. Hence, this research is vital and remains a relevant research inquiry, highlighting the ongoing debate amongst existing literature around whether or not CRA's play a significant role in determining economic security outcomes of a country. My study adds to this debate, moving beyond merely the influence, to instead investigate the causal pathways in which CRA's downgrades to 'junk status' impact economic security, using qualitative, in-depth case studies. Hence, this study will provide a fresh, and needed perspective on the impact of CRAs downgrades on a state's national economic security, focused on a small-n rather than all previous studies focused on a large-n.

Furthermore, this study is relevant to I.R. discipline as it examines a necessary and essential dimension of economic security, which needs to applied and analysed in more depth within the current climate of international relations. Additionally, this study remains necessary and relevant to the I.R. field as the impact of a downgrade to junk status is said to not only have a limited direct impact upon a state's economy. But it is seen to also be the cause of broader contagion effects, with the likes of more significant migration and lowered trade relations likely to result in neighbouring countries once a state is downgraded to *junk status.* And with the recent downgrading of South African sovereign rating to junk, it is relevant to study the impact a downgrade has had on developing state's national economic security.

Previous studies from Mateev (2012), which focused on the effects on bonds and stock market returns, and the Kaminsky, & Schmukler (2002) article, highlighting the spill-over effects across both countries and financial markets, illustrated in the Russian and Asian financial crises of the 1990s, spurring further economic instability, thus an important area of analysis. While more recent studies such as Corbet (2014) focused on Euro financial markets, found significant influence, both positive and negative, from credit agencies decision-making to contagion effects, on neighbouring states bonds and economic stability. Hence, this will be an important aspect to explore when investigating a state's financial security after a downgrade to junk status.

1.7. Hypotheses

Therefore, this study will focus on two specific hypotheses based on the impact of downgrades by CRA’s:

H1: Credit rating downgrades to 'junk status' have led to national economic insecurity
(Krantz, 2013; Rabinowitz, 2014; Mulder and Perrelli, 2002;Kraussl, 2003; Reisen and von Maltzan, 1999; Cantor and Packer, 1996; Gültekin-Karakas et al., 2011; Baum et al., 2013; Gande and Parsley, 2005; De Santis, 2012; Boninghausen and Zabel, 2015; Elliason, 2002; Pedras, 2016; González-Rozada and Levy-Yeyati, 2010; Jaramillo and Tejada, 2011.)

This statement predicts that decisions to downgrade a state to 'junk status' by all three agencies, has a direct and significant impact on a state's national economic security (GDP, inflation, debt, currency, bonds). Thus, stating that CRA's are very impactful and result in significant consequences to a state's economy.

H2: Downgrades to 'junk status' simply worsen existing economic problems such as weak institutions, corruption, and economic grievances.
(Krantz, 2013; Tichy, 2011, Cantor and Packer, 1996; Larrain et al., 1997; Reisen and von Maztlan, 1999; Kaminsky and Schmukler, 2002; Iyengar, 2012; Slabbert, 2016).

In contrast, the second hypothesis focuses on the secondary effect downgrades to junk status have a state, further worsening existing economic insecurities, rather than having a direct and significant impact on a state's national financial security. Thus, decisions to downgrade just further add to the already declining and challenging economic issues, also hindering a country's ability to progress and recover.

1.8. Methodological Discussion

A. Qualitative Research

This study will use a qualitative approach, which broadly refers to "data collection and analysis strategies that rely upon the collection of, and analysis of, non-numeric data" (Lamont, 2015, 78). As the research I will be conducting is focused on investigating how CRA's downgrade to 'junk status' impact upon a state's national economic security. Hence, to identify and assess the link, or causal pathways, between the independent variable, credit rating downgrades, and the dependent variable, national economic security. By selecting a qualitative approach, this allows for a better and more in-depth understanding of the impact of credit agencies. Therefore, as qualitative research describes a "diverse set of tools and resources that we can draw upon to collect and analyse data" (Lamont, 2015, 78), using a case study approach to investigate the causal pathways of junk status on a state. Therefore, this study aims to hold a more positivist approach, by using rational choice and data sets, to investigate how downgrades to 'junk status' purportedly hampers on a state's national economic security.

The independent variable, credit downgrades, will be operationalised using Moody's, S&P, and Fitch rating system of 'junk status' or non-investment. This is defined differently amongst the top three CRA's which will be analysed, but all have two categories: investment- grade and a speculative/ non-investment-grade. This study will focus on impact when a rating goes from investment grade- to speculative/non-investment grade, which is commonly referred to as 'junk status' (Host et al., 2012).

It must be noted, the expected impact of a downgrade to 'junk status' by all three major agencies, is said to result in (Teixeria, and Crossley, 2017)

- Exchange rate depreciation
- Interest rate increases which in turn will see more expensive debt
- Lower foreign direct investment;
- Possible redistribution of the country's resources;
- Low economic growth;
- Increase in tax rates;
- A decrease in welfare payments.

Hence, building off these expectations and focusing on five leading indicators, my study will apply an in-depth analysis of three cases. The studies by Canton and Packer (1996), Pretorius and Botha (2013), Elliason (2002) and Afonso (2003), identify the following variables they all share:

- GDP per capita
- External debt
- Inflation rate
- Fiscal balance
- Level of economic development;

The factors listed above were detected to be most relevant regarding CRA's. However, for my study, I will also use currency depreciation as this played a significant role in two of my case studies, and FDI rates and government to examine level the development. Hence, for this study, I will restrict the indicators to:

- Government bonds
- Inflation
- FDI
- Debt
- Currency depreciation

These indicators will be studied regarding national security, as well as highlighting the knock-on effect to individual economic security, for example, inflation impacting food prices.

B. Case Study Research

This study will use case-study analysis, a commonly used research method in the study of international relations as it "provides a rich and detailed understanding about how certain processes work" (Lamont, 2015, 120). I will be using three case studies focused on small-N, analysing 3 cases in-depth, providing greater internal validity. I applied criteria in my case selection, only examining cases which:

- Had an investment grade from all three agencies
- Downgraded to 'junk status' from all three agencies
- Have not yet recovered from the 'junk status' rating

This resulted in 7 cases: Greece, Croatia, Brazil, Tunisia, Bahrain, Azerbaijan, Cyrus and as recently added, South Africa. For this study, I will be conducting an in-depth analysis, so I have limited my case studies to 3 countries, I selected 3 cases as I feel it provides a more holistic picture than a standard 2 case comparison. I decided to analyse countries from different regions, selecting Greece (Europe), Brazil (Latin America) and Azerbaijan (South Caucasus/Asian continent) (Trading Economics 2019). These three cases also represent the best cases in closely examining the impact of the downgrade to junk status, as in Bahrain and Tunisia, political factors played a large role. At the same time, Cyrus has been upgraded by all agencies except Moody's. I selected Greece over Croatia, as using most-likely logic, I think this help in illustrating the impact on economic security. As the three cases, I have carefully selected will "provide insights into social processes that inform how we construct I.R. more broadly" (Lamont, 2015, 126).

In analysing my selected cases of Brazil, Greece, and Azerbaijan, all cases differ in reasoning for a downgrade to junk status, thus, making it an exciting inquiry into the causes and impact of *junk status* on a state's national economy. Whereas for Brazil prior to downgrade was filled with political uncertainty, failure to reform the pension system, a large fiscal deficit (Gillespie, 2018). In addition, a corruption-fuelled recession, with Brazil ranked 96th out of 180 countries(Gillespie, 2018), which also saw high unemployment and debt rates, at 8.44% in 2015, an increase from 6.67% in 2014 (Statista, 2020). And debt increasing from 62.31% in 2014 to 72.58% in 2015 (Country Economy, 2020).

For Greece, the downgrade in 2010/2011 hit hard, with Moody's dropping Greece rating 4 notches, from A3 to Ba1 on government bond ratings, over risks to an EU/IMF bailout package, which highlighted persisting doubts over the country's ability to manage its severe debt crisis (Melander, 2010). The Euro debt crisis which was a result from the Global Financial Crisis in 2008, saw Greece's government bond yields increase, with debt becoming expensive and unsustainable, in which Greece became reliant on financial assistance. With public sector deficit reaching 12.5% of GDP in 2009, which constitutes more than four times the stipulated E.U. amount, the Greek economy which experienced the worst economic crisis since the restoration of democracy in 1974 (Smith, 2009). Alongside the rapidly increasing public debt, which saw an increase from 113.4% in 2009 to 144% in 2010 (Index Mundi, 2020).

While for Azerbaijan, the downgrade in 2016, was as a result of the impact of the oil shock, as the oil price dropped from $105 in mid-2014 to $53.40 by early 2015, lasting until 2016, due to growing supply of glut, and the booming U.S. shale oil production (Stocker, Baffes and Vorisek, 2018). As oil to makes a third of the Azerbaijan economy, and slow-down of the economy, although the high debt was not a significant factor.

It must be noted that a limitation of my study is determining a direct causality between 'junk status' and economic insecurity. Therefore, I will be applying *before, and after* logic, as illustrated in the table below, limited to a six-month period from each agency's downgrade, as the closer to decision-making, the more accurate the impact on the state would be.

Table 1: Case Studies Credit Ratings Before and After Downgrades to Junk Status

Case studies	**S&P** *Before*	**S&P** *After*	**Fitch** *Before*	**Fitch** *After*	**Moody's** *Before*	**Moody's** *After*
Greece	BBB+ [16th Dec 2009]	BB+ [27th April 2010]	BBB- [21 Dec 2010]	BB+ [14 Jan 2011]	A3 [22nd April 2010]	BA1 [14th June 2010]
Azerbaijan	BBB- [30th Jan 2015]	BB+ [29th Jan 2016]	BBB- [11 May 2012]	BB+ [26th Feb 2016]	Baa3 [19th April 2012]	Ba1 [5th Feb 2016]
Brazil	BBB- [28th June 2015]	BB+ [9th Sep 2015]	BBB- [15th Oct 2015]	BB+ [16th Dec 2015]	Baa3 [9th Dec 2015]	BB+ [16th Dec 2015]

[Trading Economics 2019].

C. Research Methods

In terms of methodology, I will be using process tracing, based on concatenation, which aims to "identify the intervening causal processes-the causal and causal mechanism -between an independent variable (or variables) and the outcome of the dependent variable" (George and Bennet, 2005, 206), to prove causality between the two variables, 'junk status downgrade' and 'economic security'. I aim to apply process tracing in the study by studying the 'case' of a downgrade to junk status by all three major CRA's on a state. Hence, it is useful in tracing the processes that are likely to cause the outcome within a case study, which helps in limiting the list of potential causes. This will be achieved using process tracing to track hypothesised causal mechanism previously stated:

(1) Credit rating downgrades to 'junk status' have led to national economic insecurity

(2) Downgrades to 'junk status' simply worsen existing financial problems such as weak institutions, corruption, and economic grievances.

Further, I will operationalise this, using a case study approach to trace evidence of the impact of junk status on a state's national economy.

For my study, I will be using Causal Process Tracing (CPT), to answer the questions relating to 'how does a downgrade to junk status directly impact a state's national economic security, and why a downgrade has more influence over pre-existing condition (Blatter and Haverland, 2014). This is necessary, as I aim to determine the significance of credit rating downgrade impacting national economic security, rather than for example, pre-existing economic conditions, and government policies in a state. However, the shortfall of process tracing is that it requires vast access to data, and can result in various causal mechanisms. Thus, I plan to solve these issues by identifying specific scope conditions for all case studies, this will allow me to chart the repertoire of causal paths that lead to national economic insecurity, and under what condition they occur (George and Bennet, 2005, 207).

After using process tracing within each case study, I will compare the outcomes amongst all 3 cases to see if any indicators impacted are mutual, or whether the affected indicators remain case-specific.

D. Sources of data

The sources I will mainly be using for data collection will be, primary sources, in documents, and reports from Moody's; S&P; Fitch; as well as the World Bank (WB) and the IMF. In addition, government policies, economic reports and speeches will also be for my analysis. I will also make use of Secondary sources such as books and academic journals and secondary primary interviews of rating agencies.

As my study uses various data, for the indicators selected, rather than adopting quantitative research, I will use *descriptive statistical analysis*. This form of statistical analysis helps provide means to describe data, helpful in presenting trends and collecting data (Lamont, 2015 169). This leads to another approach which will be used in this study, to manage the date, I will be using thematic analysis to organise to my data following the economic indicators. This is necessary to highlight the causal mechanism, illustrating the impact of a downgrade, by analysing case studies economic security, using the selected indicators, before the downgrade, in comparison to after the drop to 'junk status' to understand the role of CRAs.

1.9. Limitations of the study

The limitations of this study must be noted, which include the data collection being limited to public reports and secondary research to examine the effects of downgrades. Thus, the main limitation remains the availability of evidence on the impact on state's economic security, which is reliable and unbiased, as it is harder to obtain information on a particular country, especially in the developing nations. However, this study plans to overcome these obstacles, using national statistics, WB and IMF reports, as well as reports from Moody's, S&P and Fitch, to examine changes in state economic security. Another limitation of this study will be in proving causation between the variables. The effect of a downgrade, and merely the current worsening financial security, can be the cause, of domestic factors, with the downgrade, not having a significant impact on the deterioration. However, this study aims to overcome this obstacle, by implementing process tracing, to examine the direct effect a downgrade to 'junk status' has on specified economic indicators. In addition it must be noted that this study has not used any human participatory, and has solely relied on secondary data. Thus ethics is not a concern.

2.0. Conclusion

To conclude the first chapter, the focus on this paper will be investigating the impact of credit rating downgrades to *junk status* on a state's national economic security. The focus will be on the three most predominant credit agencies: Moody's; Standard & Poor; and Fitch, using a qualitative study approach, with the three case studies of Greece, Brazil, and Azerbaijan. Hence, this introduction has laid out the foundation of the importance of CRA's in the modern era, and the importance to understand how much of a significant role these agencies downgrades have on a state's national economic security. While various studies exist, further explored in the following chapter, there remains a gap in examining the data from a qualitative standpoint, with the specific focus on economic security and the contagion knock-on effects on a state economy.

Chapter 2: Literature Review

2.1 Introduction

This literature review will provide an overview of the ongoing debates on CRA's within the existing literature, assessing the positives and the critiques of credit downgrades on both emerging and developed nations. This section aims to investigate how credit rating downgrades impact upon a state's development to further advance the understanding of downgrades to *junk status* on a state's national economic security. The prevailing theories are more critical of CRA's due to bias; inaccuracy; spill-over effects and 'boom-bust' cycle; credit agencies are still seen as necessary filter and data collector for states globally. While the methodologies used in existing studies tend to provide a quantitative analysis with a large-n (numerous case studies). This contrasts the qualitative, small-n approach I will be using, providing an in-depth look at the impact of a downgrade on a state's national economy. Hence, this literature review aims to understand CRA's impact's upon a country. I will firstly focus on the role and significant variables of CRA's in emerging markets, thereafter the positives and critiques of CRA's and the debate surrounding whether downgrades have a direct impact or merely accelerate existing economic issues.

2.2 The role and significant variables of CRA's

As previously discussed in Chapter 1, CRA's date back to 1800s, serving a purpose to fulfil investors needs by offering investors "valuable information about the countries, businesses entities and securities for funding" (Baresa, Bogdan and Ivanovic, 2012, 71). The agencies fulfil a needed gap in the financial market, providing accurate and relevant information asymmetry to make a standard of comparison and rating scale to which investors build on to make a portfolio of securities, ensure investors make the best decisions.

Various authors (Cantor and Packer, 1995, Reisen and von Malzan, 1999, Bhatia, 2002, Juttner and McCarthy, 2000) have found the "estimated econometrically determinants of credit ratings", in both emerging and developed markets. Juttner and McCarthy (2000) found a structural break in the rating assessment in the East Asian financial crisis of 1997, stating that "econometric estimates may convey wrong or meaningless signals to investors during a rating crisis, there is no set model or framework for judgement which are capable of explaining the variations in the assignment of sovereign ratings over time". Adding that projection that in the case of a global financial crisis rating, models may become outdated as maintain a stable relationship between ratings and economic determinants remains challenging to accomplish. However, in studying the Asian financial crisis, Juttner and McCarthy (2000) identified the following significant variables: CPI; the ratio of external debt to exports; default history; interest rate and real exchange rate. The lack of significance placed on interest and exchange rate remained variables agencies overlooked in prior to the crisis, highlighting the importance of such variables in rating criteria.

While similarly, the study by Minescu (2010), *The determinants of Sovereign Credit Rating: A Worldwide study*, concluded the factors relevant and explanatory variables of 82 countries during the period of 1996-2008, using regression analysis. This study found an overestimation of the impact of a sovereign credit rating on lower ratings, and underestimation of high ratings. In contrast, the finding illustrated that the most impactful variables were: GDP, inflation, default history and corruption. Hence, these studies provide the basis for my investigation in selecting my five variables (Debt, Exchange rate, government bonds, inflation and FDI), to analyse using an in-depth case study analysis. Thus, shifting from the quantitative study to a qualitative approach to investigate the causal pathways between the downgrades to junk status and economic security.

2.3 The necessity of CRA's

"There are two superpowers in the world…the United States and Moody's Bond Rating Service…and believe me, it is not clear sometimes who is more powerful" (Friedman, 2002).

This quote highlights the very importance of CRA's in the global financial market, to assess the creditworthiness of a state by issuing opinion based on a state's performance with either an investment or non-investment grading. CRAs can be beneficial, especially to emerging markets, as they provide access to international capital, which are seen to 'pierce the fog' of asymmetric information that surrounds lending relationships (Lynch, 1999). This influences "institutional demand and market liquidity, and serve as triggers in investment decisions and regulatory oversight" (Lynch, 1999, 5). In addition, CRAs, can also serve as monitors and help coordinate investor's beliefs in situations where the possibility of multiple equilibria is present" (Lynch, 1999, 5).

Thus it is necessary to illustrate the argument that CRAs are also a useful tool in providing access to global capital markets, as international investors prefer rated securities rather than non-assessed securities. As the gathering of information has a high cost, fees are imposed on the issuers of rated securities, rather than the sales of a particular financial product. Yet markets view the expensive as necessary to enable new investors to invest in their markets (Rabinowitz 2014). This is highlighted by Colin Powell, US Secretary of State in 2002, who argued for the CRA's: "By attaining a sovereign credit rating, your country will help reduce risk and encourage investment. A sovereign credit rating gives courage to the capital... can be your country's ticket to the benefits of the global economy and to the capital flows that exist in the global economy" (Powell, 2002). Hence, CRA's fill the gap between state and investors, providing a much-needed service for both, borrowers and lenders regarding important information about the risks associated with an investment in the country, which is expected to be reliable and accurate. My study will investigate the impact the top three agencies have on national economies once deciding to all downgrade a state to the dreaded 'junk status' from an investment grading.

2.4. The Critiques of CRA's

Whilst CRAs are credit and seen as necessary, various studies have critiqued CRA's for bias, timeliness, accuracy and reliance, as illustrated with the article by Johanson (2010) which examined the regulation of CRAs, with focus on the issue of conflicts of interest, with limited accountability for CRAs. The study provided proposals to have a global principles-based rule book, equal treatment and reliance, to ensure greater efficiency and resistant financial system. This study also investigated whether and how rating agencies responded to such criticism. It identified that the rating agencies not only improve rating timeliness but also increased rating accuracy and reduced rating volatility. The findings supported the criticism that, particularly in the past, rating agencies did not hold themselves accountable, using the required methodologies to ensure accurate opinions were given. Only once they were held accountable, did rating agencies improve their credit analysis as their reputations were on the line.

This bias is further illustrated in the Ferri and Liu (2002) study, *Do Credit Rating Agencies Think Globally? The information content of Firm Ratings around the World*, focused on the top three agencies, in 1997, 1998, and 1999, comparing both developed and developing states. The study found that developing countries saw a close relationship between firms and sovereign ratings, which differed to developed nations. The study critiqued the usage of the one-size-fits-all approach, with rating criteria used for developed states being the exact one used in developing countries.

However, the Cheng and Neamtiu (2009) *An empirical analysis of changes in credit rating properties: timeliness, accuracy and volatility,* stated that CRA's continue to face regulatory pressure and criticism for their lack of timeliness. Similarly, Gill (2005) article, *An analysis of defaults of long-term debts*, from 1995-2002, advising against excessive reliance on credit ratings, as they lack sufficient accountability to be as highly regarded.

While the Gupta et al. (2010) *The role of credit rating agencies in the sub-prime crisis* study, found a continued weakness in the methodology of CRAs, traced the development of sub-prime crisis from the immediate to the aftermath. This study found weaknesses in CRAs in performing timely and accurate rating bond obligations, once again highlighting the lack of accountability and independence of these agencies. The study by Güttler, & Wahrenburg (2007) investigates biases in credit ratings and timeliness by both Moody's and Standard & Poor's, using data from 1994 to 2004. This study found that in comparing the two CRA's, that Moody's seemed to adjust its ratings to increasing default risk in a quicker manner than Standard & Poors.

While it remains debated how much of an impact CRAs have on state's, Elliason (2002) study illustrates, that actual rating adjustments were more severe than suggested by the macroeconomic fundamentals of the time. While, CRAs have justified their downgrades, by emphasising ratings are merely 'credit opinions' on the probability of default, with rating determined by a mixture of quantitative criteria and subjective judgement, yet, under-rating a country due to bias or misinformation can have severe consequences (Krantz, 2013). This is due to the high regard for CRAs in the global system, with many investors closely following the advice of CRAs, before transferring capital to emerging markets, thus negatively impacting the ability to allow markets to borrow, and attract investors, thus weakening domestic bond markets (Krantz, 2013). Hence, it must be analysed whether there is a significant enough link between a downgrade and economic insecurity, or whether CRA's simply provide 'credit opinion', and hold little accountability. Hence, as these critiques remain prevalent in the literature surrounding CRAs, my study aims to analyse the accuracy and timeliness of CRAs downgrade to junk status from an investment rating, and the impact such decision-making has on state's national economy.

2.5. Are CRA's procyclical?

Numerous studies illustrate that credit agencies are procyclical, upgrading in good economic condition and downgrading in turbulent times (Ferri, Liu and Stiglitz, 1999), rather than predictive agencies working independently. The study conducted by Reinhart (2002) illustrates that sovereign credit ratings do not do a great job in predicting financial distress, using S&P report on Thailand in 1997, which failed to predict the debt crisis. However, various signs were indicating, such as a slow economy with falling exports, a slump in real estate and a rise in bank loans (Reinhart, 2002). Thus, Reinhart (2002) critiques agencies methodology in predicting currency crises, focusing on debt-to-export ratio, rather than currency misalignment, liquidity. Likewise, Tichy (2011) found that CRA's do not lead international financial markets; instead, they lag behind markets, and simply intensify 'boom-bust cycles'. Thus, since CRA's provide accredited advice, and with less-informed investors likely to adopt a 'follow the herd' approach, creating a homogeneous negative perception of markets. Hence, the significance of CRA's on market economies cannot be ignored, illustrated the necessity to investigate the gap in the literature, in showing how 'junk status' links to economic insecurity.

While, Mora's (2006) study examined the Asian Crisis in the period of 1997-1998, in which she found CRAs to be "sticky in nature rather than simply procyclical" (Mora, 2006). Similarly, González-Rozada and Levy-Yeyati (2010) further discovered that ratings instead react to important market news rather than anticipate them. While, Gaillard (2009), investigated claims of procyclicality, finding prevalence was much sharper during periods of high-risk aversion (1997–1998 in particular with the Asian Crisis) than periods of low-risk aversion (2005–2007). Echoing the sentiment provided by Elliason (2002), that CRAs are largely procyclical rather than counter-cyclical. Thus, it is essential to investigate for my study, as I aim to analyse the causal mechanism between downgrade and economic insecurity, to determine whether downgrades simply reflect existing economic conditions.

2.6. Downgrades have a direct impact upon a state?

As my study aims to investigate the impact of downgrade upon a state's national economy, it is essential to note whether *junk status* has a direct effect on a country, in comparison to upgrading the sovereign rating. A study by Güttler, & Wahrenburg (2007) found that downgrade by the second rating agency is of greater magnitude in the short term, and rating changes more likely after downgrades opposed to upgrades. While the study by Brooks, Faff, Hillier (2004), S&P and Fitch rating downgrades resulted in the significant market falls, with limited to no evidence of a remarkable impact on emerging markets changes. Similarly, the Koresh Galil and Gil Soffer (2011) article, *Good news, Bad news and rating announcements: an empirical investigation,* similarly found negative rating announcements resulted in minimal and at times insignificance, while positive rating was less frequent in comparison.

The Goh, & Ederington (1999) echoes this, finding the equity market reacting more frequently after negative downgrades than ones that are upgraded to investment grading. The Griffen, & Sanvincente (1992) study, used monthly data, found no evidence of any significant changes in positive upgrades, while negative downgrades, saw a decline in stock prices.

Meanwhile, a direct impact is argued by the Cantor, & Packer (1996) article, that used a sample of 49 countries rated by both Moody's and Standard & Poor. Which resulted in that rating agencies' opinions independently affecting market spreads, particularly for rating announcement on non-investment grade. While Reisen & von Maltzan (1999) concluded that most significant effects are observed in emerging markets, sovereign bond spreads.

Moreover, CRAs can have a direct impact beyond the domestic economy, as illustrated in the Corbet (2014) study, which found CRA's to have a significant influence in initiating contagion effects, with focus on the European financial markets. However, it must be noted that downgrades of Austrian and French bonds, positively influenced Greek's economic instability, with pressure reduction, which may be due to shifting focus of international financial markets under the spotlight (Corbet, 2014). Greece's Credit default swaps (CDS) spreads illustrate pressure reduction once Italy and Ireland were downgraded to non-investment. Evidence of spill-over effects can be seen with the Russian default in 1998 on industrial and developing economies (Kaminsky, & Schmukler, 2002). This mirrors the study by Li, Jeon, Cho and Chiang (2008) focused on 5 Asian countries from 1990 to 2003, with a contagion effect found in the stock market returns in neighbouring countries. This theory is backed up by the Ferreria and Gama (2007) study stock market returns from 1989 to 2003, finding significant impact on neighbouring states, particularly for emerging markets, while upgrades have no considerable effect abroad.

Similarly, the Boninghausen and Zabel (2015) article, illustrated the contagion effects, placing focus on the sovereign bond market of 73 developed. Emerging states between 1994 and 2011, concluding a strong link between a downgrade to 'junk status' and negative spill-over for countries within the same region, while upgrades are much more muted in reaction. Similarly, De Santis (2012) detected a sizeable spill-over effect for neighbouring European states of Italy, Ireland, Portugal and Spain, due to the strong impact of the downgrade to junk status on Greece. Equally, Gande and Parsley (2005), using a sample which covers 34 economies including both crisis and non-crisis periods between 1991 and 2000, find that while downgrades trigger large and significant negative cross-border spill-overs, there is no discernible market impact for upgrades. Following on, Baum et al. (2013) illustrates the effects of downgrade announcements by CRAs, have a direct effect on the Euro's exchange rate against the U.S. dollar, contributing substantially to negative spill-overs in regional stock markets, this mirroring the findings by Kaminsky and Schmukler (1999) of the Asian Crisis 1997/98. Hence, this is relevant to my study, as I aim to investigate Greece as a case study, illustrating the large reach of credit agencies.

However, regarding the impact-focused specifically on government bond spreads, Jaramillo and Tejada (2011), examine the possibility that credit ratings simply reflect changes in government bond spreads due to external factors. Their study used a set of 35 countries from 1995-2010, concluding a 36% difference in bond spreads when moving between the lowest investment grade (BBB-) and a non-investment grade.

2.7. Understanding economic security

The End of the Cold War era of national security referring to military threats saw a shift to the new era of human security, in particular, economic security, focused on the individual. Thus, building on from Baldwin (1997), criteria for economic security as: 'security for whom', 'for which values', 'from what threats' and 'by what means', economic security will be defined. And while an extensive amount of research has been placed on economic security in recent years, with particular focus on development, there remains a gap between a state's national economic security and CRA's. Therefore it is necessary to illustrate that economic security essentially refers to the adequacy of economic stability, through employment, welfare, and socio-economics. And with the understanding of security broadening to encompass various fractions of economic security, is far more focused. Yadchenko (2006), states that economic security forms the basis of any national security, and closely interlinks with various neighbouring sectors such as defence, food and energy security. While Senchagov (1995) provides a clear definition of economic security as: "a state of the economy and its institutions, at which the guaranteed protection of economic interests, aimed at developing the country's economy as a whole under the most adverse conditions of internal and external processes". Therefore, this research report must build on the existing notion of economic security and apply it to CRA's to illustrate the extent of the impact a downgrade to junk status has on a state.

2.8. Downgrades only further aid existing economic problems?

Whilst various articles highlight the debate that downgrades negatively impact upon a state, other studies have found downgrades simply worsen existing economic conditions. Tichy (2011) illustrates that CRA's play a role in boosting financial problems into liquidity and solvency crisis, using the example of Greece, as rapidly implementing a downgrade in response to a mainly political decision. As seen in Brazil and South Africa, this results in unjustifiably intensifying countries existing problems, driving up market rates, further preventing access to financial markets, and undermining the rescue operations of the IMF (Tichy, 2011). This has been further illustrated by the gradual downgrading of a sovereign rating, illustrated with Mexico in 1994/5 during the Mexican Peso crisis, can intensify the financial crisis.

Therefore, while research on the effects of rating changes has flourished in the 1990s, (Cantor and Packer, 1996; Larrain et al., 1997; Reisen and von Maztlan, 1999), and works such as (Kaminsky and Schmukler, 2002) provide an analysis on how CRAs contribute to instability, his focus remained concentrated within ten days. Similarly, Iyengar (2012) argues that CRAs (Moody's and Standard & Poor's), are not consistent in applying the criteria which results in a significant issue as the degradation of ratings, further aggravates the economic conditions for borrowing, hindering existing financial issues.

In addition, Slabbert (2016) highlights the impact of a downgrade to 'junk status' on government bond spread, concluding that while there may not be a profound effect on bond spreads, there is a substantial increase in the volatility surrounding the government bond spreads. However, with the expectation that a downgrade could result in higher debt service costs for the government, with poor credit rating states struggling to fund their debt. This study gathered mixed results, retaining an impact mainly within the short-term rather than the long-term, impacting only certain cases 10-year bond spreads. Still, this behaviour is not predictable, as it is not the only factor in play that influences a sovereign spread behaviour. With the market reacting to other macro-economic factors, as the sizeable influence of CRAs remains to be questioned. Hence, my study aims to investigate the extent of influence a downgrade to junk status has on the economic security of a state, highlighting the contrast between a sizeable direct impact, previously illustrate, and merely adding to an already worsening situation.

The study by Kraussl (2003) analyses the role of CRAs in international financial markets, focused on whether they have an impact on the financial stability in emerging market economies, using event study and panel regression. He concludes that CRAs have a substantial influence on the size and volatility of emerging markets lending, with a more significant impact when a rating is downgraded rather than upgraded. Similarly, Reisen and von Maltzan (1999), testing 29 countries from 1989 to 1997, also find a significant effect when a country was placed on review for a downgrade, mirroring, Cantor and Packer (1996) study that found an immediate impact. Hence, while a downgrade is seen to have a greater impact, studies illustrate this is particularly true for emerging economies, as Rabinowitz (2014) argues that rating agencies are "promoters of financial market turbulence". Similarly, Gültekin-Karakas et al. (2011), argued that rating agencies are inconsistent, and disfavour emerging markets more so than developed economies.

In addition, the Mulder and Perrelli (2002) study, which argues that emerging markets usually receive relatively low ratings and frequent rating downgrades, with a study focused on East Asia, in the late 1990s. He argues that although markets had various problems which resulted in the Asian financial crisis, both the political and economic imbalances were not large enough to warrant the multi-notch downgrades, which further aided and magnified the financial crisis. As the CRAs were critiqued for the handlings of the Asian crisis, false-positive ratings beforehand, and harsh rating during the crisis (Mulder and Perrelli, 2002). Rating agencies have also been critiqued for the inefficiency and poor operating practices, which was highlighted as causation to the financial crisis of 2008-2009 (Krantz, 2013). As the significant agencies, all failed to warn investors of the dangers of investing in many of the mortgage-backed securities while profiting at their expense (Krantz, 2013). CRAs were labelled the "key enablers of the financial meltdown (Krantz, 2013), with 75% of debt securities receiving AAA rating from agencies. Yet, more than 70% defaulted, hence, illustrating the strong over-reliance on rating agencies (Krantz, 2013). Thus, my study aims to build on the debate amongst authors and fill the gap by examining whether downgrades simply worsen existing economic challenges, or have a direct impact upon a state's economic security.

2.9. Conclusion

To conclude this chapter, this literature review provided an overview of the existing literature on the role and necessity of CRA's while also examining the critiques of bias, timeliness and accuracy. This chapter highlighted the current debate in the literature, with some finding CRAs have a direct impact upon a state's economy, which is contrasted by the view that CRA's ratings merely further existing economic conditions. This debate forms the basis for my study's hypothesis, as I hope to add to the existing gap in literature. I aim to investigate, using an in-depth case study approach to determine which causal pathways impact a state's national economic security.

CHAPTER 3: CONCEPTUAL FRAMEWORK

3.1. Introduction

This section will provide an overview of the theory of neoliberalism, interlinking the I.R. theory with the notion of economic development, with a specific focus on the role CRA's play in achieving development for states. Building on from the literature review, which highlighted the debate between the importance and impact of credit agencies, the conceptual framework will provide the linkage between I.R. theory in the financial market and economic security, to understand the result of a downgrade upon a state. As previously highlighted, credit agencies have gained greater importance with the triumph of capitalism in the 1990s, I have decided to analyse using the critique of neoliberal as the conceptual lens. Hence, this section will firstly define neoliberalism, understanding the basics, the actors, institutions and policies of the I.R. theory. Thereafter, examining the development gap between policy and implementation, in closing the development gap, as illustrated with the failure of Structural adjustment programmes (SAPs) in bringing development to emerging economies. Thirdly, I will highlight the interlinkage between CRA's, which are viewed as neoliberal actors, and the neoliberal framework of development. Lastly, I will provide a critique of the neoliberal conceptual framework, resulting in economic insecurity in developing states. Therefore, as illustrated in *Figure 5,* this will give a needed breakdown of neoliberalism, in the context of CRA's, highlighting the relevance of the topic to the theory I.R.

Figure 5: The Components of Neoliberalism explored in this chapter

3.2. Defining neoliberalism

Neoliberalism, a contested term, is said to be by some authors, the revival of "liberalism", suggesting that liberalism as an ideology has been absent from theory and policy-making, hence, emerging in a more relevant form (Thorsen, 2009). While others view neoliberalism as an independent ideology, descending from liberalism, sharing similar historical roots, but providing a different ideological framework (Thorsen, 2009). Early influences on neoliberalism stem from pluralism literature in the 1960s and early 1970s. However, it was first coined in the 19th century, which challenged realist assumptions, arguing that non-state actors play a role in breaking down the barriers of domestic and international affairs (Folker, 2013). This is illustrated as the use of the term neoliberalism can be divided into two evident and distinct periods. Prior to the 1970s, neoliberalism was mainly a term that was introduced in the 1930s-1960s, associated with the likes of Freiburg Ordoliberalism school, the work of Friedrich Hayek, and the counter-Keynesian economics of the Chicago school (Thorsen, 2009). But, by the end of 1970s, neoliberalism was instead used as an explanation for the shift to market deregulation, privatisation, and the end of the welfare-state (Folker, 2013). Hence, by the early 1990s, neoliberalism was seen as the "capitalism in its millennial manifestation" (Thorsen, 2009).

David Harvey provides a widely used definition for neoliberalism, which "proposes that human wellbeing can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterised by strong private property rights, free markets and free trade" (Harvey, 2005, 2). Thus, Harvey views neoliberalism as independent of liberal values and policies, stating that neoliberalism is 'a theory of political, economic practices' (Thorsen, 2009). As there is not one concise definition the term, for this study, neoliberalism will be understood as "a set of political beliefs which most prominently and prototypically include the conviction that the only legitimate purpose of the state is to safeguard individual, especially commercial, liberty, as well as strong private property rights" (Thorsen, 2009, 14). Hence, neoliberalism can generally be understood as a "loose set of ideas of how the relationship between the state and its external environment ought to be organised" (Thorsen, 2009, 15) with limited state involvement, rather than a specific political ideology.

3.3 Main Actor

Thus, the main actor in a neoliberal state is the market, as it views the role of the country opposite to Keynesian Economy (where the state reforms the economic system), regarding the state as a weakened role in the neoliberal society, to favour the free market (Harvey, 2005). As Paul Treanor (2005) stated that “operation of a market or market-like structure is seen as an ethic in itself, capable of acting as a guide for all human action and substituting for all previously existing ethical beliefs” (19). Hence there is a large focus on *globalisation*, with the desire to intensify and expand the market, by increasing transactions. Thus the role of institutions plays a large role in securing a limited role by the government.

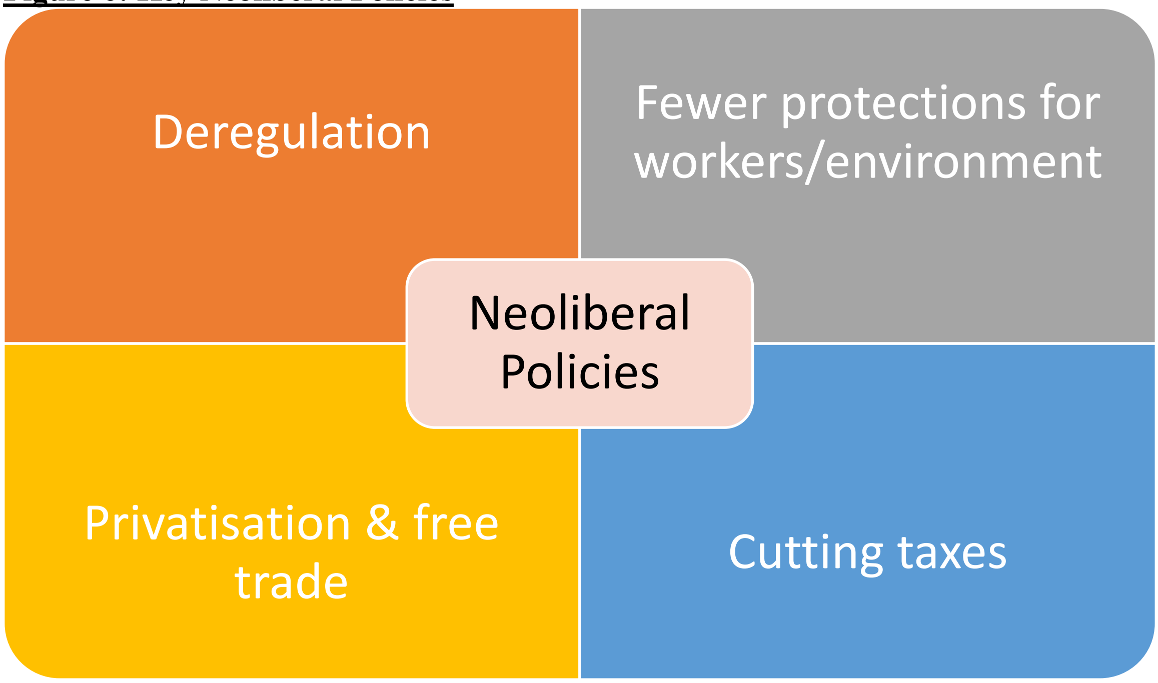
3.4. Main Neoliberal Institutions & Policies

As neoliberalism is a variant of liberal I.R. theory, there is a large focus on the role international institutions play in obtaining global collective outcomes, and pushing forward neoliberal policies of free trade, privatisation and deregulation (Thorsen, 2009). While neoliberalism notes the difficulty in obtaining international cooperation, much like a structural realist, however, with progressions of the 20th century, cooperation continues to become easier to achieve, with international institutions, to obtain particular collective interests (Folker, 2013). Thus, neoliberalists have “greater faith in the ability of human beings to obtain progressively improved collective outcomes that promote freedom, peace, prosperity, and justice on a global scale, as they argue that structure of international institutions plays an important role in determining the extent to which collective goals can be realised” (Folker, 2013, 115).

Neoliberalism continues to thrive, as imposed by powerful financial institutions such as the IMF, the WB, the World Trade Organisation (WTO) (Thorsen, 2009). For example, the WB, a financial institution that provides conditional loans to countries in need, is a product of neoliberalism. The institution currently argues that there has been a global decrease in inequality and extreme poverty, with extreme poverty having said to have decreased to a low of 10% in 2015, a slight decline from 11% in 2013 (World Bank, 2018). And with the number of people living on less than $1.90 a day falling by 68 million to a total of 76 million (World Bank, 2018). The neoliberal argument states that as a result of globalisation, the economic integration of more states actively participating within the world economy results in better efficiency of resources as countries specialise in line with their competitive advantage (Sakellariou and Rotarou, 2017). Hence, resulting in an equal world, which is less constrained by the North/South divide. According to neoliberals, this seemingly confirms, that globalisation, precisely the world economic regime which replaced Bretton Woods in 1971, results in mutual benefits rather than conflicting interests (World Bank, 2018). This is illustrated in the solution offered to Africa to reduce poverty and inequality, is a greater enhancement of free trade and increased open markets (World Bank, 2018).

Neoliberalism is understood by a set of policies implemented in the 1980s by the IMF, the W.B., and the United States of America Treasury Department, which is said to be an effort to help crisis-stricken developing through a series of reforms, known as the 'Washington Consensus' policies (Sakellariou and Rotarou, 2017). Such policies have aimed at achieving macroeconomic stabilisation, reducing governments' role in the economy, privatising public assets, and reducing public expenditure (Folker, 2013). An important factor of a neoliberal state is the retrenchment of the welfare state, as it is seen as an impediment to the functioning of the markets. Hence, cutting expenditure on public services such as education and healthcare, and placing more responsibility on the free market, which can also be seen to result in the spread of inequality in the levels of quality and production (Sakellariou and Rotarou, 2017).

Figure 6: Key Neoliberal Policies



(Thompson 2015)

Thus, vital neoliberal policies are highlighted in *Figure 6,* with firstly, the *rule of the market,* which focuses on greater openness to international trade and investment, such as the NAFTA (North American Free Trade Agreement), with limited price controls (Thompson, 2015). Hence, resulting in ultimately total freedom of movement for capital, goods, and services, which is viewed as the "best way to increase economic growth, which will ultimately benefit everyone" (Thompson, 2015). In order to achieve this limited government interference, another point is *cutting public expenditure for social services*; this includes education and health care. In addition, *deregulation and privatisation* form core characteristics of a neoliberal system, with a strong focus on *individual responsibility* (Thompson, 2015). And with the central concern being how to achieve cooperation among states and other actors in the international system, occurring when states adjust their behaviour to the actual or anticipated preferences of others', resulting in policies followed by one government being regarded by its partners as facilitating the realisation of their objectives (Thompson, 2015). In the current climate, China has surpassed the United States of America (USA) as the biggest trading nation in 2013, as well as the biggest exporter of goods since 2009 (Arora, 2016). This is illustrated in 2018, with a total export of $2,494,230,579.98 in mainly manufactured goods, clothing and textiles, to a total import of $2,134,982,614.99, in crude oil, integrated circuits, iron ores and petroleum gases, leading a positive trade balance (World Integrated Trade Solution, 2020). Thus, the neoliberal system has resulted in a greater flow of trade between states and increased capital.

3.5. Development under a Neoliberalism Framework

International development is said to have commenced following the Second World War, with President Truman's address in 1949, stating the United States declaration of support for the process of evolution from something undesirable (an underdeveloped state), to the advantageous and necessary, developed country (Rist, 2008). Thus, building on from Rostow's modernisation model in post-1945 development, providing a one-size-fits-all approach, which saw the transcendence from a traditional society, focused on agriculture, to pre-conditions for take-off, moving toward a more mechanised output of trade. In contrast, take-off saw a more significant manufacturing industry. In contrast, the drive to maturity, saw the economy becoming more diverse, and age of mass consumption is the endpoint, the increased consumer expenditure (Rostow, 1956). However, this one-size-fits-all model approach was heavily criticised due to its creation of dependency cycle for poorer states on those more developed, while ignoring the historical transgressions which continued to plague emerging countries (Wade, 2004).

However, under Margaret Thatcher and Ronald Reagan, with the establishment of Washington Consensus, free-trade and limited governance, saw the promotion of privatisation, pro-market and anti-government intervention (Reid-Henry, 2012). Thus, providing support for big business, transnational corporations and finance (Reid-Henry, 2012). This intensified globalisation, proving to be a double-edged sword, with development. Thus, the targeted measures of global free markets as a requirement to ensure any development in poorer states, rather than protectionist policies of East Asian Tigers, for example, which proved successful (Smith, 2015).

3.6. Critiques of Neoliberalism

The impacts of neoliberalism on the economic, social, and political life has been widely investigated, particularly in the context of the SAPs, which were applied in the 1980s and 1990s to countries under crisis in Africa, Latin America, and the former Soviet Union. However, with the recent economic crisis of 2008, this has furthered critiqued of neoliberal policies as many governments have been adopting austerity measures to decrease their budget expenditure (Sakellariou and Rotarou, 2017). Rist (2008), provides a challenge to the orthodox understandings of development, arguing that the United States role as world hegemony set the tone for development. And forming the replacement of colonialism, in which Truman coined the term underdeveloped, which resulted in a bifurcated world into developed vs underdeveloped (Rist, 2008). Underdevelopment refers to countries that economically 'backward', thus, creating the necessity for all underdeveloped state to transition into developed states. This is illustrated in the article by Mkandawire (2014), with the argument that ideas and policy-orientation matter influence the structure of relations and agency of the third world.

It must be noted, the dire effects of SAPs had in the 1990s, and with the use of foreign aid in continuing a cycle of poverty and ensuring wider inequality within the Global South. Structural Adjustment Policies were implemented by both the WB, and the IMF to ensure debt repayment and economic restructuring (Shah, 2013). Thus, impacting a state's domestic policies, illustrating the immense influence of IMF, as "never in history has an international agency exercised such authority" (Kingston, 2011, 117). This saw over 70 emerging state subject to 566 SAPs between 1980 to 1993 and labelled as 'Africa's lost decade' as emerging countries transferred $178 billion to Western commercial banks between 1984 to 1990 (Kingston, 2011).

Similar conditionalities have continued in the current period, which is attached to loans provided to countries in need based on neoliberal ideals. This has resulted in developing countries having to reduce spending on fundamental rights of its citizens, such as healthcare and education, hence, lowering the standard of living of their people to rather prioritise

neoliberal policies and debt repayment (Shah, 2013). These conditionalities have seen widely negative results, as highlighted in Venezuela, Sudan, and Zambia (Shah, 2013). For example, of conditionalities placed on countries to enforce policies to favour debt repayment (Kingston, 2011):
a. Privatisation of industries and cuts in government spending
b. Liberalising of capital markets
c. Market-based pricing (which usually raise the price of essential goods)
d. Higher interest rates and trade liberalisation

Hence, there remains a gap between policy implementation and development, which can be illustrated in the case of Zimbabwe. Zimbabwe saw rapid economic growth 1980s prior to the involvement of IMF, growing by 4%, with a reasonable degree of food security, debt repayment and diversification of the economy (Kingston, 2011). In comparison, significant provisions were made for education and health care services, with life expectancy increasing from 56 to 64 years. However, in 1991, Zimbabwe began a structural adjustment programme, accepting a loan of $484 million from the IMF, with the hopes of emerging the country's rapid economic growth (Kingston, 2011). With the policies enforced, included cuts in the fiscal deficit, tax reduction and deregulation of financial markets, and the removal of protectionist policies as well as lowering the minimum wage. In addition, a severe drought occurred, and with the IMF policy changes, saw restrictions on the government in curbing the impact on the economy as the country fell into recession (Kingston, 2011). The effect of SAPs which followed saw a decrease in manufacturing, real GDP, cuts in public spending saw cuts in wages with an increase in nominal interest rates and a decline in investment(Kingston, 2011). Hence, one-size-fits-all policies have hindered growth and development in emerging economies. Although China has become an evident alternative for many African countries for loans, they too bring their issues, such as the lack of using local suppliers in the development and local employment.

Caroline Thomas's article (2001), *Global Governance, development and human security: exploring the links*, highlights this issue, by examining the links between global governance, development and human security. Thomas focuses on the increasing material inequality evident between states, within states and among private corporations. Hence, the core elites have continuously benefited, from this false legitimacy of one-size-fits-all, and the developing countries have "gained little or nothing from the economic growth that has occurred as a result of globalisation to date" (Thomas, 2001, 161). She uses the example of the IMF, OECD and bond-rating agencies, to illustrate how global governance is centred around protecting the Western states. This is illustrated by holding up Western norms as universal, with the USA having 17.4% of the voting power and the OECD organisation which make decisions that only 'conforms to the interests of, the G7 core capitalist states and their corporations' (Thomas, 2001). Hence, directly impacting the human experience of security and the prospects for enhancing security, as seen defines human security as "security against economic privatisation, an acceptable quality of life, and a guarantee of fundamental human rights" arguing for a de-growth approach to development (Thomas, 2001, 161). Resulting in uneven distribution, widening income inequalities, illustrated in the present day, with 767 million people living below the poverty line of $1.90 per day, with "the world continue[ing] to suffer from substantial inequalities" (World Bank, 2016: 4). Hence, it is the one-size-fits-all model that continues to weaken the neoliberal policy regarding the implementation, as each nation as vastly differing economic and historical circumstance.

The neoliberal argument is further proven to be incorrect, as Wade (2004) refers to a recent study which highlights that among states with low/middle levels of average income, higher levels of trade openness is associated with more inequality. In contrast, higher-income countries, more openness lines with less inequality (Wade, 2004). In addition, without the reverse causation being examined, fast trade growth is assumed to be the primary cause of good economic performance. This neglects other necessary variables correlated with trade growth, such as quality of government and lack of corruption (Wade, 2004). Hence, a broader scale is required to determine a state's developmental progress, as, without a strong functioning government and low debt levels, a country's ability to progress can be hindered. A predominant factor of neoliberal policy, is the increase in inequality, with South Africa and Brazil leading the way for the largest unequal developing nations, thus further resulting in higher poverty, slower economic growth, higher unemployment and higher crime (Wade, 2004).

3.7. Link with CRAs on Development

Thus, CRA's play an essential role in the global capital markets, as the help states access funding which promotes economic prosperity and jobs. As IMF stated CRAs "allow borrowers to access global and domestic markets and attract investment funds, thereby adding liquidity to markets that would otherwise be illiquid" (Peterson, 2013, 3). In addition, capital markets continue to play a greater role in financing governments as banks become subject to higher capital requirements and other restrictions, thus increasing the demand for CRA's research and ratings (Peterson, 2013). This is due to the high regard for CRAs in the global system, with many investors closely following the advice of CRAs, before transferring capital to emerging markets, thus negatively impacting the ability for emerging markets to borrow, and attract investors, thus weakening domestic bond markets (Krantz, 2013).

Although there are various benefits to CRA's, it is not without its critiques, with rating agencies seen as 'promoters of financial market turbulence', due to the negative impact of downgrades primarily limited to emerging economies (Rabinowitz, 2014). While CRAs have justified their downgrades, by emphasising ratings are merely 'credit opinions' on the probability of default, with rating determined by a mixture of quantitative criteria and subjective judgement, yet, under-rating a country due to bias or misinformation can have severe consequences (Krantz, 2013).

Furthermore, emerging markets receive relatively low ratings and frequently rating downgrades. This is illustrated in East Asia, in the late 1990s, as Mulder and Perrelli (2001) argue that although markets had various problems which resulted in the Asian financial crisis. Both the political and economic imbalances were not large enough to warrant the multi-notch downgrades, which further aided and magnified the financial crisis. The CRAs were critiqued for the handlings of the Asian crisis, false-positive ratings beforehand, and harsh rating during the crisis (Mulder and Perrelli, 2001). Similarly, a study by Gültekin-Karakas et al. (2011), argued that rating agencies are inconsistent, and disfavour emerging markets more so than developed economies.

Similarly, rating agencies have been critiqued for the inefficiency and poor operating practices, which was a factor in the financial crisis of 2008-2009 (Krantz, 2013). The three big agencies; S&P, Moody's and Fitch, all failed to warn investors of the dangers of investing in many of the mortgage-backed securities at the epicentre of the financial crisis while profiting at their expense (Krantz, 2013). As stated, CRAs were "key enablers of the financial meltdown", with 75% of debt securities receiving AAA rating from agencies, yet, more than 70% defaulted, hence, illustrating the strong over-reliance on rating agencies (Krantz, 2013). Thus, critical errors like this could occur again. Therefore, it is necessary to examine alternatives, or as with the example of South Africa, have a more 'restrictive outlook' with 'excessive regulations, as this helped limit the impact of the financial crisis of 2008 on South Africa (Rabinowitz, 2014).

3.8. Conclusion

To conclude, this section has provided an overview of the theory of neoliberalism, highlighting the basics, policies and institutions and providing an overview of development under the neoliberal framework. In addition, a critique of the neoliberal framework, highlighting the shift in policy and implementation as development is not a one-size-fits-all model that can be used as a blueprint for all states. The policies and SAPs can further hinder development, and increase inequality, in which CRAs play an increasing role in the financial market. Thus impacting upon an emerging state's ability to develop, which will be explored further in the upcoming chapter. Hence, this has provided an overview of neoliberalism, interlinking the critical I.R. theory, and providing the foundation for understanding development in the current climate.

CHAPTER 4: HISTORICAL VIEW OF THE ROLE OF CREDIT RATING AGENCIES IN DEVELOPING STATES

4.1. Introduction

This chapter will provide a historical overview of how CRA's have evolved, with a focus on development and recovery, particularly in developing states. This is necessary to explore, as CRA's stand at a critical juncture between stagnated development and at times underdevelopment, and economic prosperity. In addition, this section will illustrate case studies of states that have been downgraded to junk status by all three agencies, from an investment rating, that have both recovered and yet to recover, to illustrate a broad overview of the impact a downgrade to junk status has on emerging economies. Therefore, this chapter aims to build on from conceptual framework which outlined neoliberal notion and critique of development, to integrate with credit agencies and the impact downgrade to junk status has on obtaining such a level of development. Hence, this chapter will firstly, outline the role of CRAs, and thereafter examine the impact of junk status on both recovered and unrecovered case studies.

4.2. Role of CRA's in the Global Financial Sector

As previously discussed in Chapter 1, the primary function of rating agencies is to facilitate the efficient allocation of credit between lenders and borrowers by increasing the level of transparency and information available in a particular capital market (Thompson, 2013). Hence, CRAs facilitate the flow of information by analysing all available data and delivering it more simply to each investor. Thus, increasing efficiency in capital markets, by reducing the asymmetry in public information, and publishing opinions about a debtor's credit risk, and how likely it is that debtor will repay its creditors (Thompson, 2013). As investors are seen to be risk-averse, yet profit-seeking, the demand for CRAs remains high. The post-Cold War era has witnessed the triumph of capitalism and neoliberal policies. With the globalisation of the financial sector, this has resulted in greater reliance and demand for CRA's (Thompson, 2013). CRAs on emerging economies remain below the first-world economies, with investors advised to only invest in entities that meet or exceed a minimum credit rating standard. While more information is available in developed and democratic states, they often propelled above emerging economies. Therefore, it must be noted that ratings are an essential tool in assessing financial stability, and determining the level of access borrowers should be granted to loans and deb (Rabinowitz, 2014).

CRAs can be beneficial to emerging markets, as they provide access to international capital, and thus helps in debt markets whereby an issuer is not well known. Rating agencies are seen to 'pierce the fog' of asymmetric information that surrounds lending relationships (Lynch, 1999). CRAs are also a useful tool in providing access to global capital markets, as international investors prefer rated securities rather than non-assessed securities (Rabinowitz, 2014). The gathering of information has a high cost, and as such, fees are imposed on the issuers of rated securities, rather than the sales of a particular financial product. Yet, markets view the expensive as necessary to enable new investors to invest in their markets (Rabinowitz, 2014).

4.3. The Impact of Junk Status on a State's National Economy

In April 2017, S&P downgraded South Africa's credit outlook to junk status, which was followed by a downgrading by Fitch Ratings (Winning, 2020). This was recently followed up by Moody's, on the 27th March 2020. With economists stating it will likely take seven years for a country to recover to an investment grading, it is essential to look at all case studies that have been downgraded, for predicting the impact expected after South Africa's recent downgrading (Winning, 2020). The effect on the national economy of a state due to a junk status downgrade remains debatable as previously illustrated in Chapter 2. Therefore, this section will provide an analysis, using the criteria of countries that have been downgraded to junk status, from an investment grading by all three agencies. This resulted in 14 states meeting the criteria: Colombia, Indonesia, South Korea, Portugal, Slovakia, Hungary, Greece, Azerbaijan, Brazil, Oman, Bahrain, Tunisia, as well as Croatia, Cyrus and South Africa (Trading Economics, 2020). For analysis purposes, I have separated states that have recovered and states that yet to recover from junk status.

While S&P, Moody's and Fitch have been critiqued for their failure to adequately provide warning of crises (Sakellariou and Rotarou, 2017), sovereign rating failures is a necessary component to explore (Bhatia, 2002). Thus, as their deviations should ideally decide sovereign rating failures from a true underlying measure of creditworthiness, yet, as explored, CRAs suffer from various shortfalls, as ratings are predicted through limited information while surrounded by default risk (Bhatia, 2002).

Figure 7 illustrates the rating failure to the long-term foreign currency sovereign ratings of both Moody's and Standard & Poor from 1997-2002, with both experiencing failures during the Asian financial crisis (Bhatia, 2002). While they differ, with S&P failure during the Russian and Argentinean financial crisis, Moody's only failed during the Russian crisis (Bhatia, 2002). Bhatia suggests rating failures were less prevalent in 1999-2002 than in 1997-1998, hinting at an improvement, however, with the 2008 financial crisis failure, criticism has continued to mount against CRA's (Bhatia, 2002).

<u>Figure 7: Sovereign rating failure statistics from 1997-2002</u>

Sovereign ratings failure statistics, 1997–2002[1/]

Failure	Failed rating (and date)[2]	Corrected rating (and date)[2]	Notches adjusted[3]	Key factor
S&P				
1997: Thailand	A (3 Sep. 1997)	BBB- (8 Jan. 1998)	4↓ (0.97)	Evaporation of reserves
1997: Indonesia	BBB (10 Oct. 1997)	B- (11 Mar. 1998)	7↓ (1.40)	Collapse of asset quality
1997: Rep. of Korea	AA- (24 Oct. 1997)	B+ (22 Dec. 1997)	10↓ (5.26)	Evaporation of reserves
1997: Malaysia	A+ (23 Dec. 1997)	BBB- (15 Sep. 1998)	5↓ (0.57)	Collapse of asset quality
1998:Rep. of Korea	B+ (18 Feb. 1998)	BBB- (25 Jan. 1999)	4↑ (0.36	Reserves replenishment
1998: Romania	BB- (20 May 1998)	B- (19 Oct. 1998)	3↓ (0.61)	Evaporation of reserves
1998: Russian Federation	BB- (9 June 1998)	B- (13 Aug. 1998)	3↓ (1.43)	Evaporation of reserves
2000: Argentina	BB (14 Nov. 2000)	B- (12 July 2001)	4↓ (0.50)	Fiscal slippage
2002. Uruguay	BBB- (14 Feb. 2002)	B (26 July 2002)	5↓ (0.94)	Evaporation of reserves
Moody's				
1997: Thailand	A2 (8 Apr. 1997)	Bal (21 Dec. 1997)	5↓ (0.68)	Evaporation of reserves
1997:Rep. of Korea	A1 (27 Nov. 1997)	Bal (21 Dec. 1997)	6↓ (7.83)	Evaporation of reserves
1997: Indonesia	Baa3 (21 Dec. 1997)	B3 (20 Mar. 1998)	6↓ (2.05)	Collapse of asset quality
1997: Malaysia	A1 (21 Dec. 1997	Baa2 (14 Sep. 1998)	4↓ (0.46)	Collapse of asset quality
1998:Russian Federation	Ba2 (11 Mar. 1998)	B3 (21 Aug. 1998)	4↓ (0.75)	Evaporation of reserves
1998:Moldovia	Ba2 (14 July 1998)	B2 (14 July 1998)	3↓ (90.00)	Evaporation of reserves
1998:Romania	Ba3 (14 Sep. 1998)	B3 (6 Nov. 1998)	3↓ (1.76)	Evaporation of reserves
2002: Uruguay	Baa3 (3 May 2002)	B3 (31 July 2002)	6↓ (2.07)	Evaporation of reserves

Source: Bhatia (2002: box 5).

Notes: 1/ Ratings failure defined by successive downgrades or upgrades of a long-term foreign currency sovereign rating by three or more notches in aggregate during any rolling 12-month period, excluding downgrades or upgrades into, out of , within, or between the ratings categories from "CCC" or "Caa" downward. Based on ratings activity up to-end July 2002, coverage of failures from August 2001 on is therefore partial.

2/ Refers to a long-term foreign currency sovereign rating.

3/ Notches of ratings downgrades (↓) or upgrades (↑). Figures in parentheses capture the speed of adjustment, in notches per month (notches of adjustment divided by the number of months from start to end of the corrective sequence).

Copied from Bhatia (2002)

Hence, the primary purpose of obtaining a credit rating is to gain investment and access to private capital markets, as well as lower debt issuance and interest costs. Studies by (Ramakrishnan and Thakor, 1984; Millon and Thakor, 1985) suggest this could be accomplished due to agency certifying its value in a market (Elkhoury, 2008). The benefits for emerging markets to be graded include:

- Fostering FDI
- Promote local capital markets
- Greater public sector financial transparency

However, the predicted effects of a downgrade are said to be far more severe, as illustrated in *Chapter 2.* Studies have found the general longer term effects of a downgrade to junk status:

- Increasing inflationary pressure and cost of living

- Exchange rate depreciation
- Increases in interest rates
- Increases debt repayment
- Lower FDI
- Low Economic growth
- Redistribution of country's state resources, away from public spending
- A decrease in grants and social security payments

Due to the occurrence of currency crashes, investors tend to be paranoid, which at times results in overreaction to sovereign rating news, in addition to local currencies and spill-over effect (Croeser, 2017). It must be noted that sovereign credit ratings are based upon a long term outlook, rather than a reflection of the current climate (Nguyen and Zu Knyphausen-Aufseb, 2014). The financial sector is primarily influenced by macro-economic variables such as inflation, GDP, and interest rates. Thus, there is less concern about the current stance of the rating agency, as reactions tend to temporary and less volatile to market news (Croeser, 2017). However, the reliance on credit agencies to attract external investors will be hindered, limiting financial corporation ability to access debt capital and FDIs (Afonso, Furceri and Gomes, 2012). In addition, they are said to have a long-lasting effect on the banking sector, and with ongoing financial crises, an overreaction to non-investment can be predicted (Croeser, 2017). Thus, illustrating the necessity to examine the causal mechanism between a junk status rating and economic insecurity.

A. States that have recovered from 'junk status'

Firstly, *Table 2* illustrates the six states that have fully recovered from junk status by all three agencies, with the years ranging from 1 to 15 years of recovery (Trading Economics, 2020). There are various causes for the downgrades of each state, such as the Asian financial crisis of 1997, which had a direct effect on both South Korea, and Indonesia (Wie, 2003). However, the recovery periods are starkly different, with South Korea taking over a year, while Indonesia took 15 years to recover. This is due to South Korea's $58.4 billion loan from IMF to keep running, and vast economic policy reforms and strong leadership which helped lead to a quick recovery (Huffpost, 2017). With strong leadership, conglomerates restructured, reduced debt levels, and focusing on pivotal business ventures. The presidency also lured foreign investors with tax incentives, subsidies, and by the end of 1999, the financial crisis was declared over, gaining investment grading back as the economy was booming (Huffpost, 2017).

Thus, South Korea economic policies included a program of macroeconomic adjustment and structural reform, which was supported by the government funding of 15.5 billion for SDR (Balino and Ubide, 1999). Policies were focused on various areas: banking sectors, restructuring and recapitalising the sector through temporary liquidity support and passing law to strengthen the independence of Bank of Korea, to ensure adequate redress of the issue of bad loans and a weak capital base (Balino and Ubide, 1999). In addition, redress of the financial sector, strengthening supervision and management to prevent the reoccurrence in the future (Balino and Ubide, 1999). The implementation strategy had to be in stages due to the magnitude, addressing the issue of insolvent merchant banks, to restore confidence. And a year later, through intense policy reform, the foreign exchange reserves rebuilt, exchange rate stabilised, and interest rates were below pre-crisis levels. In contrast, inflation rates were kept under control, and ultimately economic growth resulted (Balino and Ubide, 1999). Hence, the quick turnaround to regain investment grading (Wie, 2003).

Whilst, for Indonesia, embedded with high corruption and poor infrastructure, took over a decade, with the upgrade occurring due to the country's strong and resilient economic growth, low and declining public debt and strengthened external liquidity (Wie, 2003). This upgrade was long expected, which reduces the country's borrowing costs and closing the gap with BRIC nations, allowing for more risk-averse investors, having a positive impact on the bond market (Reuters, 2011). This resulted in improvements in corruption, increasing from 1.9 in 2001 to 3 in 2011 on the Transparency International Corruption perception index. As well as the high growth rate from 3.3 in 2001 to more than 6% in later years (Reuters, 2011). Hence, helping ensure greater fiscal stability and a boom in exports, particularly oil and coal, and with an increasing consumer market, enabling the avoidance of a recession through the 2008 financial crisis (Reuters, 2011).

Whilst Portugal, one of the worst affected countries by the euro zone's sovereign debt crisis, was downgraded to junk status. The nation struggled under lower-ranking, with political and economic turmoil, including bad loans and persistently high unemployment (Nelson, 2017), with the unemployment hit a high of 17.5% in 2013, but slowly declined, reaching under 10% by 2017 (Trading Economics, 2020). However, after five years, Portugal managed to regain its investment grade, due to economic growth, stability and debt reduction (Nelson, 2017). The upgrade was viewed to have a very significant impact, attracting investors, illustrated with the yield on Portugal's 10-year bond plunged by 0.3 % (occurs when bond prices rise), with the announcement (Nelson, 2017). While, Slovakia and Colombia faced junk status, due to economic deterioration, but managed to recover through high economic growth and reduction in debt, and ability to deal with both internal and external shocks (Nelson, 2017). Slovakia managed to recover from -5% GDP growth rate in 1999-2000, to steady growth over 5% in 2001. While Colombia GDP growth has been volatile, but after a decline to under 1% in 2009, they managed to show steady growth at over 4% (Trading Economics, 2020).

In contrast, Hungary fell to junk status, as a result of 'unorthodox policies', due to its center-right government accused of undermining the central bank's independence and imposing losses on country's foreign-owned banks (BBC, 2012). This resulted in hostility with IMF over loan facility, with foreign-currency mortgages being the most significant challenges. Ultimately, the downgrade reflected the further deterioration of the country's fiscal and external financing environment and growth outlook (BBC, 2012). With GDP declining to -2% in 2012, to a steady increase to over 1% in 2016 (Trading Economics, 2020). However, by 2016, due to improvement in economic growth, and reflecting better preparedness to handle unexpected crises, Hungary was upgraded into investment grading.

It must be noted, other states that were successful in recovering from a junk status rating by one or two of the agencies, include Ireland, from 2010-2013, and Iceland from 2008-2012 (Mutize and Gossel, 2019). Ireland's economy collapsed due to the global recession and the collapse of the local housing market, which required 64 billion Euro bank bailout (Huffpost, 2017). The loan and committing itself to austerity was all it needed, labelled the 'Celtic Phoenix', which saw strong growth, particularly in the construction sector and a strong commitment to multinational investment. It was able to exit the EU bailout in 2013, and by 2014, Ireland was one of the fastest-growing economies in the EU, at 4.8% (Huffpost, 2017). While for Iceland, as a result of the economic crisis of 2008, and reckless banking sector, were surprisingly able to swiftly recover, by placing austerity measures and political change (Huffpost, 2017). In addition to relying on IMF and neighbouring states to gain a $4.6 billion loan, which helped in stabilising the economy and keeping inflation under control. This also saw the government nationalised the banks which caused the financial crisis, and focused on diversifying the economy into renewable energy, and with a new political party voted in, by mid-2012, Iceland had strong economic growth and investment grading (Mutize and Gossel, 2019).

Table 2: Case Studies that have fully recovered from junk status from all three agencies

Case Studies	**Last Grading Before Downgrade**	**Grading after downgraded to Junk Status**	**Grading once Recovered from Junk Status**	**Current Grading**
Colombia	**S&P:** BBB- [11Jun '99]	BB+ [21st Sep '99]	BBB- [16th March '11]	BBB- [12th December '17]
	Fitch: BBB [10th August '94]	BB+ [17th March' 00]	BBB- [23Jun11]	BBB [23rd May' 19]
	Moody's: Baa3 [30th September '98]	Ba2[11Aug 99]	Baa3[31May11	Baa2 [23rd May '19]
Indonesia	**S&P:** BBB- [10th Oct '97]	BB+ [31 Dec 97]	BBB- [19May '12]	BBB [31st May '19]
	Fitch: BBB- [17th Dec '97]	BB+ [22Dec97]	BBB- [15 Dec 11]	BBB [21st Dec '17]
	Moody's: Baa3 [14th March '94]	Ba1 [21Dec97]	Baa3 [18Jan 12]	Baa2 [13th April '18]
South Korea	**S&P:** BBB- [11th Dec '97]	B+ [22nd Dec 97]	BBB- [25 Jan '99]	AA [8th August '19]
	Fitch:BBB- [11 Dec 97]	B- [23 Dec 97]	BBB- [19 Jan 99]	AA- [6Sep12
	Moody's: Baa2 [10 Dec 97]	Ba1 [21 97]	Baa3 [12th February 99]	Aa2 [18Dec15]
Portugal	**S&P** BBB- [5 Dec 2011]	BB [13th January 12]	BBB- [15 Sep 2017]	BBB [15 Mar 19
	Fitch			

	BBB- [1 apr 11] **Moody's** Baa1 [5th April 11]	BB+ [21 Nov 11] Ba2 [5 Jul 11]	BBB [15 Dec 17] Baa3 [12 Oct 18]	BBB [24 May 19 Baa3 [9Aug 19
Slovakia	**S&P:** BBB- [6th Apr 98]	BB+ [17th Sep 98]	BBB- [30th Oct 01]	A+ [31st July 15]
	Fitch:BBB- [5th Oct 98]	BB+ [22nd Dec 98]	BBB- [1 Nov 02]	A+ [8th June 08]
	Moody's: Baa3 [20th January 98]	Ba1 [30th March 98]	Baa3 [13th Nov 01]	A2 [7th April 17

Hungary	**S&P:** BBB- [11th Nov 2011]	BB+ [21 Dec 2011]	BBB- [16th Sep 2016]	BBB. (22nd February 2019
	Fitch: BBB- [11th Nov 2011]	BB+ [6th January 2012]	BBB- [20th May 2016]	BBB [22nd Feb2019]
	Moody's: Baa3 [6th Nov 2010]	Ba1 [24th November 2011]	Baa3 [4th November 2016]	Baa3.

<u>B. States that have yet to recover from 'junk status'</u>

Secondly, I will examine states that had been downgraded to junk status by all three agencies from an investment grading and have yet to recover from the junk status rating by all three agencies. This resulted in 7 cases: Greece, Brazil, Tunisia, Bahrain, Azerbaijan, Oman, and South Africa, as illustrated in *Table 3* (Trading Economics, 2020). It must be noted that Cyrus, and Croatia, which all received junk status by all three agencies from an investment grading, are not applicable. Both countries have since received an investment rating upgrade by two of the three leading credit agencies: Cyrus and Croatia have been upgraded to BBB- by both Fitch and S&P in 2018 and 2019 respectively while retaining a non-investment grade of Ba2 by Moody's (Trading Economics, 2020).

Table 3: Case studies that have yet to recover from junk status by all 3 agencies

Case studies	***S&P*** *Last Grading Before Downgrade*	***S&P*** *Grading After Downgrade*	***Fitch*** *Last Grading Before Downgrade*	***Fitch*** *Grading After Downgrade*	***Moody's*** *Last Grading Before Downgrade*	***Moody's*** *Grading After Downgrade*
Greece	BBB+ [16th Dec 2009]	BB+ [27th April 2010]	BBB- [21 Dec 2010]	BB+ [14 Jan 2011]	A3 [22nd April 2010]	BA1 [14th June 2010]
Azerbaijan	BBB- [30th Jan 2015]	BB+ [29th Jan 2016]	BBB- [11 May 2012]	BB+ [26th Feb 2016]	Baa3 [19th April 2012]	Ba1 [5th Feb 2016]
Brazil	BBB- [28th June 2015]	BB+ [9th Sep 2015]	BBB- [15th Oct 2015]	BB+ [16th Dec 2015]	Baa3 [9th Dec 2015]	BB+ [16th Dec 2015]
Tunisia	BBB- [28th June 2011]	BB [23rd March 2012]	BBB- [2 Mar 2011]	BB+ [12th Dec 2012]	Baa3 [19th Jan 2011]	Ba1 [28th February 2013]
Bahrain	BBB- [9th Feb 2015]	BB [17th February 2016]	BBB- [4th 2015]	BB+ [28th Jun 2016] BB+ [18th	Baa3 [16th Apr 2015]	Ba1 [4th March 2016]
Oman	BBB- [11th Nov 2016]	BB+ [12th May 2017	BBB- [11th Dec 2017]	Dec 2018]	Baa3 [16th Mar 2018]	Ba1 [5th March 2019]
South Africa	BBB- [4th Dec 2019]	BB- [3rd Apr 2020]	BBB- [25th Nov 2016]	BB [30th Apr 2020]	Baa3 [1st Nov 2019	Ba 1 [27th March 2020]

(Data from: Trading Economics 2020)

Brazil, prior to downgrade was filled with political uncertainty, failure to reform the pension system, large fiscal deficits, this coming as the country just came out of most prolonged recession in history (Gillespie, 2018). With the corruption-fuelled recession, Brazil ranked 96th out of 180 countries, which also saw high unemployment and debt rates (Gillespie, 2018). However, the economy in Brazil continues to worsen, whilst with a lack of political and economic reform playing a central role, impacting upon stocks and currency (CNA, 2019). Nation-wide protests over education spending freezes, and corruption, with Economic

Minister, Paulo Guedes warning that Brazil was "at the bottom of the well", slashing the forecast of economic growth to 1.5% from 2.2%, with a negative outlook expected continued (CNA, 2019). While Brazil has experienced surges and losses in the economy throughout the last decades, political weakness, and high debt placed the country at risk of junk status, however, Brazil's geopolitical position places in a better position to Greece to recover to an investment once steady economic growth is achieved.

While for Greece, the downgrade in 2010/2011 hit hard, with Moody's dropping Greece rating 4 notches, from A3 to Ba1 on government bond ratings, over risks to an EU/IMF bailout package, which highlighted persisting doubts over the country's ability to manage its severe debt crisis (Melander, 2010). The Euro debt crisis which was a result from the Global Financial Crisis in 2008, saw Greece's government bond yields increase, with debt becoming expensive and unsustainable, in which Greece became reliant on financial assistance (Melander, 2010). After the downgrade for Greece, public debt skyrocketed, currency depreciation, and the situation has still not improved, with the country asking for two more bailouts, one in 2012 and another in 2015 and 2018, with debt continuing to rise (Sakellariou and Rotarou, 2017). This will be explored in more depth in the following chapter as Greece's downgrade to junk status, is the most complex of the three cases; as it dates back to the 1980s, with inadequate economic structural complex, thus placing Greece at risk when global financial crisis occur.

Whereas for Azerbaijan, the downgrade in 2016, was as a result of the impact of the oil shock, which makes a third of Azerbaijan economy, and slow-down of the economy, although the high debt was not a factor (Weltman, 2016). On the contrary, Tunisia's downgrade was as a result of political instability, which followed the Arab Spring, negatively affecting the broader economy (Mutize and Gossel, 2019). While for Azerbaijan, following the downgrade resulted in, depreciation of currency closely followed. The continued dwindling of oil production due to ageing fields, depreciation of the currency, and increased inflation is causing substantial budget pressures, forcing up consumer prices, and debt (Weltman, 2016). And while burning through more than 70% of its reserves to defend the currency (Gulf Times, 2019). Hence, it is unlikely to win back its investment-grade anytime soon, even with a stronger foreign currency, due to weakness in the policy framework. And while the stable currency has helped inflation, growth remains slow, while it aims to diversify its economy (Gulf Times, 2019). Thus, I have found that Azerbaijan, unlike Greece, and Brazil, downgrade was due to lack of diversification of the economy, as the heavy reliance on oil placed Azerbaijan in a continuously vulnerable position, reliant on the external market.

While for Bahrain and Oman, it was the fall in oil prices and economic performance (Moody's, 2019), as Oman GDP growth dropped to -0.9% in 2016, while Bahrain continued a slow and steady rate of under 4% in 2016 (Trading Economics, 2020). As both countries are relevant on oil supply, the oil plunge from 2014-2016, with a 70% price drop, one of the most significant declines since World War Two and the 1986 collapse (Stocker, Baffes and Vorisek, 2018). Since the junk status rating, Bahrain economic growth has been volatile, with a current decline with a negative growth rate, while Oman slow economic performance of 0.3% in 2019, and a projected 3% in 2020 (Trading Economics, 2020). However, with oil prices dropping as a result of the Coronavirus, and worldwide shutdown, it seems a recover is unlikely for the foreseeable future (Allen, 2020).

And recently with Moody's downgrade of South Africa's sovereign rating to junk status, with S&P and Fitch already downgraded in 2017. This decision is a result of a weak economy, which has remained stagnant, has predicted to drop to under -0.5% GDP growth rate in 2020 (Trading Economics, 2020), as well as unreliable power supply, with the country experiencing large scale load-shedding months prior. The immediate reaction saw the Rand fall, to below R18 to the Dollar for a short period (Wallace, 2020). The predicted effects include selling of $6billion bond, and with another downgrade possibly looming if South Africa does not quickly reduce its budget deficit. In addition, the exclusion from WGBI (World Government Bond Index) is likely to see $2billion exit the country, with further downgrades to follow (Wallace, 2020). However, as this downgrade had been anticipated, the effect will be lessened as markets selling off significantly, the actual outflow is likely to be much smaller than predicted (Wallace, 2020). Hence, the continuation of junk status, for these 7 case studies, ranging from a year to 9 years, with no sign of improvement, proves the 'sticky' and difficulty of overcoming 'junk status'.

4.4. Conclusion

This chapter has set out to provide a historical overview of CRAs, while also providing an overview of relevant cases that have been downgraded to junk status from an investment grading by all three credit agencies. This comparison has illustrated the vast difference in recovery in all cases. Hence, I have found that recovery from junk status is difficult to overcome, and effective and efficient economic reform is required under strong leadership.

This is relevant to South Africa, which has just landed in junk status, and as illustrated is likely to last for several years to come, unless quick action and reform are implemented to overcome the downgrade, in the swift manner South Korea recovered.

CHAPTER 5: 'Historical Boom & Bust': Historical Trajectory of Growth & Contingency in Brazil, Greece and Azerbaijan

5.1. Introduction

This chapter will explore *what role downgrades to junks status by credit rating agencies have played in the specific case studies* (Brazil, Greece, Azerbaijan), by examining the social, political and economic landscapes of each case study in three sections: prior to the downgrade; the immediate effect of junk status; and the after effects of junk status. This is necessary to understand each country's economic development and the changes which occur with a 'junk status' label. Hence, this section will provide a qualitative discussion on the *before, and after* to the junk, status downgrade. To illustrate the causal pathways, the crucial shifts and changes, thus, enabling the examination of the importance of pre-existing socio-economic issues such as corruption and stagnant economic growth, against the negative downgrade.

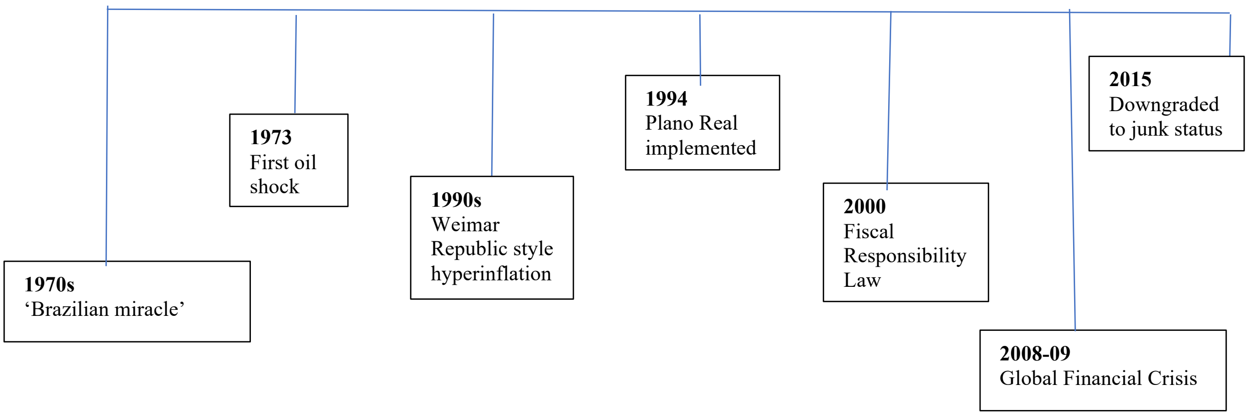
5.2. Case Studies Prior to the 'Junk Status' downgrade

This section will focus on the political, economic and social landscapes of Brazil, Greece, and Azerbaijan in the years prior downgrade to the junk status, highlighting significant changes and the economic climate of each case study. This provides a necessary foundation to examine whether downgrades merely enhance pre-existing economic conditions, rather than result in national economic insecurity. The cases will be examined from the period of 1970 to the downgrading to junk status, to provide a broad overview of the economic climate of each case. While all the cases were somewhat affected by global events such as the oil shock of 1973 and the global recession of 2008, the impacts differed and saw each study arrive at 'junk status' in different ways.

BRAZIL

Brazil is the largest country in both Latin and South America, at 8.5 million kilometres, with a large population of 212, 559, 417 (Worldometer, 2020). Brazil has the ninth-largest economy in GDP (Gross domestic product), and the largest in South America, with the economy, in agriculture, commodities, industrial and service sectors (Pwc, 2020). The country is considered an advanced emerging economy, forming part of the BRICS organisation, Brazil leads in the production of coffee, in addition to the large scale production of oranges, sugar cane and soybeans (Pwc, 2020). However, Brazil has experienced huge booms, and massive losses, illustrated from the 16th Century, Brazil became the World's leading sugar producer. Still, by the 17th Century, the sugar industry suffered, due to the rise in competition from the Caribbean (Lonman, 2014). By the 18th Century, a gold boom, with the discovery of Minas Gerais, resulted in a massive upswing in the Brazilian economy. Alongside, the coffee boom in 19th Century saw an incredible benefit and rapid growth, with Brazil producing 75% of the coffee produced worldwide, which resulted in heavy reliance on the sector (Loman, 2014). However, this proved to be only temporary, due to overproduction and a loss of demand. This was in addition to the global recession in the 1920s, hence resulting in stagnant economic growth for decades to come.

Timeline of significant Economic events from 1973– 2016 in Brazil



Nonetheless, by the late 1960s to the late 1970s, saw rapid economic growth, at 11%, faster than any other nation at the time (Smith, 1983). This was due to policy on importing substituting industrialisation, resulting in high rates of economic growth and investment, helping diversify the economy, referred to as the 'Brazilian miracle' (Loman, 2014). The dire economic climate prior had forced the government to accept loan agreements from IMF and USA, implementing programs such as the Alliance for Progress, with conditionalities in place to fight off communism, thus ensuring Brazil maintained a democratic progression (Brown University Library, 2020). This resulted in an emphasis on the neoliberal framework of the free market and limited government interference. The economic reforms focused on diversifying Brazil's exports, encouraging international investment, tax incentives and currency depreciation to promote overseas trade (Brown University Library, 2020). While, the government implemented increased tax collection, expanding the country's GDP, with exports growing 14.7% annually between 1970 to 1973, while imports increased by 21%. But this trade imbalance was covered by FDI, and inflow of capital (Brown University Library, 2020).

However, the country's inequality was continually increasing at the same time, in which Brazil remains one of the most unequal country's in the World. However, this saw inequality in income distribution increase. Still, the focus remained on Brazil's booming economy, illustrated by the construction of the Itaipu Binacional, which remains the largest hydroelectric dam in generating energy (Brown University Library, 2020). Nevertheless, the industrial boom resulted in heavy dependence on foreign petroleum. But in 1973, saw the first oil shock, in which the worldwide price of oil quadrupled to $46.35 per barrel (Amadeo, 2020). This led to a strong deterioration of Brazil's trade, as Brazil was importing over 80% of its oil consumption, which led to borrowing large amounts petrodollars to counter this shock. As the boom was built on cheap oil and inflow of capital, this 'miracle' collapsed in 1973, alongside the oil shock (Smith, 1983). However, the Brazilian economy still managed to grow at around 8% per annum, through a boost in exports, creation of alternative energy source, and the imposition of conversation measures to cut down the petroleum use (Smith, 1983).

But in the 1980s, higher interest rates and less willing to borrow, caused issues for Brazil due to its strong reliance on foreign lending, increasing external indebtedness, and economic growth coming to a halt, as foreign debt soared to $87 billion (Smith, 1983). This, in conjunction with political turbulence, with military dictatorship stepping down, seeing the return to democracy, which allowed for more focus on social-political issues such as inclusion and addressing inequality (Lonman, 2014). Yet, high spending resulted in high inflation, enhanced due to old monetary financing deficits, frequent depreciation and indexation, but IMF loan of $2.5 billion lessened the burden (Smith, 1983).

Brazil experienced Weimar Republic style hyperinflation from the 1980s to 1994, further affecting inequality in the country (Loman, 2014). This is illustrated in *Table 4,* with rates skyrocketing, reaching 30,377% in 1990 (Watkins, 2020). While the economy did not decline, economic growth remained stagnant until hyperinflation was under control.

Table 4: Brazil's Rate of Inflation from 1981 to 1995

Year	Rate of Inflation
1981	100%
1982	100%
1983	138%
1984	192%
1985	226%
1986	147%
1987	228%
1988	629%
1989	1430%
1990	30,377%
1991	400%
1992	1020%
1993	1929%
1994	2076%
1995	66%

(Watkins, 2020).

Nonetheless, by 1994, the implementation of the Plano Real proved to be a turning point, focused on three areas: fiscal adjustment (increased tax collection); URV (institutional unit of account); and launch of the new currency, 'the real' (Banco Central Do Brasil, 2020). This also saw the cutting public spending and ended the indexation of the economy, privatisation, which resulted in cheaper imports, which impacted domestic production. This strategy was successful in terminating hyperinflation, which was down to 22%. Still, economic volatility continued, with heavy reliance on the inflow of foreign capital, and high interest rates contributed to the deterioration of fiscal accounts, which was further affected effected by the Asian and Russia financial crisis (Loman, 2014). This saw Brazil experience a financial crisis in 1999, due to the already weak financial system, with a surge in inflows, and high domestic interest rates, resulting in domestic financial fragility in the banking sector, and an increase in public debt (Palma, 2006). Thus, the international financial crises added financial strain on Brazil (Palma, 2006).

Hence, by 2000, the introduction of a Fiscal Responsibility Law resulted in the implementation of hard-budget constraint legislation. This enabled the government to effectively provide help in controlling public spending as inspired by the IMF (de Mello and Callegari, 2017), as well as IMF loan package of SDR 13 billion (Loman, 2014). Brazil's economy continued to grow throughout the 2000s, with exports increasing by 43% from 2002 to 2005 (Lonman, 2014). However, this was halted in early 2008, when the global financial crisis struck. Still, Brazil's resilience was highlighted, straining financial markets, and fall of commodity prices, as Brazil enacted countercyclical policies, increasing public spending and lowering interest rates. This saw a strong economic recovery in 2010, with GDP going from -0.9% in 2009 to 7.5% in 2010, as well as the discovery of large oil reserves (Watts, 2016).

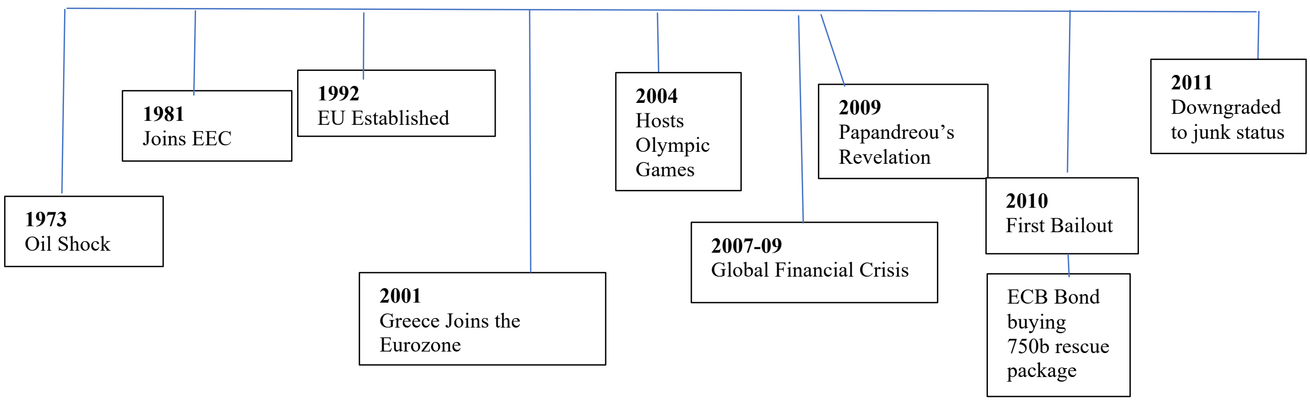
Nevertheless, from 2012, the economic growth rate has continued to fall, filled with political uncertainty, with a failure to reform the pension system, large fiscal deficits, jumping from -2.52% in 2012 to -10.25% in 2015 (Country Economy, 2020), this coming as the country just came out of longest recession in history (Gillespie, 2018). A corruption-fuelled recession saw Brazil rank 96th out of 180 countries in corruption. In addition to the high unemployment, which continued to climb from 7% to 10% by 2015 (CEIC, 2020) and debt rates increasing from $400 000 in 2012 to over $500 000 in 2015 (CEIC, 2020). All these factors were pivotal in leading to the decision to downgrade Brazil's credit rating to 'junk status' by 2015, as Moody's stated the large deficit and lack of economic growth, proving to be a snowball effect, with inflation surging past 10% in 2015 (Watts, 2016). Although Brazil had economic booms and busts throughout history, the large-scale corruption probes which began in 2014, implicating the President Michel Temer and cabinet members (Felter and Labrador, 2018), the prolonged economic recession were the leading cause in a downgrade to junk status.

<u>GREECE</u>

Greece is a democratic country, along the Mediterranean Sea, located in South-eastern Europe (Pwc, 2020), with a population of 10,430,935 (Worldometer, 2020). Greece gained independence from the Ottoman Empire in 1829 and has since joined international organisations of NATO (Northern Atlantic Treaty Organisation) in 1952, and EU (European Union) in 1981, as well as a member of the European Economic and Monetary Union in 2001, as the country uses the Euro currency (Pwc, 2020). Traditionally, Greece was an agricultural country; however, currently, tourism is Greece's most significant industry, alongside shipping, with Greek-owned maritime fleet making up the largest in the World (Anglo info, 2020).

However, Greece is the lowest income per capita of all EU countries (Angloc info, 2020). The top exports of Greece include refined petroleum, packaged medicaments, aluminium plating, non-fillet fresh fish and pure olive oil; while the biggest import was crude petroleum (OEC, 2020).

Timeline of significant Economic events from 1973-2011 in Greece



Tracing back Greece's economic past illustrates turbulent economic conditions which interlink to issues experienced today. While after the Second World War, Greece underwent an 'economic miracle', with an average growth of 7% between 1950 and 1973, with low unemployment and a moderate rate of inflation (Hirst, 2015). Industrial production grew rapidly, alongside Greece's tourism industry, with financial support incoming from the USA under the Marshall Plan, to halt the spread of communism (Hirst, 2015). Thus, similar to Brazil's 'miracle', Greece's Miracle was stopped due to the 1973 oil shock. By 1974, the country fell into a sharp recession, with high inflation, increasing from under 5% to over 25%, remaining above 10% for the next two decades (Hirst, 2015). Unlike Brazil which was able to curb the effects of the oil and lessen dependence, through the construction of an alternative energy source, stabilisation policies of Constantine Karamanlis, of the new democratic government, was unable to curb the high inflation rates. The second oil shock of 1979, further hampered down on the Greek economy, dropping from GDP growth of 7.2% in 1978 to -1.6% by the end of 1981 (Country Economy, 2020). The changes in government to PASOK, saw a rapid increase in debt-to-ratio, from 20.8% to 91.2% between 1980 to 1990, as the government borrowed heavily (Husson, 2015). This was mainly driven by increases in wages and pension funds; however, corruption, further hindered economic prosperity under the "Koskotas scandal" (Hirst, 2015). George Koskotas was accused of embezzling € 220million, with political members involvement questioned, resulted in political unrest (Hirst, 2015).

Greece joined the EU (EC) in 1981, which is said to benefit, particularly smaller economies due to (Hungarian Chamber of Commerce and Industry, 2020):

- Stability, security, democracy
- A stimulus to GDP growth, increase in jobs and higher wages and pension
- Growing domestic market and demand
- Free movement of labour, goods and services as well as capital
- Free access to the consumer market of the EU

However, in these benefits were not felt as in 1989, with a new government, the New Democracy, in power, attempts to reform the economy was implemented, ‘shock-therapy’ reforms (Hirst, 2015). By 1992, the government signed the Maastricht Treaty, which applied conditionalities to limit government deficits and debt levels, to engage with EMU. Hence, joining the EMU (European Monetary Union), appeared to be a saving grace, that would result in lower inflation rates and nominal interest rates. This would, in turn, encourage private investment and spur economic growth, while the single currency would also eliminate transaction costs, allowing more revenue for the deficit and debt reduction (Johnson, 2019).

In 2001, Greece joined the Eurozone, with the benefits of joining are said to be increased investment as all members are perceived as a safe place to invest, which resulted in lower interest rates, allowing Greece to borrow at a much cheaper rate, which saw an increase in spending. However, fiscal problems still existed due to lack of revenue, with social spending expenditure below the EU average expenditure, mostly resulted in tax evasion (Johnson, 2019).

However, this again had a reverse effect, as Eurozone has conditionalities, which Greece had to comply with in accordance to Maastricht Treaty guidelines. In addition, Greece was accepted to EMU under false pretences, as debt and deficit did not meet the Maastricht limits (Sakellariou and Rotarou, 2017). While the signing of the Maastricht Treaty, did stabilise the economic situation for years to come, it did not reduce debt, which is illustrated with the stabilisation of debt to GDP ratio, from 1993 to 2007, which increased slightly from 91.2% to 103.1% (Husson, 2015).

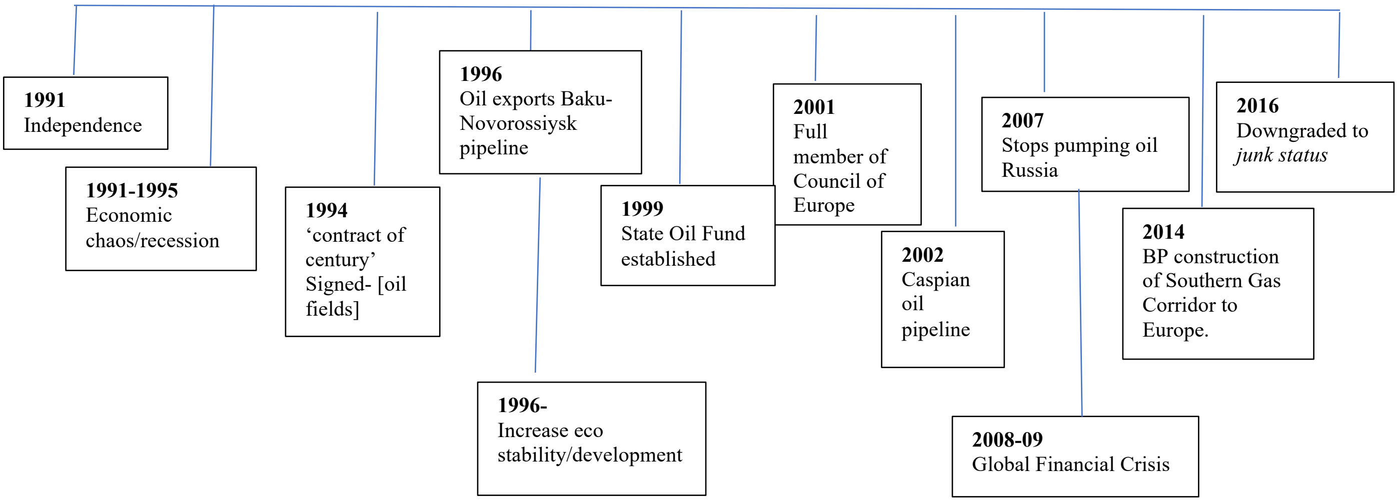
The Global Financial Crisis of 2008 played a massive role in exposing Greece’s pre-existing challenges, with the recession weakening Greece’s tax revenues, worsening the deficit, in addition to a liquidity crisis. This forced the government to seek bailout funding, whilst CRAs continued to all downgrade Greece to 'junk status' further hindering their ability to access funding (Sakellariou and Rotarou, 2017).

Thus, the change from the state-led model to a capitalistic model, alongside reliance on bailouts that Greece was forced to accept, saw a further reduction in public spending. This resulted in severe consequences such as increases in extreme poverty and unemployment, along with pension funding being drastically cut (Sakellariou and Rotarou, 2017). The Euro debt crisis which was a result from the Global Financial Crisis in 2008, saw Greece's government bond yields increase, with debt becoming expensive and unsustainable, in which Greece became reliant on financial assistance. Greece's debt to GDP ratio surged, from 2007 to 2014, which saw a sharp increase from 103% to 175.4% (Hirst, 2015). Thus, creating a sovereign debt crisis that resulted in the downgrade to junk status by all three major agencies in 2010/11, and Greece continues to be unable to recover from to this today.

AZERBAIJAN

Azerbaijan, situated in southwestern Asia, boarded by Iran, Armenia, Georgia, Russia and the Caspian Sea, is a former Soviet Union republic, has been an independent state since the collapse of the USSR in 1991 (BBC, 2018). Thus, Azerbaijan's history is a complete contrast to the two previous case studies, as there was a clear shift from communism to capitalism, in 1991. Azerbaijan is an oil-rich country, with a population of 10,124,809, with a majority Shiite population (Worldometer, 2020). The economy is based on gas and oil, steel, iron, chemical products and textiles. At the same time, agriculture makes a smaller, 5.2% of the GDP, with crops including wheat, fruits, potatoes, tea, cotton and tobacco (BBC, 2018). Hence, Azerbaijan exports are mostly centred around oil and natural, which account for 95% for total export revenue, while imports include manufactured goods, cars, and agriculture.

Timeline of significant Economic events from 1991-2016 in Azerbaijan



After gaining independence in 1991, Azerbaijan began to focus on its sovereign rights in the economic field, and implement an independent policy aimed at on different types of property, a transition to a market economy and integration into the global economy (Holscher, 2012). Economically, the years after the independence can be divided into two main periods: the period of 1991-1995 which was characterised by economic chaos and regression; the period after 1996, which saw an increase in macroeconomic stability and dynamic economic development due to policy implementation, achieving socio-economic development and integration into the global economic system within a short period, despite the unfavourable initial conditions (Holscher, 2012).

As Azerbaijan is an oil-rich country, one of the main challenges was efficient use and reallocation of the benefits from rich oil and gas endowment, this saw the foundation of the use of Azerbaijan's hydrocarbon reserves for the benefit of the people was laid by the signing of the "Contract of the Century" in 1994. This was achieved through the adoption of the Decree promoting cooperation with international companies in 1999, as well as State Oil Fund established to channel the revenues to non-oil sectors (Holscher, 2012).

Azerbaijan overcame the first period of economic regression and chaos, through the agreement to oil exports Baku-Novorossiysk pipeline in 1996. As well as developing entrepreneurship, creating a favourable business environment to attract domestic and foreign investment, thus policy was heavily focused on social-economic development. Strategies such as Heydar Aliyev helped overcoming recession during the new stage of development, as it allowed for diverse forms of property and privatisation. This resulted in GDP increasing 90.1% in 1995-2003, with increases in the government budget, real wages and a decrease in inflation, with total capital investment over $20billion (Holscher, 2012).

Azerbaijan has joined in most international institutions, such as the IMF, World Bank and Asian Development Bank. This is said to help in creating a market economy and form social, diversified national economy which possesses the ability of self-development and to integrate them to the world economy. In addition, policies such as the State Program of Socio-Economic Development of the Regions of Azerbaijan (2009-2013) and State Program of Poverty Reduction and Economic Development in the Republic of Azerbaijan (2008-2015), in creating economic diversification and development (Holscher, 2012). These programs have planned to support entrepreneurship in institutional mechanisms, agriculture, and non-oil sectors The Republic of Azerbaijan Ministry of Economy, 2018). In addition, focus was placed on accelerating privatisation processes of certain entities, and developing the agricultural industry, while ensuring environmentally friendly methods are implemented (The Republic of Azerbaijan Ministry of Economy, 2018).

The implementation of these policies resulted in strengthened economic stability, with increased development, the stability of national currency and confidence of banking systems increased, with effective conservative external debt strategy. And despite the global financial crisis, Azerbaijan preserved economic stability, economic growth, reduction in poverty, with economic growth of GDP growing by 9.3% in 2009, and 840 thousand new jobs created, which saw S&P rating forecast to 'positive'. The progressions made in the socio-economic sphere are reflected in the improving assessments of the Azerbaijan economy by international rating agencies. This is illustrated with Azerbaijan's position improving in the Global Competitiveness Report of the World Economic Forum, entering the category of countries with 'high average incomes', as well as the UN Development Programme on Human Development in 2010, joining a group of countries with 'high human development (Holscher, 2012).

While the 'contract of the century' has propelled Azerbaijan economically, setbacks did arise, with corruption resulting in loss of revenue and projects, illustrated with the case of Azerbaijan oil scion, bought a watch worth $1.35 million. Thus, they weakened leadership has further hindered economic prosperity, while political disputes remain ongoing, over the Nagorno-Karabakh conflict between Azerbaijan and Armenia (Kauzlarich, 2019).

However, the economy regressed, even though some improvements in diversifying the economy occurred, reliance on the oil market was still strong, with 80 percent of the total budget are made from energy sources. This resulted in an extensive dependency on imports, and during the economic crisis, prices were skyrocketing, causing a public outcry (Jafarli, 2016). The economic regression accelerated existing issues within economic and political systems, due to the lack of free speech, politically-motivated arrests, and an overall weak local government (Jafarli, 2016). Thus, the oil shock directly resulted in a slowdown of the economy, which was already fragile, and further resulted in currency depreciation, and thereafter a downgrade to junk status in 2016 (Neuwirth, 2016).

Therefore, to conclude the economic overview on the three cases prior to the junk status downgrading by all three major agencies, illustrates that while global affairs all impact each study, the extent and outcome drastically differ. All cases vary in economic focus, with Greece relying on tourism, Brazil on agriculture and Azerbaijan on oil. Firstly, Azerbaijan proves to be an outlier, currently having transitioned from communist governance to a capitalistic framework. Both Brazil and Greece, were impacted by the oil shocks of 1973, and 1979, however, Brazil was able to provide effective economic reform and alternative energy supply, Greece was harder hit and relied on dependency on organisations to ensure a stable economy. All three cases were impacted by the financial crisis, with Greece, suffering the most severe, falling into a sovereign debt crisis, and ultimately junk status. At the same time, Azerbaijan heavy reliance on oil industry proved problematic with the drop in oil price in 2014, while Brazil's domestic policies and affairs dictated, with corruption and failure of the pension system, in addition to a loss in fiscal deficit and economic growth. Hence, this was important to note in investigating whether CRAs downgrades merely accelerate existing economic insecurities or directly impact a state's economic security.

5.3. THE IMMEDIATE IMPACT OF THE 'JUNK STATUS' RATING ON SPECIFIC CASE STUDIES

Following on from the economic conditions which led to the downgrade to junk status by all three agencies, this section will illustrate the immediate impact, focused on the first six months of the junk status, to highlight the impact a downgrade to junk status has on a country. This is needed to further the investigation on whether 'junk status' leads to national economic security, rather than simply accelerate existing economic challenges, using the five selective indicators: Government bonds Yields; FDI; Inflation; External Debt; Currency exchange rate. I have selected these indicators as they were the most predominantly reoccurring indicators throughout existing literature and leading indicators in the downgrading to a non-investment grading.

BRAZIL

CRA's	**Date Downgraded**
S&P	Sep 9 2015
Fitch	Dec 16 2015
Moody's	Dec 16 2015

Table 5: The Effect after Standard & Poor's downgrade of Brazil to junk status

S&P	September	October	Nov	Dec	Jan	Feb
Gov bonds Yields	15.530	15.860	15.960	16.560	15.690	15.510
Inflation	0.82%	1.01%	0.96%	1.27%	0.90%	0.43%
Exchange Rate $	3.9041	3.8753	3.7850	3.8828	4.0553	3.9651

Table 6: The Effect after Fitch's downgrade of Brazil to junk status

Fitch	Dec	Jan	Feb	Mar	Apr	May
Gov bonds Yields	16.560	15.690	15.510	13.830	12.320	12.850
Inflation	1.27%	0.90%	0.43%	0.61%	0.78%	0.35%
Exchange Rate $	3.8828	4.0553	3.9651	3.6984	3.5639	3.5416

Table 7: The Effect after Moody's downgrade of Brazil to junk status

Moody's	Dec	Jan	Feb	March	April	May
Gov bonds Yields	16.560	15.690	15.510	13.830	12.320	12.850
Inflation	1.27%	0.90%	0.43%	0.61%	0.78%	0.35%
Exchange Rate $	3.8828	4.0553	3.9651	3.6984	3.5639	3.5416

A. Government Bonds Yields

The downgrade to junk status by had an immediate impact on Brazil's 5-year bond yield, however, with Standard & Poor's downgrade in September, no effect is illustrated. Instead, the downgrade by both Fitch and Moody's on the Dec 16 saw a drop by -5.25% in the following month of January, which continued to decrease in the following months, only improving by May 2016 (Investing, 2020). Hence, the impact on junk status occurred once all three agencies had downgraded Brazil to junk status, which saw a continued decrease for months to come (Investing, 2020). However, this impact was minor, and thus did not seriously impact the government bonds in any way.

B. Inflation

The impact on the inflation rate was only slightly affected, particularly after the downgrade by Moody's and Fitch, which saw an increase to 1.27% from 0.96%, however, this impact was short-lived, decreasing within the months following. Thus, illustrating only once all agencies had downgraded Brazil to junk status, was a margin of impact illustrated.

C. Exchange Rate

However, the exchange to the US dollar, had a more significant impact, increasing from 3.5190 BRL/USD to 3.9041 BRL/USD (ICAEW, 2020). This is directly after the downgrade by S&P, resulting in the largest increase of all downgrades by the credit agencies. Thus, highlighting the significance of junk status rating by S&P.

Thereafter, the exchange rate remained relatively steady, inclining once again after the further downgrades, from 3.8828 BRL/USD to 4.0553 BRL/USD, the high exchange rate, lasted only temporarily as by March 2016, the rate was steadily back to 3.6984, further declining as months went on. Thus the immediate impact was felt, but the long term effects of junk status proved insignificant. Thus, while more significant impact can be traced, it remained temporary and minor, and therefore, junk status had little effect on Brazil currency.

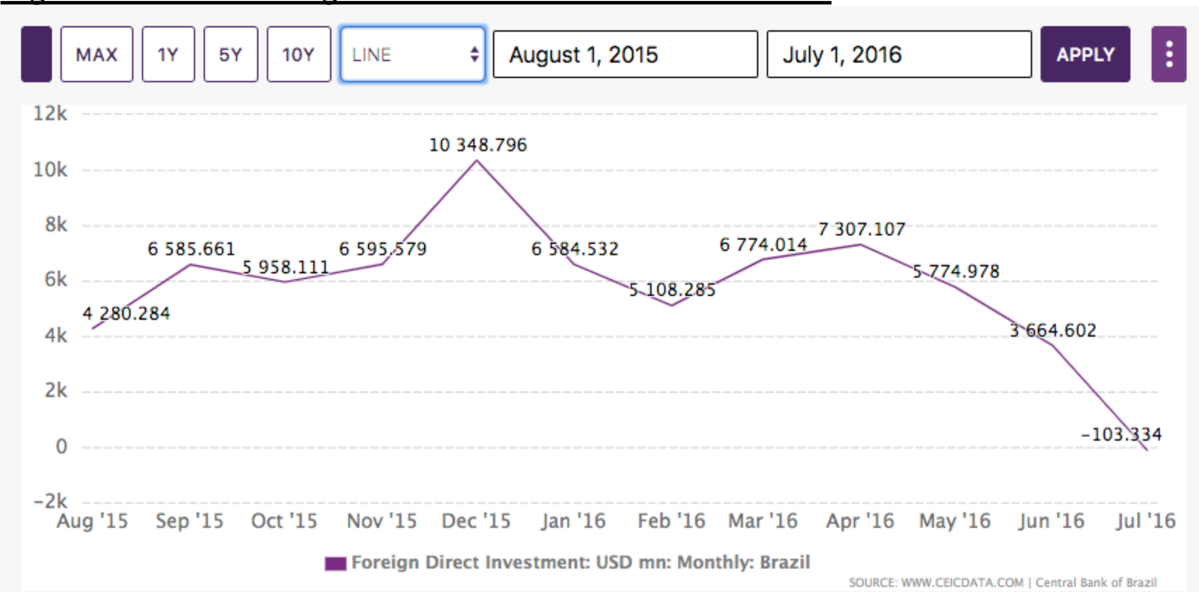
D. FDI

Regarding FDI (foreign direct investment), a slight decline is illustrated in *Figure 8,* after the downgrade by Standard & Poor, in September. However, this is temporary with a stark incline during the November-December period of 2015 (Ceicdata, 2020). Thereon, until further downgrades by both Fitch and Moody's in December, which saw a steep decline, from 10 348.796 to 6 583.5432 in January, which continues to decline in investment in the months after (Ceic data, 2020). Hence, illustrating the impact of all three agencies downgrade playing a significant role, rather than a single agency downgrade on Brazil's economy. The FDI continued to worsen for months after the downgrade, becoming an intricate and contagion effect to overcome (Ceic data, 2020). Thus, the biggest impact of junk status once downgraded by all three agencies is one the FDI.

E. External Debt

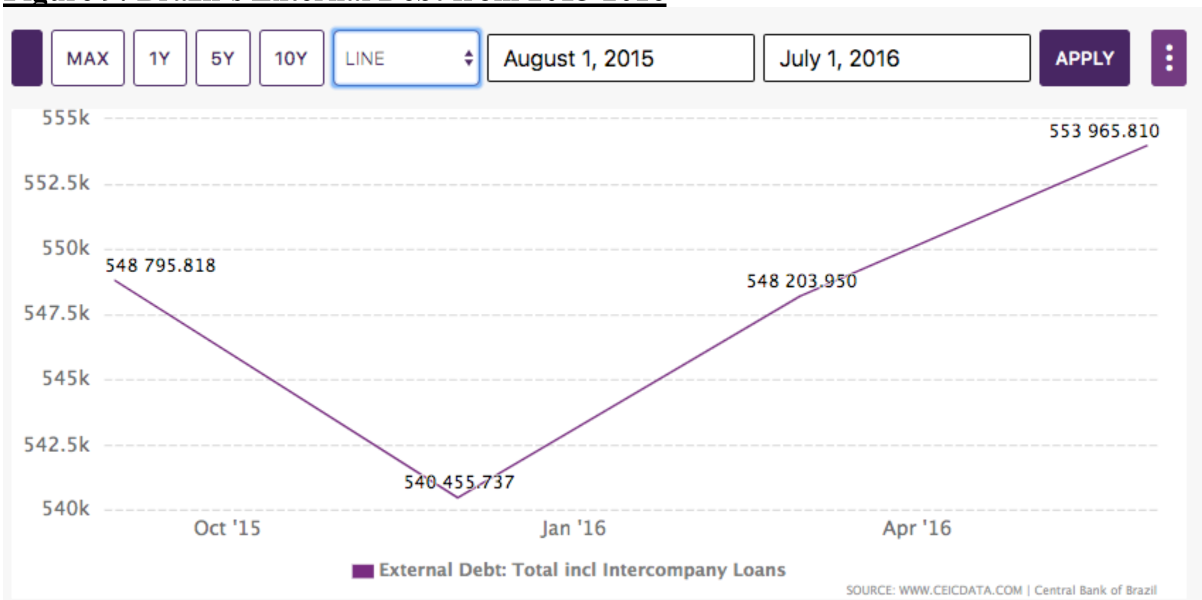
While *Figure 9* illustrates the external debt, also demonstrating a lack of effect after S&P's downgrade, with a decline in external debt. However, as illustrated with FDI, a direct impact is illustrated once all three agencies have declared a country to have a 'junk status' label, illustrating a stark incline in debt right from December, which continues to climb and cause a continuous burden for the country to overcome. Hence, FDI and External Debt remain the two indicators most severely impacted by the downgrade, once all three agencies had rated Brazil.

Figure 8: Brazil's Foreign Direct Investment from 2015-2016



CEIC Data (2020)

Figure 9: Brazil's External Debt from 2015-2016



CEIC Data (2020)

Therefore, overall, the immediate impact on Brazil, was minimal for inflation, government bonds and exchange rate, which illustrated only a slight and temporary effect. However, once Moody's and Fitch had downgraded Brazil to junk status, alongside S&P, a direct and significant impact that had long-term implications is illustrated in the FDI and external debt.

Thus, the market seemed to shrug off the junk status label, seemingly pro-actively managed the risk before the downgrade for inflation, exchange rate and bonds, yet the unable to quickly recover on the FDI and Debt.

GREECE

CRA	**Date Downgraded**
S&P	Apr 27 2010
Fitch	Jan 14 2011
Moody's	Jun 14 2010

Table 8: The Effect after Standard & Poor's downgrade of Greece to junk status

S&P	Apr 10	May	June	July	August	September
Gov bonds yields	11.140	8.405	11.010	10.874	12.200	10.516
Inflation	0.80%	-0.26%	-0.48%	-0.69%	1.93	0.16
Exchange Rate $	254.08	271.08	278.83	266.01	264.43	260.21

Table 9: The Effect after Fitch downgrade of Greece to junk status

Fitch	Jan 11	Feb	March	April	May	June
Gov bonds yields	12.965	14.290	16.306	17.649	17.032	19.476
Inflation	-1.30	3.26	0.62	0.18 %	-0.21 %	-1.39 %
Currency Exchange rate $	255.03	249.54	243.08	235.77	237.59	236.73

Table 10: The Effect after Moody's downgrade of Greece to junk status

Moody's	Jun 10	July	August	September	October	November
Gov bonds yields	11.010	10.874	12.200	10.516	11.328	12.592
Inflation	-0.48%	-0.69%	1.93%	0.16%	0.22%	0.41%
Exchange Rate $	278.83	266.01	264.43	260.21	245.15	249.94

A. Government bonds Yields

Analysing the 5-year bond yield highlights that the downgrade by S&P (Table 8) in April did have an immediate impact illustrated in the drop (-24.55%) to 8.405 in May, however, the bonds continue to vary, increasing shortly after in June by 30.99%, only to drop by -1.24% after the downgrade by Moody's to 10.874 (Investing, 2020). However, it must be noted, that prior to downgrading by S&P and Moody's, the 5-year bond rates were much lower, at 6.154. Thus the impact on bond rating appears not have had a significant effect, instead of resulting in a surge and more stability (Investing, 2020). Lastly, with the drop, the rating by Fitch, saw a slight decrease, by -4.53%, but a quick and steady recovery followed the coming months, with increases of over 10% (Investing, 2020).

B. Inflation

The inflation rates, saw a decrease with the first downgrading by S&P and Moody's, to -0.26%, and further to -0.69%. However, by August, there was an increase to 1.93% from negative -0.69%. Thus, only an immediate direct impact was seen, as an increase did occur months after. With the last downgrade to junk status by Fitch, a direct result occurred, increasing from -1.30% to 3.26%, hence similarly to Brazil, illustrating the impact once all three agencies downgrade a state to junk status. However, this impact proved to be temporary, with a stark decrease in inflation rates in the months following.

C. Exchange rate

Similarly, the impact of the junk status, while only temporarily, saw an immediate yet minor, increase to the US dollar, from 254.08 GRD/USS to 271.08 GRD/USD after the downgrade by S&P, with a similar increase once downgraded by Moody's, from 271.08 GRD/USD, to 278.83 GRD/USD. However, little change occurred once Fitch downgraded Greece to junk status, highlighting the importance and monopoly of Moody's and S&P. Thus, as stated, these effects remained temporary and minor, with the exchange rate declining steadily months after the downgrade.

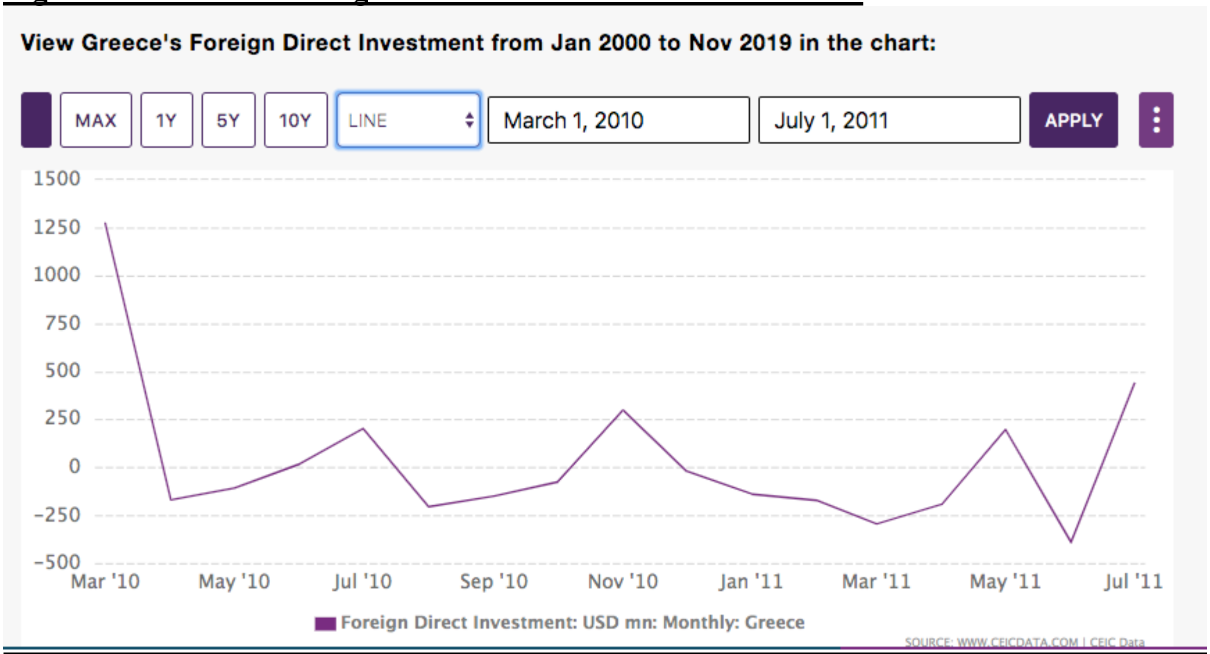
D. FDI

On the other hand, Greece's foreign direct investment saw an immediate impact from S&P downgrade as illustrated in *Figure 10*, with a steep decline in investment from April which has since continued, thus, differing from bond yield and inflation, with S&P agency having a significant impact without the other agencies. Yet, downgrades from Moody's and Fitch just further declined the foreign direct investment in the country, which illustrated the volatility of Greece's economy (Ceic, 2020).

E. External Debt

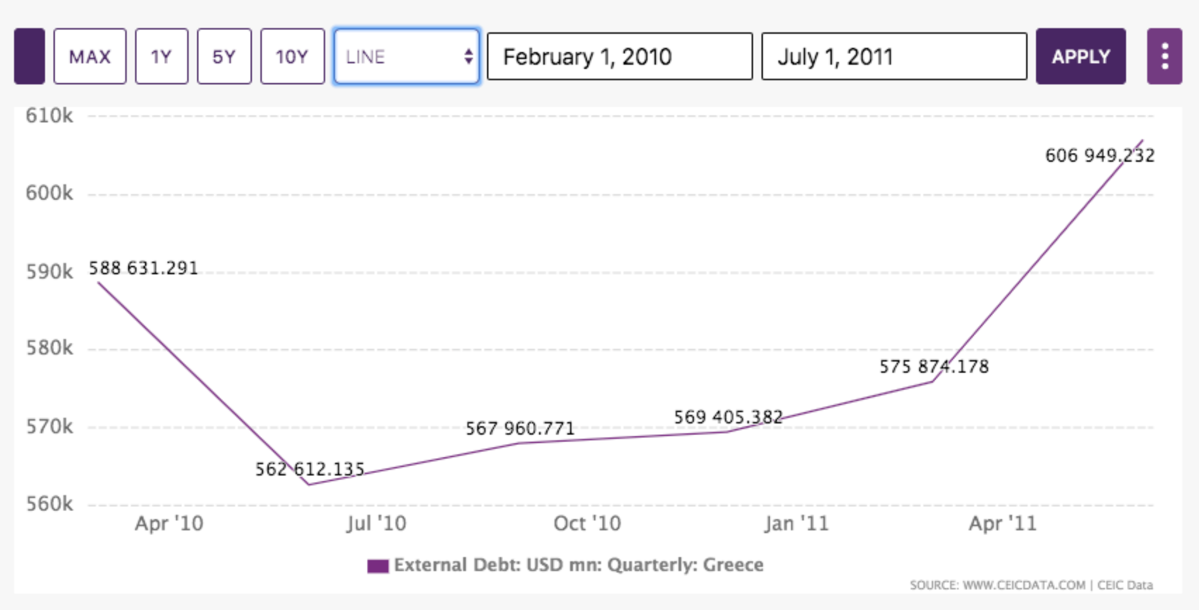
Similarly, the external debt illustrated in *Figure 11*, the downgrade by S&P saw the largest decline in debt for Greece; however, after the downgrade from Moody's a steady incline continued. Once Fitch had downgraded the country to junk status, a sharp incline continued with debt massively increasing in the coming months, from 575 874.178 to 606949.232 (Ceic, data 2020).

Figure 10: Greece's Foreign Direct Investment from 2010-2011



CEIC Data (2020).

Figure 11: Greece's External Debt from 2010-2011



CEIC Data (2020).

Therefore, the immediate impact on Greece as limited and minor in the Exchange Rate, Inflation and Government bond. However, the downgrade by S&P had a direct and significant impact on the FDI and external debt of Greece. Thus, illustrating that no all indicators and sectors of the economy are immediately significantly impacted by a downgrade. Still, the impact on foreign investment and interest rate on external debt is costly. As this was existing economic insecurity for Greece, the downgrade to junk has accelerated these economic insecurities.

AZERBAIJAN

CRA	**Date Downgraded**
S&P	Jan 29 2016
Fitch	Feb 26 2016
Moody's	Feb 5 2016

Table 11: The Effect after Standard & Poor's downgrade of Azerbaijan to junk status

S&P	Jan	Feb	March	April	May	June
Inflation	13.8%	11.7%	10.8%	10.5%	10.4%	10.52%
Exchange Rate $	1.6033	1.5665	1.5428	1.5129	1.4913	1.5412

Table 12: The Effect after Fitch's downgrade of Azerbaijan to junk status

Fitch	Feb	March	April	May	June	July
Inflation	11.7%	10.8%	10.5%	10.4%	10.52%	10.64%
Exchange Rate $	1.5665	1.5428	1.5129	1.4913	1.5412	1.5869

Table 13: The Effect after Moody's downgrade of Azerbaijan to junk status

Moody's	Feb	March	April	May	June	July
Inflation	11.7%	10.8%	10.5%	10.4%	10.52%	10.64%
Exchange Rate $	1.5665	1.5428	1.5129	1.4913	1.5412	1.5869

A. Government bonds

Due to the limited information available, I was not able to find government 5yr- bond yields, and thus make an accurate comparison.

B. Inflation Rate

The inflation rate, while relatively high, which continued throughout the months after the downgrade to junk status. Yet, the downgrade by the agencies had little to no impact in further hindering on increasing the inflation rate.

C. Exchange rate

While the Azerbaijan currency exchange rate, slightly weakened with the announcement of junk status, it stayed relatively stable (Investing, 2020). Thus, much like Greece and Brazil had a minimal and temporary impact on the exchange rate.

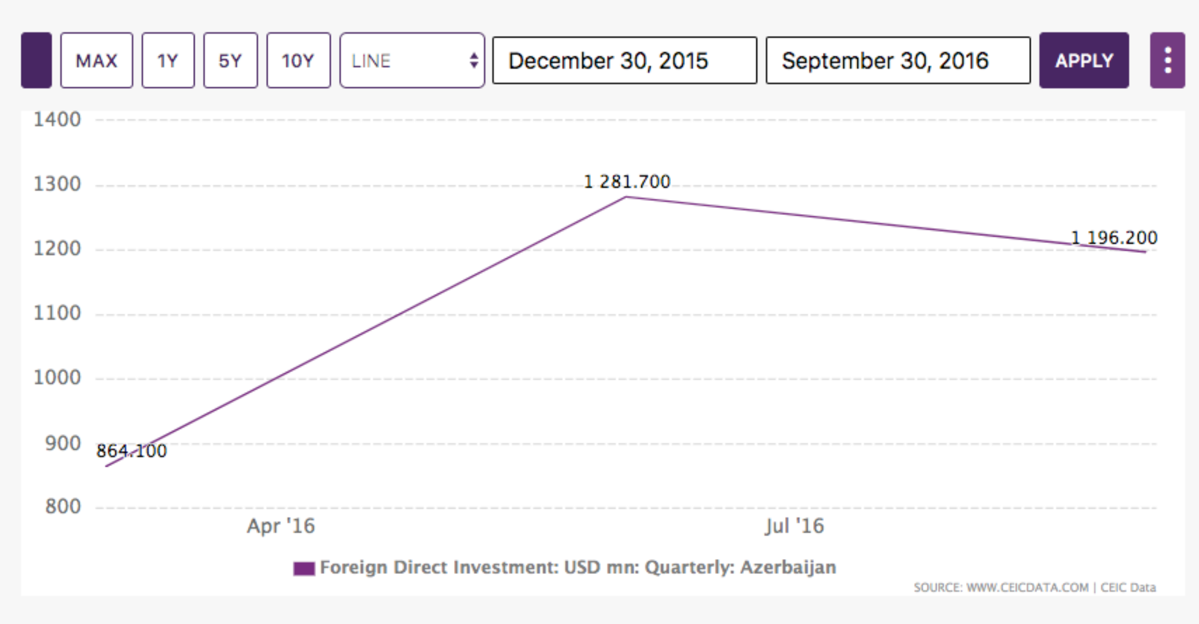
D. FDI

The impact of the downgrade to junk status was not directly felt on foreign direct investment, as illustrated in *Figure 12,* with investments steadily increasing until around June 2016, thus, illustrating a contrast to that of Greece and Brazil, which saw a more direct impact from the downgrade (Ceicdata, 2020).

E. External debt

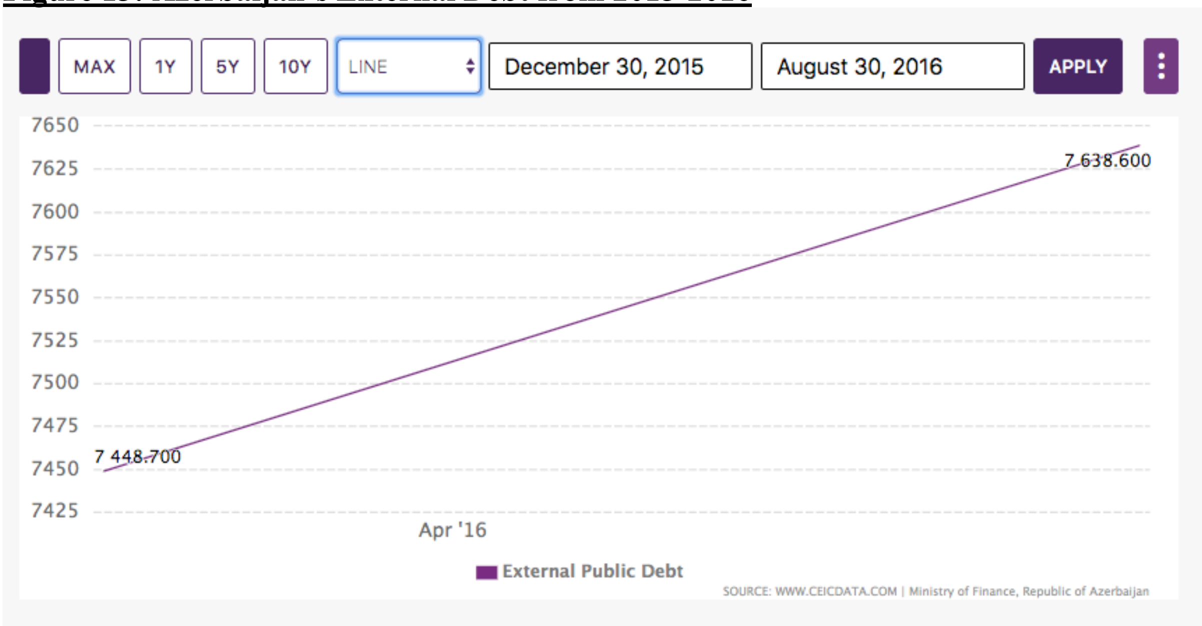
However, external debt saw a steady incline, illustrated in *Figure 13* since the downgrade by all three agencies which continued to climb for months after the downgrade, thus mirroring more closely the impact on Brazil and Greece (Ceicdata, 2020). therefore the most severe and significant impact from the downgrade for Azerbaijan was felt on the external debt.

Figure 12: Azerbaijan's Foreign Direct Investment from 2015-2016



CEIC Data (2020).

Figure 13: Azerbaijan's External Debt from 2015-2016



CEIC Data (2020).

Therefore, the immediate impact on Azerbaijan was minimal, more so than both Brazil and Greece, however, the downgrade by all three agencies saw a much larger impact on the external debt of Azerbaijan which continued in the long-term. However, as existing economic insecurities existed, the downgrades did little to further this or directly impact it, only illustrating a further hindrance in the FDI and external debt. Hence, overall, all cases experienced a minimal and temporary impact on bonds, inflation and exchange rate. However, the FDI and External debt illustrate that downgrades by all three agencies can further negatively hinder a state's national economy.

5.4. CASE STUDIES AFTER TO 'JUNK STATUS' DOWNGRADE

This section will briefly analyse the economy of all three states after the downgrade, as all three cases remain in a junk status rating, to the present day. This is necessary to illustrate the before and after logic and analyse, whether downgrades by all three agencies have long-term impacts on a state's economy. This section will briefly view both the political and economic climates of all three case studies to trace further the causal mechanism between a downgrade and economic insecurity.

BRAZIL

As stated earlier, the impact of junk status on Brazil was limited, And with a more closed market, as well as BRICS membership, this limits reliance on foreign neoliberal financial institutions as Brazil has solid relations with both China and Russia. However, in 2016, the Brazilian pricing source for local currency for government bond's changed from Citi Trader to Thomson Reuters. But, unlike South Africa, who was excluded from WGBI in May 2020, as they no longer meet the criteria, Brazil, still maintains admission. Brazil also created LTNs (Letra Tesouro Nacional) in the 1970s, as a protection for investors from currency losses, created as an inflation index bond. This has become critical as a short term facility to fund the Brazilian government, and lessen inflation and monetary policy (OVO 2020). Hence, the Brazilian Deputy of Transportation Minister Natalia Marcassa stated: "the loss of Brazil's investment-grade credit rating will have little effect on foreign investment in upcoming road, railway and airport concessions" (Soto and Goy, 2016).

A. Impact on the Political Landscape

Politically, Brazil has continued to face social unrest, with nation-wide protests over education spending freezes, and corruption, with Economic Minister, Paulo Guedes warning that Brazil was "at the bottom of the well" (Gillespie, 2018). Furthermore, Transparency International severely lowered Brazil corruption rankings to 96th out of 180, from 79th in 2016 (Gillespie, 2018). Thus, the ongoing issue over governance and corruption plagues the country's ability to enforce strong leadership required to implement economic reforms and recover from junk status, as illustrated with South Korea.

B. Impact on the Economy

The impact of junk status rating had a relatively small effect on Brazil in comparison to Greece, with existing economic woes proving to be the most significant challenge Brazil continues to face, rather than the label of junk status. Brazil is still a member of Citi Group and has strong ties with Russia and China, rather than heavily relying on Western CRAs of Moody's, Fitch and S&P, thus enabling Brazil to have access to funding to an extent still. However, the economy in Brazil continues to worsen, whilst with a lack of political and economic reform playing a central role, impacting upon stocks and currency (CNA, 2019).

Brazil's economic growth has been stagnant, and slow, averaging 0.5%, thus hindering its ability to recover from junk status (Trading Economics, 2020). Brazil's unemployment has risen to 12.20% in 2020 from 11.60% (CEIC, 2020), the previous month. In addition, Brazil has sunken deeper into junk 'debt' status, as Fitch further downgraded the country into junk status (Gillespie, 2018). This proved as another setback for Brazil, which suffered the longest recession in its history, only recovering in 2017. Thus, while the immediate impact of a downgrade to junk status was limited for Brazil, however, the pre-existing economic conditions prove to be a challenge in recovery from the junk status label, as economic insecurity continues to flourish in the country.

C. Impact on Social-Economic Challenges

Brazil's socio-economic sector remains constrained, with civil unrest, and continued failure of the pension system, with many retiring too young, gaining too many benefits (Delport and Hendricks, 2020). While a Bill has been passed, the effects have yet to be seen. And with high toll from COVID deaths, political divide and unrest continues to destabilize the unity of the country. While Brazil saw positive growth in the beginning of the year, the pandemic has diminished such gains, further hinder socio-economic stability in the country (Delport and Hendricks, 2020).

GREECE

Greece is said to be the worst-case scenario, due to the excessive debt, which hinders its ability to gain and attract large-scale investment. Although Greece's economic turmoil dates back to the 1980s economic depression, with Eurozone allowing for economic instabilities to be swept under, with the 2008 financial crisis proving to be the last straw. And a decade after junk status rating, structural issues remain apparent, as Greece economic woes continue (Molho, 2017).

A. Impact on the Political

Politically, as Greece is reliant on tourism as a significant contributor to its GDP, the ongoing CO-VID pandemic, has placed this on a halt since the start of the year, thus negatively affecting Greece's economy, as the World has implemented a global lockdown (Santander, 2020). While Greece has seen economic progress, with growth accelerating, and debt at 176% expected by the IMF, to decline to 171% and 167.1% in 2020 and 2021 respectively (Santrander, 2020). The New Democracy, currently in power, has implemented new economic reforms, with a series of privatisations in the infrastructure and energy sectors (Santrander, 2020). Thus, Greece is still a reflection of the worst-case scenario, with economic recovery remaining a large challenge to overcome.

B. Impact on the Economy

Following on from the immediate reaction to the junk status rating, Greece's economy continued to worsen, with a sharp rise in unemployment, increasing poverty and inequality for years to follow particularly in 2013, and thus increasing socio-economic challenges within the country. And with some attempts made with policy reforms, with welfare reform providing some improvements, however, this also resulted in cuts which disrupted health care and social services (Matsaganis, 2013). A misguided policy response saw labour deregulation, which saw the lowering of worker's compensation and weakening labour market institutions, as this was seen as key in restoring competitiveness within the market (Matsaganis, 2013). While trade balance has seen some improvement, due to the reduction of imports, rather than policy reform, yet, workers pay, and conditions continued to decrease (Matsaganis, 2013). Hence, this saw Greece's unemployment hit 27,7% in 2013, however, with new policies and reform, a steady decline of unemployment has continued, with a current rate of 16,7% in 2019 (Eurostat, 2019).

In addition, S&P has raised Greece's sovereign credit rating by one notch, from BB- to B+. with a newfound confidence in the country's new government and its policies (Nikas and Genovese, 2019). However, it remains far below investment status, highlighting that more needs to be accomplished to regain its investment-grade. Hence, an improved economic outlook and budgetary performance, and a favourable government debt structure, is a positive step in recovering from ‘junk status’ (Nikas and Genovese, 2019). Thus, the issues of high external debt, a pressured banking-system and a challenged monetary transmission mechanism remain the main points of focus for Greece moving forward (Nikas and Genovese, 2019).

C. Impact on Social-Economic Challenges

Greece’s socio-economic has yet to show great improvement, with policies failing to compensate for the continued economic crisis, and rather “reinforced the adverse effects of the recession on the distribution of incomes” (Matsaganis 2013). And with the sharp rise in unemployment, and the risk of poverty increasing, the social safety net continues to widen amongst the population. While some progress was made through welfare reform, cuts in social services and worsening working conditions, saw the lowering of wages to compensate for restoring competitiveness. Thus, socio-economic situation requires adequate reform and increased economic prosperity to ensure progression in the social living standard in Greece (Mansaganis 2013).

AZERBAIJAN

The Azerbaijan economy has slightly improved, however, remains heavily reliant on the world o. Thousand thus, the lack of diversity in the economy continues to plague the country’s ability to overcome junk status.

A. Impact on the Political

Azerbaijan has made limited progress in economic reforms, with both private and public sector corruption and structural inefficiencies continuing to hinder development, particularly in non-oil sectors. But it must be noted that Azerbaijan has made considerable improvements in their position on the Transparency International Corruption Index 2019, moving up from 152 to 126 out of 180 countries (Nordea, 2020). However, the lack of foreign investment has hampered on the country’s ability to progress, highlights the effect of CRA’s on the national economy. A strong credit rating would promote and boost the economy, which would help in diversifying the economy. In addition, the continued political conflict with Armenia over Nagorno-Karabakh regime hinders peace and stability, necessary to attract foreign investment (Azerbaijan Economy, 2020). However, the economy is still centred and reliant on world oil prices to determine the economic prosperity in the long-term for Azerbaijan (Nordea, 2020). However, with the ongoing CO-VID19 pandemic, and the lockdown, economic prosperity and strong oil price seem unlikely in the coming future.

B. Impact on the Economy

The decline of the economy continued, with higher inflation, reaching 12.90% in 2016; however, by 2017, inflation rates had declined to 1.92% (Macrotrends, 2020). Affects due to drop in oil price, were also felt in the reduction of the construction sector, the weakened banking sector and currency depreciation. Thus, leading to 2017, whereby Baku allowed for the state-owned International Bank of Azerbaijan (IBA), to swipe some outstanding debt, and ordered for a restructuring of Azerbaijani courts (Azerbaijan Economy, 2020). Thus, the label of 'junk status' impedes on the government's ability to overcome the challenge of attracting investment. Thus a difficult cycle of economic insecurity continues to thrive for Azerbaijan, as economic woes remain deep-rooted and complex.

C. Impact on Social-Economic Challenges

Azerbaijan government cracked down on civil unrest, in 2016, widening the gap between the active civil society of the nation, arresting political activists and journalists. Alongside preventive laws on nongovernmental organisations from independently operating, while constitutional reform was introduced (Human Rights Watch, 2017). While the President has pardoned various human rights activists, some restrictions still remain for the opposition. Hence, social freedoms of association, press and movement remain constrained, with inadequate living conditions, particularly for women and children reported by the UN (Human Rights Watch, 2017). With young population, Azerbaijan, there have been increased policies to strengthen services and protections for the young people, with help of UNICEF (Human Rights Watch, 2017). However, as Azerbaijan is dominated by one ruling party, opposition parties to continue to gradually grow, with dire living conditions resulting in high labour migration, as the economy still remains heavily reliant on oil (BTI, 2018). And with even less success in decentralizing political system and facilitating democratic reform (BTI, 2018). Thus, the socio-economic sector has continued to face hardships after the downgrade to junk status.

5.5. Conclusion

To conclude, this chapter has attempted to analyse the role CRA's downgrades to junk status have played in specific case studies of Greece, Brazil and Azerbaijan. This was necessary to help in examining whether credit agencies junk status lead to economic insecurity, or merely just further enhance existing economic challenges. From this limited research, I have found that while it appears a downgrade to junk status mainly has little consequences which follow immediately after all agencies downgrade the country to 'junk'. Thus, accelerating existing economic and social challenges within the country, and limiting the ability to overcome these challenges effectively, with political reforms, and economic cuts. And with the label of junk status, the ability to attract new and vast foreign investment proves far more challenging, thus adding to the cycle of economic insecurity, which states find challenging to overcome.

Table 14: Summary of the findings

	BEFORE				Junk		After
	1970	**1990**	**The 2000s**	**Key triggers**		**MAIN ISSUES**	
Brazil	'Miracle' Oil Shock Debt	Hyper-Inflation	Corruption Fiscal Deficit		GDP Corruption Pension fund		Corruption GDP
	1970	**1990**	**The 2000s**				
Greece	-Oil shock Debt	Debt EU	Debt GDP		Sovereign Debt Euro Crisis		Debt Inflation GDP
	1970	**1990**	**The 2000s**				
Azerbaijan	-Still part of USSR	-Recession -Contract of the Century	Oil Inflation		Oil Price		World oil prices

CHAPTER 6: CONCLUSION

6.1. Introduction

This section will briefly conclude the research report, providing final discussion on the findings, highlighting the limitations of the study and providing a way forward for future research.

6.2. Discussion on findings

This report examined the impact of a downgrade to junk status by all three agencies, investigating the causal mechanism between a downgrade, and a state's national economic security. I hypothesised that either CRA's downgrade would result in a direct impact or either further existing economic challenges within a country. This research has illustrated, though in a minimal capacity, that the extent of the effect a downgrade is limited to a case-to-case basis. Greece remains a prime example of how a downgrade to junk status can further hinder existing economic challenges, resulting in a more significant challenge to overcome. While, Brazil and Azerbaijan, the extent of the impact is less visible, with external and domestic factors leading the economic security of the state, rather than effects of a downgrade.

6.3. Possible Alternatives

This essay has highlighted the issues and critiques of the current monopolisation of credit rating agencies, the current power structures, enable bias ratings and create difficulty for emerging economies, particularly those in Africa due to political instability, yet, these downgrades, limit the progression of emerging markets, and hinder their development, continuing a cycle of human insecurity.

This study has highlighted the issues and critiques of the current monopolisation of credit rating agencies, with the current power structures enabling bias in ratings and creating difficulty, particularly for emerging economies, highlighted with Azerbaijan. Given South Africa's recent downgrade to junk status, and critiques from various African nations, illustrates that downgrades remain challenging to overcome, and limit the progression of economic growth and development, thus, continuing a cycle of economic insecurity. I believe alternatives to the neoliberal, Western monopolisation CRA's is required to ensure greater transparency and progression for emerging economies. A possible alternative could be by the BRICS nations creating a new credit rating company, as an effort to break the dominance of the big three

CRAs. BRIC was formed in 2006, to represent the world's emerging economies, involving the major powers of the Global South: Brazil, Russia, India and China, in 2010 South Africa joined to form BRICS, to ensure representation of Africa within the organisation (Qobo and Siko, 2015). The organisation is meant to provide an alternative to the alliances of the G7 and G20, which remain dominated by core economies, therefore BRICS advocates against Western domination (Qobo and Siko, 2015). BRICS, is intended to "represent the collective interests of the developing world" (Qobo and Siko, 2015, 286), which has seen benefits for South-South relations as China has gone on to become South Africa's top trading partner, accumulating more than \$6.8 billion worth of South Africa's exports (WTEx, 2017). Since South Africa joined BRICS, Africa's trade grew substantially, from 4.6% to 19%; hence the positive contribution BRICS has on the African Continent (Mabanga, 2015). Thus, the creation of a BRICS credit rating agency, would enable a more favourable climate for emerging economies to progress, ensuring more neutral stance, while still providing the benefit of Western CRAs, opening new markets up to a global scale. This would a allow for a more 'understanding approach to African emerging economies, thus enabling higher ratings, and greater human security in the long-term.

In addition implementing global policy could ensure accountability and transparency by CRAs. Using the Act passed in South Africa, whereby Members of Parliament drafted the Credit Rating Services Bill, which was adopted in November 2012, in an attempt to regulate CRAs, as an example (Rabinowitz, 2014). This, ensures accountability is taken by CRA's, rather than their current position of merely offering a credit 'opinion'. The Act also attempts to ensure CRAs are held accountable for negligent ratings, exposing rating agencies to civil liability. Hence the Act set out 5 main objectives (Rabinowitz, 2014):

(a) Ensure responsible and accountable credit rating agencies;
(b) Protect the integrity, transparency and reliability of the credit rating process and credit ratings;
(c) Improve investor protection;
(d) Improve fairness, efficiency and transparency of financial markets;
(e) Reduce systemic risk.

Thus, the current neo-liberal structures in which credit-rating agencies thrive, merely provide a one-size-fits-all model to development, which in turn sees only the elite and developed states profit and remain protected (Thomas, 2001). Whilst emerging and vulnerable economies continue to face downgrades and the severe economic consequences which follow. This hinders development, due to currency depreciation, and worsening existing economic insecurities. Therefore, as Thomas (2001) argued, alternative paths must be explored, "one that better reflects the concerns of the majority of the worlds states and citizens' (Thomas, 2001, 174).

6.4. Limitations of the study

This study was not without its limitations, the small sample size of 3 varying case studies, restricted the ability to make generalisations and identify patterns of behaviour. This research is limited its ability to make generalisations and statements surrounding tracing the causal pathway between downgrades to junk status and economic insecurity. Thus, evidence from this study is limited to the cases provided, with a focus on 6-month period after the downgrade in analysing the direct and immediate impact. As especially with emerging markets mainly, the effect of a downgrade, and simply the current worsening economic security, can be caused by domestic factors, with downgrades not maintaining a significant factor. This is highlighted with the case study of Brazil in particular, as existing economic factors play a significant role in the political and economic outcome rather than the downgrade to junk status. This study also was limited in information on Azerbaijan 5-year government bonds, which hindered the ability to provide an adequate comparison.

6.5. Recommendations for Future research

I suggest that more thorough analysis should be conducted, with multiple economic indicators, as my study was limited to the effects of 5 indicators, which does not illustrate the full picture. I would also suggest a broader case study sample, as the results appear to differ on a case-to-case basis, with each market reacting differently to the announcement of junk status. However, it must be noted that no conclusions can be made on how a country will respond to downgrade, as various causalities are at play in a state's national economy.

It would be beneficial to repeat this study using South Africa as a case study in the future, as the country has just been downgraded to junk status by all three agencies. Once enough information is made available, this would be essential and necessary to examine if the effects as the announcements appear to South Africa as worst-case scenarios like Greece, or the downgrade will have a little impact like Brazil, without external factors leading the economic challenges.

6.6. Conclusion

To conclude, the findings show that while credit downgrades by all three major agencies to junk status, have a minimal and temporary effect on economic indicators of government 5yr bonds, inflation and exchange rates. Yet, a significant impact on both the FDI and external debt. However, the extent and longevity of these impacts are based on a case-to-case basis, which accelerates pre-existing economic insecurities, as illustrated with Greece. At the same time, Brazil and Azerbaijan, it can be argued are the result of external factors.

This study has investigated the dreaded notion of junk status, to examine whether the impact on a state's national economy is as problematic as it is predicted, hindering development and investment. I have found in my case studies, that CRA's are procyclical, and thus merely enhance existing economic insecurities, whilst limiting opportunities to prosper as investment looms and debt skyrockets.

Therefore, this study has built on from the current debates on credit agencies, as procyclical or directly impactful, to study in a more in-depth approach, the impact a downgrade has on a state's economy. I provided a conceptual framework of neoliberalism, illustrating how CRAs have evolved, and play a significant role in development. Thereafter I illustrated the cases of recovered vs yet to recover, to highlight the vast differences in each case-to-case, with South Korea recovering in quick succession. At the same time, Indonesia took over 16 years. Thus, it must be emphasised that the recovery is dependent on the case study, the pre-existing factors and economic reform, which is implemented afterwards.

For my findings, I was restricting my approach to 5 indicators: exchange rate, inflation, government bonds, external debt and FDI, on three case studies of Brazil, Greece, and Azerbaijan, in which I limited the immediate impact to the first six months. Surprisingly, I found that not all indicators were affected immediately, and some minimally for a temporary period. However, FDI and external debt clearly illustrated a direct impact between a downgrade to junk and increased debt and lower investment. Further, the long-term effects are limited, as Brazil and Azerbaijan illustrate. Thus, it is rather a case-to-case basis, with various factors in play, that can result in taking 16 years to recover as opposed to 1 year. Therefore, my study aimed to answer in what ways *credit rating downgrades impact upon a state's national economic security*. Hence, I have found that CRA's downgrades merely accelerate existing economic conditions, rather than directly impact upon a state's national economic security. Still, the extend and recovery is dependent on the individual case study.

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