

Latest findings from a study of the empirical
relationship between European stock and
sovereign credit default swap markets

Bachelor Thesis

Department of Banking and Finance
University of Zurich

Chair of Financial Economics
Prof. Dr. Felix Kübler

Author: Andri Schnider

Field of study: Banking and Finance

Supervisor: Runjie Geng

Submission date: August 23, 2017

Abstract

The aim of this thesis is to examine the empirical relationship between the sovereign credit default swap (CDS) and the stock market for a sample of five European countries, namely Germany, Ireland, Italy, Portugal, and Spain for the years 2013 to 2016. The focus lays on the analysis of the lead-lag relationship between the two markets in order to ascertain in which market informed traders operate.

Analyzing the contemporaneous relationship by using correlation measures, I find that sovereign CDS spread changes are negatively associated with stock market index price changes. Moreover, that negative correlation is more pronounced for countries whose CDS spread is higher. Further, by analyzing the lead-lag relationship in a vector autoregressive framework, I find that the stock market clearly leads the sovereign CDS market for all sample countries. Thus, my results indicate that informed investors mainly trade in the stock market rather than in the sovereign CDS market.

Keywords: Credit default swap, sovereign credit derivative, stock market, lead-lag relationship, price discovery, informed trading