

The Basics of a Spot Transaction

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A spot transaction refers to an exchange of currencies at the prevailing market rate. For most currencies, a spot transaction consists of a transaction intended to settle in two business days, but for the Canadian dollar (CAD) and Mexican peso (MXN) a spot transaction is often settled in one business day.

However, if CAD or MXN is exchanged for a currency other than the USD or each other, then the two day convention stands. The spot market is the trading mechanism used to move funds on a day-to-day basis, allowing you to buy and/or sell domestic or foreign currency without any rate adjustment to account for interest rate differentials.

It should be noted that some currencies can settle within spot value (same day or next day value) but the interest rate differential is factored into the rate.

EXAMPLE:

Someone in Europe would like to purchase a home in the US, and will need to fund their USD account for the transaction. They will need the funds in two days, so they book a spot transaction today, thereby locking in the rates at which the two currencies will be exchanged.

In two days' time, they transfer the required EUR funds to the counterparty and receive the USD into their account.

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