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SOVEREIGN CDS SPREAD DETERMINANTS AND SPILL-OVER EFFECTS

Abstract:

This paper examines the determinants of CDS spreads and potential spillover effects for Eurozone countries during the recent financial crisis in the EU. We employ a Panel Vector Autoregressive (PVAR) model which combines the advantages of traditional VAR modelling with the advantages of a panel-data approach. In addition to variables that proxy for global and financial market spread determinants we also employ variables that proxy for behavioral determinants. We find that the determinants of CDS variance are neither uniform nor stable during different periods and different countries. For instance, as we move from 2008 to 2014 the impact of the slope of the term structure on CDS spread variance is increasing for Spain, Portugal, Italy, Greece, Ireland, and decreasing for Germany, France, Netherlands, Belgium and Austria. Other findings indicate that investor sentiment may be an important CDS spread determinant during the period between 2008 and 2010, along with other factors, while spillover effects may run from Spain and Italy to core countries while spillover effects from Portugal, Greece, and Ireland are of minor importance.

Keywords:

Financial Crisis, CDS, Spreads, Panel VAR, Sentiment

JEL Classification: G12, G15