How Much Does It Cost To Short Sale A Stock Index?

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Abstract

Options prices have been used extensively to assess the cost of short selling. The price of the underlying of the options implicit in the options prices is obtained using the Call-Put Parity and compared to the underlying price prevailing in the market. The disparities between the two prices are attributed to short sale constraints. This approach overlooks the fact that in the same way that options could be used to short sale the underlying, they could also be used to buy it. Therefore, Call-Put Parity disparities are related to both possibilities and thus standard measure of short sale costs implicit in options prices underestimated this cost. We suggest a new decomposition of the Call Put Parity disparities that we implement in the case of European options on a dividend protected stock index in a market without market makers. We estimate the cost of buying the underlying and the cost of short selling it through the option markets, the difference between the two costs being the incremental cost of short selling.

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