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A NEW RISK APPETITE INDEX AND CDS SPREADS: EVIDENCE FROM AN EMERGING MARKET

Abstract:

The aim of this study is introducing a new risk appetite index (RISE) methodology and then elaborating especially on its benefits while dealing with sovereign default probabilities. More specifically, providing two types of risk appetite indices, both calculated at individual investor level before aggregation, we present the relationships of these indices with 5y CDS spreads and then discuss the possibility of some new financial instruments which could well be used for hedging or speculating. The core weekly data include all investors' individual holdings of all securities on the stock exchange (BIST) of Turkey, closing prices of largest 100 firms' index (BIST100), and 5y CDS spreads of Turkey since 2008. Because of data limitations, the evidence comes from only one developing country but generalization of the main finding seems to be quite possible and testable since the new methodology introduced is flexible enough to be applied in different settings and / or countries.

Keywords:

Risk appetite, CDS, Sovereign, Emerging markets, Turkey

JEL Classification: E44, G00, G01