

INTEREST RATE MODELS

Homework Assignment #2

Andrew Lesniewski

Baruch College

New York

February 27, 2017

Problems

1. Assume an interest rate model with a constant instantaneous OIS rate f_0 , and a constant instantaneous LIBOR rate l_0 . Consider a spot starting swap maturing T years from now (T is an integer). For simplicity, assume that the coupon dates on both fixed and floating legs are equally spaced with all day count fractions equal to 0.5 and 0.25, respectively. Also, for simplicity, neglect the 2 business day lag between LIBOR fixing and start of an accrual period.
 - (i) Find an explicit expression for the values of both legs of the swap.
 - (ii) Determine the par coupon on the swap.
2. Prove formula (30) on page 48 of Lecture Notes #1.
3. Consider a frictionless market $(S_1(t), \dots, S_N(t))$ and a self-financing portfolio with weights $(w_1(t), \dots, w_N(t))$. Given a numeraire $\mathcal{N}(t)$, show that the portfolio expressed in terms of the relative prices $(S_1^{\mathcal{N}}(t), \dots, S_N^{\mathcal{N}}(t))$ is self-financing.

This assignment is due on March 6