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Sovereign Default: The Role of Expectations*

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Abstract

In the standard model of sovereign default, as in Aguiar and Gopinath (2006) or Arellano (2008), default is driven by fundamentals alone. There is no independent role for expectations. We show that small variations of that model are consistent with multiple interest rate equilibria, similar to the ones found in Calvo (1988). For distributions of output that are commonly used in the literature, the high interest rate equilibria have properties that make them fragile. Once output is drawn from a distribution with both good and bad times, however, it is possible to have robust high interest rate equilibria.

Keywords: Sovereign default; multiple equilibria; good and bad times.
JEL Codes: E44, F34.

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