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Relationship between future currency exchange rate and current currency futures prices

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Abstract

This paper is an attempt to explore the relationship between the future currency spot rate and the currency futures rates for Indian rupees and US dollar. Cost-of-carry model has been used to derive the implied spot rate from the currency futures rate and examined whether this rate can be an indicator of the current currency spot rate. Further, the implied spot rate is used to predict the short-term spot rates. The results indicate that the current currency futures prices convey very little information about the future spot exchange rate which has not been indicated by the spot market rates. Also the cost-of-carry model doesn't appear to hold strongly for the INR-USD case. Further, the implied spot rates derived from the currency futures rate are good predictor of short-term of future spot rates. In this case, the implied spot rates derived from the futures rate slightly overprice the US dollar.

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