Financial Integration, Development and Stability: Lessons from the Crisis

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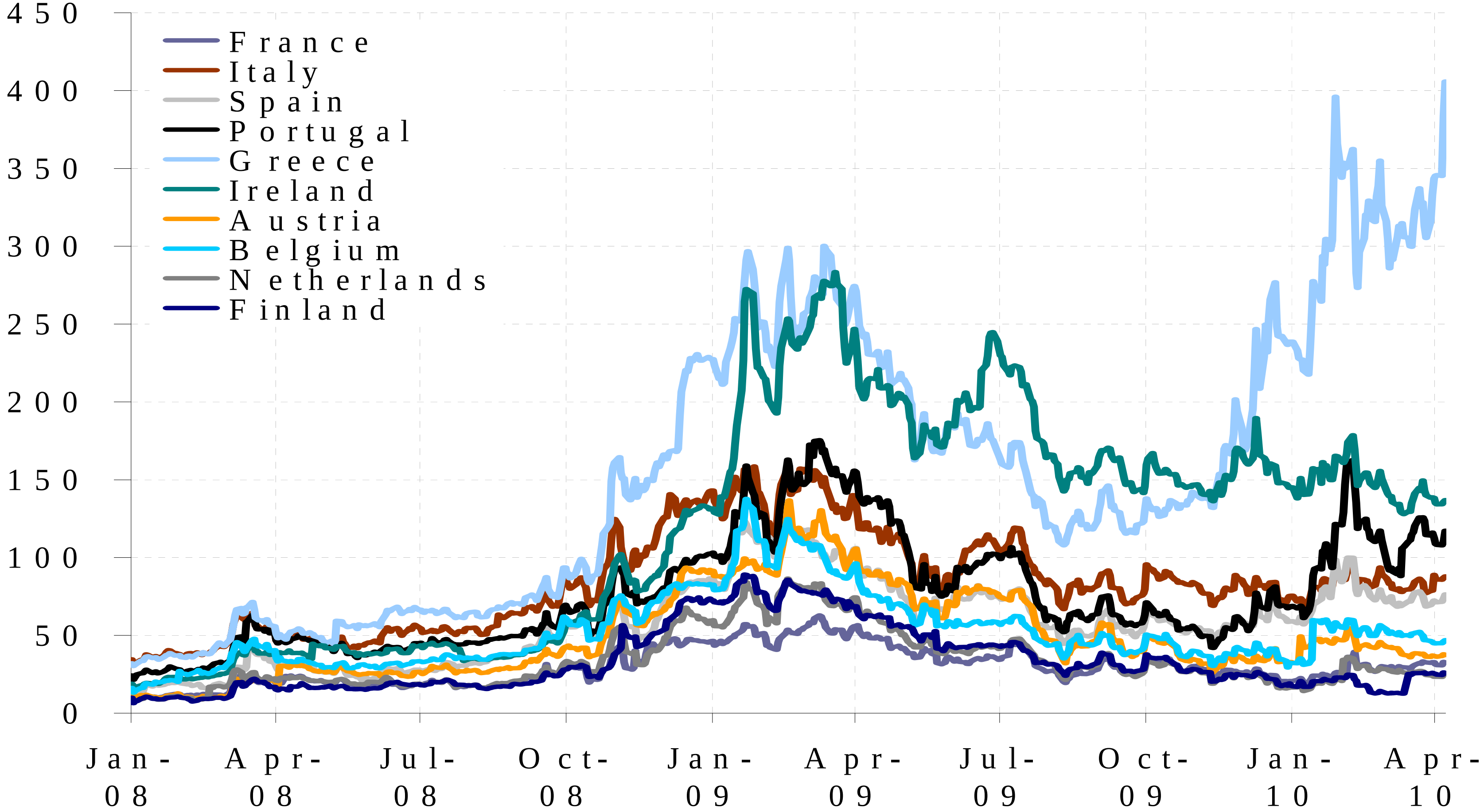
Developments in euro area sovereign bond yield spreads

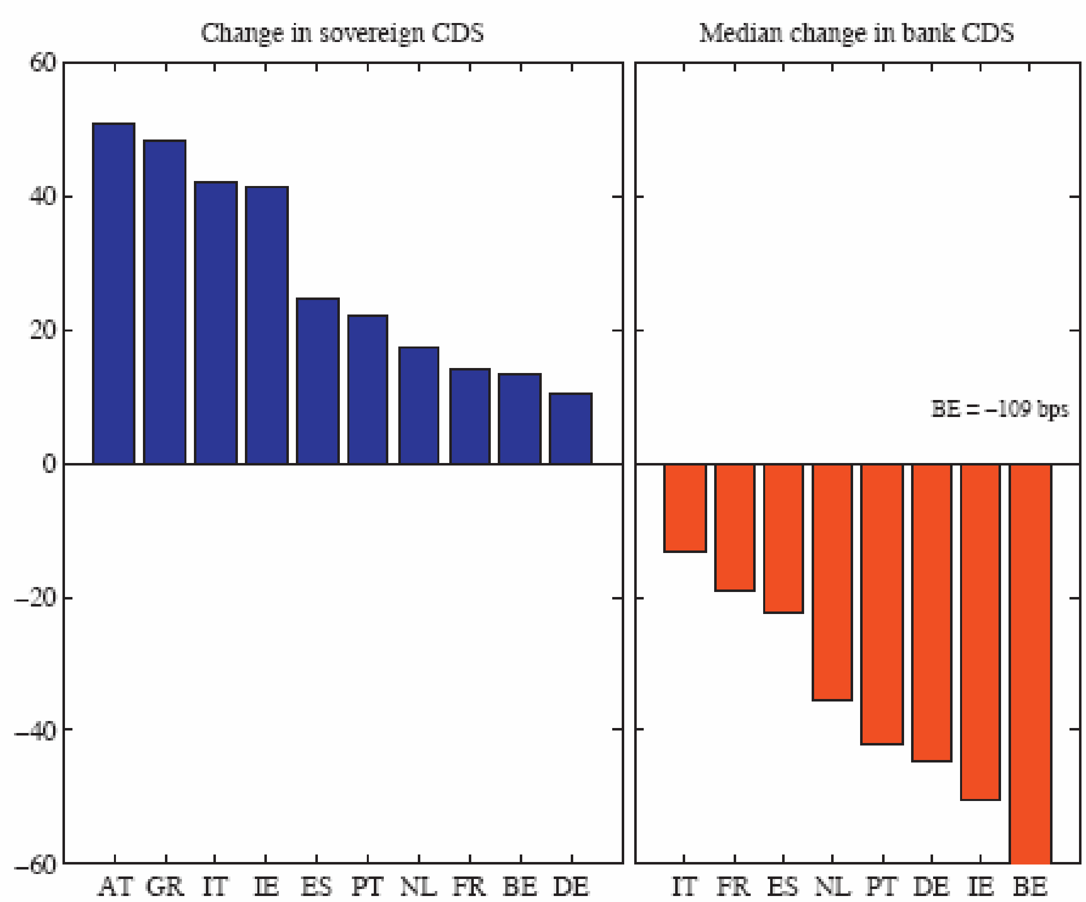
Selected euro area sovereign ten-year bond yield spreads vs Germany Jan. 2007 – Apr. 2010

(basis points)



Risk transfer from the financial sector to the government

Change of average CDS premia between early and mid October 2008 *(basis points)*



Source: Ejsing and Lemke (2009)
Note: Due to insufficient data, there is no reporting of bank CDS for Austria and Greece in the left panel

The role of credit risk and liquidity premia

Average five-year CDS premia and sovereign bond yield spreads

(basis points)

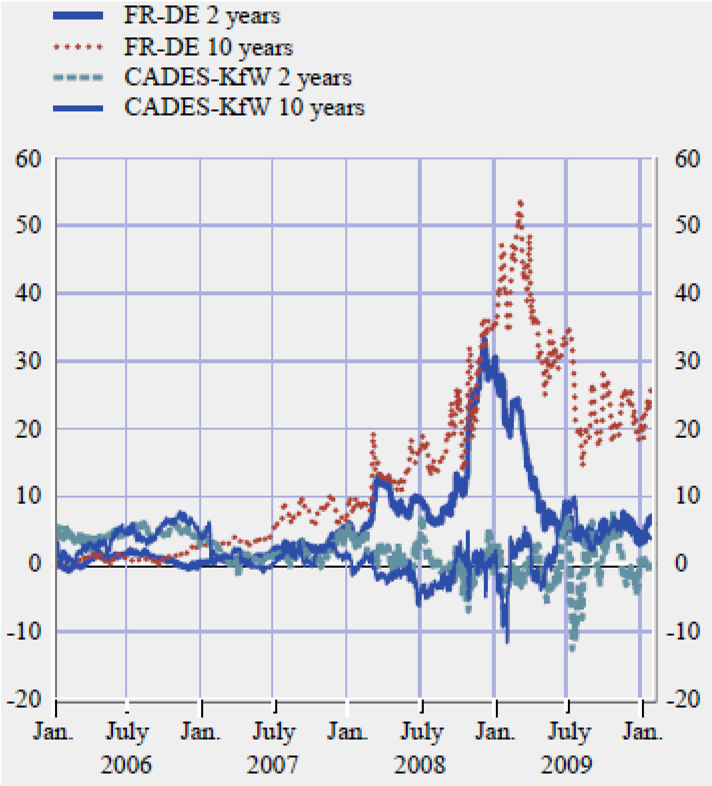
- **While the co-movement between CDS premia and sovereign bond yield spreads suggests that a large part of the fluctuations in the latter during the crisis was due to changes in the relative pricing of credit risk, other factors also influenced the pricing of government debt**
- **There is evidence that market liquidity conditions played a vital role in the widening of sovereign bond spreads during the crisis**

Source: ECB Financial Integration Report 2009

Note: The five-year CDS (yield) spread is computed as a difference between the five-year CDS (bond yield) of the respective countries against the CDS (bond yield) of Germany.

The relevance of liquidity premia for the French-German sovereign yield differential

French-German sovereign and agency yield spreads *(basis points)*



Source: ECB Financial Integration Report 2009

Note: French Cades and German KfW bonds enjoy full state guarantee of the respective government.

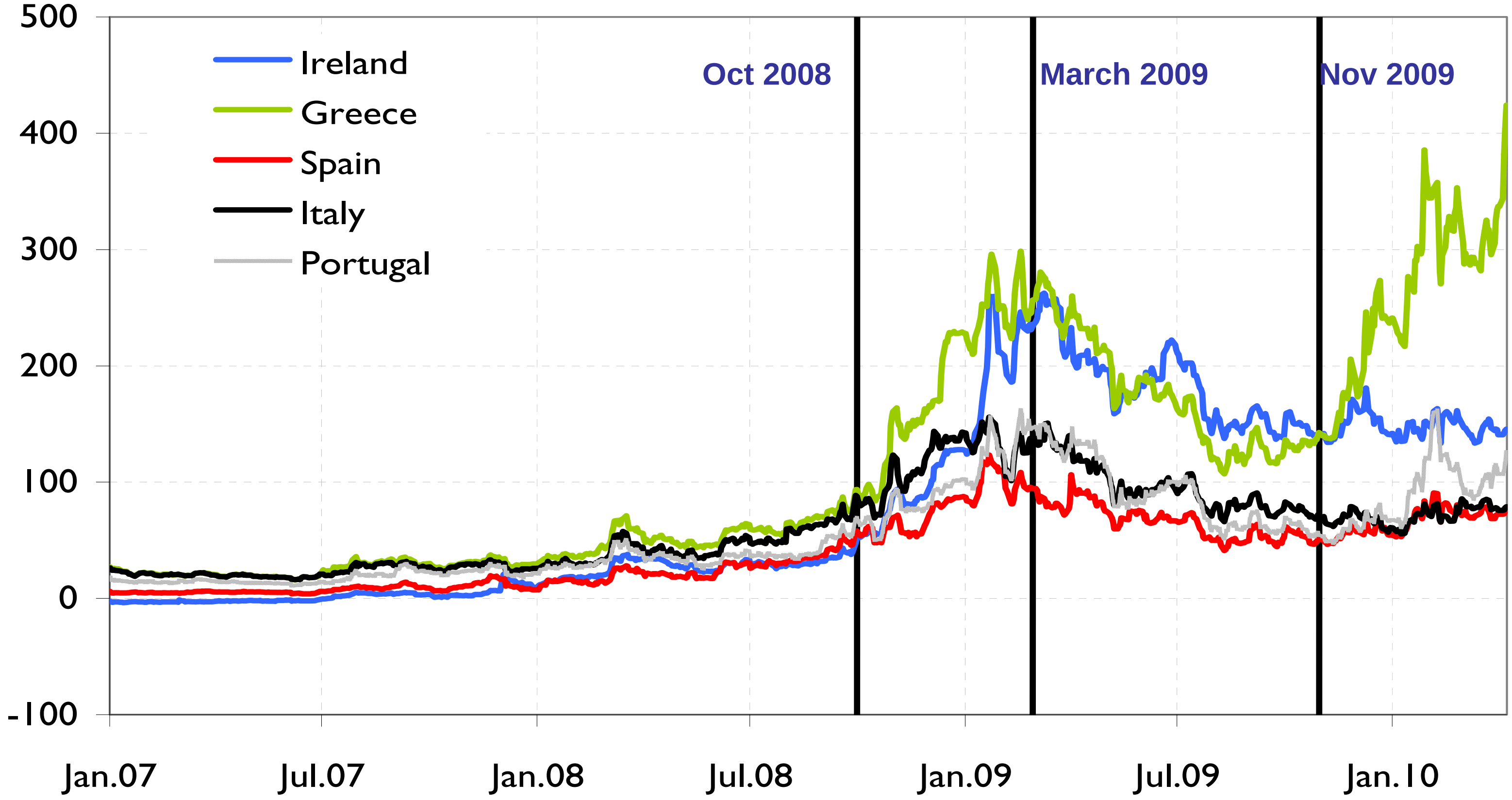
- **Take a closer look at French-German sovereign bond spread developments:**
  - **In March 2009 the difference between their ten-year bond yields reached more than 50 basis points**
  - **Did the spread reflect different perceived credit risks? Or did it reflect liquidity differentials?**

- **Debt securities issued by the French CADES and the German KfW would be expected to have the same risk characteristics as French and German government debt, respectively, since the debt securities issued by these two agencies are guaranteed by the respective governments**

- **Agency spreads remained remarkably stable: This suggests that there were no significant changes in the perceived relative credit quality, but liquidity factors favoured the German bond market**

The role of country-specific credit risk

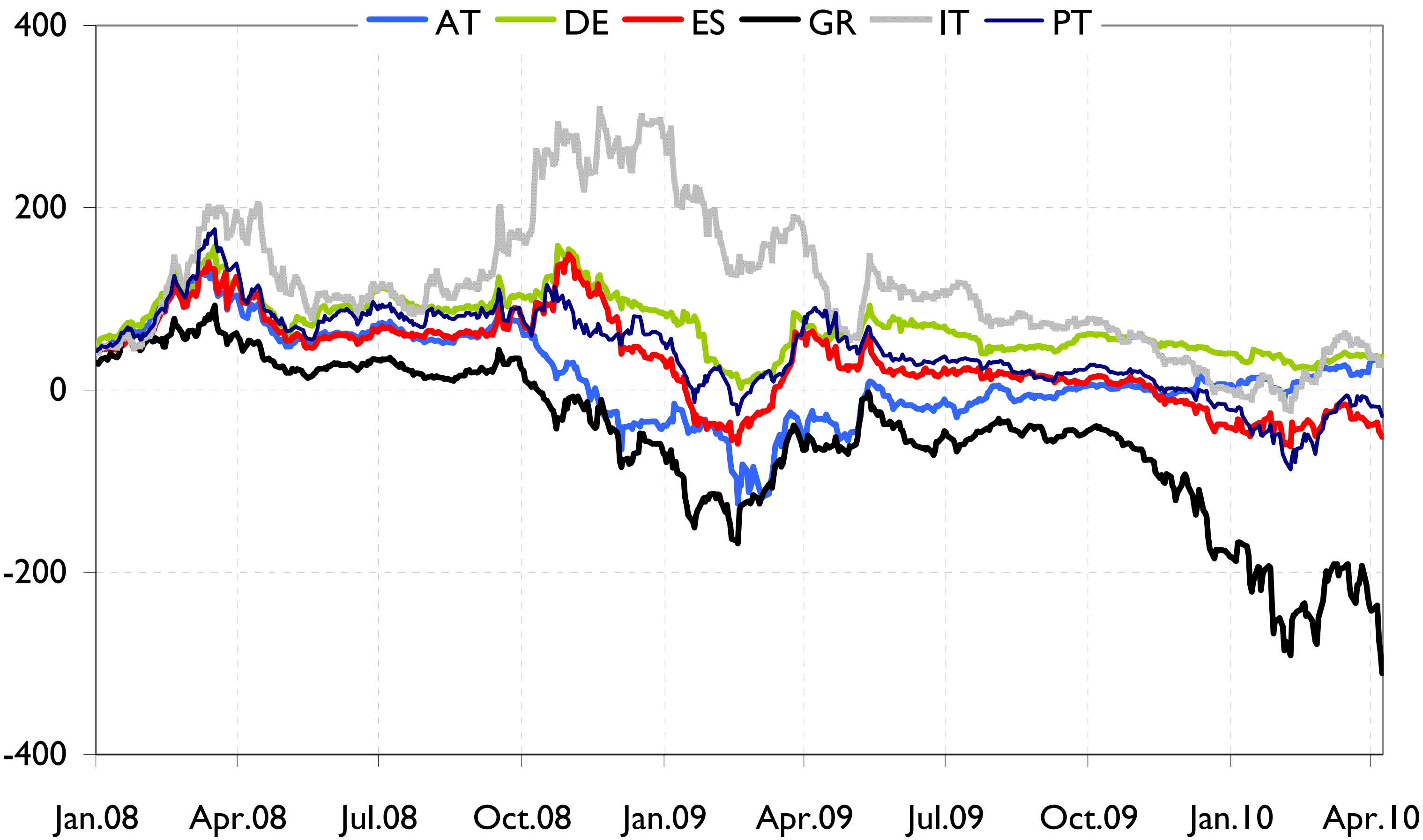
Selected euro area sovereign ten-year bond yield spreads vs Germany Jan. 2007 – Apr. 2010
(basis points)



Latest observation: 8 April 2010
Sources: Datastream and ECB calculations.

The relationship between corporate and sovereign credit risk premia

Difference between telecom companies' and sovereign 5-y CDS premium *(basis points)*



Source: Datastream, Latest observation: 8 April 2010
Note: Difference between 5-y sen. CDS premia of major telecom company and sovereign issuer of the respective country

The relationship between bank and sovereign CDS premia

Sovereign and bank 5Y CDS spreads

(basis points; first snapshot: 30 Sep. 2009; second snapshot (*): 30 Mar. 2010)