BOOK REVIEW

Name of the Book: Foreign Exchange Concepts and Arithmetic Explained: Fundamentals of Forex Made Easy to Understand

Author: Mr. Sugata Datta

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Mark Douglas, a highly respected author and a pioneer in trading psychology once said that "No man ever reached to excellence in any one art or profession without having passed through the slow and painful process of study and preparation." How so true!

The fascinating and somewhat enigmatic and at the same time glamorous world of foreign exchange, largely existing in an invisible way, is difficult to fathom. Foreign exchange (Forex or FX) plays the most important role in international trade. One can imagine its importance from the fact that every day approximately USD 10 trillion is traded on forex market globally.

Forex market as seen today has evolved from an ancient barter system. What started as bartering one item for another evolved into Gold Standard when nations engaged in trade pegged value of national currencies to physical gold. Come 1944, amidst dark clouds of Second World War, Bretton Woods agreement was reached by major nations of the world and agreed to peg their currencies to United States Dollars (USD), replacing the Sterling Pound of Great Britain. Please note that the USD was fully backed by gold. But 1973 witnessed delinking of USD from gold and currencies; including USD, moved to free-floating exchange rate system where demand and supply of currencies determined their exchange rates.

And with this – free floating exchange rates – introduced. How to determine value of one country's currency against another country's currency? Apart from economic laws of demand and supply, variety of factors are at work, which are not so easy to comprehend. It requires some study and preparation.

To navigate the complex world of forex, one needs a sound grasp of not only theoretical aspects of forex but also arithmetic behind the exchange rate mechanism. The book "Foreign Exchange Concepts and Arithmetic Explained: Fundamentals of Forex – Made Easy to Understand" authored by Shri Sugata Datta, talked about the world of foreign exchange. The book is an essential guide to understand and to appreciate various nuances of foreign exchange in general and arithmetic in particular. This book demystifies various concepts of foreign exchange and explains in detail the forex arithmetic to arrive at exchange rates for different types of transactions in a lucid way. Shri Datta's experience of more than three decades is distilled in the contents and flow of these concepts in the book.

By the very nature, forex touches all walks of life and is a matter of concern to all, irrespective of whether one is engaged in international trade or investments or remittances. Take for example, a roadside tea-stall owner in a rural place: he does not have direct exposure to forex market. Yet, he too is affected, directly or indirectly, when prices of fuel go up or when export of sugar is liberalized or export of tea from the country touches record highs. All these – price of fuel,

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export and import of raw materials like sugar and tea - affect the tea-stall owner, though he has no direct exposure to forex market, one way or the other.

As noted above, understanding forex is quite complex to ordinary people. Many practitioners describe forex as commodity. But they fail to drill down the concept in the minds of people. This book addresses various technical aspects in a simplified language supported by examples and flowcharts.

Spread across 18 chapters, the book starts with an introduction that sets the objective: Explain. This one word – Explain – is lived through the book.

First five chapters of the book are devoted to explaining basics and certain technical aspects of forex. Chapters are arranged such that each chapter while having a link to the previous chapter, can be read in isolation also.

Chapters 1 to 5 successfully build the necessary understanding of various shades of foreign exchange. Later chapters built on these put them into action to describe and explain how foreign exchange rates are arrived at.

The first chapter sets the tone of the book; second chapter elaborates on not only what is domestic currency and foreign currency; and also brings out differences between currency and money. Currency of one nation cannot be money in another country as money necessarily has to have the attribute of medium of exchange apart from medium of store of value. Money can be used to purchase goods and/or services in exchange. For example, INR is currency and plays the role of money in India where INR can be used to purchase goods and services. However, INR cannot function as money outside India, though it will always be called currency of India. After explaining what foreign exchange is, the chapter also addresses the question: why do we need foreign exchange.

The third chapter takes the readers to a higher level when it unravels subtleties of foreign exchange rates, cross-currency rates and factors affecting forex rates. The fourth chapter clarifies the characteristics of forex market. Chapter five explains the commodity nature of forex in the most intelligible fashion. A complex matter explained such that readers are left with no confusion any longer.

Chapter 6 and onwards focuses on foreign exchange arithmetic, the second titular part.

Chapter 6 introduces readers to the world of foreign exchange quotations; like direct and indirect quotes, concept of market maker and market taker, spreads between buying and selling rates and factors affecting such spreads, forex maxims, e.g. Buy Low/Sell High and vice versa in direct and indirect quotations.

Chapter 7 on calculation of merchant rates is interesting and will appeal to users of the forex market – bank customers in general and exporters/importers in particular. This chapter deals with what is called Merchant Rates and how they are calculated. Merchant Rates are foreign exchange rates quoted by a bank to its customer – be him an exporter or importer or even for inward or outward clean remittances. The chapter details how different types of merchant rates are calculated and more importantly, why profit margins are required by banks to mitigate risks in foreign exchange market. I am pretty sure once reasons for why profit margin is required for banks is understood and imbibed by the readers, there will be no friction between the banks and the customers.

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Having explained basic concepts of exchange rates in Chapters 6 and 7, author introduces the readers to the mechanics of cross rates and explains what and why of cross rates and calculation of cross rates in Chapter 8.

Chapter 9 throws light on what is nostro account, vostro account and loro account. All these terms are explained with simple to follow examples, making it easy for readers to grasp the differences between these three types of forex accounts.

Chapter 10 delves into the idea of value dates like cash, tomorrow (tom) and spot as well as difference between business day and working day. Important concepts to comprehend before one venture in Chapter 11 which deals with nuances of forward rates and forward margins. This chapter describes what are forward rates, why are they different from spot rates and how forward rates are calculated from spot rates.

Chapter 12 complements Chapter 11 by explaining convention of quoting forex margins.

Chapter 13 focuses on various types of forex rates such as Telegraphic Transfer (TT) Buying or TT Selling or Bill Buying; including sight bills and usance bills or bill selling and also explains concept of normal transit period, whereas Chapter 14 deals with cross-currency forward rates.

Chapters 15 to 18 deal with technical aspects of forex rates like forward contracts, early delivery, cancellation and extension.

Chapter 15 clarifies concepts about forward contracts. Once what is forward contracts is understood, reader is taken to next level of early delivery of forex in Chapter 16. This chapter details early delivery, mechanisms and mechanics of early delivery and rules for early delivery.

Chapters 17 and 18 reveal the fascinating mathematics and logic for cancellation and/or extension of forex contracts. These two chapters explain what cancellation/extension is, discuss various scenarios like cancellation on due date or prior to due date, passing on profit/loss to customers, etc. Concepts like cancellation and extension of forward contacts are described in easy language with plenty of examples and flowcharts.

Each concept of foreign exchange and rate mechanism like two-way quotes, advanced Normal Transit Period (NTP), forward rates, forward margins, swaps, premium, discount, extension, cancellation, is covered in the book. Each concept is explained in a lucid and jargon-free language and lot of examples.

Exporters and importers, who regularly use banks' foreign exchange services, will find chapters on forward contracts, early delivery, extension and cancellation of forward contracts more interesting. Because these are the situations happening in real life so often and customers are at times intrigued by why and how banks quote rates in such situations.

Throughout the book, all chapters carry extensive number of examples to explain various concepts and/or calculations. Flowcharts complement examples and make it easier to comprehend various forex concepts and logic behind forex arithmetic.

Every question regarding forex that may arise in the mind of an ordinary person, who unbeknownst to him is an indirect participant in forex market; is answered in an easy-to-understand, jargon-free language with plenty of examples. To reinforce reading and understanding, exercises are included at the end of each chapter.

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Readers will find that examples are solved step-by-step, with detailed explanations as to why a particular rate is chosen. For example, while discussing bill buying rate for sight bills, the topic not only covers what is bill buying but also what is sight bills, what is usance bills, how to account for NTP while purchasing a sight bill and why, how and what amount of premium will be added to the spot rates is explained in great detail, in plain English. This way, readers not only identify with the example or problem but also are able to appreciate the mechanism or logic for banks quoting certain rates in certain circumstances.

This book is an essential guide for beginners and professionals alike. This book bridges the gap between academic theory and real-world market operations with clarity and precision.

What sets this book apart is its methodical approach to forex arithmetic. The book deconstructs highly complex mathematical calculations step-by-step, cementing the logic behind each step. The book covers topics like, direct and indirect quotes and bid-ask spreads, forward rate calculations, premium and discount computations, calculation of cross-currency rates, step-by-step calculation of TT buying/selling and Bill buying/selling rates, margins, NTP, cancellation or extension or early delivery of forward sale/purchase contracts and how to calculate profit or loss on such cancellation/extension/early delivery, etc.

This book succeeds at its principal aim: to explain and to clear the mystery surrounding how forex rates are arrived at and quoted to the users. This book will prove extremely useful to both seasoned treasury professionals, for quick reference and explanation to customers in a language that the customers understand and to beginners; to assimilate fundamentals of forex and various concepts under forex.

This book offers both – conceptual clarity and confidence in calculation of rates. Readers are taken through a journey at the end of which one finds truly enlightened. Learners as well as advanced practitioners will find the contents of the book demystifies various nuances of forex such that forex no longer remains enigmatic.

Before I conclude, I must mention that this book is a masterfully written book by an industry veteran Shri Sugata Datta; who is an uncontested authority on forex matters. The book is successful at simplifying concepts as well as arithmetic of forex without compromising on the essentials.

Like the famous Warrant Buffett once said in the context of equity market – You don't need to be rocket scientist. It is equally applicable to forex market also. You do not need to be a rocket scientist to understand various aspects of forex and forex arithmetic. This book demystifies the otherwise intimidating and mystic, enigmatic world of foreign exchange. This book will surely prove a useful resource to all practitioners as well as students of the forex.