

ABSTRACT

In this thesis, we have conducted study on carry trade with Indian Rupees as base currency. We have chosen eleven currencies for this study: currencies of United States of America (USD), United Kingdom (GBP), Europe (Euro) and Japan (JPY), Australia (AUD) and New Zealand (NZD) selected from developed economies and currencies of China (CNY), Hong Kong (HKD), Russia (RBL), Brazil (BRL) and Singapore (SGD) from developing economies. There are various studies on characteristics of carry trade. We have conducted study on characteristics of carry trade between Indian rupees and these eleven currencies. The characteristics of carry trade included in this study are: skewness, kurtosis, standard deviation, mean, long run memory and persistence. Then in this study, we have tried to find the relationship of carry trade returns with other asset class: equity return, bond return, commodity returns. For this study we have employed the VAR analysis and we find that equity has positive relationship with carry trade return; bond has insignificant relationship, commodity returns have mixed relationship with carry trade returns. We find dynamic relation of carry trade returns with returns of these asset classes. Further, we have delved into the question which macro or financial factors can give the indication of carry trade returns. Along with finding the relevant factors we have also tried to find the efficient method. We have included interest rate difference, volatility in equity market, exchange rate volatility, interest rate difference volatility, liquidity in foreign exchange market and commodity index. Ordinary least square, multi variate adaptive regression spline and ARIMAX have been used for analysis. Results are mixed for different variables with different methods. Lastly, we have studied the formation of portfolio in carry trade. We have employed interior point method and Non –dominant sorting genetic algorithm II for this study and we have found three major sub-periods

in period of study using the structural breaks in the returns of equity. We have used four objective functions including weighted sum of risk and return, utility maximization, diversification ratio and Rao's quadratic entropy. We find that the interior point method is efficient and weighted sum of risk and return is the most efficient objective function.

Keywords: carry trade; emerging market; characteristics, determinant of carry trade; portfolio of carry trade.