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Convergence Patterns in Sovereign Bond Yield Spreads: Evidence from the Euro Area

Nikolaos Antonakakis[♣], Christina Christou[♠], Juncal Cunado[♦] and Rangan Gupta[*]

Abstract

This study examines the convergence patterns of Euro Area (EA) 17 countries' sovereign bond yield spreads (relative to German bund) over the period of March 2002 to December 2015, by employing the convergence algorithm developed by Phillips and Sul (2007). The empirical findings suggest rejection of full convergence across the EA17 countries' bond yields spreads, and the presence of a certain number of clubs. In particular, three subgroup convergence clubs emerge, with Cyprus, Spain, France, Greece, Ireland, Lithuania, Luxembourg, Latvia, Portugal and Slovenia in the first; Belgium, Italy and Malta in the second; and Austria, Finland, Netherlands and Slovakia in the third club. Moreover, there is also evidence that the first two clubs could be merged to form a larger convergence club. The transitional curves indicate that, despite short-run divergences, EU17 sovereign bond yield spreads tend to converge in the long-run, with the exception of those in Greece and Cyprus, indicating the strong attempts of most of the countries under investigation to adopt fiscal policies that eventually contribute to a convergence pattern.

JEL Classification: C33; E61; G12; H77

Keywords: Sovereign bond yield spreads; Club convergence; Euro Area

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