Tomorrow could bring a new threat

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From Prof Eric De Keuleneer.

Sir, Introducing credit default swap prices for some sovereign borrowers may sound legitimate, but a CDS market for US debt is weird ("**Sovereign CDS prices soar as debt mounts**", December 4).

The CDS market started as a place where one could buy genuine protection against genuine credit risk; then it was also used to help structure "creative" financial transactions, synthetic collateralised debt obligations and the like. It may also have been used by short sellers to complement assaults on some companies, in particular banks.

Now it is used – even by credit rating agencies (they used to be references; now they go with the wind) – to indicate our fears and angst about financial institutions, and the financial system as a whole. The opaque and illiquid nature of the CDS market, particularly in times of crisis, means that this "indicator" role is prone to manipulation.

The appearance of the notion of risk on US Treasury debt means that academics will need a new definition of a riskless interest rate; but no problem, we will love debating it. More worrying is that tomorrow any Dr Strangelove, be it a wealthy alien country or the ultimate "short only" hedge fund, may want to destroy what remains of confidence in the financial system.

To do this, they could massively buy CDS protection on US debt, so as to bid the price upwards and make sure to hit headlines and start a panic. By the way, who is offering to protect us against US credit risk, Citibank and AIG?

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