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Analysis of CDS indicators in Europe

It is not only the current level of CDS indicators that is worth analyzing but their change over time can also lead to relevant conclusions. This short study aims to present how CDS premia have changed since October 2008 in certain countries (Hungary, Germany, Austria, France, the Visegrád countries and the PIIGS countries). According to the analysis, the current CDS figures for Hungary and the other Visegrád countries are around the October 2008 base, while German and Austrian credit risk premia are almost double the figure of October 2008, the French equivalent is three-and-a-half times higher and premia for PIIGS countries (data excluding Greece after March 2012, due to its technical default) are five-fold more on the market.

After the bankruptcy of Lehman Brothers confidence between credit institutions crumbled, the banking system became unstable. The firm conviction that one of the largest investments banks in the world or a developed country cannot go bankrupt has been shaken. Therefore the observing of CDS indicators of not only enterprises but certain countries has also come into limelight. In the first quarter of 2012 Greece in practice filed for bankruptcy protection, and its creditors canceled a part of its debts. Since then CDS premium for Greece has not been listed, because the country has practically defaulted.

Regarding the groups of countries observed in the analysis, CDS is calculated as the weighted average of the CDS of individual countries' nominal GDP. Greece slightly distorts the graphs as its credit default premium had increased exponentially for a short period and as the country went in fact bankrupt it was no longer included in the calculation. For the year 2012 the 2011 GDP figure was utilized which does not cause large differences in the CDS calculation of the groups of countries (4-5 basis points).

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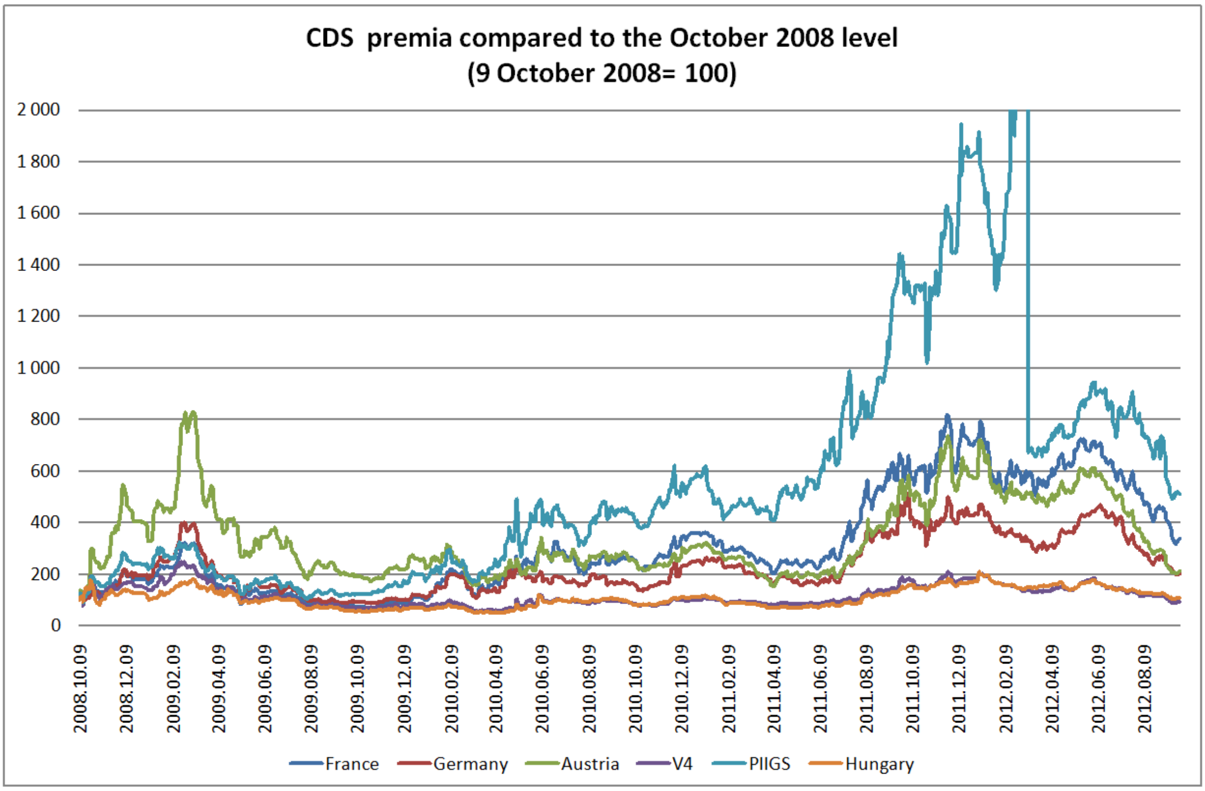
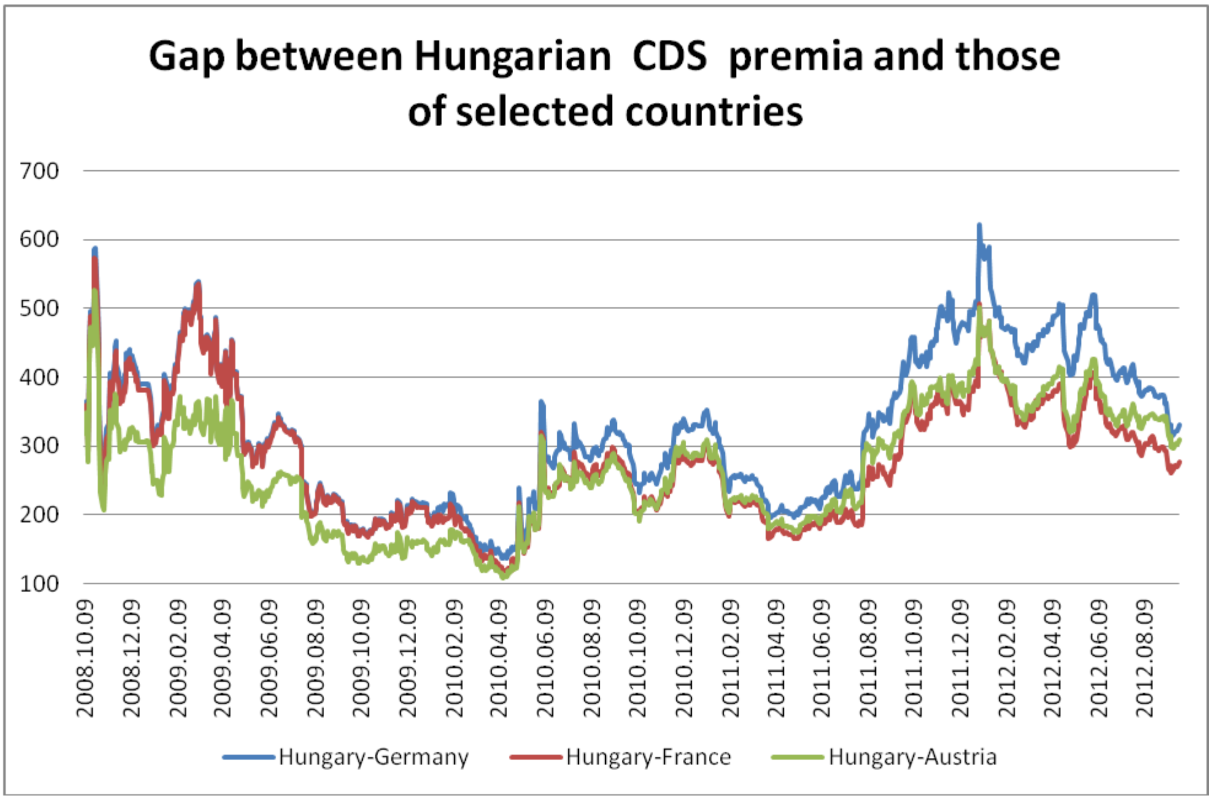


Source: Reuters, NGM calculation

The above graph shows that calculating with an October 2008 base the volatility of CDS indicators has been the most muted for Hungary and the V4 including the country. For the calculation the figure of 9 October 2008 was taken as 100 which stands for levels at the onset of the crisis reflecting conditions four years ago. While relevant data for Hungary and the region oscillated in a band of 50-250 basis points compared to the base (09.10.2008=100), developed and PIIGS countries have all been exposed to high volatility. As German, Austrian and French data certainly had a very low base initially, therefore higher volatility is justified. On the other hand, considering this indicator our region and Hungary have outperformed the PIIGS countries, although this group of countries includes large economies.

Quite obviously, the debt level of a country hugely influences its CDS pricing. As soon as it had entered office the Hungarian government recognized this issue and fully concentrating on debt reduction results have already been achieved and the Government of Hungary continues to be committed to this policy.

Analyzing current data and figures of one year ago it can be concluded that debt levels have increased in the majority of EU member countries (in 23 out of 27), to the greatest extent in Portugal (17.2 percentage points), Cyprus (11 percentage points) and Ireland (8.2 percentage points). In Hungary, however, in Q1 2012 general government debt declined to 22 399bn HUF which corresponds to a decrease of 1.8 percentage points and 4.1 percentage points compared to Q4 2011 and Q1 2012, respectively. Furthermore, according to the latest statistics of Q2 2012, general government debt amounted to 77.6 percent of GDP.



Source: Reuters, NGM calculation

It is also apparent that in comparison to developed countries Hungarian CDS premia are still high, but the underlying trend can be viewed as positive. As the graph signals Hungarian CDS spread vis-a-vis the Austrian, French and German equivalent has declined close to 300 basis points which may indicate a return to a relatively favourable trend, lasting from the beginning of 2010 until the end of 2011, when in comparison to developed countries Hungarian statistics were 200-250 basis points. Analyzing Hungarian data it can also be observed that since the period of global economic turbulences in January 2012 our credit risk premium has substantially declined. The indicator was around 600-650 basis points in January 2012 and currently it is 378 basis points, which corresponds to a decrease of about 220-270 basis points, of which a decline of 120 basis points was recorded in the second half of this year.