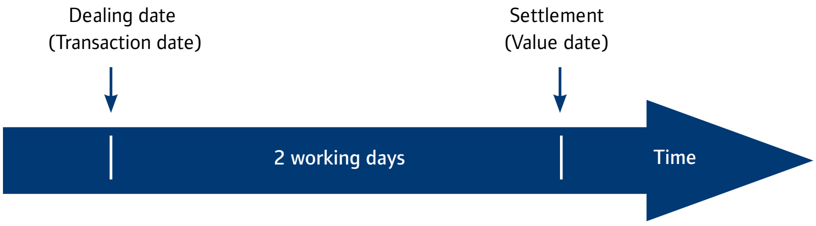
The Spot Market

What is the Spot Market?

A spot transaction is the exchange of one currency for another currency, fixed immediately in respect of an underlying foreign exchange commitment, at a specified rate, where settlement takes place two business days later. The two day settlement process is due to the fact that the bank requires two business days notice to process payments due to time zones and currency cut-off times. In instances where urgent payments/receipts are to be processed, one-day value or even same-day value rates of exchange may be provided depending on currency cut-off times. It is also commonly known as 'Spot Cover'.



There are two spot rates for a currency. The bid rate is the rate at which one currency can be purchased in exchange for another (the price maker's buying rate), while the offer rate is the rate at which one currency can be sold in exchange for another (the price maker's selling rate). The difference, or spread, between the two rates provides the bank's profit margin on transactions. It is very important to understand who is buying and who is selling, this is because the opposite of what the client wants is what happens from the bank's perspective. That is,

- if the client is buying – the bank is selling
- if the client is selling – the bank is buying.

Each decimal in an exchange rate is commonly referred to as a 'point' or 'pip'. For example, if the USD to rand (ZAR) rate is quoted as USD/ZAR6.8550 and subsequently weakens to USD/ZAR6.8620, the rate is said to have moved by 70 points or pips.

Example:

A Forex Trader quotes you the following price: USD/ZAR6.4640/50.

The USD is referred to as the base currency or commodity currency (BID) that is the rate at which the dollars are bought. For each dollar received, the trader will pay ZAR6.4640.

The ZAR is referred to as the quoted currency or the terms currency (OFFER) that is the rate at which dollars are sold. For each dollar sold, the trader will receive ZAR6.4650.

The meaning of the quote is that if you wanted to sell one USD, the trader will pay you ZAR6.4640 and if you wanted to buy one USD, you will pay the trader ZAR6.4650.

If the trader simultaneously had one buyer and one seller at the price above, the trader would generate a profit of USD0.0010 per transaction. Thus, on a trade of one million rand, the trader would make a profit of USD1 000.

Types of spot deals

The types of spot deals in the South African market are:

Rand/USD deals – The bank sells USD to an importer against a payment in rand, or the bank buys USD from an exporter and settles in rand.

USD/Foreign currency deals – The bank sells foreign currency to an importer against payment in USD, or the bank buys foreign currency from an exporter and settles in USD.

Rand/Foreign currency deals – The bank sells foreign currency to an importer against payment in rand, or the bank buys foreign currency from an exporter and settles in rand.

Foreign currency/Foreign currency deals – The bank sells foreign currency, such as British sterling (GBP), to an importer against payment in another foreign currency, say euros. Or, the bank buys foreign currency, such as British sterling, from an exporter and settles in another foreign currency, say euros.

Settlement

The settlement date is referred to as the 'value date', which is the date on which funds change hands, that is the date the sender's account is debited and the receiver is credited. There are various methods of settlement, which varies the settlement dates or value dates depending on the type of transaction. As mentioned before, spot transactions are settled two business days after the application date. The exchange rate is fixed at the rate quoted when the deal was negotiated, even if there have been exchange rate fluctuations since then.

A deal done with one-day value means that the foreign currency is settled one business day after the application date. A deal done with same day value means that the foreign currency is settled the same day as the application date. It may not be possible to obtain 'same day' value for certain transactions, for example when dealing with Japan or Australia, owing to the time differentials. No foreign exchange trade dealings take place on Saturdays, Sundays and public holidays.

Cross rates

In the foreign exchange market, all currencies are quoted against the USD. As you would expect, not all cross border transactions are conducted exclusively in USD. Merchants invoice, or are invoiced in, a variety of currencies. This necessitates determining a price or exchange rate between the rand and the other currencies. Thus, there is a need for a 'cross rate' where currencies are quoted against other currencies which are not the USD.

By knowing the USD/ZAR exchange rate, as well as the price of other currencies to the dollar, it is a simple mathematical calculation to establish a cross rate, that is the rand to the foreign currency exchange rate. (Bear in mind that banks and brokers run books in cross currencies and therefore a client can ask for a cross rate directly without the trader having to do all the calculations).

Example:
A Japanese importer of electronic equipment asks the bank for a EUR/JPY quote, thus the bank trader would calculate the price as if the client wanted to: (a) Sell JPY and buy USD (the bank would buy JPY and sell USD) and (b) sell USD and buy EUR (the bank would buy USD and sell EUR). If the following quotes were given: USD/JPY 112.75/85 and EUR/USD 1.0785/95, then part (a) of the transaction would be done at 112.85 and part (b) of the transaction at 1.0795.

The resulting exchange would be: 112.85 x 1.0795 = 121.82 (This is the EUR/JPY quote). Multiplication occurs as the USD is quoted against the JPY as the base currency and against the EUR as the quoted currency. Should the reverse occur (the foreign currency is the quoted currency against the USD), the individual rates would be divided.

Application of spot dealing

Once the spot transaction conforms to exchange control requirements, application for spot dealing can be done in writing (giving specific information on a company letterhead), by telephone (giving specific information), via Standard Bank's Forex Trading System (clients can obtain exchange rates which can be accessed through 'Business Online') or by direct dealing (Companies with large foreign exchange exposures may qualify to deal directly with our forex dealing room). Both suppliers and receivers of goods or services can make use of the facility as it caters for diverse types of commercial and financial transactions. Rates of exchange fluctuate second by second. When the bank quotes a rate of exchange, the company must accept or reject it immediately. The acceptance of a rate of exchange is binding.

Contact details

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