Geopolitical risk and emerging market sovereign risk premia

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Resumen:

This study examines how geopolitical risk (GPR) transmits to sovereign credit risk in emerging market economies (EMEs), using monthly data on the 5-year sovereign credit default swap (SCDS) and the J.P. Morgan Emerging Markets Bond Index (EMBI) spread for 13 EMEs over the period of January 2005–October 2025. Using fixed-effects panel local projections, the framework is extended to allow for state-dependent transmission. Differences in impulse responses across states are attributed to specific macrofinancial fundamentals. Three main findings are identified. First, an increase in the GPR index raises both SCDS and EMBI spreads. Second, disaggregating the index into its subcomponents reveals a larger response to threats than to acts, consistent with the possibility of anticipation effects in sovereign credit markets. Third, evaluating the state-dependent impulse response around the Russian invasion of Ukraine yields substantially different responses, with the post-invasion configuration increasing the sovereign risk premia response. Our findings show the importance of modeling the state-dependent transmission of geopolitical shocks and provide a useful tool for incorporating geopolitical scenarios into sovereign risk analysis.

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