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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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Issue Date

2006

Publication Type

Journal Article

DOI and Other Identifiers

10.22004/ag.econ.50281 (<http://dx.doi.org/10.22004/ag.econ.50281>)

Record Identifier

PURL Identifier

http://purl.umn.edu/50281

Published in

Review of Applied Economics

Volume

02

Issue

1

Page Range

63 - 80

Total Pages

18

JEL Codes

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G21

Record Appears in

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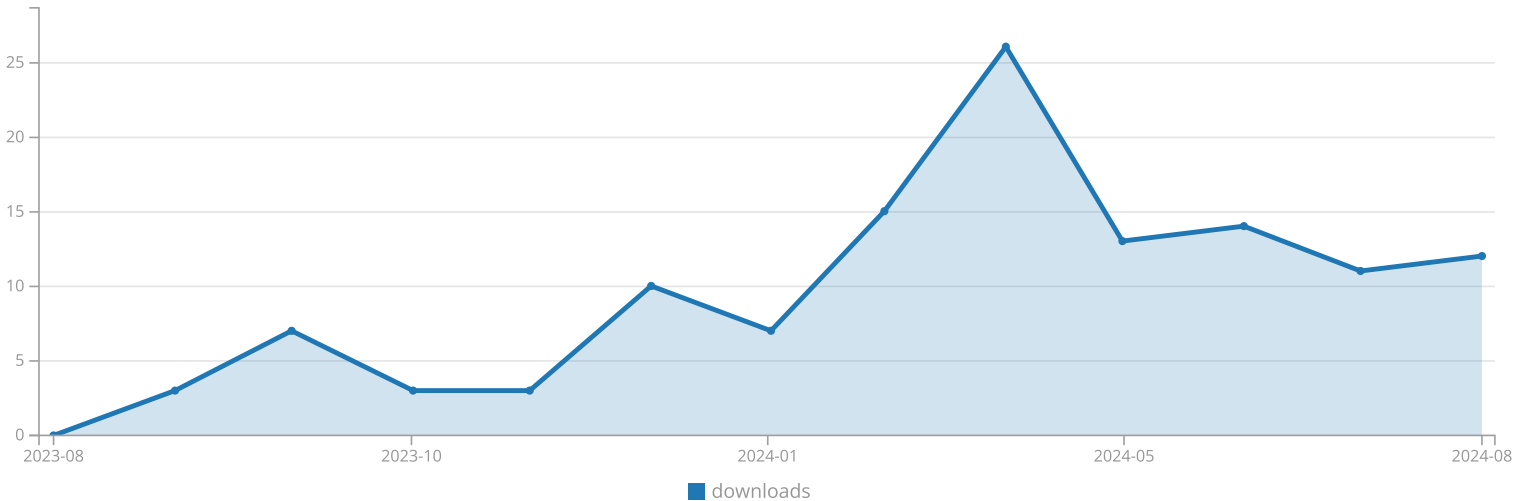
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