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Interbank forward foreign exchange swap

Market maker's BID

As in the above conversation, the market maker (High Street Bank) has quoted and the market user (Dealing Bank) requests to deal in the six months at **43 points EUR Premium** - the **left hand side** of the market maker's **43 - 48** two way 6 months price:

The following transactions and value dated cash movements are involved. The market maker Sells spot and **Buys forward** the base currency (the market maker's BID for forward EUR) on the swap:

Value **Spot**:
Market maker
 High Street Bank **SELLS EUR 1,000,000.00 @ 0.9000** and **Buys USD 900,000.00**

Value **6 month forward**:
Market maker
 High Street Bank **BUYS EUR 1,000,000.00 @ 0.9043** and **Sells USD 904,300.00**

In dealing terminology this may be referred to as "**Points against me**" by the market maker and "Points my favour" by the market user. The USD cash flows across the two value dates show the market maker a "cost" and the market user a "benefit" of USD 4,300.00 - being the equivalent of 43 points on EUR 1 million (43 X 1 X USD 100.00).

As noted earlier in this chapter, the forward swap points, the standard method of quotation in the forward foreign exchange market, are equivalent to the interest rate differential between the two currencies involved. The EUR swap points at a forward **Premium** indicate that six months Euros have a lower interest rate than US Dollars at the moment this deal is struck.

The points "**against him**" or cost here for the market maker (High Street Bank) are the cost of giving up the currency with the lower interest rate (EUR) in exchange for the currency with the higher interest rate (USD) for the period of the swap.

The points "**his favour**" or benefit received here by the market user (Dealing Bank) are compensation for giving up the currency with the higher interest rate (USD) and receiving the currency with the lower interest rate (EUR) for the period of the swap. The swap provides both parties with an accurate cost of switching such cash flows.

Market maker's OFFER

Had the transaction been effected on the right hand side of the market maker's price (at **43 points EUR Premium 43 - 48** two way 6 months price the following transactions and value dated cash movements would result.

The market maker Buys spot and **Sells forward** the base currency (the market maker's OFFER of forward EUR) on the swap:

Value **Spot**:
Market maker
 High Street Bank **BUYS EUR 1,000,000.00 @ 0.9000** and **Sells USD 900,000.00**

Value **6 month forward**:
Market maker
 High Street Bank **SELLS EUR 1,000,000.00 @ 0.9048** and **Buys USD 904,800.00**

The points "**his favour**" or benefit received here by the market maker (High Street Bank) are compensation for giving up the currency with the higher interest rate (USD) and receiving the currency with the lower interest rate (EUR) for the period of the swap.

The points "**against him**" or cost here for the market user (Dealing Bank) are the cost of receiving the currency with the higher interest rate (USD) whilst giving up the currency with the lower interest rate (EUR) for the period of the swap.

The swap provides both parties with an accurate cost of switching such cash flows.