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Measuring sovereign risk spillovers and assessing the role of transmission channels: A spatial econometrics approach

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Abstract

We contribute to the literature on international risk spillovers by developing a unified framework based on spatial econometrics that enables us to address the following questions: (i) what are the effective transmission channels - real linkages and informational channels - of international risk spillovers across countries and/or regions, (ii) what are the most dominant ones, and (iii) which countries are most at risk for their environment and which are suffering the most from international exposure. Our analysis, based on 41 advanced and emerging economies from 2008Q1 to 2012Q4, shows that among the considered channels for explaining international spillovers of sovereign bond spreads, the informational channel is of utmost importance. Our results challenge previous findings from the literature in which the empirical strategy did not accommodate altogether important features of country spillovers, such as the co-existence of multiple transmission channels in the presence of contemporaneous and time-lagged interactions. Ultimately, our stress-testing analysis reveals important insights on countries prone either to international spillovers, international exposure or both at the regional and the worldwide level.

Keywords: sovereign risk, transmission channels, spatial dynamic panel data, spillover analysis

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