

ABSTRACT

This paper will investigate the information flows between the onshore and offshore forward rates of the Rupee-Dollar exchange rates, and their underlying spot rates. The offshore forward rates i.e. the non-deliverable currency forwards, is of importance because of their potential for volatility spill-over to the domestic spot and forward exchange rates, thereby impacting exchange market behavior. The NDFs are cash settled contracts, unlike the domestic currency forwards which are based on delivery. There is also rupee currency futures contracts in India, traded in National Stock Exchange (NSE) against currencies such as US Dollar, Euro, Pound Sterling and Japanese yen, which are also cash settled like the offshore non-deliverable forward contracts. The present study does not include rupee currency future rates for empirical testing.

Using the augmented GARCH formulation, this study explores the information flows among these market segments: onshore forwards rates and offshore NDF exchange rates with their underlying spot exchange rates; in order to understand the signaling and spillovers from one market segment to the other. There is also the possibility of arbitrage between onshore and offshore forward rates, thereby encouraging speculative behavior in the Indian currency markets.

The study will be useful as one would draw appropriate signaling of the Rupee-Dollar Rates from either onshore or offshore forward rates, and this will help the exchange market interventions strategies pursued by the Reserve Bank of India.