Sovereign and corporate credit risk: Evidence from the Eurozone

Mascia Bedendo*
Audencia Nantes

Paolo Colla†
Bocconi University

Abstract. We study the impact of sovereign risk on the credit risk of the non-financial corporate sector in the Eurozone using credit default swap data. We show that an increase in sovereign credit spreads is associated with a statistically and economically significant increase in corporate spreads and, hence, firms' borrowing costs. A deterioration in a country's credit quality affects more adversely firms that are more likely to benefit from government aid, those whose sales are more concentrated in the domestic market, and those that rely more heavily on bank financing. Our findings suggest that government guarantees, domestic demand, and credit markets are important credit risk transmission mechanisms.

Keywords: sovereign risk, corporate credit risk, credit default swaps, Eurozone.
JEL classification: G01, G15, G32.

* Department of Finance, Audencia Nantes School of Management, 8 Route de la Jonelière, 44312 Nantes, France; tel +33.2.40378136; e-mail: mbedendo@audencia.com
† Corresponding Author: Department of Finance, Bocconi University, Via G. Röntgen, 20136 Milano, Italy; tel. +39.02.5836.5346; fax. +39 02.5836.5920; e-mail paolo.colla@unibocconi.it.