

# EXECUTIVE SUMMARY

## I. Research Question

The objective of this thesis is to evaluate the factors that determine sovereign CDS spreads of European countries. The focus is set on global risk aversion and local economic variables. It is assumed that the influence of global risk aversion decreased during the sovereign crisis, whereas information about a country's indebtedness and economic health increased.

## II. Approach

The dataset contains fifteen Euro area countries where the five year CDS and several economic indicators are available since 2004. First, the CDS of every country in the dataset is examined on its relation to global risk aversion. A regression is estimated, based on daily data of the CDS spreads and the VIX index, which aims to proxy global risk aversion. Second, a panel regression is done with local economic information like public indebtedness and economic health on a monthly basis. Again the influence of these variables on sovereign CDS spreads is tested in order to find the determinants of sovereign risk.

## III. Key Results

The results of the empirical analysis reject the first hypothesis as the explanatory power of the VIX index even increases during the sovereign crisis. Hence, global risk aversion was even a stronger driver of CDS spreads than before. The second hypothesis, however, is approved by the estimation of the local information model. Thus, local economic factors increased their influence on risk spreads during the crisis. Along with the VIX, the debt to GDP ratio, the business cycle, retail sales and local stock market returns are found as significant determinants of European sovereign CDS spreads.

## IV. Conclusion

The increase in explanatory power of local economic information demonstrates the market participants' increasing sensitivity to these factors during the crisis. Hence public indebtedness and economic health became more important factors in the assessment of sovereign credit risk. However, global risk aversion also drove spreads to the high levels seen during the financial crisis.