Forward points

The way that a swap works is that one party buys/sells dollars against krónur at a spot rate (in a spot trade) and at the same time makes a forward agreement to sell/buy US dollars against krónur after a specific time at a specific rate known as the forward rate (in a forward trade). Thus a currency swap is a single agreement involving both a spot trade and a forward trade.

The forward rate does not represent a forecast by parties to the agreement about the exchange rate of currencies after a specific time. It is merely the sum total of the spot rate and the forward points, which are based on the interest rate differential between the respective currencies. Forward points can be either positive or negative (often referred to as the forward premium/discount). Since the Icelandic króna is a high-interest currency at present compared with main trading partners and the interest rate differential is positive, the forward points are positive (i.e. there is a forward discount on the spot rate that leads to the forward rate being higher than the spot rate).

Forward points are calculated as follows:

$$\text{Forward points} = S \cdot \left(\frac{1 + \left(v_{ISK} + a_{ISK}\right) \cdot d/360}{1 + \left(v_{FOR} + a_{FOR}\right) \cdot d/360} \right) - S$$

S	=	spot rate
v_{ISK}	=	domestic interbank interest rates
a_{ISK}	=	domestic interest rate spread (positive in the case of forward buying, otherwise negative)
v_{FOR}	=	foreign interbank interest rates
a_{FOR}	=	foreign interest rate spread (positive in the case of forward sale, otherwise negative)
d	=	number of days