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Cost of 'insurance' against defaults on sovereign debt rise 67% as global financial fears intensify

— 73% of countries see cost of 'insurance' against defaults on their sovereign debt rise
— Cost of U.S. 'insurance' rose 282%, ahead of potential June 1 default

The cost of insuring against sovereign debt defaults remains sky high, increasing by an average of 67% over the past year*, shows research by global specialty (re)insurance group Chaucer.

Credit Default Swaps (CDS) have soared in the past year as investors believe there is an increasing risk of countries defaulting on their debt. CDS are used to protect businesses against a default on the debt of a third party, including a government.

73% of the 88 countries in Chaucer's study have seen the cost of CDS on their sovereign debt rise*, as global financial worries increase.

Investors remain concerned that the sharp rise in interest rates globally, raising the cost to service debt, has increased the risk of countries defaulting. The prospect of a further slowdown in economic growth is also worrying investors, which would make it even tougher for governments to repay their debt. Many advanced economies have sharply increased their level of borrowing over the last few years, particularly during the pandemic, to fund increased spending and to make up for a shortfall in tax revenues.

With investors concerned that governments may be unable to repay this debt, the average cost of insuring against a sovereign debt default globally has risen by 67% year on year*.

The U.S. has seen the cost of a CDS on its sovereign debt skyrocket in the last few months, increasing by 142% since November 2022 and 282% year-on-year since April 2023*. Instability in the U.S. banking sector and rising interest rates have dramatically increased the risk of a U.S. default. The U.S. is currently experiencing a potential debt crisis, with political impasse meaning the debt ceiling hasn't been raised. Should this not happen by June 1st the Government would theoretically be unable to borrow money.

In other advanced economies, the risk of default is rising significantly; for example, the U.K. has seen CDS on its sovereign debt increase by 131% in the past year*. Investors remain concerned about the U.K.'s economic prospects following the September mini-budget which deteriorated investor confidence. In the past year, the yield on a UK 10-year

gilt rose from 1.91% to 3.67%, reflecting a fierce sell-off in the bond market**. Governments depend on the sale of bonds in order to fund their spending.

The costs of other forms of insuring against government default have also increased in the past year, such as contract frustration insurance. If a government falls into economic difficulty they are more likely to cancel corporate contracts to reduce their spending. 'Contract frustration insurance' would provide cover for companies that suffer losses from the failure of the other party to fulfil the terms of the contract.

With the risk of default rising in many developed economies, not just developing ones, demand for contract frustration insurance is increasing among Western economies. Corporates are seeking to mitigate a further slowdown in economic growth, which would likely impact government contracts being fulfilled. The construction, infrastructure and property industries are likely to be most affected.

Jonathan Bint, Senior Analyst & Underwriter at Chaucer says: "The risk of default in many countries worldwide is growing at a fast pace. Even in economies as advanced as the U.S. and U.K the cost of insuring against a default is rising."

"Whilst few mainstream investors expect either the UK or US to actually default that doesn't mean that being a creditor to those Governments is without financial risk. The worsening state of public finances are particularly worrying for corporates seeking to protect themselves financially from potential cancellation of government contracts."

"The debt of developed economies has ballooned in the last few years and governments have been unable to sufficiently stimulate economic growth to sustain this increase in debt. Increases in bond yields are indicative of investors viewing advanced economies as higher-risk."

"In an effort to quell inflation, central banks have raised interest rates quickly, but this has increased the cost of repaying their large debt pile. As economic stability declines, the chances that governments will cancel prior agreements made with corporates increase significantly."

"Contract frustration insurance can protect against the rising risk of governments cancelling contracts. Without this cover, companies that depend on expensive government contracts could be taking a big risk given the worsening economic environment."

CDS year-on-year change by country*

Country	2022	2023	Change	% Change
Pakistan	848.6	4505.8	3657.2	431%
United States	17.7	67.4	49.7	282%
Ecuador	899.0	3046.2	2147.2	239%
Kenya	466.5	1183.0	716.5	154%
Egypt	756.6	1845.8	1089.2	144%
Nigeria	520.4	1246.2	725.8	139%
United Kingdom	11.6	26.8	15.2	131%
Tunisia	1041.1	2296.5	1255.4	121%
Cameroon	372.3	751.5	379.2	102%
Sri Lanka	4281.8	8332.1	4050.3	95%

**Year-end is 27 April 2023. Data concerns prices of a 5-year CDS.*
***Year-end is May 2nd 2023.*

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