

FOREX Asian Option

A FOREX Asian option or Asian currency option is a special type of option contract where the payoff depends on the average of the underlying exchange rates over a certain period of time. The payoff is different from the case of a European option or American option, where the payoff of the option contract depends on the underlying FOREX rate at exercise date.

Asian FOREX options allow the buyer to purchase or sell the underlying foreign exchange rate at the average rate instead of the spot rate. Asian options are commonly seen options over the OTC markets. Average rate options are less expensive than regular options and are arguably more appropriate than regular options for meeting some of investment needs. Average can be calculated in a number of ways (daily, weekly, monthly, etc.).

One advantage of Asian options is that they reduce the risk of market manipulation of the underlying instrument at maturity. Another advantage of Asian options involves the relative cost of Asian options compared to European or American options. Because of the averaging feature, Asian options reduce the volatility inherent in the option; therefore, Asian options are typically cheaper than European or American options.

Asian options have relatively low volatility due to the averaging mechanism. They are used by traders who are exposed to the underlying asset over a period of time. The arithmetic average rate options are generally used to smooth out the impact from high volatility periods or prevent rate manipulation near the maturity date, which makes the options less expensive.

Currency options are one of the most common ways for corporations, individuals or financial institutions to hedge against adverse movements in exchange rates. Corporations primarily use FOREX options to hedge uncertain future cash flows in a foreign currency. The general rule is to hedge certain foreign currency cash flows with forwards, and uncertain foreign cash flows with options.

Options give market participants many opportunities to limit risk and increase profit. Currency market fluctuations can have a lasting impact on cash flow whether it is buying a property, paying salaries, making an investment or settling invoices. By utilizing FOREX Asian Options, business can protect themselves against adverse movements in exchange rates.

Reference:

<https://finpricing.com/lib/EqLookback.html>