

Abstract

In the first chapter, the empirical relationship between CDS premia and government bond spreads is examined for Portugal, Italy, Ireland, Greece, and Spain. The analysis yields some evidence of a long-term relationship between the two markets in the sense of cointegration. In most cases, only CDS premia contribute to the price discovery process. In the other instances, both markets contribute more or less equally. This suggests that bond spreads react only sluggishly to long-term imbalances, as measured by the cointegrating relationship, behaviour that may be due – at least partially – to liquidity effects.

In the second chapter, a rolling-crisis-window approach for contagion testing is applied, derived from and enhancing an approach proposed by Forbes and Rigobon (2002). The rolling-crisis-window approach helps account for crises of longer-than-usual duration, as is case for Greece since its crisis began in October 2009. This rolling-crisis-window approach is applied to test whether the co-movements of sovereign CDS premia increased significantly after the Greek debt crisis started. The sample consists of daily data between October 2008 and July 2010 for 39 countries from both emerging and industrialized countries. The test results indicate that there were periods of contagion for CDS markets during the Greek debt crisis, which contrasts with the results of Forbes and Rigobon (2002) for equity markets during the East Asian crisis in 1997-98, the Mexican peso crisis in 1994, and the U.S. stock market crash in 1987, challenging their conclusion of “no contagion, only interdependence.”

In the third chapter, the rolling-crisis-window approach is applied to equity markets during these three crises and the results are compared to those of Forbes and Rigobon (2002). The sample consists of daily returns of 32 MSCI equity market indices in both local currencies and US dollars. In contrast to the static approach of Forbes and Rigobon (2002), the rolling-crisis-window approach yields ample evidence of contagion during these crises. This result is further supported by extensive robustness tests that entailed altering the periods of relative stability and using daily returns in US dollars instead of the local currency.