

Sovereign Credit Default Swaps, Sovereign Debts and Volatility Transmissions across Emerging Markets

Francis In*

Department of Accounting and Finance, Monash University

Phone: 61-3-9905-1561

E-mail address: Francis.In@BusEco.monash.edu.au

Byoung Uk Kang

Graduate School of Management, Korea Advanced Institute of Science and Technology

Phone: 82-2-958-3689

E-mail address: wayfarer@kgsn.kaist.ac.kr

Tong Suk Kim

Graduate School of Management, Korea Advanced Institute of Science and Technology

Phone: 82-2-958-3018

E-mail address: tskim@kgsn.kaist.ac.kr

June, 2006

* Corresponding author, Francis In, Department of Accounting and Finance, Monash University, Clayton 3168, Victoria, Australia Tel : 61-3-9905-1561, Fax : 61-3-9905-5475, E-mail address : Francis.In@BusEco.monash.edu.au

Abstract

In this paper, we use sovereign credit default swap (CDS) prices and emerging market government bond credit spreads to study and compare their abilities in information processing and transmission across nations. In contrast to approaches used in previous studies, first we identify the long-run co-movements between the sovereign CDS prices and their corresponding credit spreads using the Canonical Cointegration Regression (CCR), and carry out an analysis on short-run dynamics including price discovery and volatility spillovers using the bivariate CCR-ECM with an EGARCH specification. We then investigate the credit spreads inter-linkages across the major emerging market debtors located in Latin America. Advantage of the multivariate EGARCH model enables us to detect the volatility transmission mechanisms, which gives valuable insights into market participants' perception towards emerging market credit worthiness.