

Sovereign, Bank and Insurance Credit Spreads:

Connectedness and System Networks*

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Abstract

Macrofinancial risk has become increasingly important over time as global markets have become increasingly more connected. We apply several econometric measures of connectedness based on Granger-causality networks to the changes of sovereign risk of European countries and credit risk of major European, U.S., and Japanese banks and insurers to investigate the evolution of these connections. Credit risk for banks and insurers is measured using a version of the Merton Model (Contingent Claims Analysis) applied to risk-adjusted balance sheets. We highlight connections among banks, insurers, and sovereigns by quantifying the effects of risk transmission within and across countries and financial institutions.

Keywords: Sovereign and Credit Risk; Financial Institutions; Liquidity; Financial Crises; Contingent Pricing

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