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Foreign Exchange Market in India a Brief Background

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Abstract:

A key assumption in the concept of foreign exchange risk as that exchange rate changes are not predictable and that this is determined by how efficient the markets for foreign exchange rates. Research in the area of efficiency of foreign exchange markets has thus far been able to establish only a weak form of the effluent market hypothesis conclusively which implies that successive changes in exchange rate cannot be predicted by analyzing the historical sequence of exchange rates. However, when the efficient markets theory is applied to the foreign exchange market under floating exchange rates there is some evidence to suggest that the present prices properly reflect all available information. In India some financial centers are more developed tan others in the foreign exchange market. Thus, Mumbai, Kolkata and Chennai are more developed than others. Some of the foreign exchange transactions being seasonal the markets are also seasonal. This research paper deals with the issues in foreign exchange market in India.

Keywords: Concept, Foreign Exchange, Conclusively, Floating, Transactions.

Introduction:

The foreign exchange market in India started in earnest less than three decades ago when in 1978 the government allowed banks to trade foreign exchange with one another. Today over 70% of the trading in foreign exchange continues to take place in the interbank market. The market consists of over 90 Authorized Dealers (mostly banks) who transact currency among themselves and come out "square"or without exposure at the end of the trading day. Trading is regulated by the Foreign Exchange Dealers Association of India. A self regulatory association of dealers since 2001. Clearing and settlement functions in the foreign exchange market are largely carried out by the Clearing Corporation of indie Limited (CClL) that handles transactions of approximately 3 5 billion US dollars a day about 80% of the total transactions.

The liberalization process has significantly boosted the foreign exchange market in the country by allowing both banks and corporations greater flexibility in holding and trading foreign currencies. The Sodhani Committee set up in 1994 recommended greater freedom to participating banks, allowing them to fix their own trading limits interest rates on fixed deposits and the use of derivative products. The growth of the foreign exchange market in the last few years has been nothing tees than momentous in the last 5 years. From 2001 to 2005-06. Trading volume in the foreign exchange unmistakable downward trends in that proportion. (Part of this dominance. Though results from double-counting since purchase and sales are added separately, and a single interbank transaction leads to a purchase as well as a sales entry.) This is in keeping with global patterns. In March 2006, about half (48%) of the transactions were spot trades, while swap transactions (essentially repurchase agreements with a one-way transaction spot or forward combined with a longer-horizon forward transaction in the reverse direction) accounted for 34% and forwards and forward cancellations made up 11% and 7% respectively. About two-thirds of all transactions had the rupee on one side. In 2004, according to the triennial central bank survey of foreign exchange and

derivative markets conducted by the Bank for International Settlements (BIS (2005a)) the Indian Rupee featured in the 20th position among ail currencies in terms of being on one side of all foreign transactions around the globe and its share had tripled since 1998. As a host of foreign exchange trading activity, India ranked 23rd among all countries covered by the BIS survey in 2004 accounting for 0.3% of the world turnover. Trading is relatively moderately concentrated in India with 11 banks accounting for over 75% of the trades covered by the BIS 2004 survey.

Intervention in Foreign Exchange Markets:

The two main functions of the foreign exchange market are to determine the price of the different currencies in terms of one another and to transfer currency risk from more risk-averse participants to those more willing to bear it . As in any market essentially the demand and supply for a particular currency at any specific point in time determines its price (exchange rate) at that point. However, since the value of a country's currency has significant bearing on its economy, foreign exchange markets frequently witness government intervention in one form or another, to maintain the value of a currency at or near its 'desired" level. Interventions can range from quantitative restrictions on trade and cross-border transfer of capital to periodic trades by the central bank of the country or its allies and agents so as to move the exchange rate in the desired direction. In recent years India has witnessed both kinds of intervention though liberalization has implied a long-term policy push to reduce and ultimately remove the former kind. It is safe to say that over the years since liberalization, India has allowed restricted capital mobility and followed a 'managed float" type exchange rate policy.

Indian Foreign Exchange Market:

In India there are many commercial and co-operative banks that are authorized to deal in foreign exchange called Authorized Dealer and are eligible to operate in the foreign exchange market. However, not all co-operative banks are authorized to deal in foreign exchange. These banks cover their open position in currencies in London, through their correspondents or branches abroad or in India in the interbank market. There are no published figures as thousands of crores of foreign trade are put through and crores foreign remittances and a host of other purchases and sale take place. In the process of such purchases and sales directly with the public, the authorized dealers would have various currencies which they try to dispose of by matching demand with supply in inter-bank market. it is only the unmatched net requirements that are purchased from the RBI, or excess sold to the RBI. The data on turnover in foreign exchange market both merchant and interbank and RBI operations of purchase and sale are now published in the RBI monthly bulletins.

The foreign department of every and draws up a position sheet for each currency daily in which purchases and sales of the currency are recorded, as the banks generally avoid taking any exchange risk by keeping uncovered balance and are not permitted to do so under the previous regulations, they try to cover their position by the end of the day. When the purchases exceed sales, the credit balance is plus (or long) and overbought. This is to be covered by equal sales of that currency. When the sales exceed purchases, the debit balance is minus, short or oversold position and is to be covered by equivalent purchases. These sales and purchases would include both spot and forward, import bills or export bills negotiates or purchased, clear sales or purchases (other than through bills, namely, by TT,MT, Cheques, drafts) BC sales and OD sales etc.

Before entering into the inter-bank marker, the banker decides how much to hover and what the outstanding balance position in his books is. Banks operate in the inter-bank market through the foreign exchange brokers. In every important market centre, some brokers operate in these dealings. The banker keeps some minimum balances in all his accounts the delivery to meet the customer needs

as they accrue. The more exactly he synchronies the delivery dates of his purchases and sales the greater is his profit. The finer the rates he quotes.

Exchange Rate:

There is a price for everything, good or service or finance and money just like interest rate is the price for borrowing money or ready cash or credit. Exchange rate is any currency in terms of other currencies. Each nation state has its own currency and is valid and acceptable in that state or nation. If one nation to pay to any other nation the currency of loner has to be exchanged for the latter . In the similar manner the residents of one nation pay to any other nation. They have to convert their money in to the currency of the receiving country. Then the rate of conversion of the currency unit of one country in to the currency units of any other country i$ called the exchange rate.

Exchange Rate System In India

India was formal member of the sterling area from September 1939 to June 1972 during which period the external value of the rupee (exchange rate) was kept stable in terms sterling since the establishment of MP. of which India was a lender member‘ the external value 01 the rupee was declared in terms of gold and US dollar and its value was maintained stable in terms of E by purchases and sales at sterling by the RBI . Rupee was devalued tame, namely, in Sept 1949 by 30.05% and in June 1966 by 36 05% to maintain parity With 5 Since June 1966. This link With sterling which was maintained by keeping the rupee stable in terms at sterling and using the sterling as an intervention currency was justified on the grounds that the bulk of India ‘s trade was either With sterling area or was denominated in sterling and that India’s foreign interests lie with sterling which was considered at that time a stable and strong reserve currency.

With the breakdown of the Briton Woods system in August 1971, and the floatation of various major currency . The Indian rupee was temporarily kept pegged to the US at Rs .7.5 per US $1 and this rate was kept stable by intervention in the market by purchases and sales of sterling, Rupee dollar peg was used to determine the rupee sterling rate. This position continued up to December 1971. When under the Smith Sodhian agreement. The exchange rate was fixed in terms of US dollar and the rupee was again linked to sterling thereafter. This sterling linked proved short-lived up to June 1972, when sterling and major wrenches started floating between June 1972 and September 1975. rupee was kept stable in terms of sterling but was allowed to fluctuate against all other currencies During this period rupee was effectively devalued against all major currencies other than it by as much as 18 ~ 20%. Since the effect of such depreciation was not favorable to India with her inelastic supplies of export goods and growing debt burden, along with the rising import bill, India decided to deal itself with E completely in September 1975. Since then, the external value of rupee was determined by the market value. As quoted in London, of a basket of currencies The currencies included in the basket and the relative currency weights as well as the method of compilation of the exchange rates were kept confidential. Since then the rupee valuation has been based on a mix of international currencies with which indie has trade relations and better is hrs position. The better he foreseen the trends in exchange rates we interest rates in various centers. The more efficient he is and the better in hi.

In the inter-bank market, banks put through the dealings of purchase and sale or wrench through authorized brokers in each centre are in contact with other centers in India and in foreign countries for effecting marching transactions in venous centers, export bills, and various remittances are daily purchased and sold by banks Imports give rise to payments abroad and purchase for foreign currencies. Adds the bulk of the imports in India are on government account and the keeps the

account of the public sector undertakings and of the government the SBI enters the foreign exchange market mostly as a buyer of foreign currencies Exports are more concentrated in the private sector, in which all banks are involved in varying degrees. Hence, sales of foreign currencies in the exchange market are more evenly spread among the banks in India. Many times, brokers cannot match in the local centers for old currencies like Austrian Shilling or Nigerian naira or Libyan dinar, which are to be put through in a more sophisticated marker like London of Singapore.

Conclusion:-

The foreign exchange market is a market where foreign currencies are bought and sold. It is an over-the-counter market. it operates round-the-clock. The market may have spot as well as forward transactions. The former involves immediate delivery of currencies, while the latter involves delivery at a future date. Normally, the rates should not vary among different markets, but when they vary, arbitrage takes place conferring profits up on arbitrageurs and ultimately making the rates uniform among different markets. Exchange rate denotes the ratio between the values of two currencies. it is quoted in newspaper either in a direct or in an indirect way. The quote shows buying and selling rates.

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