Economic Complexity and Sovereign Risk Premia

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Abstract:

Sovereign risk premia is a measure associated with the probability of a country's inability to pay its sovereign debt perceived by the markets. In addition to macroeconomic, global and institutional factors, investors may also be looking deeper at the productive capacity of a country to assess that risk. In this regard, this paper analyses the impact of economic complexity, measured by the Economic Complexity Index (ECI), on sovereign risk premia. The results reveal that, after controlling for relevant macroeconomic variables, global factors and institutional indicators, the economic complexity has a significantly negative impact on sovereign risk premia, captured by the sovereign CDS spreads. This finding is valid both for advanced and emerging economies. An economy's ability to produce complex goods, which requires bringing in different sorts of knowhow and capabilities together, might serve as an indicator of economy's resilience to shocks relative to other economies. Thus, enhanced economic complexity is associated with reduced country risk.

Keywords: Economic Complexity, Sovereign Risk Premia

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