

Introducing the JSE's Interest Rate Division's Derivatives Products

The JSE's Interest Rate Division provides investors with the opportunity to trade interest-rate products in both the cash and the derivative markets. Interest-rate derivatives allow market participants to hedge against adverse movements in the level of rates. As a part of the growth strategy for the division, the JSE plans to introduce more derivatives products in the near future.

The following two interest rate futures have been created in response to the market's need to manage interest rates effectively within the regulated trading environment that the JSE offers.

Bond futures

Bond futures are conventional, fully margined, physically settled, futures contracts defined on R 100,000 nominal of each of the exchange's spot bonds. The near, middle, far and special contracts are listed at any time. Longer dated contracts may be listed from time to time if there is demand.

The contracts trade on yield to maturity for settlement on their delivery dates. They are physically settled on the $t+3$ date of their expiry date. The settlement price is found from their closing yield to maturity, using the standard bond pricing formula. There is a daily explicit mark-to-market to the value determined from the bond pricing formula at the day's mark-to-market yield to maturity.

Hedgers use bond futures to protect an existing portfolio against adverse interest rate movements. Hedgers therefore seek to reduce risk. Hedgers have a real interest in the underlying spot bonds and use futures as a way of preserving their value. Arbitrageurs profit from price differentials of similar products in different markets, for examples price differentials between the spot bonds and the futures. Investors use bond futures to enhance the long-term performance of a portfolio of assets. Speculators use bond futures in the hopes of making profit on short-term movements in prices. Speculators therefore seek to enhance risk with the aim of making a profit. Speculators have no interest in the underlying spot bond market other than taking a view on the future direction of the bond's price.

JIBAR Futures

In the South African financial markets, JIBAR (Johannesburg Interbank Agreed Rate) is used as the barometer of short-term interest rate movements. JIBAR is an average rate (determined from borrowing and lending rates) that is independently derived from quotes obtained from a number of different banks for one, three, six and twelve month terms. In particular, the 3 month JIBAR rate is used as a benchmark and is quoted as a yield and disseminated to the market on a daily basis.

Aimed at the institutional investor and professional trader, the 3 Month JIBAR Futures contract is future created by the JSE's Interest Rate Division. The future is based on the JIBAR rate and represents an efficient way to obtain exposure to the South African interest rate markets. The 3 Month JIBAR futures can be used to speculate on the future direction of interest rates, manage money market portfolios, hedge OTC derivatives such

as FRAs and interest rate swaps, hedge borrowings and investments, arbitrage and manage interest rate risk inherent in a futures portfolio.

If a trader expects interest rates expected to fall, he would go long and buy a JIBAR Future. On the contrary, if a trader expects interest rates to rise, he would go short and sell a JIBAR Future. A futures position can be closed out by entering into an opposite trade. Thus a long position can be closed by selling an equivalent contract or letting it expire. The difference between the purchase and sale price represents the profit or loss of the position.



To find out more about the trading opportunities this market offers to both private and professional traders contact the JSE Interest Rate Division on 011 520 7000 or email interestrates@jse.co.za