

ANALYSING THE RELATIONSHIP BETWEEN CURRENCY FUTURES AND SPOT EXCHANGE RATES VOLATILITY IN INDIA

ABSTRACT

India moved away from pegged exchange rate to the Liberalized Exchange Rate Management System (LERMS) in 1992 and the market determined exchange rate regime in 1993 which is considered as an important structural change in the exchange rate market. With increased volatility in exchange rate and to mitigate the risk arising out of excess volatility, currency futures were introduced in India in 2008 which is considered as second important structural change. It is believed that the currency futures will help in hedging the exposures of exchange rate to unfavorable movements in exchange rate. The role of derivatives for risk taking and risk management cannot be understated by any means and it has increased significantly in recent times. This paper focuses at the relation between volatility in the exchange rate in the spot market and trading activity in the currency futures. The results show that there is a two-way causality between the volatility in the spot exchange rate and the trading activity in the currency futures market.