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Economic Links and Credit Spreads

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## ECONOMIC LINKS AND CREDIT SPREADS

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**Abstract**

Counterparty risk is an important determinant of corporate credit spreads. However, there are only a few techniques available to isolate it from other factors. In this paper we describe a model of financial networks that is suitable for the construction of proxies for counterparty risk. Using data on North American supplier-customer network of public companies, we find that, for each supplier, counterparties' leverage and option implied volatilities are significant determinants of corporate credit spreads in the period after the 2008-2009 U.S. recession. Our findings are robust after controlling for several idiosyncratic, industry, and market factors.

**Keywords:** NARMA, network autoregression, counterparty risk, corporate credit spreads, supply networks.

**JEL Classification Numbers:** C21, C31 (Cross-Sectional Models), C51 (Model Construction and Estimation), C58 (Financial Econometrics), G12 (Asset Pricing).

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