THE RELATIONSHIP BETWEEN PRICE OF CREDIT DEFAULT SWAP CONTRACTS AND ECONOMY PERFORMANCE: EMPIRICAL EVIDENCE IN MALAYSIA

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ABSTRACT

Over the past few months, Malaysia has experienced economy turmoil and it became a worrying trend for investors. This study is an attempt to identify the performances of Malaysia economy performances towards the Credit Default Swap (CDS) price from first quarter of 2008 until second quarter of 2016. There are total of three explanatory variables used which are the equity market performance, interest rate and inflation. This three variables are represented by the Kuala Lumpur Composite Index (KLCI)' points, Overnight Policy Rate (OPR) and Consumer Price Index (CPI) respectively. On the other hand, CDS spread are used as the dependent variables in this study. The design of this research comprises 32 secondary data of each variables from first quarter 2008 until second quarter 2016. Furthermore, in the process of findings, the researcher is using E-view 8.1 software in order to generate all the output for analysis purposes. The results indicate that only two out of three predictors are significant related to the CDS spread. The overall study intends to contribute and give ideas to the future researcher, speculators, investors, and policy makers in their perspective about CDS and also to help them in decision making on the unpredicted investments in Malaysia.

CHAPTER ONE

INTRODUCTION

1.1 OVERVIEW OF THE STUDY

This research is focus on the study of relationship between demand of Credit Defaults Swap (CDS) contract and the performances of Malaysia. In this chapter, it is include the background of study, problem statement, research objectives, research questions, significant of study and scope of study.

CDS is a contract between CDS holders and issuers in order for CDS holder transferred the risks of defaults to the issuers. In short, the CDS is like insurance. It shifts the default risk of debt instruments onto an insurance company or other CDS issuers in exchange for a certain premium. In case there are defaults in investors' investment, the CDS issuers will bare the costs. It is depend on the agreement between CDS holders and issuers on how the payments are made. Different issuers have different terms. The CDS is most commonly known and widely used member of a very large family of securities called credit derivatives. They are specifically designed for the trading as well as the management of credit risk. CDS are used for financial institution and investors to manage their portfolio of credit risks more efficiently and effectively.

The CDS became famous during the Subprime Financial Crisis in 2008. Subprime Crisis was trigger in United Stated. However, Malaysia and other countries are also affected due to the dominos effects. At that time people who knew about the issuer of Mortgage Backed-Security is not going to fulfill their debt obligation in the