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The Determinants of Credit Default Swap Premia

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Abstract

Variables that in theory determine credit spreads have limited explanatory power in existing empirical work on corporate bond data. We investigate the linear relationship between theoretical determinants of default risk and default swap spreads. We find that estimated coefficients for a minimal set of theoretical determinants of default risk are consistent with theory and are significant statistically and economically. Volatility and leverage have substantial explanatory power in univariate and multivariate regressions. A principal component analysis of residuals and spreads indicates limited evidence for a residual common factor, confirming that the theoretical variables explain a significant amount of the variation in the data.

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