Forex swap

A forex swap is a simultaneous purchase and sale of identical amounts of one currency for another with two different value dates, normally spot to forward. Therefore, a FOREX swap consists of two transactions: a spot transaction and a forward transaction. Effectively the FOREX swap is two exchange contracts packed in one: a spot foreign exchange transaction and a forward foreign exchange transaction.

A foreign exchange swap is a contract under which two parties agree to exchange two currencies at a set rate and then to re-exchange those currencies at an agreed upon rate at a fixed date in the future. Therefore, a FOREX swap consists of two transactions: a spot transaction and a forward transaction.

A FOREX swap or forex swap agreement is a contract in which both parties agree to exchange one currency for another currency at a spot FOREX rate. The agreement also stipulates to re-exchange the same amounts at a certain future date also at a forward FOREX rate. Many people confuse forex swaps with cross forex swaps. They are totally different. A cross forex swap is an interest rate swap in which two parties to exchange interest payments and principal on loans denominated in two different currencies.

In a forex swap, one party simultaneously borrows one currency and lends another currency to a second party. The repayment obligation is used as collateral and the amount of repayment is fixed at the FOREX forward rate. FOREX swaps can be considered riskless collateralized borrowing/lending. The contract virtually allows you to utilize the funds you have in one currency to fund obligations denominated in a different currency, without incurring foreign exchange risk.

A forex swap deal can be used if you have a currency, which you do not need before a certain time, but at the same time have a short-term need for another currency.

Swap deals are used for managing currency risks, postponing the term of forward-deal and optimizing financing.

The most common use of FOREX Swaps is for institutions to fund their foreign exchange balances. FOREX swaps are also used by importers and exporters, as well as institutional investors who wish to hedge their positions. They are also used to speculate and, by incurring a risk, attempt to profit from rising or falling exchange rates.

Forex swaps are OTC trades and have credit risk. In the case that one of the parties is unable to fulfill its obligation, the other party will have to sign another contract with a third party, thus being exposed to market risk at that time.

Reference:
https://finpricing.com/lib/EqVariance.html