

Local Volatility Pricing Models for Long-dated FX Derivatives

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We study the local volatility function in the Foreign Exchange market where both domestic and foreign interest rates are stochastic. This model is suitable to price long-dated FX derivatives. We derive the local volatility function and obtain several results that can be used for the calibration of this local volatility on the FX option's market. Then, we study an extension to obtain a more general volatility model and propose a calibration method for the local volatility associated to this model.

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