HOW

TO GET STARTED TRADING CME INTEREST RATE PRODUCTS

CHICAGO MERCANTILE EXCHANGE®

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Since the introduction of financial futures at the Chicago Mercantile Exchange in 1972, the importance of futures in transferring financial risk has been proven by the explosive growth in the market. The vast array of CME interest rate products allows professionals to manage interest rate risks ranging from one day to ten years.

Interest rates, which loosely can be defined as the price of money, affect the livelihoods of individuals and businesses each and every day. The cost of a home mortgage, the finance charge applied to a credit card balance, the amount of interest received on a savings account or the coupon on a corporate bond issue are all examples of the interest rates that influence our personal and commercial activities. Like all goods and services, interest rates are determined by the market forces of supply and demand; however, the federal government also can influence key interest rates via monetary policy, that is, by adjusting them upward or downward to slow down or stimulate the economy. Interest rate levels often are regarded as key indicators of a country's economic health.

The money market comprises the markets for short-term, heavily traded credit instruments with maturities of less than one year. Money market instruments include Treasury bills, commercial paper, bankers' acceptances, negotiable certificates of deposit, Federal Funds, and short-term collateralized loans. While the markets for these various instruments are distinct, their respective interest rates reflect general credit conditions with adjustments for differences in risk and liquidity.

As the money markets have become more liquid, money managers borrow and lend in whichever markets offer a price advantage. No longer willing to leave balances as unproductive, non-interest-earning demand deposits, corporations today are making more aggressive use of cash management techniques. Cash market participants primarily use the CME's interest rate products for pricing and hedging their money market positions.

CME INTEREST RATE PRODUCTS

The CME lists a variety of contracts on short-term US and foreign interest rates. Here's a brief description of the markets on which the CME products are based:

THREE-MONTH EURODOLLARS

Eurodollars are simply US dollars on deposit in commercial banks outside of the United States. The Eurodollar market has burgeoned over the past 30 years as the dollar has become a world currency. Eurodollar deposits play a major role in the international capital market. The interbank market for immediate (spot) and forward delivery of offshore dollars is deep and liquid, giving banks the ability to fund dollar loans to foreign importers without incurring currency exchange risks.

Eurodollar deposits are direct obligations of the commercial banks accepting the deposits. They are not guaranteed by any government. Although they represent low-risk investments, Eurodollar deposits are not risk-free.

The CME's Eurodollar time deposit futures contract reflects the London Interbank Offered Rate (LIBOR) for a three-month, $1 million offshore deposit. A total of 40 quarterly futures contracts, spanning ten years, plus the two nearest serial (non-quarterly) months are listed at all times. Eurodollar futures are the cornerstone of the Exchange's interest rate quadrant and are the most liquid exchange-traded contracts in the world when measured in terms of open interest.

ONE-MONTH LIBOR

LIBOR is a reference rate for dealing in Eurodollar time deposits between commercial banks in the London Interbank Market. LIBOR often is the benchmark rate for commercial loans, mortgages, and floating rate debt issues. The CME's LIBOR contract is analogous to the Eurodollar contract, but represents one-month LIBOR on a $3 million deposit. The Exchange currently lists twelve consecutive monthly LIBOR futures at any given time.

13-WEEK TREASURY BILLS

As direct obligations of the US government, Treasury bills are considered risk-free debt instruments and provide the foundation for the money markets because of their unique safety and liquidity. Because of their risk-free nature, changes in the yield on T-bills reflect "pure" interest rate movements. Four quarterly T-bill futures contracts are available for trading at any given time.

EUROYEN

Analogous to Eurodollars, Euroyen are Japanese yen deposits outside Japan. Like the dollar, the Japanese yen is globally traded on a 24-hour-a-day basis. The CME's Euroyen futures are fully fungible with the Euroyen contracts traded on the Singapore International Monetary Exchange (SIMEX). Via the Mutual Offset System with SIMEX, open positions may be held either in Chicago or Singapore. Like the SIMEX, the CME currently lists twelve quarterly Euroyen contracts, covering three years.

ONE-MONTH FEDERAL FUNDS

Federal Funds are funds in excess of reserve requirements held by member banks of the Federal Reserve System, transferable between those banks within one business day. Because the reserve accounts banks maintain at the Fed are not interest-bearing, selling Fed Funds allows institutions to earn a positive return on balances that might otherwise lie idle. The most common Fed Funds transaction is an overnight, unsecured loan between two banks.

The CME lists twelve consecutive Fed Funds futures, the same as LIBOR, with a new month added on the first business day following expiration of the front-month contract.

91-DAY CETES*
(MEXICAN TREASURY BILLS)

Certificados de la Tesoreria de la Federacion, commonly referred to as Cetes, are government-issued, short-term discount instruments that are denominated and paid in Mexican pesos. The Cetes market is considered the benchmark for short-term interest rates in Mexico. Like US Treasury bills, Cetes are issued in a variety of maturities, with 28-day and 91-day maturity issues the most common.

28-DAY TIIE
(MEXICAN INTEREST RATE)

The Tasa de Interés Interbancario de Equilibrio, or TIIE, is a benchmark interbank interest rate that represents the price at which Mexican banks are willing to borrow from or lend to the Bank of Mexico (the country's central bank). The TIIE is an equilibrium or market-clearing rate.

THE CME-SIMEX MUTUAL OFFSET SYSTEM (MOS)

In 1984, the Chicago Mercantile Exchange, in partnership with the Singapore International Monetary Exchange, pioneered an innovative approach to futures trading known as the Mutual Offset System (MOS). Through the MOS, contracts opened on one exchange can be liquidated or held at the other. The CME-SIMEX link effectively extends the trading hours of both exchanges beyond their operating hours, allowing traders to manage their overnight risk. This agreement, the first international futures trading link of its kind, is available for both Eurodollar and Euroyen futures.

For a more detailed description of MOS, please consult the brochure titled *CME/SIMEX Mutual Offset System: The World's Most Successful Trading Link.*