

Currency Futures: All the Gyaan on How to Trade Them

Today, Classroom is shifting gears a little bit to something that is not done in the past. Currency and not just currencies but currency futures as well. It is a relatively new phenomenon in India but very vibrant and liquid and perhaps the largest traded market globally which is why you need to understand what it is about and whether you as well can participate in the process.

In an interview with CNBC-TV18, Ananth Narayan, Regional Head - FICC, Standard Chartered Bank, U Venkataraman, ED, MCX Stock Exchange and Jamal Mecklai, CEO, Mecklai Financial Services gave their perspective on currency futures and hedging.

Below is a verbatim transcript. Also watch the accompanying video.

Q: How would you define currency futures and what is it intended to do?

Narayan: Let's start with what is a currency in the first place. As we all know, as long as we have global trade and global capital flows, we encroach into each others currencies, there is a need for a currency market much like we have a commodity market where the price of one currency can be expressed in terms of the other. The futures market is a derivative of that.

Basically you trade contracts on the exchange much like you do the equity and commodity contracts. And these are standardized contracts against the margins and so on and so forth. But overall clearly this market is a huge market, the largest asset market in the world, 24X 7 if you exclude the weekends.

If you wake up in the middle of the night you will see currency markets moving between New York close and Tokyo open. So it's a very vibrant USD 4 trillion per day volume market overall. If you include derivatives, it's a pretty large multibagger. So it is probably the most important market in the world today.

Q: The reason that's given off turn in terms of currency futures and why it's important is the arbit term hedging. How would you define why currency futures are important and why they are such an important tool universally now?

Mecklai: If you look globally, currency futures are not hedging tools. They are basically a speculative tool. Ananth was talking about the USD 4 trillion is actually not currency futures, it's the total currency market which is the OTC (Over-the-counter) market, most of which is between banks and large corporates and a smaller fraction of it is the currency futures but it's still a huge amount.

While theoretically the currency futures market can be used for hedging and globally certainly in some countries for example Mexico, etc. the currency futures are used for hedging. You can judge that from the fact that the open interest. Open interest is sort

of, when someone takes a position and carries it for two days, three days, one month, two months obviously they could be speculative but they could also be people who are looking to lock in a price in the future.

But the vast bulk of currency liquidity is intraday, meaning you buy now and you get out in 20 minutes. Now that's not hedging, that's trading, that's speculation. Nothing wrong with that, we are all here in markets to make money. I think in India today thus far at least the currency futures market which has done very well, which has grown to, I think grew up to about USD 7 billion a day in about three years or two and a half year was almost 100% speculation.

There has been a fall back in the volumes because of some stamp duty issues but the market is still very liquid but fortunately or unfortunately it's still largely speculative. To make it meaningful for hedgers, RBI needs to make a few structural changes.

Click on the following link for the complete show video:

http://www.moneycontrol.com/video/business/currency-futures-allgyaanhov-to-trade-them_472145.html

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