Abstract
In this paper, I investigate the development and determinants of CDS spreads for 18 major
European banks between December 2001 and January 2004 applying factor analysis to daily data.
Two clear-cut conclusions can be drawn. First, the dominating first common factor that explains 88 percent of all variation in the system, impacts on all banks in a similar direction. This suggests a strong market integration. However the size of the response of each bank's CDS spread to the first common factor differs substantially, probably reflecting differences in individual bank's exposure and riskiness. Second, the first common factor appears significantly related to the European P/E ratio and the European-wide 2-year nominal interest rate. This finding suggests that the common factor may be interpreted as a general indicator of market conditions.