

CHAPTERS

▶ FOREWORD	1
▶ ONE-Trading Foreign Exchange: A Changing Market in a Changing World ▶ p. 3	<ul style="list-style-type: none"> 1. How the Global Environment Has Changed 3 2. How Foreign Exchange Turnover Has Grown 4
▶ TWO-Some Basic Concepts: Foreign Exchange, the Foreign Exchange Rate, Payment and Settlement Systems ▶ p. 9	<ul style="list-style-type: none"> 1. Why We Need Foreign Exchange 9 2. What “Foreign Exchange” Means 9 3. Role of the Exchange Rate 9 <ul style="list-style-type: none"> Bilateral and Trade-Weighted Exchange Rates 10 4. Payment and Settlement Systems 11 <ul style="list-style-type: none"> Payments via Fedwire and CHIPS 12
▶ THREE-Structure of the Foreign Exchange Market ▶ p. 15	<ul style="list-style-type: none"> 1. It Is the World’s Largest Market 15 2. It Is a Twenty-Four Hour Market 16 3. The Market Is Made Up of an International Network of Dealers 18 4. The Market’s Most Widely Traded Currency Is the Dollar 19 5. It Is an “Over-the-Counter” Market With an “Exchange-Traded” Segment 21
▶ FOUR-The Main Participants in the Market ▶ p. 23	<ul style="list-style-type: none"> 1. Foreign Exchange Dealers 23 2. Financial and Nonfinancial Customers 24 3. Central Banks 25 <ul style="list-style-type: none"> Classification of Exchange Rate Arrangements, September 1997 26 4. Brokers 27 <ul style="list-style-type: none"> In the Over-the-Counter Market 27 Voice Brokers 29 Automated Order-Matching or Electronic Broking Systems 29 In the Exchange-Traded Market 30
▶ FIVE-Main Instruments: Over-the-Counter Market ▶ p. 31	<ul style="list-style-type: none"> 1. Spot 31 <ul style="list-style-type: none"> There Is a Buying Price and a Selling Price 32 How Spot Rates Are Quoted: Direct and Indirect Quotes, European and American Terms 32 There Is a Base Currency and a Terms Currency 33 Bids and Offers Are for the Base Currency 33 Quotes Are in Basis Points 34 Cross Rate Trading 34 Deriving Cross Rates From Dollar Exchange Rates 34 2. Outright Forwards 36 <ul style="list-style-type: none"> Relationship of Forward to Spot—Covered Interest Rate Parity 36 Role of the Offshore Deposit Markets for Euro-Dollars and Other Currencies 37 How Forward Rates Are Quoted by Traders 38 Calculating Forward Premium/Discount Points 38 Non-Deliverable Forwards (NDFs) 39

CHAPTERS

▶ FIVE—Main Instruments: Over-the-Counter Market (continued from last page)	3. FX Swaps	40
	Why FX Swaps Are Used	40
	Pricing FX Swaps	41
	Some Uses of FX Swaps	41
	Calculating FX Swap Points	43
	4. Currency Swaps	44
	Purposes of Currency Swaps	44
	5. Over-the-Counter Foreign Currency Options	45
	The Pricing of Currency Options	48
	Delta Hedging	51
	Put-Call Parity	52
	How Currency Options Are Traded	52
Options Combinations and Strategies	53	
Foreign Exchange Options Galore	54	
<hr/>		
▶ SIX—Main Instruments: Exchange-Traded Market ▶ p. 59	1. Exchange-Traded Futures	59
	Development of Foreign Currency Futures	62
	Quotes for Foreign Currency Futures	63
	2. Exchange-Traded Currency Options	64
	3. Linkages	65
	Linkages Between Main Foreign Exchange Instruments in Both OTC and Exchange-Traded Markets	65
<hr/>		
▶ SEVEN—How Dealers Conduct Foreign Exchange Operations ▶ p. 67	1. Trading Room Setup	67
	2. The Different Kinds of Trading Functions of a Dealer Institution	68
	3. Trading Among Major Dealers—Dealing Directly and Through Brokers	69
	Mechanics of Direct Dealing	69
	Mechanics of Trading Through Brokers: Voice Brokers and Electronic Brokering Systems	71
	4. Operations of a Foreign Exchange Department	73
5. Back Office Payments and Settlements	75	
<hr/>		
▶ EIGHT—Managing Risk in Foreign Exchange Trading ▶ p. 77	1. Market Risk	77
	Measuring and Managing Market Risk	78
	Value at Risk	78
	2. Credit Risk	80
	Settlement Risk—A Form of Credit Risk	81
	Arrangements for Dealing with Settlement Risk	82
	Sovereign Risk—A Form of Credit Risk	83
	Group of Thirty Views on Credit Risk	83
	3. Other Risks	83
	<hr/>	

CHAPTERS

<p>► NINE-Foreign Exchange Market Activities of the U.S. Treasury and the Federal Reserve ► p. 85</p>	<ol style="list-style-type: none"> 1. U.S. Foreign Exchange Operations Under Bretton Woods Authorization and Management of Intervention Operations 86 2. U.S. Foreign Exchange Operations Since the Authorization in 1978 of Floating Exchange Rates 87 3. Executing Official Foreign Exchange Operations Techniques of Intervention 88 4. Reaching Decisions on Intervention 91 5. Financing Foreign Exchange Intervention 92 	<p>86</p> <p>87</p> <p>88</p> <p>91</p> <p>92</p> <p>93</p> <p>94</p>
<p>► TEN-Evolution of the International Monetary System ► p. 97</p>	<ol style="list-style-type: none"> 1. The Gold Standard, 1880-1914 97 2. The Inter-War Period, 1919-1939 99 3. The Bretton Woods Par Value Period, 1946-1971 100 4. The Floating Rate Period, 1971 to Present 103 	<p>97</p> <p>99</p> <p>100</p> <p>103</p>
<p>► ELEVEN-The Determination of Exchange Rates ► p. 107</p>	<ol style="list-style-type: none"> 1. Some Approaches to Exchange Rate Determination 107 <ul style="list-style-type: none"> The Purchasing Power Parity Approach 107 The Balance of Payments and the Internal-External Balance Approach 108 The Monetary Approach 109 The Portfolio Balance Approach 110 Measuring the Dollar's Equilibrium Value: A Look at Some Alternatives 111 How Good Are the Various Approaches? 112 2. Foreign Exchange Forecasting in Practice 113 <ul style="list-style-type: none"> Assessing Factors That May Influence Exchange Rates 114 3. Official Actions to Influence Exchange Rates 115 <ul style="list-style-type: none"> Continuing Close G7 Cooperation in Exchange Markets 117 	<p>107</p> <p>107</p> <p>108</p> <p>109</p> <p>110</p> <p>111</p> <p>112</p> <p>113</p> <p>114</p> <p>115</p> <p>117</p>
<p>► TWELVE-Epilogue: What Lies Ahead? ► p. 119</p>	<ol style="list-style-type: none"> 1. Global Financial Trends 119 <ul style="list-style-type: none"> Introduction of the Euro 119 Increased Trading in Currencies of Emerging Market Countries 120 2. Shifting Structure of the Foreign Exchange Market 121 <ul style="list-style-type: none"> Consolidation and Concentration 121 Automated Order-Matching Systems 121 3. New Instruments, New Systems 122 	<p>119</p> <p>119</p> <p>120</p> <p>121</p> <p>121</p> <p>121</p> <p>122</p>
<p>► FOOTNOTES</p>		<p>125</p>