The SDGs and sovereign bond spreads: investor implications

"A better SDG performance could benefit both governments and institutional investors"

E. ten Bosch, M. van Dijk and D. Schoenmaker – Erasmus University

The deadline of 2030 for achieving the United Nations Sustainable Development Goals (SDGs) is fast approaching, and the pressure on governments to meet these targets is intensifying. The implications of not achieving the SDGs could have negative consequences for sovereign bonds. For example, biodiversity loss (SDG 15) could lead to a loss of natural pollination, increased risk of crop failure, and long-term economic losses for countries and investors. This paper analyzes the relation between the SDGs and global sovereign bonds' credit default swap (CDS) spreads to research whether sustainable development is priced into the sovereign bond market.

Principal Findings

- A significant negative relation exists between a country's SDG index and its CDS spread.
- This effect is stronger for longer maturities, in line with the long-term objectives of SDGs.
- An increase of one standard deviation in the SDG index is associated with a decrease of approximately 17 basis points in the 5-year CDS spread.
- This is economically significant, as a change of just a few basis points can yield big financial benefits for governments with large sovereign bond issuances.
- The results are most consistent with the perceived default risk driving this relation, rather than with investor preferences.

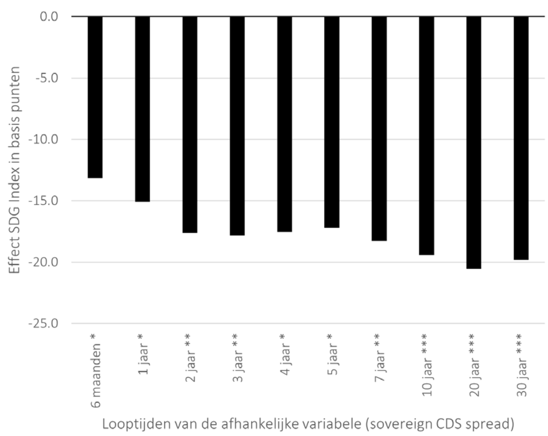

Figure portraying regression results: Relation between SDG Index and different maturity CDS spreads

Key Takeaways for the Industry

- There is a potentially important relation between sustainability and CDS spreads. Better SDG performance could benefit governments financially, socially and ecologically.
- Investing in sovereign bonds of countries that invest in sustainable development can benefit investors, allowing impact investing to extend into sovereign bond strategies.

Want to know more? Read the paper
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