# Financial Derivatives

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# **Answer 1**

The exchange rate is affected by a large number of macroeconomic variables such as inflation and changes in interest rates (Venkatesan & M.S.Ponnamma, 2017). Inflation has a negative impact on the exchange rate of a currency which means that an increase in inflation affects the currency of the country in which price level has risen. This relationship is a one-way relationship which means that a decrease in inflation does not necessarily improve the exchange rate. If the country is facing current account deficit, its exchange rate will be negatively affected and this variable has a two-way effect on the exchange rate which means that both increase and decrease in the current account deficit will have an impact on the exchange rate of any country. Some other complex relationships need to be studied to know the macroeconomic factors affecting the exchange rates for any country. Interest rates cause the savings to change, which in turn affect the current account deficit (Maurya, 2017).

# **Answer 2**

Futures, forwards, and options are all types of derivatives having different characteristics. Forward and futures contracts are made to make the delivery of assets on some future dates. These assets can be some items of daily use or some specialized financial instruments. These derivatives have their specialized markets for trading, also called the standardized markets. Futures and forwards imply obligations on both the buyer and seller while in case of options, only the sellers have the obligations to fulfill. The buyers in options have the rights but no obligation to acquire some position related to the underlying asset. The uses for all kinds of derivatives are similar to each other (Wolf, 1987). They are all used to speculate some future events, hedge against some specific risk, and to shift between the spot and futures markets (Lyuu, 2001).

# **References**

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