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Forex trading demystified - part 2 of 6

Last week, we acquainted ourselves with the nitty gritty of the forex markets and the nuts and bolts of the trade - the contract size, the tick price and the expiry mechanisms. This week, we progress to the triggers that set the directions of the forex markets and how you can read them, interpret them and finally profit from them.

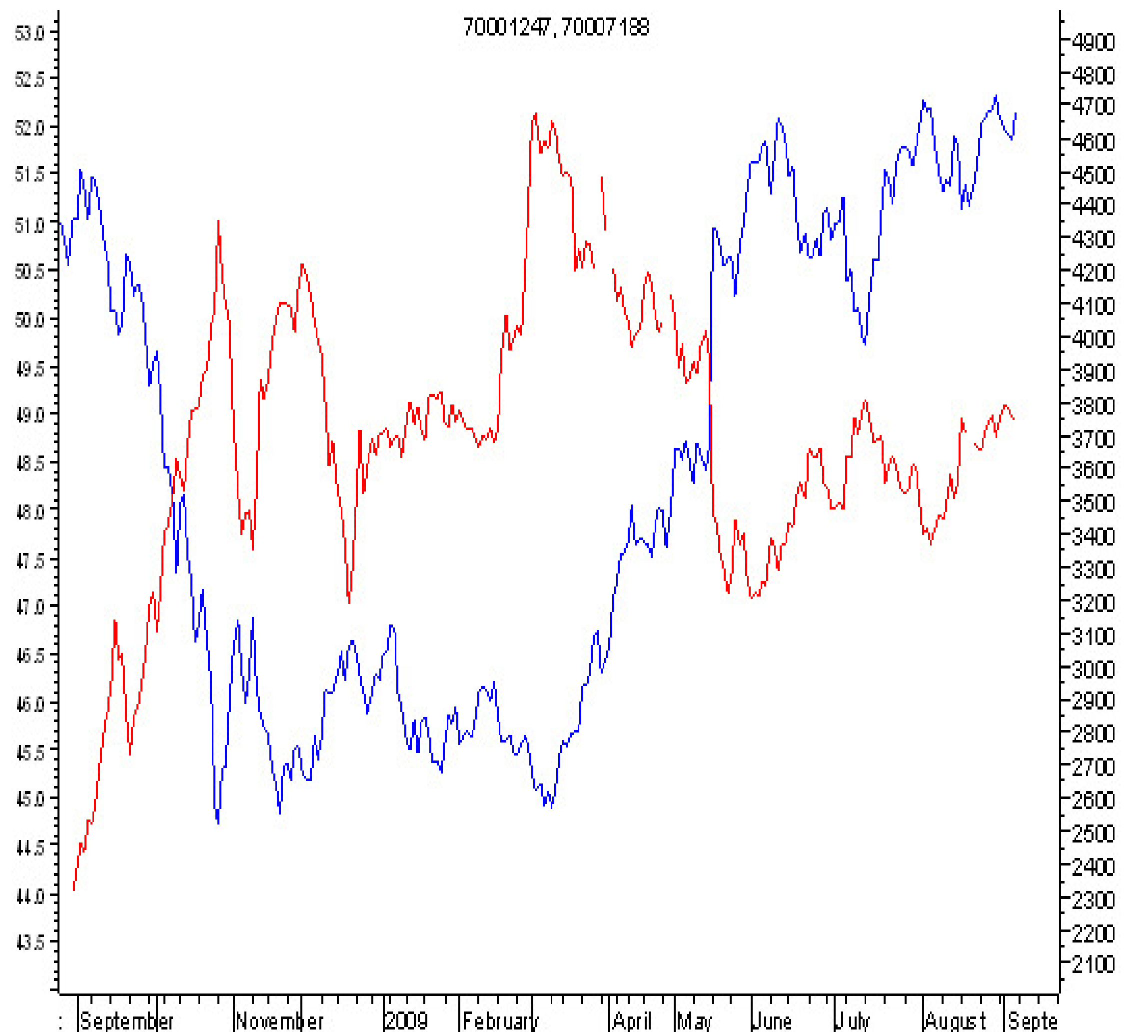
1) **Economic data** - national currencies are swayed by the announcements by central banks, regulators, governments and allied powers that may impact the GNP, GDP, Inflows and FDI into the country. For example, the US govt releases unemployment data, housing data, non-farm payroll data, balance of trade data regularly. If the data is favourable for the USA, the currency (USD) strengthens and vice versa. In the Indian context, the interest rate announcements in the quarterly credit report is keenly awaited by the forex markets. Monsoons play a large part in the price discovery process in the June - Sept quarter as our economy still depends heavily on agriculture for growth and sustainence. Ever since the govt has announced a drought like situation, the INR has weakened vis-a-vis the international currency basket.

2) **Act of God** - any natural calamity of vast magnitude adversely impacts the national currency. Traders will recount how the Tsunami impacted the INR adversely and sent the Rupee plumbing lower vis-a-vis the US greenback.

3) **Act of war** - history is replete with examples of strife situations sending the affected nations' currencies plummeting downwards. Examples are the Saudi Arabian Rial, Kuwaiti and Iraqi Dinars during the two gulf wars. The USD falling immediately after the WTC 9/11 attacks, the INR post the 26/11 attacks, the UK pound sterling after the London bombings. These spikes are temporary in nature and provide just about enough volatility for the risk taking traders to make quick and clear profits.

4) **Stock market performance** - in my opinion, this is the most watched, followed and easy "indicator" for the forex trader. Note how the rising benchmark indices buoy the INR and vice versa. To prove my point, look at the enclosed graphic which shows the Nifty as a blue line and the USD as a red line. Note how the USD weakens (implying Rupee strengthens) when the Nifty 50 rallies and vice versa. Forex traders often have home grown trading "setups" which they formulate from their personal experiences in the markets, based on these very parameters. Some of them are - go short on the USD if and when the Nifty rallies for 2 days or more in a row. Go short on the USD if the Nifty hits a new 3 / 6 monthly high. Go long on the USD if the Nifty falls or 2-3 days in a row.

The permutations and combinations are virtually endless. Remember that stock market indices are barometers of economic strength of the country whereas the currency is the index of the country as a whole. Therefore the prospects of both are deeply connected with each other. If you can reliably forecast the direction of the equity markets, you can play the forex markets fairly accurately as well. We will understand this issue in greater detail in the near future



to be concluded ......

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The columnist is the author of the book "A Traders Guide to Indian Commodity Markets" and invites feedback at vijay@BSPLindia.com or (022) 23438482.

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