Box 3 Measurement of transactions in financial derivatives

A financial derivative contract is a financial instrument that is linked to another financial instrument, indicator or commodity through which financial risks (such as interest-rate risk, foreign-exchange risk, equity and commodity price risks and credit risk) can be traded in their own right in financial markets. The value of a financial derivative contract is derived from the price of an underlying instrument, even though transactions and positions in financial derivatives are treated separately from the values of the underlying instruments to which they are linked. Financial derivative contracts are used for risk management, hedging, speculation, and arbitrage. Hedgers use financial derivatives to reduce the risk associated with the potential future price of an asset, while speculators use them to take positions on the future movements in the price of an asset. Arbitrageurs take offsetting positions in two or more instruments to lock in profits due to discrepancies between prices in two different markets.

In the case of South Africa, data on transactions in financial derivatives are only disseminated for the banking sector as the sector mainly transacts with non-resident parties in derivative instruments. Other domestic sectors transact with the banking sector in financial derivatives which, in turn, transacts with non-resident parties for hedging purposes. Financial derivatives are valued at market prices in the balance of payments and international investment position. If market price data are unavailable, other fair value methods (such as option models or present values) may be used to value these transactions.