

① Regulator of foreign currency in India

↓
RBI

↓
FEDAI

(Foreign Exchange dealer
association of India)

② Strongest currency of world is Kuwait Dinar.

③ Appreciation of a currency → A currency appreciate when price of that currency increases.

Example → Spot rate: \$ 1 = ₹ 80
Forward rate: \$ 1 = ₹ 85

④ Depreciation of a currency → A currency depreciate when price of that currency decreases.

Example → Spot rate: \$ 1 = ₹ 80
Forward rate: \$ 1 = ₹ 75

⑤ Nobody can hold foreign currency as government does not allow for it. But foreign currency can be held in foreign currency bank account.

⑥ Bid rate → The rate at which bank buys a currency is known as bid rate.

⑦ Ask rate → The rate at which bank sells a currency is known as ask rate.

⑧ Spread → Difference between bid rate and ask rate.

Note → Generally bid rate is less than ask rate.

⑨ one way quote → $\$1 = ₹80$

⑩ Two way quote → $\$1 = ₹75 / ₹80$
bid rate ask rate.

⑪ Direct quote → Price of 1 unit of foreign currency in home currency.

$$\$1 = ₹80$$

⑫ Indirect quote → Price of 1 unit of home currency in foreign currency.

$$₹1 = \$0.01$$

⑬ Swap point → Difference between spot rate and forward rate is known as swap point.

(14) Money market hedge

(a) IF foreign exchange is receivable

- Borrow an equivalent amount of present value of Invoice from foreign market.
- Convert at spot rate
- Deposit with Indian Bank
- Withdraw after specific period
- Repay borrowing along with interest out of proceeds from foreign customer.

(b) IF foreign exchange is payable

- Deposit an equivalent amount of present value of Invoice in foreign market.
- Convert it at spot rate.
- Borrow from Indian Bank
- Repaid after specific period along with interest.
- Pay to foreign supplier out of proceeds from deposit.

(15) Cross rate → Exchange rate calculated using two or more other exchange rate is known as Cross rate.

Example

$$\text{\$ } 1 = \text{₹ } 80/81$$

$$£1 = ₹ 90/92$$

then cross rate will be \$ per £

(16) Interbank rate → Exchange rate applicable in transaction between two bank.

(17) Interest rate parity theory

According to interest rate parity theory, currency with higher interest rate will depreciate in future and currency with lower interest rate will appreciate in future.

$$\textcircled{1} \text{ Fair's Forward rate} = \text{Spot rate} \left(\frac{₹}{\$} \right) \times \left[\frac{(1 + \text{PIR})^n}{(1 + \text{PIR}(\$))^n} \right]$$

here PIR = periodic interest rate.

$$\textcircled{1} \text{ Premium/discount on \$} = \left[\frac{\text{PIR}(₹) - \text{PIR}(\$)}{1 + \text{PIR}(\$)} \right]$$

(18) International Fisher effect

$$(1 + \text{Real Interest rate}) \times (1 + \text{Inflation rate}) = (1 + \text{Nominal interest rate})$$

⑱ Purchasing power parity theory

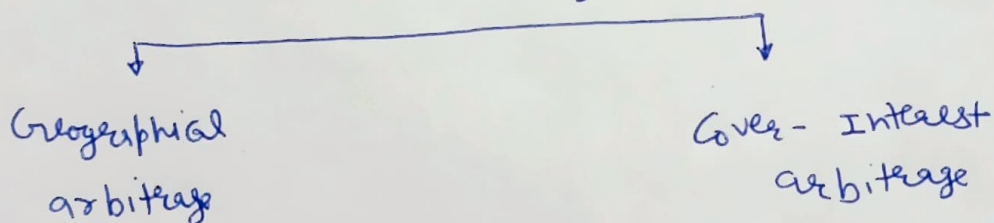
① According to purchasing power parity theory, exchange rate of two currencies depend on price of a product in different countries & inflation rate.

② Currency with higher inflation rate will depreciate in future.

③ Fair forward rate = Spot rate $\left(\frac{₹}{\$}$) $\times \left[\frac{(1 + \text{Inflation}(\text{₹}))^n}{(1 + \text{Inflation}(\$))^n} \right]$

④ Purchasing power parity theory is also known as Law of one price or Inflation rate parity theory

⑳ Arbitrage → Act to earn risk free profit is known as arbitrage



㉑ Leading → Payment before due date

Lagging → Delaying the payment beyond due date