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On the pricing of GDP-linked financial products

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Abstract

This paper discusses the pricing of GDP-linked financial products. GDP-linked bonds for instance are bonds which pay a coupon tied to the changes of GDP (Gross Domestic Product): if economic growth is low, the coupon decreases while a strong economic rise leads to a higher coupon. Therefore these innovative financial instruments are able to translate changes in the business cycle and long-term prospects into changes in the issuing country's debt service, taking into account GDP development. Against the background of a growing interest in macro-indexed financial instruments and Argentinas very recent offer to issue GDP-linked bonds, different characteristics of GDP-linked bonds are briefly discussed and a simple pricing approach for GDP-linked bonds and European options on GDP development is provided assuming a Black-Scholes type environment.

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The authors thank Professor Wolfgang Bühler, University of Mannheim, for the kind provision of the data. His interest rate and bond data base contains price data and yields from all bonds traded at German securities exchanges.

Notes

¹ Further details on these interviews and a more detailed discussion on suitable characteristics can be found in Schröder et al. ([2004](#)).

² Both examinations are conducted using data from the interest rate and bond database of the Chair of Finance at the University of Mannheim. A detailed description of the analysis of performance and cash flow sensitivities of GDP-linked bonds in general, as well as of a quantitative in-depth comparison between the prices of straight bonds and the derived prices of GDP-linked bonds can be found in Schröder et al. ([2004](#)).

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