BACHELOR of ECONOMICS
International Program

Thammasat University | Thailand

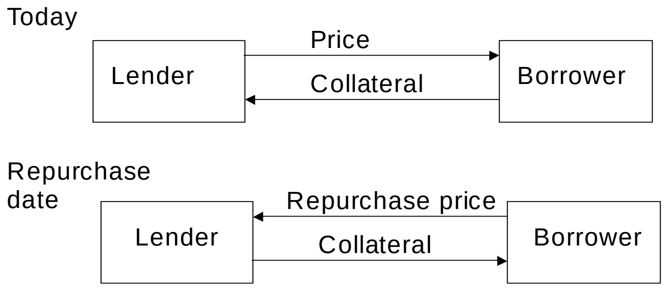
**Fixed Income (FN351)**

# Repurchase agreements

*Anchada (Aida) Charoenrook*

## How to borrow?

- Margin account
- Repurchase agreement (Repo)




- From borrower's side: Repo; From lender's side: Reverse repo



## How to borrow?

- Risk to lender using Repo

  - Collateral changes in price

    Lend principal at or lower than the price of collateral

    Repurchase price = margin+price of collateral

  - Credit risk of lender is less important than lending without collateral

# Example

- GS enters into a repurchase agreement with Bank of America to borrow using as collateral a government coupon bond which is currently priced at 102.00 ($100) face value. It wants to enter into a 1-week repo for 10M. Bank of America requires 5% margin. Interest rate in the repo market is 2% annually.
- GS is said to enter into a repo agreement and Bank of America enters into a reverse repo

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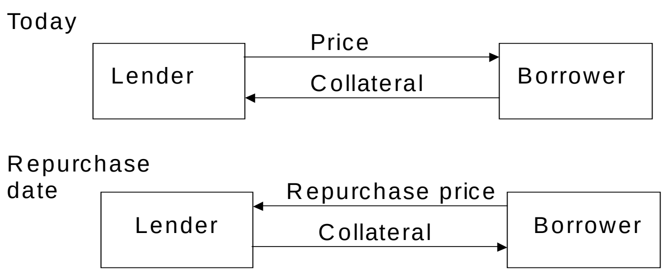
## How to borrow?

- Repurchase agreement (Repo)




- Interest rate at 2% annual or 0.038% per week [(1.02^(1/52))-1]
- Collateral value =100M*1.05 = 105M
- Number of bonds as collateral =105/102=1.0294 *1M/100=10294 bonds
- Price =1M (1-0.0038) = 0.9962M, Repurchase price = 1M

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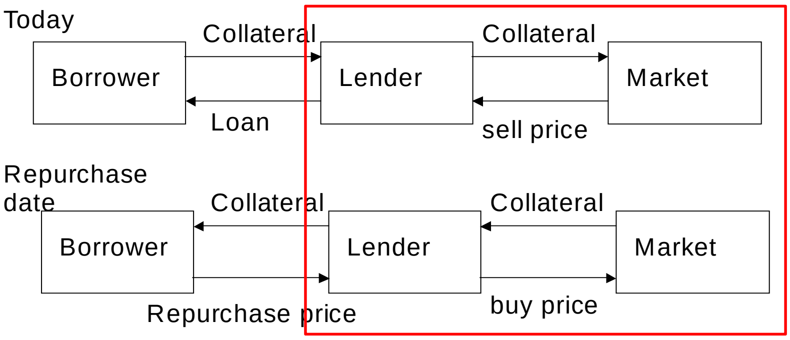
## Short selling using the Repo market

- Repurchase agreement (Repo)




- The Repo market is usually for short-term lending and borrowing

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