

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 method (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 20 different explanatory variables for a panel of 47 countries for the 1980-2010 period. Most of the previously suggested determinants were attributed high inclusion probabilities. Only the "foreign exchange reserves growth" and the "exports growth" scored low by their inclusion probabilities. We also find a role of variables previously not included in the literature's spread determinants — "openness" and "unemployment" 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

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