Sovereign Credit Risk and Exchange Rates: Evidence from CDS Quanto Spreads

Patrick Augustin, Mikhail Chernov & Dongho Song

WORKING PAPER 24506

DOI 10.3386/w24506

ISSUE DATE April 2018

REVISION DATE June 2018

Sovereign CDS quanto spreads—the difference between CDS premiums denominated in U.S. dollars and a foreign currency—tell us how financial markets view the interaction between a country's likelihood of default and associated currency devaluations (the Twin Ds). A noarbitrage model applied to the term structure of quanto spreads can isolate the interaction between the Twin Ds and gauge the associated risk premiums. We study countries in the Eurozone because their quanto spreads pertain to the same exchange rate and monetary policy, allowing us to link cross-sectional variation in their term structures to cross-country differences in fiscal policies. The ratio of the risk-adjusted to the true default intensities is 2, on average. Conditional on the occurrence of default, the true and risk-adjusted 1-week probabilities of devaluation are 5% and 77%, respectively. The risk premium for the euro devaluation in case of default exceeds the regular currency premium by up to 0.3% per week.

Download a PDF

Information on access

Acknowledgements and Disclosures

Citation and Citation Data

Other Versions

Published Versions

Patrick Augustin & Mikhail Chernov & Dongho Song, 2019. "Sovereign credit risk and exchange rates: Evidence from CDS quanto spreads," Journal of Financial Economics, .

Related

TOPICS

- Econometrics
- Estimation Methods
- Macroeconomics
- Money and Interest Rates
- Financial Economics
- Portfolio Selection and Asset Pricing
- Financial Markets

PROGRAMS

- Asset Pricing

More from the NBER

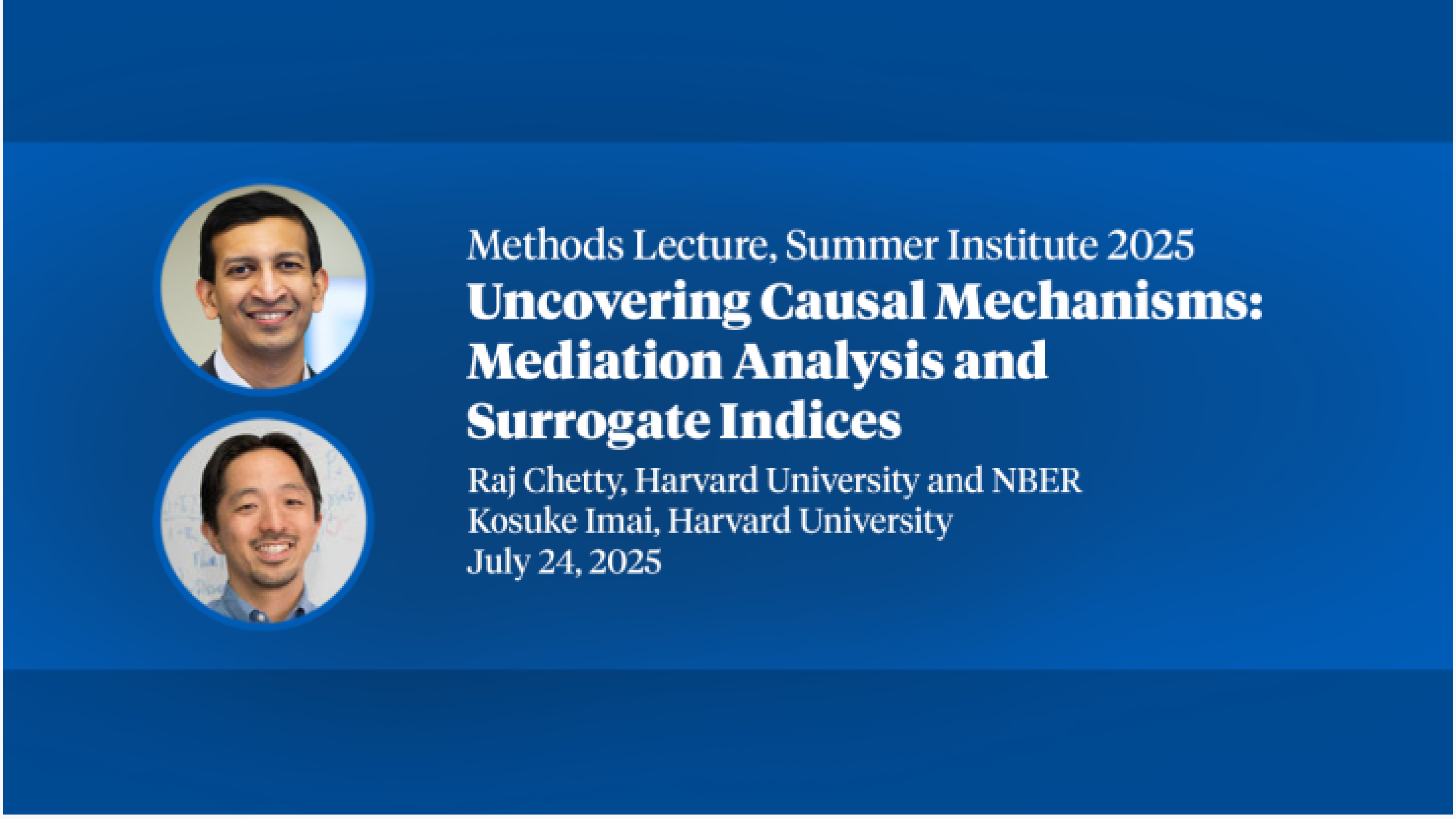
In addition to working papers, the NBER disseminates affiliates' latest findings through a range of free periodicals — the NBER Reporter, the NBER Digest, the Bulletin on Health, and the Bulletin on Entrepreneurship — as well as online conference reports, video lectures, and interviews.

2025, 17th Annual Feldstein Lecture, N. Gregory Mankiw," The Fiscal Future"

FELDSTEIN LECTURE

PRESENTER: N. GREGORY MANKIW

N. Gregory Mankiw, Robert M. Beren Professor of Economics at Harvard University, presented the 2025 Martin Feldstein...



2025, Methods Lecture, Raj Chetty and Kosuke Imai, "Uncovering Causal Mechanisms: Mediation Analysis and Surrogate Indices"

METHODS LECTURES

PRESENTERS: RAJ CHETTY & KOSUKE IMAI

SlidesBackground materials on mediationImai, Kosuke, Dustin Tingley, and Teppei Yamamoto. (2013). “Experimental Designs...

2025, International Trade and Macroeconomics, "Panel on The Future of the Global Economy"

PANEL DISCUSSION

PRESENTERS: OLEG ITSKHOKI, PAUL R. KRUGMAN & LINDA TESAR

Supported by the Alfred P. Sloan Foundation grant #G-2023-19633, the Lynde and Harry Bradley Foundation grant #20251294...

National Bureau of Economic Research

Contact Us
1050 Massachusetts Avenue
Cambridge, MA 02138
617-868-3900
info@nber.org
webaccessibility@nber.org