## Chapter 14: The foreign exchange market

# Textbook Questions

### Review questions

*The following questions appear in the textbook on page 448.*

*Answer the following questions.*

**What market type is the spot forex market: formalised as an exchange or OTC?**

**OTC.**

**How are exchange rates quoted?**

**One unit of the base currency and units or part thereof of the variable currency.**

**What is the name for the difference between a bid and an offer rate?**

**The bid–offer spread.**

**What is a cross rate?**

**A cross rate is an exchange rate between two currencies, neither of which is the USD.**

**If the USD/ZAR exchange rate changes from USD/ZAR 10,23 to USD/ZAR 10,56, which of the following are correct in terms of currency appreciation/depreciation: the ZAR depreciated against the USD; the USD appreciated against the ZAR; more ZAR were required to buy one USD; fewer USD were required to buy one ZAR?**

**All are correct.**

**What is the main motivation for doing a forward deal?**

**The spot price that will prevail in the future is uncertain.**

**A US investor on T+0 buys GBP 1 million (a UK deposit) at a *spot* exchange rate of GBP/USD 1,25 (i.e. she pays USD 1 250 000 for the deposit, and then buys a UK bond for GBP 1 million). She is concerned that the GBP is about to depreciate. How would she hedge the investment in the forex market?**

**The US investor will sell GBP 1 million forward.**

**The principle of interest-rate parity is consistent with the fair value pricing of forward contracts. Is this statement true or false?**

**True.**

***Foreign exchange swaps* (also called *forex swaps* or just *swaps*) are the exchange of two currencies now at a specific exchange rate (which does not have to be the current exchange rate but is usually one close to the current rate – it is a benchmark rate) coupled with an agreement to exchange the two currencies at a specified future date at the specified exchange rate plus or minus the swap points. Is this statement true or false?**

**True.**

**What are the two brands of options?**

**American and European.**