

How the financial world is changing

June, 2011 - Nicholas Payne, Director and Fund Manager

Brazil Credit Default Swaps (CDS)



As at 15th June 2011. Source: Bloomberg.

The chart above shows one year Credit Default Swap (CDS) prices for both Brazil and the US. This is essentially the insurance premium the market asks against a default on the sovereign debt of a nation – the lower the number, the cheaper the premium and hence, the lower the implicit probability that a sovereign nation will default on its debt.

Now this is merely a one year time horizon, but even so, its message is pretty powerful and seemingly unthinkable until recently, namely that the market is charging a higher premium to insure US treasuries than Brazilian sovereign bonds.

It's tempting to think that this marks some kind of "top of the market" for Brazil. In our view it does not. It represents the shifting reality of the global financial system – the recognition that risk is increasing in the developed markets with bloated debt burdens and large government deficits, whilst many emerging nations have their debt house in relative order.