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Market Valuation and Risk Assessment of Canadian Banks

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Abstract



This paper applies the asset valuation model developed by Rabinovitch (1989) to the six largest Canadian banks. The model is an extension of the Merton (1977a) option-pricing model with the incorporation of stochastic interest rates. We then introduce a measure of distance-to default, Z-score. Our results indicate that the market value of bank assets is almost always below its book value and that Canadian banks have a very low insolvency risk over time, except for 1982 and 1983. We also find that both the market valuation of the bank assets and the z-score of these Canadian banks demonstrate similar regime switches in the late 1990s, which may be related to regulatory changes during the 1990s.

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Title	Market Valuation and Risk Assessment of Canadian Banks
Keywords	asset pricing (https://ageconsearch.umn.edu/search?f1=keyword&as=1&sf=title&so=a&rm=&m1=p&p1=asset%20pricing&ln=en); financial institution (https://ageconsearch.umn.edu/search?f1=keyword&as=1&sf=title&so=a&rm=&m1=p&p1=financial%20institution&ln=en)
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Subject(s)	Financial Economics (https://ageconsearch.umn.edu/search?f1=subject&as=1&sf=title&so=a&rm=&m1=p&p1=Financial%20Economics&ln=en) Risk and Uncertainty (https://ageconsearch.umn.edu/search?f1=subject&as=1&sf=title&so=a&rm=&m1=p&p1=Risk%20and%20Uncertainty&ln=en)
Issue Date	2006
Publication Type	Journal Article
Digital Object Identifier	https://doi.org/10.22004/ag.econ.50281 (https://doi.org/10.22004/ag.econ.50281)
Record Identifier	https://ageconsearch.umn.edu/record/50281
PURL Identifier	http://purl.umn.edu/50281
Published in	Review of Applied Economics

Volume	02
Issue	01
Page Range	63 - 80
Total Pages	18
JEL Codes	G12 G21
Record Appears in	Lincoln University (/collection/130?ln=en) > Review of Applied Economics (/collection/1076?ln=en)

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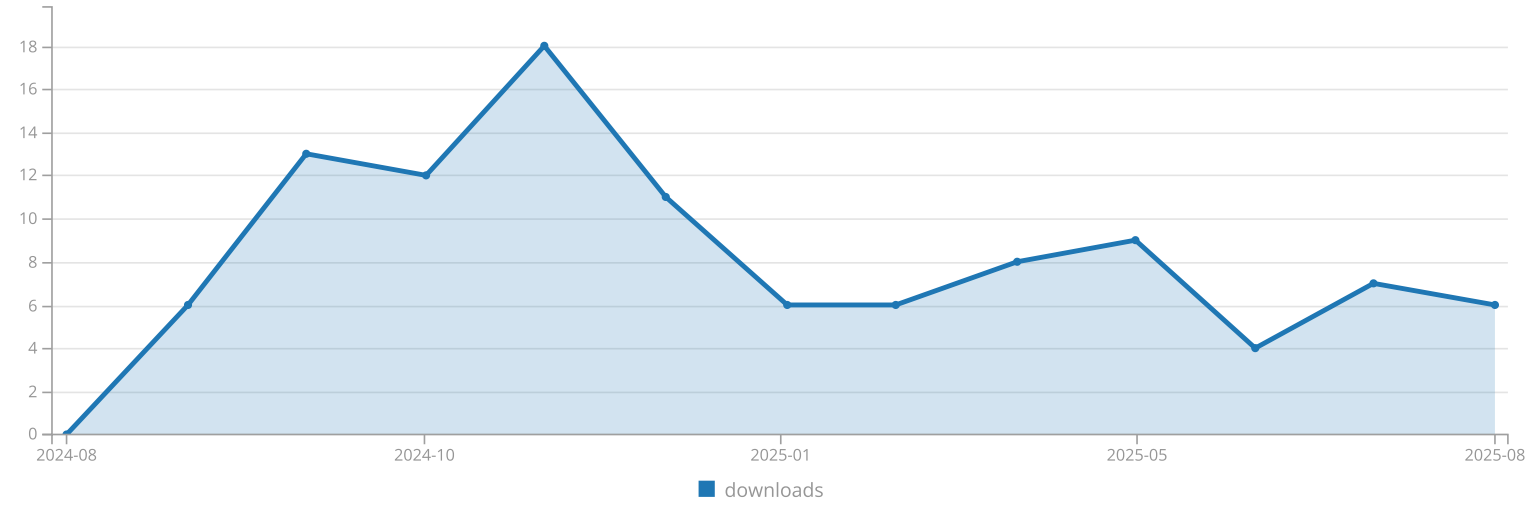
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