# Basics of Foreign Exchange Market in India

## Foreign Exchange: Basics

- What is Foreign Exchange (Forex)
- How are currency prices determined
- What is foreign exchange rate policy in India
- Operation of Forex market
- Characteristics of Forex
- Commonly traded currencies
- Market Participants

# Foreign Exchange: Basics

Foreign Exchange, Forex (FX) as it is called is trading of a single currency for another at a certain price and bank deposits on the over-the-counter (OTC) market place. It simply means buying one currency and selling the other. The values appreciate and depreciate as a result of various economic and geo-political factors. The objective of FX trader is to make profits from these fluctuation in prices, speculating on which way the foreign exchange rates are likely to move in the future.

Currency trading markets are available 24-hrs a day, five days a week, Sunday being a holiday. Forex transactions are generally quoted in pairs because when one currency is bought, the other is sold. The first currency is called the 'base currency' and the second currency called the 'quote currency'.

# How are currency prices determined?

Currency prices are determined by a host of economic and political conditions, most importantly, interest rates, international trade, inflation, and political stability. Occasionally, the government participates in the foreign exchange market to influence the value of the country's currency by either flooding the market with their domestic currency to lower the price or buy in order to raise the price. This is known as central bank intervention.

When the currency of our country appreciates corresponding to the prices of another country, the price of goods of our country go up abroad and foreign goods prices in our country come down.

# Foreign Exchange rate policies in India

Since the onset of liberalisation, Foreign Exchange markets in India has experienced tremendous growth. In February 1992, started to make the Rupee convertible, and in March 1993, a single floating exchange rate in the market of Forex in India was started.

The Indian Foreign Exchange Market comprise of the buyers, sellers, market mediators and the Monetary Authority of India. The main centre of Foreign Exchange in India is Mumbai with other centres in all the major cities such as Kolkata, New Delhi, Chennai, Bengaluru, Pondicherry and Cochin.

Foreign Exchange Dealers Association is a voluntary association that also acts as a regulator. All resident individuals/HUFs and eligible corporate meeting the FEMA criteria are eligible to trade in Forex.

## Operation of Forex Markets

Like commodity market, foreign exchange market also operates as:

-Spot Market, which handles only spot/current transaction. The rate of exchange is one that prevails at the time the transaction takes place.

- Forward Markets for Forex is the market which handles foreign exchange meant for future delivery. Currency derivatives is a binding contract to buy/sell a currency exchange rate at an agreed price in the future. Like any other derivative trading, currency derivatives also are efficient risk management instrument and the benefits of hedging, speculation, arbitrage and leverage can be derived from it.

# Commonly traded currencies

Currencies are indicated by three letter symbols. The standard symbols for some of the most traded currencies are:

EUR – Euros

USD – United States Dollar

CAD – Canadian Dollar

GBP – British Pound

JPY – Japanese Yen

AUD – Australian Dollar

CHF – Swiss Franc

## Cont..

The majors holding 75% of all market operations on Forex are the EUR/USD, GBP/USD, USD/CHF and USD/JPY. The USD is considered a major currency pair because it is represented in all currency pairs. The pairs which do not include the USD are called cross currency pairs or cross rates.

The following are the cross rates that are actively traded:

EUR/CHF = euro-franc

EUR/GBP = euro-sterling

EUR/JPY = euro-Yen

GBP/JPY = sterling-Yen

AUD/JPY = Aussie-Yen

NZD/JPY = kiwi-Yen

# Market Participants

Central bank such as RBI play a very important role in the foreign exchange markets. They participate in the foreign exchange market to regulate currencies as per their economic requirement. Central banks control the money supply, inflation and/or interest rates.

Commercial companies trade in small quantities as compared to banks or speculators. Their trades have a relatively short-term impact on the market rate.

THANK YOU

Click to Open an Account & Details

Read Our Research Reports

Read Experts Blog