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Pricing Interest-Rate-Derivative Securities

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The Review of Financial Studies, Volume 3, Issue 4, October 1990, Pages 573–592, https://doi.org/10.1093/rfs/3.4.573

Published: 30 April 2015

Abstract

This article shows that the one-state-variable interest-rate models of Vasicek (1977) and Cox, Ingersoll, and Ross (1985b) can be extended so that they are consistent with both the current term structure of interest rates and either the current volatilities of all spot interest rates or the current volatilities of all forward interest rates. The extended Vasicek model is shown to be very tractable analytically. The article compares option prices obtained using the extended Vasicek model with those obtained using a number of other models.

Oxford University Press

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