Euro slips after reports the ECB is concerned about exposure to Turkey

–The euro fell half a percent against the dollar after reports that the ECB officials are concerned about European banks' exposure to Turkey.

–Data from the Bank for International Settlements (BIS) showed that Spanish banks are due $83.3 billion by Turkish borrowers; French lenders are owed $38.4 billion; and banks in Italy are owed $17 billion, the FT reported.

–Perhaps, more importantly, the European Union (EU) relies heavily on Turkey to contain the flow of migrants trying to reach Europe.

The euro dropped sharply against the dollar on Friday morning, following reports that the European Central Bank (ECB) is concerned over the impact of a weak Turkish lira on European banks.

The euro also fell 0.5 percent to trade at $1.146 in the early hours of Friday. This followed a report by the Financial Times that Spain's BBVA, Italy's UniCredit, and France's BNP Paribas could be particularly impacted by the ongoing depreciation of the lira. The ECB declined to comment on the story.

Over the last year, the Turkish currency has lost about 33 percent of its value against the dollar on the back of large fiscal stimulus, growing inflation and current account deficit, as well as intervention from President Erdogan on central bank policy decisions.

Lira’s depreciation could dent European banks that have invested in Turkey. According to the report, the ECB is particularly concerned that Turkish citizens might not be prepared to support the depreciation of the lira and will start defaulting on foreign-currency loans. These represent about 40 percent of the total assets in the Turkish banking sector.

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Meanwhile, the cost of insuring exposure to Turkish debt rose on Thursday to the highest level since 2009. Turkey’s five-year credit default swaps rose to 379 basis points, hitting the highest since April 2009.

“Of course, a full blown Turkish banking crisis would have some negative repercussions on euro zone banks that have large credit exposure to Turkey or own Turkish banks. But overall, the euro zone banking exposure seems too small to cause a significant crisis,” Carsten Hesse, European economist at Berenberg bank said in a note to clients Friday morning.

“But even if we are wrong and a potential meltdown of the Turkish banking sector would cause serious trouble for some euro zone banks, bank supervisors in the region would have sufficient tools at their disposal to contain the damage. That the fallout from Turkey could cause any credit crunch in any part of the euro zone seems highly unlikely,” he said.

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On Friday morning, the lira hit another record low, plunging to as far as 6 against the U.S. dollar. According to Viraj Patel, foreign exchange strategist at ING, there's "limited scope for a EUR/USD rebound in the short-term."

"That said, during the sharp lira sell-off this morning, the spillover into the euro was limited, implying that the euro contagion effects may be more acute and muted than initially feared. This may hold for the time being unless the implications for the European banking sector deteriorates materially," he said in a note.

However, the economic turmoil in Turkey could have other consequences for the euro zone. The 19-member area runs a trade surplus with Turkey, having exported 63 billion euros ($76.2 billion) last year alone. Thus, if Ankara loses economic power to purchase foreign goods, there could be a direct impact, even if small, on euro zone growth.

Perhaps, more importantly, the European Union (EU) relies heavily on Turkey to contain the flow of migrants trying to reach Europe.

"A deep Turkish recession could lead to more migrants leaving Turkey for the EU. Currently more than three million Syrian refugees are living in Turkey," Hesse warned.

The high inflow of migrants and refugees has been a contentious point for European leaders, with some publicly refusing to receive them. At the same time, the increased presence of migrants and refugees across Europe has led many citizens to vote for more extremist and radical parties, which could become a big headache for mainstream parties ahead of fresh European elections next year.

“Despite disputes between Turkey and the EU on many issues, the EU has a strong interest in a stable Turkey,” Hessen said.

WATCH: Turkish crisis not ‘Greece 2.0’ says strategist

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