FOREX OPERATIONS

FOREX OPERATIONS

- International transaction in cash requires two distinct purchases
  - Purchase of foreign currency
  - Purchase of good/service with the FC

FOREX OPERATIONS

- **FOREX: An expression to denote foreign currency**
- **Also covers the method by which a currency of one country is exchanged for that of another.**
- **Exchange Rate: rate at which one currency is exchanged with another currency**
- **FOREX trading: sale and or purchase of a currency**
- **Transaction is always from the bank's point of view**
- **Item referred is always foreign currency**
- **Purchase: Buying Rate :Bank has purchased foreign currency**
- **Sale: Selling Rate: Bank has sold foreign currency**

FOREX OPERATIONS

- Organisational setting within which individuals, governments and banks buy and sell foreign currencies
- Only a small fraction of daily transactions in foreign exchange involve trading of currency
- Most foreign exchange transactions involve transfer of bank deposits

FOREX OPERATIONS

- **Deposits, credits and balances payable in foreign currency**
- **Drafts, travellers' cheques, letter of credit or bill of exchange expressed or drawn in Indian currency but payable in foreign currency**
- **Drafts, travellers' cheques, L/Cs, etc. drawn by banks, institutions or persons outside India but payable in Indian currency**

FOREX OPERATIONS

- **Characteristics of foreign exchange market**
- **<u>An Over The Counter market</u>’**
- **No physical presence in the same sense as a stock exchange or commodity market**
- **The participants deal among themselves and settle their transactions directly**
- **There is no exchange or clearing house**

FOREX OPERATIONS

<u>Only market open 24 hours</u>

- **FX Market is a 24 hour market**
- **It starts when a calendar business day opens in Sydney, Tokyo, Hong Kong, Singapore and then moves to Middle East to Europe to New York to the West Coast of United States where the calendar business comes to a close**
- **FX Market operates seven days a week (Middle East Markets function on Saturdays and Sundays)**
- **Effectively it is a 24 hour a day / seven days a week / 365 days a year Market!**

FOREX OPERATIONS

- **<u>No single location – no barriers</u>**
- FX market is not located in a single building
- No specific market place exists
- FX market is global in nature / character
- While the market does not exist at each and every center in the world, it is accessible from any part of the world
- **<u>Exchange rates fluctuate every four second</u>**
- **<u>Settlement of transactions normally does not take place simultaneously</u>**
- **<u>.Highly liquid market</u>**
- **<u>Money / capital / debt markets also impact FX market</u>**

FOREX OPERATIONS

- **Direct Quotation**: a given number of units of domestic currency per unit of foreign currency
- E.g $ 1=Rs 47.00
- **Indirect Quotation**: a given number of units of foreign currency per unit of domestic currency
- E.g Rs 100= $ 2.10
- wef 2nd August 1993.direct quotations are followed in INDIA

FOREX OPERATIONS

- **Two- way Quotations:**
- Major banks that act as market-makers always give two-way quotes; gives depth and volume to the market
- Forex quote from the bank side is two way quote-one at which the quoting bank is willing to buy and the other the bank is willing to sell
- E.g :US$ 1=Rs 47.15-47.25
- Principle in case of Direct Quote: **<u>BUY LOW SELL HIGH</u>**
- As such ,Bank would purchase 1 US$ at Rs 47.15 and would sell 1 US at Rs 47.25
- Principle in case of Indirect Quote: **<u>BUY HIGH SELL LOW</u>**

FOREX OPERATIONS

- **NOSTRO** Account:
- A foreign currency account maintained by a bank in India with a bank abroad
- our account with you.
- BOI’s US$ ACCOUNT WITH CITI BANK
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FOREX OPERATIONS

- VOSTRO account:
- A rupee account of a foreign bank (abroad) with a bank in India
- Your account with us
- CITI BANK RUPEE ACCOUNT WITH BANK OF INDIA

FOREX OPERATIONS

- <u>LORO</u> account:
- A bank’s account with another bank
- Their account with you
- Bank of India ,New York branch US$ account with Citi Bank New York

FOREX OPERATIONS

- Types of Exchange Rates:
- READY/CASH: settlement of transaction on the same day.
- TOM :settlement of transaction on the next working day
- SPOT: settlement of transaction to be done on the second working day
- In the forex market all rates that are quoted are generally spot rates
- FORWARD: BEYOND spot date
- Forward rate = Spot rate + Premium (- discount)
- Value Date: date on which entry is passed in the accounts, delivery of funds

FOREX OPERATIONS

- Merchant rates: Quotes offered to merchants (importers, exporters) by banks.
- Inter-bank rates: The rates quoted by banks for dealing in the inter-bank market.
- Merchant quotations: In India all merchant quotations for foreign currencies shall be in so many rupees for one unit of foreign currency except for Japanese Yen, Italian Lira and Belgian Franc (Rs/100 units of the currency)
- All quotes are in four decimal places with the last two digits in the multiple of 25

FOREX OPERATIONS

- Merchant Rates:
- In a purchase transaction, bank buys foreign currency from a customer and pays in Indian Rupees
- Sometimes receipt of foreign currency is immediate and in some cases time is involved
- Depending upon the time involved in realization of foreign currency, there are two types of Buying and Selling Rates

FOREX OPERATIONS

- FEDAI prescribes types of rates of merchant transactions:
  - TT (buying)- clean inward remittances
  - Bill (buying)- purchase/discount of export bills
  - TT (selling) clean outward remittances
  - Bill (selling) remittance for import bills

FOREX OPERATIONS

- Factors influencing exchange rates
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- Short term factors
-
- - commercial
- - financial
-
- Long term factors
-
- - currency and economic conditions
- - political and industrial conditions
-

FOREX OPERATIONS

- **International trade risks**
- **Buyer risk**
-
- **- Non-acceptance risk**
- **- Non-payment risk**
- **- Quality claim risk**
- **- Credit risk**
- **Seller risk**
-
- **- Non-shipment risk**
- **- Quality goods not supplied**
- **- Late shipment risk**

FOREX OPERATIONS

Other risks

- **Bank failure risk**
- **Settlement risk**
- **Competition**
- **Genuineness of documents**
- **Price risk**
- **Legal risk**
- **Spread risk**
- **Market risk**

FOREX OPERATIONS

- **Risks in foreign exchange operations**
  - **Exchange risk**
  - **Settlement risk**
  - **Liquidity risk**
  - **Country risk**
  - **Sovereign risk**
  - **Interest rate risk**
  - **Operational risk**

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FOREX OPERATIONS

- Value date: It is customary, in foreign exchange market, to quote a rate to do the deal but exchange the currencies not on the same day but generally afterwards.
- Forward rate: Has two components
  - Spot rate
  - Forward points or forward differentials

- Forward rate is the rate when the value of the deal is fixed beyond the spot date i.e. beyond the second working day after the deal