The Greek Sovereign Debt Crisis

Are Credit Default Swaps To Blame?

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Bachelor Thesis

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Executive Summary

This thesis is confronted with the problem of the Greek sovereign debt crisis and specifically with the question of whether the Greek credit default swaps that were used both by hedgers and speculators had an impact on the Greek sovereign debt crisis. The thesis focuses on the time period between November 2011 and March 2012, when Greece experienced a credit event. It is an important topic as risk in general, and in this specific case the risk of default, will never be absolutely eliminated. Nowadays with market complexities and growing globalization, the topic of risk seems more important than ever. What will happen to Greece does not only have an impact on Greek citizens and Europe, but will have consequences for all economies worldwide. Therefore, it is important to understand if there exists a financial instrument that rather than helping to minimize the risk, is increasing it.

The thesis starts by explaining in detail how CDS contracts work. It explains the different participating parties and their intentions. The notional amount will be defined in gross and net notional amounts and for a better understanding an example will be drawn. The thesis will focus on single name CDS, but will also briefly refer to multi name CDS that are commanding, together with the single name CDS, 88% of the market.

An important issue that almost caused a big problem for the CDS market's credibility in 2012 was the definition of a credit event. The credit events listed by the International Swaps and Derivatives Association are further explained during the thesis. At the moment no stock exchange exists that trades CDS contracts, but they are available on the Over-the-counter market where they can be specialised to investors' specific needs, but less monitored. After understanding the fundamental tools of a CDS contract the thesis starts to have a closer look at the sovereign debt crises and in particular the Greek sovereign debt crisis where debt as a percentage of GDP played a crucial role.

Political decisions have directly affected the markets many times. Therefore the thesis analyses in detail the most volatile period during the crisis to explain which political decisions or announcements had a positive impact and which ones a more negative impact.

The results will be computed with the help of the statistics software SPSS. First of all it draws a linear regression for both the CDS spreads and the bond yields, with every parameter computed individually. Later the joined effect will be computed in a model and the significance of the parameter will be determined. The parameters for the regressions used are the VIX (investor's risk appetite), ATHEX (the stock index at the Athenian stock exchange), Euribor (risk free rate) and the Greek debt. The results show that the Greek CDS spreads did not endanger the stability of the global market.

The Granger Causality Test calculated in chapter 4 supports the results found in this thesis that the Greek bond yields do Granger-cause the Greek CDS spreads and therefore are affecting the Greek CDS' future performance, whilst the Greek CDS spreads are found to give no further information about the bond yields' future performance. The results show that the Greek CDS spreads are not to blame for the Greek sovereign debt crisis and the event of Greece defaulting.

In a final excursus the thesis shows the comparison from the Greek and Argentine sovereign debt crisis, as they are considered to be similar. Unfortunately, it appears that no lessons were learnt from the Argentine crisis. A table shows the many similarities between the two sovereign debt crises but also highlights the most important difference: when Argentina pegged its Peso to the US Dollar it was just in a 'quasi-monetary union', whereas Greece is arranged in a real monetary union.