International Journal of Economics, Commerce and Management
United Kingdom ISSN 2348 0386 Vol. VIII, Issue 1, January 2020
http://ijecm.co.uk/

SOVEREIGN CREDIT RATING MANAGEMENT - EVIDENCE FROM UZBEKISTAN

Davirova Shakhlo
Tashkent Institute of Finance, Uzbekistan
shakhlo2505@gmail.com

Abstract

It is important for the investor to keep track of the country's credit rating. Because investors, international financial institutions have permanent representation in many countries and have the opportunity to conduct independent research on the current economic situation. The paper studies the sovereign rating condition of Uzbekistan, the impact of credit rating on economic growth and financial development of the country. According to results newly assessed country will mostly consider to achieve economic growth through external debt. Moreover better credit rating will improve internal financial system of a country as well.

Keywords: Sovereign credit rating, insolvency, economic growth, financial development, Uzbekistan

INTRODUCTION

Getting a credit rating is a very time-consuming process. The rating agency uses a wide range of instruments. For example, the national government's creditworthiness is assessed in quantitative and qualitative terms. The quantitative indicators assess the government's ability and willingness to repay its public debt. The deductive and inductive methods are used to calculate the sovereign credit rating. Deductive methods are used to estimate global systemic factors and are intended to predict the size and duration of default. Inductive methods are based on fundamental factors that influence the ability of the national government to pay off. It analyzes the 8 major areas that affect sovereign default. Quantitative and qualitative indicators of government risk assessment are studied and evaluated in terms of functional relevance.

Political risks reflect the willingness to pay the obligations of the government, not the individual borrower or company. In some cases, even when resources are available, the government does not want to fulfill its obligations. This indicates that economic indicators are linked to political indicators.

Opportunities and directions for fulfilling the government debt obligations in national and foreign currencies vary, and the methods of repayment vary. Therefore, it is not appropriate to use the same methods in assessing these indicators. In carrying out rating research, it is necessary to take into account key political and economic risks. First and foremost are the following: stability of political institutions, involvement of wide strata of the population in political processes; the structure of the economy and income of the population; Fiscal policy and flexibility; monetary policy and inflationary factors; the degree of integration into global trade and financial systems; internal and external factors affecting national security; availability of natural resources, pension payments; the tendency of price inflation to change; exchange rate policy; the degree of flexibility of the state balance of payments. These indicators are a factor that reflects and evaluates the country's solvency. However, the institutional structure of the country's economy, operative monitoring and adjustment of decisions in the changing situation. The more centralized the decision-making process, the better credit rating the country will have. Factors that have a positive impact on the country's credit rating may include sustained economic growth, improved living standards, and equitable resource allocation.

As a result of deep analytical processes the rating is given and the rating is given by the Standard & Poor's agency. The highest rate is given to the government, which has the capacity to pay its debts on time and willingly. There is no uniform formula for calculating these ratings. Analytical variables are interrelated and differ in each currency separately. Based on the information obtained, it is submitted to the rating committee for review and the credit rating is determined and reported to the government. At the Customer's discretion, the rating may not be officially announced or revised. The rating for revision may not be changed.

The final step in the process of obtaining a credit rating is to establish a constant control over the rating level. The rating agency is constantly monitoring the sovereign rating and can lower or increase its rating. This stage is based on systematic analysis of the economy of the country, which is slower in scope of work. As a result, the country is assigned a sovereign credit rating, which may vary.

The programs for reforming and improving the sustainability of the financial and banking system for 2011-2015 aim to achieve the sovereign credit rating of the Republic of Uzbekistan by 2015. Currently, the Central Bank and the Cabinet of Ministers are working to obtain sovereign ratings from the leading rating agencies.

It is important for the investor to keep track of the country's credit rating. Because large investors, international financial institutions have permanent representation in many countries and have the opportunity to conduct independent research on the current economic situation.

The credit rating of the country is in the issuer's rating group, which means the ability of the recipient country to repay its borrowings in time. The first ratings were published in 1909 by John Muda based on the activities of railway companies. Today, Moody's Investors Service, Moody's, Standard & Poor's Corporation, S&P and Fitch Investors Service are recognized by a number of agencies.

The credit rating of the country and the individual company cannot be higher than the credit rating of the country, i.e. the credit rating of the country serves as a threshold.

LITERATURE REVIEW

"A sovereign credit rating helps to obtain financing from abroad because the rating serves as a focal point in financial monitoring and acts as an information equalizer in investment decisions". (Boot et al. (2005)). For a nation planning to sell debt securities, a sovereign credit rating is of great economic significance. Credit rating is important in attracting (foreign) investments because many investors prefer ratings to unrated securities with seemingly similar loan risk (Cantor & Packer, 1996). Boot et al. (2005) illustrate that credit rating agencies play a significant economic role in two ways minimizing financial fragility. Second, the credit monitoring procedures of the companies reduce cost of monitoring. Second, the credit rating of institutional investors, such as pension fund managers, who are constrained by regulatory limits, is of key importance for investment allocation decision. Kim and Wu (2008), who demonstrated that foreign currency debt ratings promote the financial sector growth and are a catalyst in attracting capital streams, stressed the importance of sovereign credit ratings.

Sovereign Credit rating in Uzbekistan

The international rating agency Moody's Investors Service for the first time rated the rating of Uzbekistan at B1, the outlook is "stable". This is stated in the message of the agency. Uzbekistan already had S&P Global Ratings and Fitch Ratings at "BB-" with a "stable" outlook. Moody's explains the current changes by four factors: the country's economic potential is moderate, supported by strong growth potential and demographic trends, balanced by low wages and competitiveness.

Institutional capacity is rated as "very low," while fiscal capacity and risks of political stability are rated "moderate."

The international rating agency Fitch Ratings affirmed the long-term credit rating of Uzbekistan in foreign and national currencies at the level of "BB-" (risky obligations with speculative features). The rating outlook is stable.

According to Fitch analysts, the ratings of Uzbekistan reflect, on the one hand, a good sovereign balance, low government debt and a history of high growth compared to countries with comparable ratings and, on the other hand, significant dependence on the commodity sector, high inflation and structural weaknesses in terms of low per capita GDP and weak levels of the institutional environment and the quality of management relative to issuers with comparable ratings.

Fitch notes that Uzbekistan's authorities remain committed to greater exchange rate flexibility and lower inflation after liberalizing the foreign exchange market in September 2017. However, the effectiveness of monetary policy is limited by a high level of financial dollarization (37.4% of deposits and 56.5% of loans), a high share of state financing of loans below market rates (50% of outstanding loans) and poorly developed local capital markets. Improving coordination between achieving monetary policy goals and financing government projects and programs will be key to strengthening monetary policy and reducing risks to macroeconomic stability, the agency said.

Fitch expects inflation to average 15.2% in 2019, dropping from 17.9% in 2018 and slowing to 13.5% in 2020, well above the projected median level of 4% for the rating category " BB. "

According to Fitch forecasts, the country's economic growth will reach 5% in 2019 and will increase to 5.5% in 2020, ahead of forecast growth for the current median for the rating category "BB". Growth will be driven by public investment in strategic projects, spending on housing and infrastructure. Long-term growth potential is underpinned by favorable demographics and abundant natural resources.

Uzbekistan's dependence on the commodity sector (60% of exports of goods and 37% of budget revenues) is higher than that of competitors, and structural lending weaknesses are expressed in low per capita GDP and weaker indicators of management quality. According to Fitch, a dynamic, comprehensive, and broad reform program raises some concerns about the co-ordination and institutional capacity of governments to effectively plan and implement policy measures while minimizing economic imbalances.

Despite the current strong focus of the country's political leadership on the reform program, Fitch believes that a delay in showing its advantages in terms of higher growth, increased private investment and job creation, combined with higher than expected social costs, could have caused “ fatigue from reforms ”, although it would not affect social stability. Fitch first assigned Uzbekistan a long-term credit rating of “BB-” in December 2018.

Sovereign credit risk and financial development

For a country which intends to issue debt securities, a sovereign credit rating is of great economic importance. The fact that many investors prefer rating securities rather than ratings that seem to have comparable credit risk is key to attracting (foreign) investment (Cantor & Packer 1996). Boot et al. (2005) shows the economically meaningful role of credit rating agencies in two ways, to reduce financial vulnerability. Second, the credit monitoring practices of the companies reduce the costs of monitoring. Furthermore, ratings of credit play a crucial role in the decision for investment allocation of institutional investors such as managers of pension funds, constrained by regulatory constraints. Kim and Wu (2008) further emphasize the importance of sovereign credit ratings, which demonstrate that foreign currency debt ratings facilitate the growth of the financial sector and catalyze the attraction of capital flows. We also find local currency ratings essential to domestic stock and bond markets, but local ratings do not contribute to attracting foreign funds. For financial stability, a well-functioning local bond market is important as it enables countries to issue long-term bonds in their local currency. This mitigates the issue of the original sin, the infamous monetary failure and maturity in emerging economies ' debt positions. Figure 1 illustrates the idea establishing a causal link between credit rating provision and financial development is an exercise plagued by endogeneity issues and selection bias.

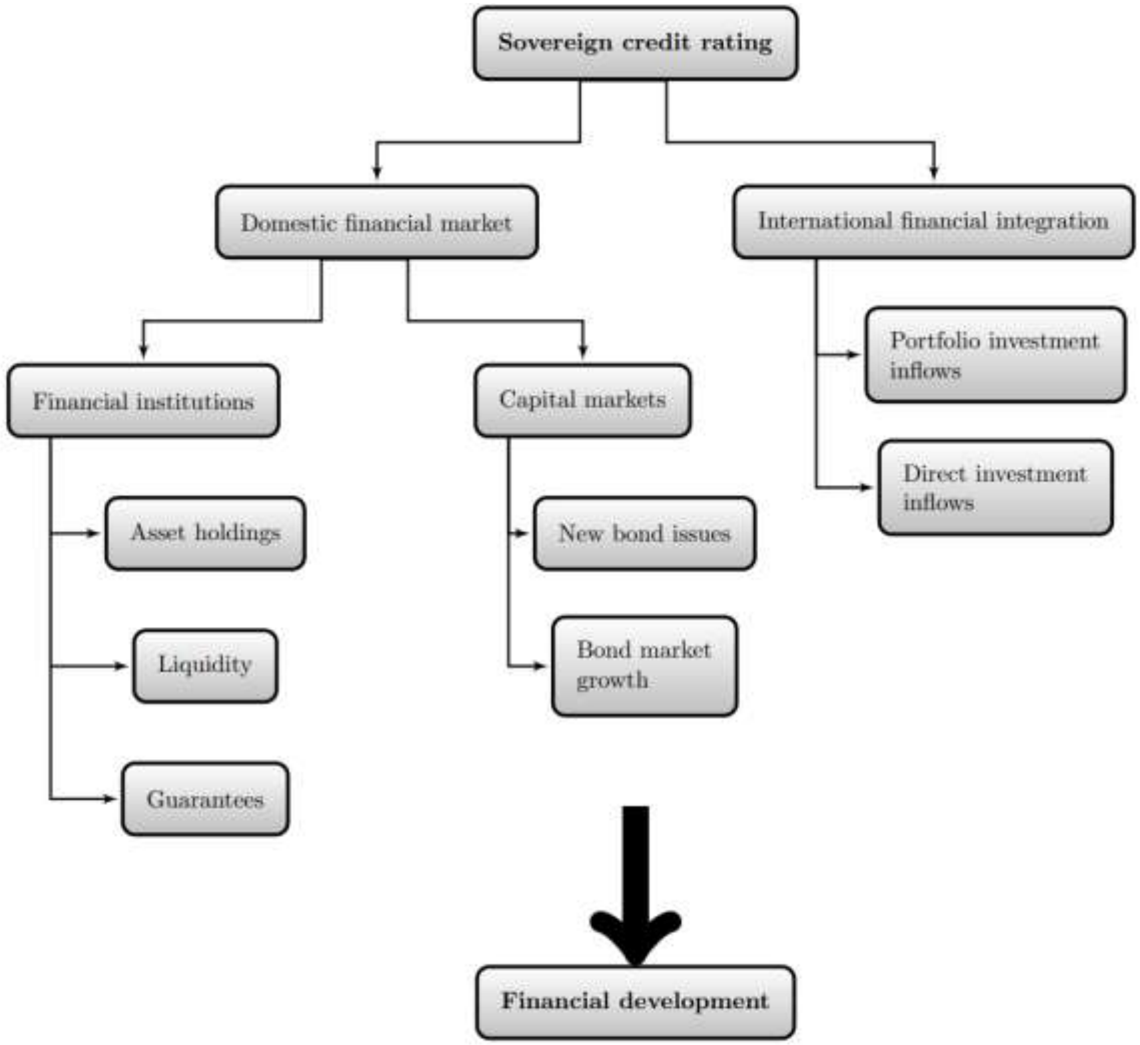

Figure 1: The impact of sovereign credit rating provision on financial development

Source: Author's compilation based on the literature review

ANALYSIS OF QUALITY INDICATORS INFLUENCING THE SOVEREIGN RATING OF THE REPUBLIC OF UZBEKISTAN

Each aspect of the analysis is as closely related to economic risk as it is to political risk. Both they and others are represented by the main deterrents of the credit risk level. economic risk determines the ability of the government to repay its debt in a modern manner and is functionally dependent on quantitative and qualitative factors. The political risk loses the political freedom of the government and the willingness to pay for its obligations, reflecting its quality that differs from most other emitter categories. At times, the government may refuse to fulfill its obligations, and even when it does, it may have the necessary financial resources to pay its debts on time. In practice, political and economic risks are closely intertwined. The government, which does not want to pay its debts according to the law, pursues an economic policy that directly reduces its repayment capacity. Thus, the actions of the government and other issuers to repay their debts are the result of a number of economic and political factors affecting public policy in general. Moreover some government performance indicators impact on the sovereign credit rating of the country.

Table 1. Worldwide Governance indicators

Indicators
Rule of law
Control of corruption
Government effectiveness
Regulatory quality
Voice and accountability
Political stability
Transparency
Ease of doing business

Source: World Bank

The consistency of and impact on public safety, such as health costs arising from untreated air pollution, natural disaster like hurricane or drought, or catastrophic incidents like a nuclear incident, are further environmental concerns to address. All these may bring pressure to the credit ratings of the sovereign on a variety of platforms, including lower output, increased government debt and deficit or a major export reduction.

Table 2. Indicators reflecting environment issues

Indicators	Adjustment Factors
Climate change vulnerability	Environmental policies
CO2 emissions	Exposure to natural disasters
Renewable energy	
Protected areas	
Protection of biodiversity	
Freshwater stress	
Material footprint	
Quality of environmental data	

Source World Bank

Government education, including schools and universities, training programmes, and basic research and development is a key task of government. The level of human capital available is stimulated by education, but the quality of education is essential to enable citizens to switch occupations as required. Training is also a key social stability element. Learning is a life-long activity facilitated by new technologies and has enormous potential to reduce the risk of rejection in parts of society.

Table 3. Educational indicators

Indicators	**Adjustment Factors**
Literacy rate	Education policies
Youth literacy rate	
Primary enrolment ratio	
Secondary enrolment ratio	
Tertiary enrolment ratio	
Children out of school	
Pupil-teacher ratio	
Teacher quality	
Quality of education data	

Source World Bank

CONCLUSION

In general we believe that it has a positive effect on the classified country's financial sector to earn the initial sovereign ranking. Nonetheless, in reference to our conclusions, we want to share a minor worry. In fact, a newly-evaluated country relies more than before on external funding. Uzbekistan issued $1 billion in Eurobonds for its first venture into international debt markets. Improving the sovereign credit rating will increase the demand for the Eurobonds of Uzbekistan, and with the improved credit rating interest rate for international debt will be lower. Literature review has shown that better credit rating reduces financial vulnerability and the condition of financial market in the country will be improved and transactions that will lead financial development in a country.

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