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# Managing Credit Risk with Credit and Macro Derivatives

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## Abstract

We use the industrial organization approach to the microeconomics of banking, augmented by uncertainty and risk aversion, to examine credit derivatives and macro derivatives as instruments to hedge credit risk for a large commercial bank. In a partial-analytic framework we distinguish between the probability of default and the loss given default, model different forms of derivatives, and derive hedge rules and strong and weak separation properties between deposit and loan decisions on the one hand and hedging decisions on the other. We also suggest how bank-specific macro derivatives could be designed from common macro indexes which serve as underlyings of recently introduced financial products.



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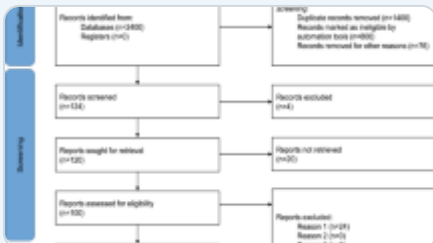
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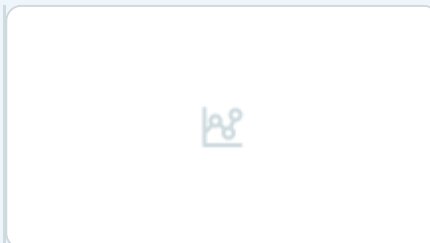
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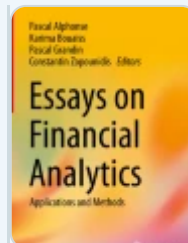
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