Microstructures in Indian foreign exchange market

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At the outset, the present study questions the relevance of macroeconomic models in exchange rate determination. Alternatively, the study examines the relevance of market microstructure theory in the foreign exchange market. In doing so, it examines the impact of micro variable, namely information (both private and public information), on the changes in exchange rate in the short-run. Based on the high frequency data for Indian rupee/ US dollar exchange rate for the month of August 1999(source: Olsen & Associates), and with the help of simple OLS and GARCH-M models, the study concludes that public information does not have much significant impact on the rates in the short run. Further, the study, interestingly, finds that private information (order flow) has significant impact on the exchange rate. The study also examines the macro-micro nexus in the exchange rate determination. It has found that micro variables (order flow and the number transactions) are more important than the macro variables (interest rates) in studying the short-term changes in the Indian foreign exchange market outcomes.

Further, to substantiate the above results, the researcher has undertaken a primary survey, with the help of structured mailed questionnaire, on the Indian foreign exchange dealers to understand the short-run dynamics of the market. The sample of the study is 84 dealers (22% of the total dealers). The initial analyses from the primary survey corroborates to the findings of the secondary data analysis. That is, the majority of the dealers feel that short-term changes in Indian Rupee/US dollar market is basically influenced by the micro variables like market movement, Central Bank intervention etc.. Also majority of dealers feel that exchange rate movements reflects changes in macroeconomic fundamentals only in the long-run.

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