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Role of Foreign Exchange Management in Currency Trading

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Abstract

Foreign exchange market or forex market is the main focus of this article which is one of the largest contributors in the global economy in recent times. The number of people joining currency trading is rapidly increasing in the global market and especially during the pandemic it enhanced. The forex market refers to the decentralised market for the trading of currencies which determines specific foreign exchange rate for every currency which is briefly discussed in this article. The study further includes a brief description of pros and cons of joining the forex market with reference to the foreign exchange management regulations in different countries. Secondary sources have been used for assembling relevant data regarding the forex market and all the findings are presented through a systematic table. All the articles and journals that are reviewed for data collection are accurately cited as well as thematically discussed in this article. Systematic presentation and thematic analysis of all the findings enhances understanding and significance of this study. As a result, it is identified that foreign exchange management plays a very crucial role in currency trading in the global forex market as it controls and manages all the exchanges in every currency.

Keywords

currency trading, foreign exchange management, foreign exchange market, liquidity.

INTRODUCTION

Background of the study

The study sheds light on foreign exchange management which refers to the legislations and rules for currency trading in different countries. The market of currency trading is called foreign exchange market which is also known as the forex market [1]. Considering this, the global forex market size was ***US$ 753.2 Billion in 2022*** and the market size is rapidly increasing day by day. The figure below represents the turnover of the global forex in 2016 and 2019 which helps to understand the growth of the market. ***About 88.3%*** of currency trading was by USD in 2019 which was ***87.6%*** in 2016 [2]. It is identified that the pandemic crisis in 2019-20 has boosted the growth of the global forex market. The forex market reached ***about $6.6 trillion per day in 2019***. There are several and specific legislations regarding currency trading in different countries. The particular article identifies the role of foreign exchange management in currency trading in different countries.

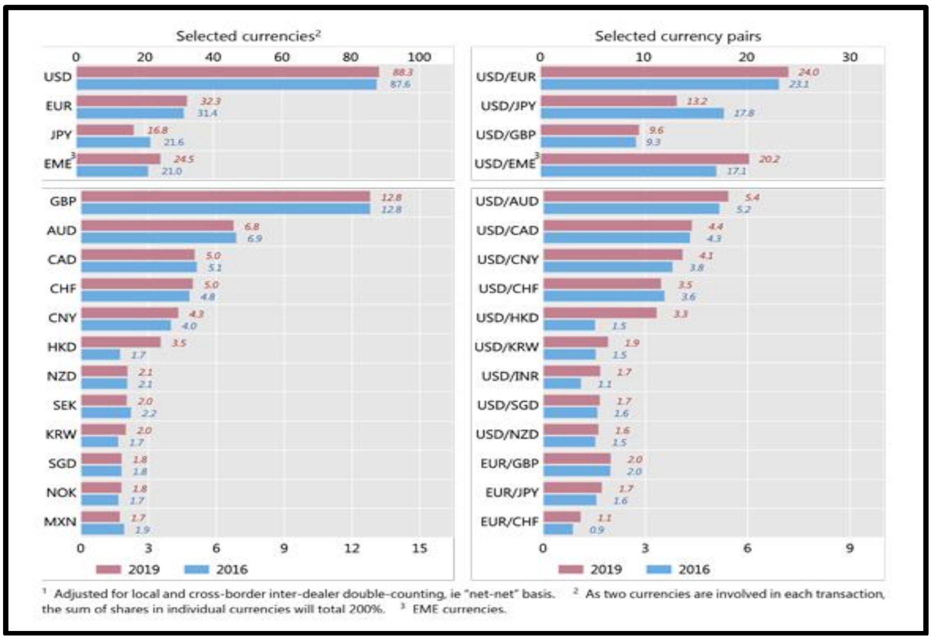

Figure 1: Global forex market turnover by currency and currency pairs
(Source: [2])

Aim and objectives

The study aims to understand the concept of foreign exchange management and its crucial role in currency trading. In regard to this, particular objectives are,

- To understand the concept of foreign exchange market in different countries
- To demonstrate foreign exchange management and legislations associated with it
- To elaborate the role of FEMA in currency trading
- To evaluate the impacts of digitalisation on currency trading in recent times

METHODS AND MATERIALS

Research design

Research designs are used for properly structuring the research studies and there are two types of research design that are used in studies. Qualitative and quantitative are the two specific research designs which are used for maintaining a particular structure for research studies. In this particular study, ***qualitative design*** has been adopted as it is capable of sustaining significance of an article as well as requires less time than quantitative design [3]. Thereafter, qualitative design is all about collecting non-numerical data from relevant sources and evaluating them qualitatively. Specific methods that are used gathering qualitative materials for this study are discussed below.

Data collection sources

Using appropriate sources for data collection is important in order to assemble relevant data for a research study. As the qualitative design has been implemented in this study, therefore it is important to choose sources that are capable of collecting qualitative data. There are two categories of sources that provide qualitative sources such as primary sources and secondary sources. Interviewing people is the primary qualitative source and observing articles and journals are the secondary qualitative sources [4]. Interviewing people who have effective knowledge about the global forex market will be a time consuming process. Therefore, the ***secondary qualitative sources*** have been used for data collection in this study. Different scholarly articles and journals are observed for gathering findings which are evaluated by using relevant methods.

Inclusion and exclusion criteria

A few criteria are followed while collecting data which have played crucial roles in maintaining significance and relevance of this study. Articles that are published after 2018, only included as well as all the selected articles needed to be based on the forex market and currency trade. In addition to that, doctoral dissertations and conference papers are excluded for avoiding the chances of using wrong information about currency trading.

Sample selection

The set criteria are followed and ***a total of 7 articles*** are selected as samples for this study which are capable of providing recent and relevant data about the forex market and currency trading. About 20 articles were found based on the same topic but among them 10 journals were published before 2018 and 3 more articles were doctoral dissertations. After excluding these 13 articles based on the criteria and finally 7 articles are selected for gathering data and findings for this article.

Data analysis process

Adopting specific processes and techniques for analysing data properly is important as data analysis is one of the major parts of research studies. Non-numerical data has been collected by using secondary qualitative sources, therefore using qualitative processes such as systematic analysis, thematic analysis for data analysis is relevant [5]. ***Systematic analysis*** has been used for presenting all the core findings of this study from the seven articles as well as ***thematic analysis*** process has been used for evaluating all the findings for better understanding. The key findings and the significance of the findings from the seven articles are presented in the systematic table which enhances the significance of this study. Apart from that, thematically discussing all the key points sustains the relevance and significance of the article.

RESULTS

A total of 7 articles are observed which provide relevant information about the forex market and associated factors. Different perspectives of different authors regarding the foreign exchange management and forex market are identified. All the core findings are presented through the systematic table below.

Table 1: Presentation of data through systematic table

Sl. No.	Source	Methods	Key findings	Significance
1.	Aslam et al. 2020 [6]	-secondary methods -reviewed reports -quantitative analysis	● The COVID-19 pandemic has boosted the growth of the global forex market in a short time ● Investors are free to structure the investments strategies in the forex market for exploiting market efficacy	The article discusses the influence of the COVID-19 pandemic on the efficiency of the forex markets. It is identified that investors are allowed to structure their investments according to their convenience

			● Forex market efficiency is pivotal in capital formation and resource allocation which enables economic stability of their investors as well as leads to economic development	which enhances the efficiency of the forex market. Apart from that, capital formation and resource allocation plays crucial roles in improving efficiency in the forex market.
2.	Yang et al. 2019 [7]	-secondary methods -Empirical results -qualitative analysis -quantitative analysis	● Foreign exchange is one of the most important components of finance market yet it is a complex system ● "Normalised Tree Length", Degree Distribution, Centrality Analysis and "Survival Ratio Analysis" are the "Dynamic Network Topological Properties" of the forex market ● Forex market is a typical heterogeneous in which some hub nodes plays crucial roles in the market	The study identified the components and properties of the forex market. As per the findings, "Normalised Tree Length", Degree Distribution, Centrality Analysis and "Survival Ratio Analysis" are the "Dynamic Network Topological Properties" of the forex market.
3.	Evans & Rime, 2019 [8]	-secondary methods -reviewed reports -quantitative analysis	● Spot and forward are the instruments of forex market that influence the behaviour of the market and create an environment including the features of the market ● Currency trading by financial end-users is generally generated by speculative, risk management and allocative motives ● Currency trading by non-financial end-users is influenced by cross-border investment, risk management and goods trade.	This particular article tells about the structure of the forex market and it is identified that the structure is quite complex and typical. According to the author, spot and forward are the major components of instruments of the forex market that influence the environmental behaviour of the market. In addition to that, there are different types of components that influence the currency trading of the financial end-users and non-financial end-users. Speculative, risk management and allocative motives are the influencers for financial end-users and cross-border investment, risk management and goods trade are the influencers for non-financial end-users.
4.	Huynh et al. 2020 [9]	-secondary methods -reviewed reports -quantitative analysis	● The existence of connectedness and asymmetric spillovers is identified among the exchange rates during the presence of trade policy uncertainty ● The return connectedness is not stronger than the volatility spillover between "exchange rate and trade policy uncertainty" ● The trade policy uncertainty plays a crucial role in driving "exchange rate volatility" in the global forex market	This study discusses the impacts of connectedness and asymmetric spillovers on financial markets. Different states of connectedness and asymmetric spillovers are identified with and without the presence of trade policy uncertainty. Volatility spillover is stronger than return connectedness with the presence of trade policy uncertainty which signifies that the trade policy uncertainty is a crucial part of the global forex market.
5.	Tiwary, 2019 [10]	-secondary methods	● Foreign exchange exposure refers to the measure of the changes in	This specific article discusses the concept of foreign exchange

		-reviewed reports -quantitative analysis	profitability, case flows and market values of business companies due to the foreign exchange rate ● There are three types of foreign exchange exposure such as translation exposure, transaction exposure and operating exposure ● Exchange rate, time of maturity, strike rate, volatility and risk free interest rate are the influencing factors for currency options prices	exposure which is all about the measurement of financial stability of business companies and firms in different foreign exchange rates. As per the author, there are a total of three types of foreign exchange exposures which are translation exposure, transaction exposure and operating exposure. Further, the article also tells about the influential factors for currency options prices in the global forex market which are exchange rate, time of maturity, strike rate, volatility and risk free interest rate.
6.	Sohil & Alzoubi, 2018 [11]	-primary methods -interviewed people -qualitative analysis	● Digital transformations have a positive impacts on financial markets which brought significant changes in the global financial market ● Technologies enhances accessibility of adequate information for users as well as it decreases the issues of documentation ● Lack of predictability in crypto currencies and poor capability of governmental authorities to process online trading businesses are the two negative impacts of digitalisation on financial market	The study tells about the impacts of digital transformation on the financial market worldwide. The use of modern technologies has become one of the common parts of daily life and the use of technologies in currency trading has been highly and positively impacting the growth of the forex market. As per the author, technologies such as the internet, computers, mobiles and others are capable of improving accessibility of information for the users and that boosts their investment interest and structure which is impactful on the forex market positively.
7.	MANTA et al. 2021 [12]	-secondary methods -Empirical results -qualitative analysis	● Modern technologies bring financial stability by enhancing accessibility of information for the users ● Blockchain technology enhances security of personal data of the users which improves their trusts and efficiency ● Although modern technologies requires higher technical knowledge, these are positively impactful on financial stability of users in forex market	The article describes the impact of technologies and the contribution of blockchain technology in securing data of users in the forex market. Security and privacy of the personal data of the users is one of the major priorities which can be assured by using blockchain technology.

(Source: Self-created)

DISCUSSION

Theme 1: Overview of foreign exchange market and its state during the COVID-19 pandemic

Foreign exchange market is known as the most liquid currency exchange market which is the largest market in the world. An overview of the concept and types of foreign exchange market is presented in this portion of the study. The figure below represents the utilities of the forex market which facilitates international trading, ease of transactions, establishment of standards and determination of exchange rate [13]. Thereafter, it is identified that the forex market is a type of "over-the-counter (OTC)" market without any central marketplace for facilitating standardisation and trading during the exchange of currencies. On the other hand, there are five types of forex market in the world which are spot market, future market, forward market, options market and swap market [10].

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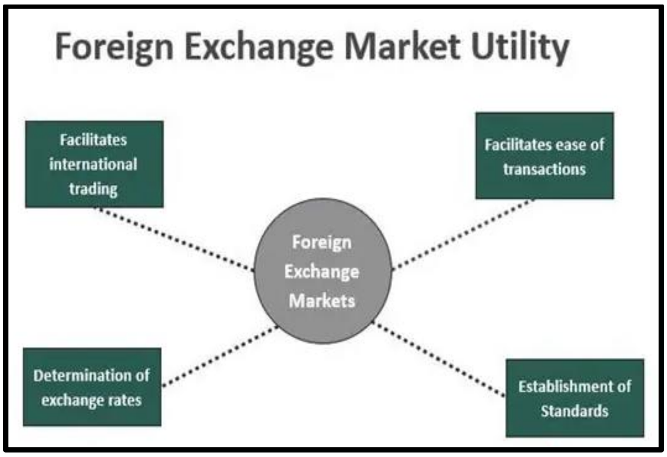

Figure 2: Utilities of forex markets
(Source: [13])

All the different types of forex markets have some particular features which are also discussed in this section of the study. The spot market requires immediate currency delivery which also demands quick payments based on the prevailing exchange rates [14]. Spot transactions are the transactions in which currency exchange occurs within two days from the contract date. Apart from that, the forwards market includes the transactions in which currency exchange occurs at a specified date and the forward rates are quite similar to the spot rates in the global forex market [8]. Further, future market refers to the future contracts in which currencies are traded on future exchanges which have fixed maturity date and contract size.

On the other hand, swap markets include the exchange of two streams in two different currencies. These transactions are also known as double transactions which purchase or sell the same currencies for forwarding delivery. Options market is the last category of forex market which allows a forex market to operate buy or sell of foreign currencies at a strike rate [15]. In contrast, it is identified that the efficiency of the forex market has enhanced during the COVID-19 pandemic. After varying "degrees of forex market efficiency" before the pandemic and during the pandemic, it is identified that market efficiency is pivotal in terms of both capital formation and resource allocation which ultimately leads to economic stability and development [6]. An effective growth of the global forex market is identified which signifies that pandemic has positively impactful on the growth of the financial market. It can be stated that the state of the global forex market was stable during the endemic crisis.

Theme 2: Currency trading in India and the UK

Currency trading refers to the exchange of different currencies of different countries at a strike rate. The state of currency trading in different countries is presented in this portion of the study. This section specially sheds light on India and the UK forex markets which are known as the largest forex markets in the world. In India, currency trading are based on currency derivatives such as options and futures which include some specific basic terminology. The terminologies of currency trading in India are pairs, pip, bid and ask price, base currency, lot size, leverage, spread and quote currency [16]. In pair terminology, currencies are traded in pairs such as USD/INR which is the most used currency terminology in the country.

On the other hand, it is identified that currency trading is only allowed in seven particular pairs in India. The particular pairs are USD/INR, JPY/INR, EUR/INR, EUR/USD, GBP/INR, USD/JPY and GBP/USD [17]. Thereafter, it is identified that investment banks and commercial banks are major participants in the currency trading of India in pair trading. Apart from that, central banks, investment managers and hedge funds are the other major participants of the currency market in India. There are particular rules and regulations regarding participating in the currency trading market of India which are briefly discussed in the next section of the study.

In contrast, the currency market of the UK is also one of the largest forex markets in the world which are also based on some of the currency pairs. Specific pairs in the UK forex market are EUR/USD, EUR/CHF, EUR/GBP, EUR/JPY, GBP/JPY, NZD/USD, GBP/USD, USD/CAD, USD/JPY and USD/CHF [18]. An average daily pip movement is highest for GBP/JPY which is 93 in a day which signifies that currency trading in this specific pair is beneficial for investors. The process of currency trading is quite similar in India and the UK. The only difference is that there are several rules and restrictions for currency trading in India but there are no specific exchange control restrictions in the UK forex market [19].

Furthermore, there are some common economic indicators used in the UK forex market for understanding the state of the market. The indicators include inflation rate, balance of payments of the country, interest rates, fiscal policies, governmental participation in intervention in currency markets and monetary policies [20]. In addition to that, "Simple moving average (SMA)", fibonacci retracements, "Relative strength index (RSI)", "Moving average convergence divergence (MACD)", stochastic indicator, bollinger bands, and elliott wave are the technical indicators of the forex market in the UK.

Theme 3: Foreign Exchange Management and its role in currency trading

In India, particular rules and legislation under the ***"Foreign Exchange Management Act 1999"*** are identified. A brief review of the particular act and its associated legislations are presented in this portion of the study. The particular legislation deals with the transfer of foreign exchanges, financial transactions and any other type of transactions in the currency market. These rules are important for improving risk management and reducing financial declines due to fluctuations [7]. Section 3, 4, 6, 7, 8, 10, 12, 13, 15, 36 and 37 of the particular act deals with the transaction aspects in the currency market of India [21].

As per the rules of foreign exchange management in India, exchanging currency in foreign pairs is illegal and the users have to exchange currencies in the specific pairs that are given. Trading currencies in foreign pairs is punishable in India and a person can be fined for Rs 10,000 for a day due to using foreign pairs. Considering this aspect, the main objective of the specific act and regulation in India is to facilitate payments and external trade with the maintenance of efficiency in the forex market in India.

FEMA is the significant act of managing forex market India which is briefly discussed in the previous part of this study. The major goal of the act is to facilitate payments and external trade in India. Therefore, the regulation ensures facilitating the external trade of currencies in India which improves efficiency in the forex market. Apart from that, it is identified that trade policy uncertainty plays a crucial role in managing connectedness and asymmetric spillovers [9]. The article shows that return connectedness becomes weaker than asymmetric spillovers in the presence of trade policy uncertainty. Apart from that, there are several barriers and challenges in currency trading in the forex market of India which are dealt with and prevented by the foreign exchange management regulation. The particular legislation contributes to orderly development and proper maintenance of foreign exchange market which leads to positive impacts on the growth of the forex market in India.

Theme 4: Impact of digitization on currency trading

Adoption of technologies is a part of life in this digital era and the use of technologies in currency trading has changed yet improved the efficiency of currency trading. Digital currencies are highly accessible and it supports several information accesses easily. Although it requires a higher level of technological knowledge and skills among the users, it is easier to control the trading of the currencies through digital platforms [11]. It is identified that digital currencies are capable of increasing efficiency in cross-border payments as it requires less time to deal with parties of other countries through digital platforms.

In addition to that, digital currencies are also capable of providing alternative credit information for trade finance and that ensures security of data. It is important to have proper details regarding the credits for enabling transparent transactions. Therefore, digitalisation enhances efficiency in digital currency by improving its transparency [12]. Along with that, digital currencies can alleviate the problems of de-risking. In short, digital technologies increase efficiency of the users in currency trading which leads to economic development of the users and the market. There are many applications and online websites which help users to get access to crypto currency. On the other hand, implications in FDIs, financial inclusion and lack of digital knowledge are the challenges for using digital currency trading.

CONCLUSION

It can be concluded that the forex market has a great contribution in the improvement of the global economy. During the pandemic crisis in 2019-20, the use of technologies has enhanced which has a positive impact on the growth of the forex market. A huge number of people have joined the forex market during the pandemic crisis through technological devices such as mobile, internet computers and others and that refers to crypto currency trading. Apart from that, the foreign exchange management regulations are crucial in managing financial risks and improving efficiency in currency trading. Different countries are managing their forex market through these regulations. Further, technology adoption has highly boosted the growth of the forex market and it is identified that most of the currencies trade by USD. This is highly beneficial for strengthening the economic stability of the USA.

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