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The New York Times Jumps the CDS Shark

by: Felix Salmon

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If [Paul Krugman](#) and others want the New York Times ([NYT](#)) to be the paper of record, especially when it comes to matters economic, they're going to have to do better than [this](#):

Like the [credit default swaps](#) that hid Greece's obligations, the instruments weighing on our municipalities were brought to us by the creative minds of Wall Street.

That's Gretchen Morgenson, who ought to know better. The derivatives that hid Greece's obligations were currency swaps, not credit default swaps.

But it gets worse. If you follow Morgenson's hyperlink, you get to the [Times Topics page on credit default swaps](#): the part of nytimes.com which is trying to compete with Wikipedia in terms of giving a clear overview of topics in the news. Columnists have some leeway to express opinions; the Times Topics pages should be assiduously accurate and impartial. Yet:

These instruments played a pivotal – and controversial – role in the financial crisis in the United States. Now, these swaps are emerging as one of the most powerful and mysterious forces in the crisis shaking Europe.

In essence, a credit default swap is a form of insurance. Its purpose is to make it easier for banks to issue complex debt securities by reducing the risk to purchasers, just like the way the insurance a movie producer takes out on a wayward star makes it easier to raise money for the star's next picture.

I'm not even going to try to enumerate all the inaccuracies here. Were credit default swaps really pivotal in the U.S. crisis? They certainly brought down [AIG](#), and a couple of smaller monolines. And they made synthetic CDOs possible — without them, the “unfunded super-seniors” which did so much damage to many huge banks could never have existed. But they weren't pivotal in the sense that absent CDS, the crisis wouldn't have happened.

But we'll give the NYT the “pivotal role” bit just because it's *simply untrue* that credit default swaps “are emerging as one of the most powerful and mysterious forces in the crisis shaking Europe”. (Even assuming there *is* a crisis shaking Europe.) In what way, exactly, are CDS emerging as particularly powerful in the latest Eurocrisis? CDS volumes on Greek debt are a fraction of the total amount of debt outstanding, and certainly no sovereign has written huge amounts of credit protection, thereby racking up enormous contingent liabilities, in the way that AIG did. In fact, European sovereigns aren't players in the CDS market *at all*.

In order to believe that CDS are “shaking Europe”, you have to believe that when one market player buys sovereign credit protection off another market player, in a transaction both sides think they're going to make money on, finance ministries across the continent start to tremble. It's silly. Sovereign credit spreads have moved up and down in sometimes-dramatic fashion for decades, long before CDS were even invented. And they will continue to do so even if CDS are banned. And there's *no indication whatsoever* that volatility in European credit spreads is any higher now than it would have been absent the CDS market. Indeed, there's a [colorable case](#) that the opposite is true, and that the ability to hedge one's exposure in the CDS market has made the European sovereign bond market *less* volatile.

As for the NYT's idea of the “purpose” of a CDS, all I can say is that I have no idea whatsoever where they got that one from. At least on the CDS/Greece connection, you can see how various European politicians love to be able to

blame Goldman Sachs ([GS](#)) rather than themselves for their woes. But this just makes no sense at all. *What* “complex debt securities”, exactly, can banks issue more easily if CDS reduce the risk to purchasers? Presumably we’re not talking about simple bonds and loans here, since they’re not complex at all. Is the idea that banks somehow help companies issue debt bundled with CDS insurance? I’ve seen a few monoline wraps in my time, but nothing like that.

In any case, by putting all this garbage on its Times Topics pages, the NYT has pretty much given up any hope of having the tiniest bit of credibility in the debate over CDS. The WSJ ([NWS](#)) might be sensationalist, but I haven’t ever seen it go this bad.

(A big hat-tip here to [Anal_yst](#), who writes faster and meaner than I do, and to [@taste_arbitrage](#).)

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Felix Salmon arrived in the United States in 1997 from England, where he worked at Euromoney magazine. He also wrote daily commentary on Latin American markets for the former news service Bridge News, freelanced for a variety of publications, helped set up the New York bureau of a financial... [More](#)

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