

## Forex option

A forex option is a contract that gives the buyer the right, but not the obligation, to buy or sell a certain currency at a specified exchange rate on or before a specified date. Forex options are one of the most common ways for corporations, individuals or financial institutions to hedge against adverse movements in exchange rates.

A forex option is a derivative contract that grants the buyer the right but not the obligation to exchange money denominated in one currency into another currency at a pre-agreed exchange rate on a specified future date. The FOREX options market is the deepest, largest and most liquid market for options of any kind. Most FOREX derivatives trading is over the counter (OTC) and is lightly regulated.

There are call options and put options. Also a forex option could be European style or American style. Call options provide the holder the right but not the obligation to purchase an underlying currency at a specified FOREX rate on a future date, while Put options give the holder the right to sell an underlying currency at a specified FOREX rate on a future date. A European option can be exercised only at the expiration date of the option, whereas an American option can be exercised anytime during its life.

FOREX options contain Vanilla FOREX option and Listed FOREX option. Although both have similar characteristics, they differ mainly in two respects: First, Vanilla options are traded OTC while Listed options are exchanged-traded. Secondly, the underlying of Vanilla options is FOREX spot while the one of Listed options is FOREX future. Nevertheless, their analytics are very similar.

Forex 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. Investors buy calls when they think the FOREX rate will rise or sell a call if they think it will fall. Selling an option is also referred to as "writing" an option. On the other hand, they buy puts if they think the FOREX rate will fall, or sell one if they think it will rise.

One of the most common reasons for using FOREX options is for short-term hedges of spot FOREX or foreign market positions. Unlike a forward contract that locks in the FOREX rate for a future transaction, FOREX options allow the investors to benefit from favorable FOREX rate movements. 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 Options, business can protect themselves against adverse movements in exchange rates.

FOREX Options are also useful tools which can be easily combined with Spot and Forward contracts to create bespoke hedging strategies. There are many bullish, bearish and even neutral strategies that can be implemented with options contracts. Spread strategies that are used in equity options can also be used with FOREX options, including vertical spreads, straddles, condors and butterflies.

Reference:

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