Abstract

The spread between interest rate and sovereign bond rate is commonly used indicator for country's probability to default. Existing literature proposes many different potential spread determinants but fails to agree on which of them are important. As a result, there is a considerable uncertainty about the correct model explaining the spread. We address this uncertainty by employing Bayesian Model Averaging (BMA). The BMA technique attempts to consider all the possible combinations of variables and averages them using a model fit measure as weights. For this empirical exercise, we consider 44 different explanatory variables for a panel of 47 OECD countries for the 1980-2010 period. Most of the previously suggested determinants, including "public debt" or "budget balance", were attributed low inclusion probabilities. We find a role of variables previously not included in the literature's spread determinants - "unemployment" and "government consumption" which rank high by the inclusion probability. These results are robust to a wide range of both parameter and model priors.

JEL Classification	C6, C8, C11, C51, E43
Keywords	Sovereign Spread Determinants, Model Uncertainty, Bayesian Model Averaging

Author's e-mail	semanv()gmail()com
Supervisor's e-mail	marek.rusnak()cerge-ei()cz