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# **Euro at Risk: The Impact of Member Countries' Credit Risk on the Stability of the Common Currency\***

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## ABSTRACT

In this paper, we propose a new indicator of euro stability. We make use of this new indicator and empirically investigate the impact of changes in sovereign risk of Eurozone member countries on the stability of the Euro. The stability of the Euro is proxied by decomposing Dollar-Euro exchange rate options into the moments of the risk-neutral distribution. Our stability measure can nicely separate periods of Dollar instability (the subprime crisis period) and Euro instability (the sovereign debt crisis period). In particular, we document that only during the sovereign debt crisis, changes in the creditworthiness of member countries with vulnerable fiscal positions have a significant impact on the stability of the common currency. Interestingly, however, the market perceives Greece not to be 'systemically relevant'.

**Keywords:** European sovereign debt crisis, currency options, credit default swaps, currency stability, crash risk, tail risk, sovereign capital structure arbitrage.

**JEL-Classification:** G13, F31

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