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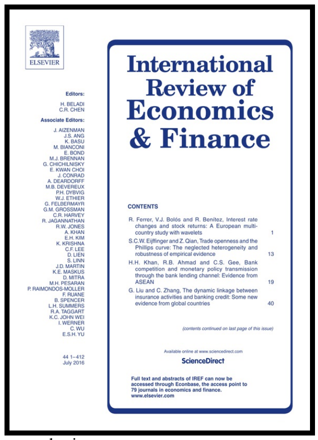

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Directional and bidirectional causality between U.S. industry credit and stock markets and their determinants

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Abstract

We examine the causal links between U.S. industry-wise credits and stock markets. The full sample bootstrap Granger causality results show that all stock markets Granger cause their CDS counterparts and there is also bidirectional causality for the banking, healthcare and material industries. The short-run parametric stability tests highlight that the full sample parameters are not stable and hence less reliable. The bootstrap rolling window estimations confirm the inconsistency in the CDS-stock causality relationships where bidirectional causalities are also found between the credit and stock markets that vary over different sub-samples. Finally, we analyze the impact of different financial and macroeconomic determinants on the CDS-stock causality through a probit model. Overall, the business conditions, stock market volatility, default premiums, Treasury bond rate and the slope of the yield curve are major drivers of the CDS-stock nexus. Our findings provide possible explanation for varying and mixed previous empirical findings in the existing literature, and hence have useful investment implications.

JEL Classification: C32, G20, G32

Keyword: Credit default swap; stock; bootstrap rolling windows; Granger non-causality; Probit.