Research in International Business and Finance xxx (xxxx) xxx–xxx

Contents lists available at ScienceDirect

Research in International Business and Finance

journal homepage: www.elsevier.com/locate/ribaf

Full Length Article

Determinants of emerging markets' financial health: A panel data study of sovereign bond spreads

Edinaldo Tebaldi[a,*], Hana Nguyen[b], John Zuluaga[c]

[a] Bryant University, United States
[b] Boston College, United States
[c] Van Eck Associates Corporation, United States

A R T I C L E I N F O

JEL Classification:
F34
F37
F65
G15

Keywords:
International finance
Sovereign bonds
Risk premium
GMM

A B S T R A C T

This research uses Arellano and Bover (1995) and Blundell and Bond (1998) GMM estimator to pinpoint the determinants of sovereign spreads in thirty-one emerging economies from 1994 to 2014. The empirical analysis provides evidence that GDP growth, real effective exchange rate, and political liberation play an essential role in determining the spreads. Openness and geography are surprisingly not significant drivers of a country's riskiness. In addition, the estimates show a considerable impact of the 1997–1998 Asian Crisis and the 2008–2009 Financial Crisis on emerging countries' spreads. However, there was no significant increase in bond spreads in the post-Financial Crisis period.

1. Introduction

The early 1990s was marked by a heavy reliance on bonded debt in emerging markets. Fig. 1 shows that the value of sovereign bonds issued by these nations skyrocketed from a modest level of less than $17 billion in the 1980s to more than $290 billion by the end of 1999 (Bank of International Settlements, 2014). Ever since, assessing the risk characteristics of emerging nations' borrowing in the bond markets has been the focus of the international financial community. Today, emerging market sovereign bond issuance continues to grow to more than $740 billion, almost matching the size of the bond markets in developed nations (see Fig. 2).

Sovereign bonds are a major source of external financing for emerging markets and have significant implications for the operation of international capital markets. The yield spread of sovereign bonds, since the mid-1990s, has rapidly and markedly become a useful indicator of the risks of default that emerging markets entail. This spread, abbreviated as *sovereign bond spread*, is the difference between the yield of a sovereign bond and that of the virtually-free-of-default-risk US Treasury debt security of a comparable maturity. This difference is the spread that compensates investors for the additional risk when they hold risky debt securities from emerging economies whose creditworthiness and fundamentals are much weaker than those of the United States. Kamin and Kleist (1999) shows that emerging market spreads have strong relationships with the creditworthiness of the borrowing country.

Researchers have proposed empirical models that estimate sovereign bond spread and studied the different determinants of underlying economic fundamentals that affect bond spreads. They have also strived to answer the question of whether the sovereign bond yield spread is appropriately priced in relation to country-specific fundamentals of that particular emerging economy. However, the literature is still thin when it comes to the examination of the extent to which the contribution of factors determining sovereign bond spreads change across regions, over different periods, and over different stages of financial performance for each country. For

* Corresponding author.
E-mail address: etebaldi@bryant.edu (E. Tebaldi).

http://dx.doi.org/10.1016/j.ribaf.2017.07.135
Received 26 February 2017; Accepted 6 July 2017
0275-5319/ © 2017 Elsevier B.V. All rights reserved.

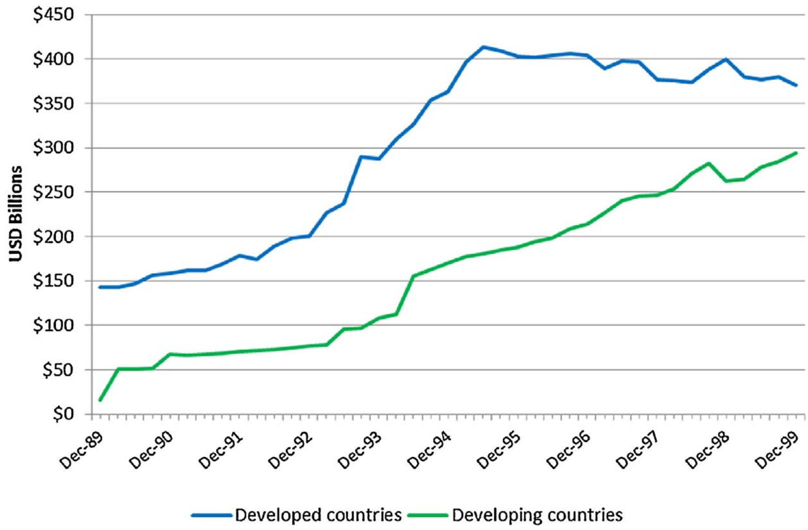

Fig. 1. Sovereign Debt Issuance of Developing and Developed Markets in the 1990s.
Source: Bank of International Settlements (2014)

instance, Ferrucci (2003) warned that not taking into account changes in time may cause the model to break down during periods of crisis due to structural breaks in estimation parameters or yield curve effects.

This research aims to fill the gap in literature and evaluate how the estimates change during financial economic cycles (during the Financial Crisis and after the Financial Crisis) by dissecting data into distinguished regions of the world during separate periods of financial distress. The paper uses Arellano and Bover (1995) and Blundell and Bond (1998) GMM estimator and data of 31 emerging economies to estimate sovereign bond spreads. The period in examination ranges from 1994 to 2014. This research aims to study (1) the determinants of sovereign bond spreads of developing economies, (2) the changes in effectiveness of those determinants during and after financial crises, and (3) the degree of significance of sovereign spread across regions.

The rest of this paper is organized as follows: Section 2 – Literature Review. Section 3 – Theoretical Framework and Econometric Methodology – describes the empirical methodology, explains the input variables, and provides the details of the collection of data. Section 4 summarizes the results. Finally, Section 5 concludes the research and offers some final insights into the topic.

2. Literature review

The surge of empirical literature in secondary bond market analysis started in the early 1990s, when Brady bonds became the main source of capital in emerging markets and when the development of indices of secondary market bond spreads increased rapidly after the implementation of the Brady Plan (Emerging Markets Traders Association, 2009).

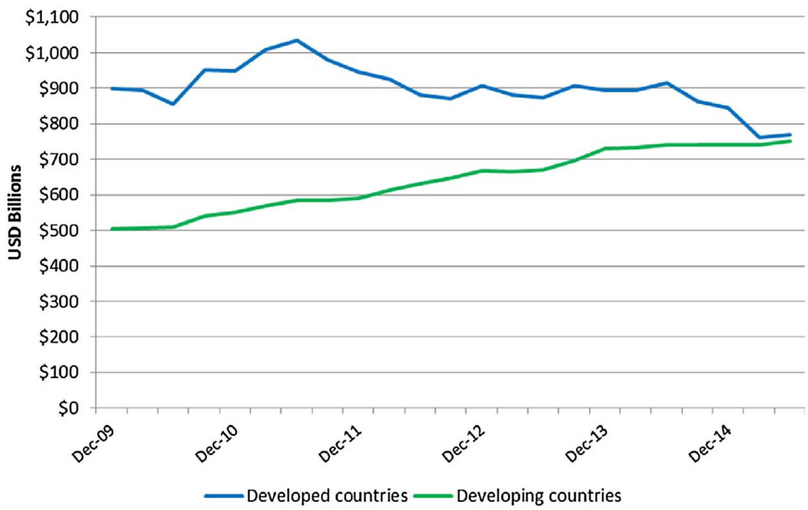

Fig. 2. Sovereign Debt Issuance of Developing and Developed Markets in the 2010s.
Source: Bank of International Settlements (2014)

Download English Version:

https://daneshyari.com/en/article/7413715

Download Persian Version:

https://daneshyari.com/article/7413715

Daneshyari.com