The non-deliverable forward (NDF) market

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In news– The Reserve Bank of India, seeking to arrest the rupee's slide, is asking local banks to not build additional positions in the non-deliverable forward market, a move that could lead to offshore volatility spilling into local markets, bankers.

What is non-deliverable forward market?

- An NDF is a short-term, **cash-settled forwards contract that investors use to trade in currencies in an offshore market**.
- The two involved parties create a settlement between the contracted NDF rate and the leading spot price when both parties agree on a notional amount.
- NDFs in the non-deliverable forward market are always settled in cash and are non-deliverable, meaning the trader can not take the delivery of the currencies.
- The largest NDF markets are in the Chinese yuan, Indian rupee, South Korean won, New Taiwan dollar, and Brazilian real.
- Much like a Forward Contract, a NDF lets one lock in an exchange rate for a period of time.
- However, instead of delivering the currency at the end of the contract, the difference between the NDF rate and the fixing rate is settled in cash between the two parties.
- **A NDF is usually executed offshore, meaning outside the home market of the illiquid or untraded currency**.

How does a Non-deliverable Forward market work in India?

- The non-deliverable forwards market **works with the exchange of cash flows between the two parties based on**

the NDF price and the prevailing spot price. In the transaction, one party agrees to settle the contract by paying the other party the difference resulting from the exchange.

- These contracts are OTC (over-the-counter) and are usually settled in the offshore currency market.
- For example, if a currency is restricted to be traded outside the country, it becomes impossible to settle trade with someone who is outside the country.
- In this case, the parties use NDFs within the non-deliverable forward market that converts all the profits and losses to a freely traded currency in both countries.

What are Forward Contracts?

- A forward contract, also known as forwards, is a private agreement between two parties to purchase or sell the underlying asset at a predetermined time at a specific price.
- Any forward contract is subject to both market risk and credit risk.