

Financial Stability and Integration within the Eurozone

Credit Default Swaps interrelation with Capital Market Imperfections

ABSTRACT

The link between CDS and capital markets is exhaustive and its limitations that reduce the range of financial contracts that agents can sign and/or that prevent them to be honored are called imperfections. These restrictions of CDS and capital markets can determine the intensity of riskiness of the EU banking sector and thus the level of financial stability and integration of any EU member state's financial economy. Our study examined the credit default swap interrelationship with capital market imperfections as it relates to the financial stability and integration within the Eurozone.

We looked at the characterizations of financial stability, financial integration, CDS and capital markets. We created a financial stability index using indicators from money, bond, equity and exchange markets. Then we integrated capital markets by the use of correlation and regression experiential methods. Additionally, we then analyzed the differential of credit default swap (CDS) spreads and interest rate yields (spreads) of capital markets.

The interrelationships of CDS and capital markets were explained with the complications considering the consequences of imperfections in EU capital markets. Results of CDS and capital market imperfections within the contemporary challenges in quantifying financial stability and integration among EU member states were also deliberated.