

[DOI: 10.20472/IAC.2015.020.007](https://doi.org/10.20472/IAC.2015.020.007)

JORGE ANDRAZ

University of Algarve - Faculty of Economics, Portugal

NÉLIA NORTE

University of Algarve - Faculty of Economics, Portugal

CRISTINA OLIVEIRA

University of Algarve - Faculty of Economics, Portugal

NEW INSIGHTS ON THE LONG-TERM RELATIONSHIP BETWEEN SOVEREIGN BONDS DEBT AND CREDIT DEFAULT SWAPS IN PORTUGAL:*

Abstract:

The paper full title is "New insights on the long-term relationship between sovereign bonds debt and credit default swaps in Portugal: What has changed with the financial crisis?"

This paper aims at identifying the relationship between government bonds spreads and credit default swaps premiums in Portugal for long and short maturities, and to what extent the financial crisis that hit the country in 2010 may have changed such relationship nature in both maturities. Daily data are used in maturities of two and five years, covering the period from May 1, 2007 to October 7, 2011. Based on structural change and cointegration analysis we estimate Autoregressive Distributed Lag error correction models for the subperiods prior and after the moment crisis started. The nonstationarity of data is not due to unit roots but to structural changes as a consequence of the financial crisis. This issue is the main distinctive feature of our study since as data report different integration orders, the procedure of differentiating to get stationary data is not appropriate. In the light of this remark, results reveal the absence of cointegration over the sample period, with important differences prior and after 2010. The long-run relationship in the 5-year maturity markets was interrupted with the crisis, but a long-run relationship in the 2-year maturity markets has been enacted. Both markets perform an important role in price discovering in the 2-year segment.

Keywords:

credit default swaps, sovereign bonds, credit risk, cointegration, price discovery

JEL Classification: C13, C32, G10

*The authors are pleased to acknowledge financial support from Fundação para a Ciência e a Tecnologia and FEDER/COMPETE (grant PEst-C/EGE/UI4007/2013).