Executive Summary

In this thesis I aim to address the role of Sovereign Credit Default Swaps (SCDS) in the European Sovereign Debt Crisis (ESDC). I divide this thesis in two parts. In the first one, I examine the origins of CDS and their main uses. Then I exhibit the market development before and after the global financial crisis which started in 2007. I continue by analyzing the role of CDS in the subprime crisis in the United States (US) and subsequently in the ESDC. In this part I also pay attention to the main directions of scientific work in the field of CDS and SCDS and I conclude by explaining and evaluating the European Union (EU) regulators' ban on SCDS short selling.

In the second part of the thesis I turn my attention to SCDS spreads and sovereign bond yields in order to determine how they respond to credit rating downgrade announcements. I carry out an event study, whereby I use a sample of six Eurozone countries in the period 2009-2016. I examine and analyze the reaction of each country's SCDS spreads and sovereign bond (SB) yields to downgrade events separately and draw parallels between the countries if necessary. Additionally, I also discuss the relationship of SCDS spreads and SB yields for each country separately.

I find that the SCDS spreads and SB yields of countries with weak macroeconomic fundamentals react positively to downgrades with great consistency while stronger fundamentals countries' reaction is sometimes negative. The former is in line with the existing literature on this topic whilst the latter deviates from current findings which is perhaps due to my adapting the event study methodology used in the majority of papers to my specific case. I additionally find that the theoretical relationship between SCDS spreads and SB yields mostly holds, i.e. they move in the same direction after a downgrade event. However, this direction is not always positive.