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The Implied Market Price of Weather Risk

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Abstract

Weather derivatives (WD) are end-products of a process known as securitization that transforms non-tradable risk factors (weather) into tradable financial assets. For pricing and hedging non-tradable assets, one essentially needs to incorporate the market price of risk (MPR), which is an important parameter of the associated equivalent martingale measure (EMM). The majority of papers so far has priced non-tradable assets assuming zero or constant MPR, but this assumption yields biased prices and has never been quantified earlier under the EMM framework. Given that liquid-derivative contracts

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