

DEVELOPMENTS IN INTERNATIONAL CURRENCY DERIVATIVES MARKETS: IMPLICATIONS FOR INDIA

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ABSTRACT

The breakdown of the Bretton Woods system gave rise to the floating exchange rate regime that brings along with it substantial currency risk. This investigation shows that spot exchange rates in such a system are not determined solely by macroeconomic variables. The paper attempts to theoretically examine the problems in International Derivatives markets which are also likely to arise in India when currency futures' trading is introduced. It is observed that there is an unknown return in foreign currency investments as captured by Currency Surprise. This study questions whether there really exists a misalignment between spot and forward foreign exchange rates. This has implications for the premiums paid on currency derivatives – larger fluctuations in the exchange rate leads to greater premiums.

Keywords: currency risk, currency surprise, misalignment, spot rates, forward rates, currency futures.