Modeling the Effect of Macroeconomic Factors on Corporate Default and Credit Rating Transitions

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Abstract

We explore how general economic conditions impact defaults and major credit rating changes by fitting reduced-form Cox intensity models with a broad range of macroeconomic and firm-specific ratings-related variables. For all corporate issuers in the period 1981 - 2002 we find both types of factors strongly influenced the risk of a credit event. However, while the effects of ratings-related factors were consistent with expectations and very robust under different specifications, significance levels and even signs for the macro variable coefficients depended heavily on which other variables were included. This sheds light on the disparate results reported in earlier studies.

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