Foreign Exchange and Commodities

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Foreign Exchange (FX) Transaction

Foreign Exchange transactions are agreements between the counterparties to:

- Purchase one currency against another
- At a specific date
- At an agreed upon price (the FX rate)

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The FX Marketplace

Global over-the-counter market

24 hours, 5 days a week

Largest, most liquid market

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Volatility in FX

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Why FX is Traded

Payment facilitation	Risk management	Speculation	Diversification
• Make a payment in a foreign currency	• Protect value of future payments against fluctuation in FX rates	• Generate profit from an expected change in FX rates	• Diversify asset holdings into other currencies

Currency ISO Codes

Each currency is referred to by 3 letters

Currency ISO codes	
USD	US Dollar
EUR	Euro
JPY	Japanese Yen
GBP	Pound Sterling
CHF	Swiss Franc
AUD	Australian Dollar
CAD	Canadian Dollar
NZD	New Zealand Dollar

Quoted vs. Base Currency

Currency quoted first is the base currency

Other currency is the quoted currency

EURUSD : 1.1325

1 EUR is worth 1.1325 USD

Pair Quotation

Common currency pairs	
EURUSD	Euro vs. US Dollar
USDJPY	US Dollar vs. Japanese Yen
GBPUSD	British Pound vs. US Dollar
USDCHF	US Dollar vs. Swiss Franc
AUDUSD	Australian Dollar vs. US Dollar
USDCAD	US Dollar vs. Canadian Dollar
NZDUSD	New Zealand Dollar vs. US Dollar

FX Crosses

Currency pairs not including USD

Overall quoting conventions apply

Individual pairs can be quoted in different ways

Direct quote
- Domestic currency is the quoted currency
- CHF/GBP in the UK

Indirect quote
- Domestic currency is the base currency
- GBP/CHF in the UK

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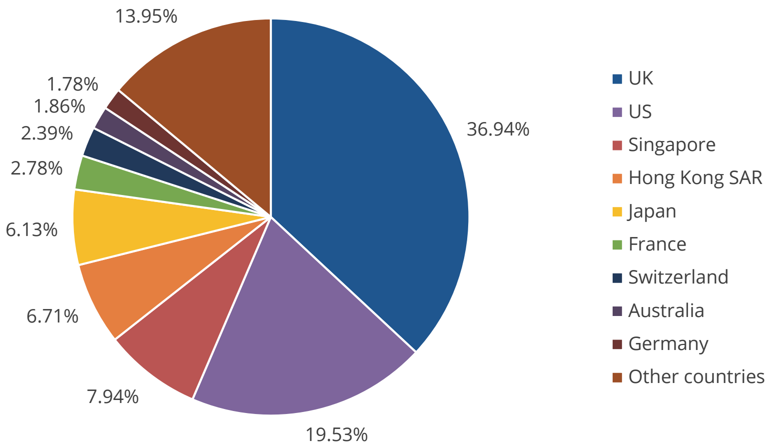
Daily FX Transactions Breakdown – By Country



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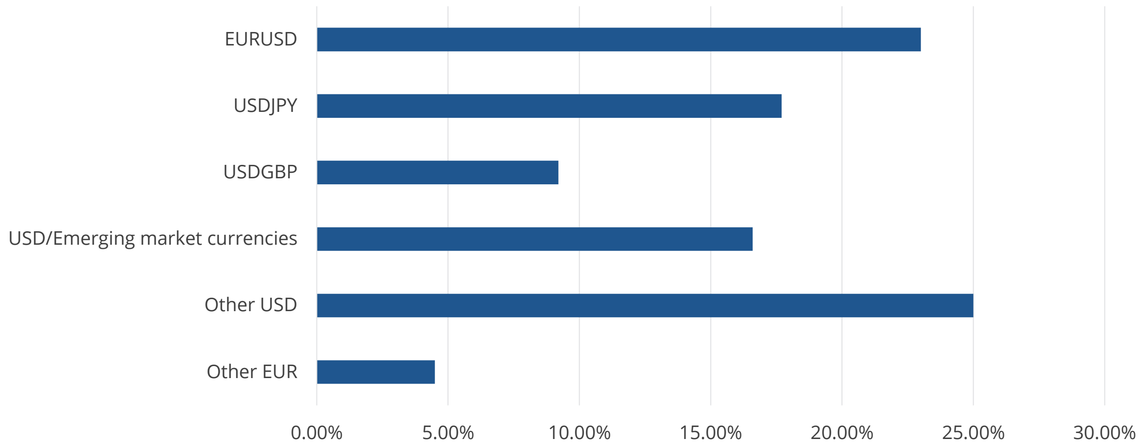
Daily FX Transactions Breakdown – By Currency Pair



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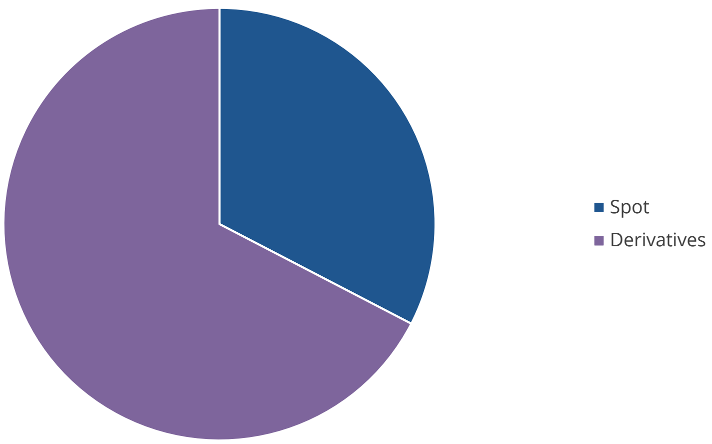
Daily FX Transactions Breakdown – By Instrument Class



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Bid and Ask Prices

Ask: the price at which clients buy EUR

EURUSD : 1.1325 | 1.1326

Bid: the price at which clients sell EUR

Spot Market Trading

Currencies are priced in relation to another currency

If you buy one currency of a pair, you automatically sell the other

Expect base currency to appreciate

- Long base currency
- Short quoted currency

Example:
EURUSD trades at 1.1325/26 and you expect EUR to appreciate to the 1.18 area. Buy EUR at 1.1326

Expect base currency to depreciate

- Short base currency
- Long quoted currency

Example:
EURUSD trades at 1.1325/26 and you expect EUR to depreciate to the 1.06 area. Sell EUR at 1.1325

What Drives FX Spot?

- Interest rate differential
- Inflation differential
- Economic developments
- Monetary policy
- Political stability
- Purchasing power parity

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What are Commodities?

Commodities are usually raw materials, often used to produce other goods.

Soft and Agricultural Commodities	Hard Commodities
Coffee	Crude Oil
Sugar	Rubber
Corn	Gold
Cotton	Silver
Soybeans	Natural Gas
Pork bellies	Other metals
Live cattle	

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Commodities vs. Financial Assets

Commodities	Pure financial assets
• Real assets • Limited substitution, inelastic demand • Usually restricted in supply	• Claim on future cash flows • Demand elastic

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Commodity Price Volatility

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Who Trades Commodities and Why?

Producers/consumers	• Commodity producers looking to lock in the price at which they can sell future production • Commodity consumers wanting to be protected against price surges in the future
Investors/speculators	• Trade commodities for investment returns • Various trading strategies and investment horizons

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How are Commodities Traded?

Commodity markets

Spot market

- Commodities are bought and sold for “immediate” delivery and payment
- Price is referred to as the spot price
- Also referred to as physical trading

Futures market

- Contracts to buy or sell a certain amount of a specific commodity at the agreed upon price
- Settlement occurs at the agreed upon date in the future

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Commodities Futures Example

Crude oil futures contract specs (know as WTI futures)	
Contract unit	1,000 barrels
Price quotation	US Dollars and Cents per barrel
Tick size	$0.01 per barrel
Tick value	$10 per contract
Contracts	Monthly contracts for the current and next 8 calendar years
Settlement	• Physical (F.O.B. at any pipeline or storage facility in Cushing, Oklahoma) • Light sweet crude oil, grade and quality as defined in CME rulebook chapter 200

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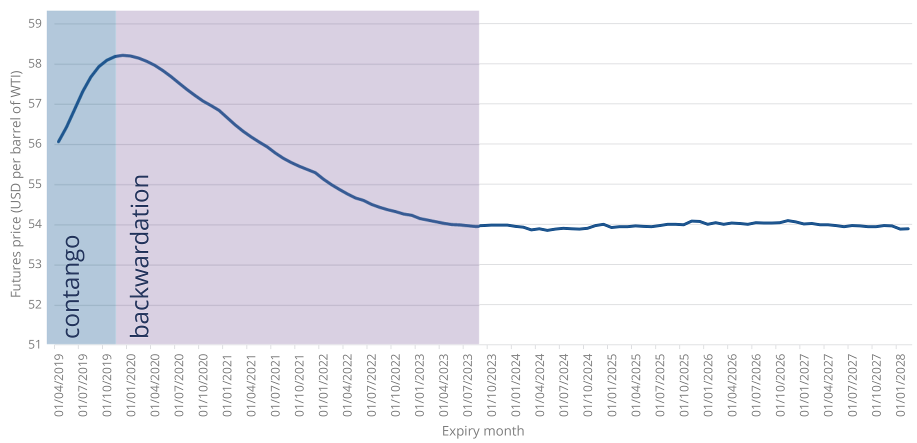
Futures Curve Example



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