Relationship between Spot and Futures Rate: Role of Risk Premium in the Indian Currency Futures Market

Synopsis
The case explores the relationship between currency futures and realized spot rates for the Indian rupee US dollar exchange rate. Using futures contracts with maturities of one, two and three months, the case examines the unbiasedness of futures quotes as a predictor of the future spot exchange rate as well as the nature of time–varying risk premiums in the Indian market. Empirical estimates, obtained using monthly data, suggest the biasedness of futures quotes as a predictor of the future spot rate for contracts with maturities of two and three months. The results also indicate significant time–varying risk premiums in the considered futures market, while the premium is of greater magnitude and more significant with increasing maturity of the contracts. Additionally, the case provides a glimpse of the Global Currency Markets and Indian Currency Futures Market, and the Trading Mechanism of Currency Futures.