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Commonality in Credit Risk of Central and East European countries

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We analyse the sovereign credit risk of the Central and East European (CEE) countries in terms of Credit Default Swaps (CDS) spreads during and after sovereign debt crises. A commonality of credit risk of the countries was investigated using the principal component analysis (PC). We found a strong commonality between CDS spreads changes. The first PC explains 77.5 percent of CDS changes. We used a regression analysis technique to estimate the main factors determining credit risk of the individual countries. Our investigation shows, that euro equity return and changes of the volatility index VIX have significant impact on the credit risk of the individual country. We did not establish any impact of the changes of the amount of the debt to GDP on CDS changes in all the countries of the CEE. The current account position does not have any observable impact on credit risk of the countries either. After elimination of an evident influence of the factors affecting the countries' CDS spreads changes, a commonality between residuals was perceived. Our analysis revealed that a commonality between CDS spreads of the CEE countries is greater than that between local equity markets returns. The aspects of changes of the countries' credit risk in different sub periods were tackled. At the beginning of the crisis, the Baltic countries were more vulnerable; however, the second wave of the crises mostly affected Central European countries including those that are in the Eurozone.

Keywords: credit, sovereign risk, CDS, CEE countries, spread.
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