

Exploring Forex Carry Trade Strategies: Maximizing Profit Through Interest Rate Differentials



If you've traded any type of CFDs, you're likely familiar with the Forex carry trade strategy. While widespread low-interest rates make it more challenging to profit from this strategy at present, it has been a popular method of generating income for many years. By utilizing the carry trade strategy, you aim to benefit from the varying interest rates offered by each currency. As we discuss in this post, to employ the carry trade strategy, you must consider both advantages and disadvantages.

Understanding Forex Carry Trade

The fundamental principle behind the carry trade strategy involves purchasing a high-interest currency in comparison to a low-interest currency. The variation in interest rates is subsequently paid to you by your broker. Interest payments are generally made on a daily basis with a triple payment on Wednesday to cover the weekend period. For example, if the EURO has a 3% interest rate, and the USD has a 1% interest rate, you may consider purchasing the EURUSD, and your broker will pay you the 2% difference in interest rates.

The popularity of carry trades stems from the high interest rates that many currencies have offered over the years, which enabled profitable carry trades that could be further amplified with the use of leverage. In the past, the Australian Dollar and New Zealand dollar were the most commonly traded currencies for the carry trade due to their higher interest rates. However, at present, it is more challenging to make a profit from the carry trade strategy because of falling interest rates worldwide across major economies.

Major Central Banks Overview

Central Banks	Current Interest Rate	Next Meeting	Last Change
Reserve Bank of Australia	0.100 %	4-6-2021 - 04:30	11-3-2020 - 03:30
Federal Reserve	0.250 %	4-28-2021 - 18:00	3-15-2020 - 21:00
Swiss National Bank	-0.750 %	3-25-2021 - 08:30	1-15-2015 - 09:30
European Central Bank	0.000 %	4-22-2021 - 11:45	3-10-2016 - 12:45
Bank of Japan	-0.100 %	4-27-2021 - 03:00	1-29-2016 - 03:00
Reserve Bank of New Zealand	0.250 %	4-14-2021 - 01:00	3-15-2020 - 19:00
Bank of Canada	0.250 %	4-21-2021 - 14:00	3-27-2020 - 13:00
Bank of England	0.100 %	5-6-2021 - 11:00	3-19-2020 - 14:30

Advantages of Carry Trading

The carry trade strategy tends to perform exceptionally well when a particular currency's central bank raises its interest rates. In this scenario, you can benefit from both higher interest payments and the appreciation of the currency's value as more traders look to purchase it for carry trades. As the demand for the currency increases, the price is likely to surge, and you can also profit from the capital gain on your trade. Consequently, currencies often experience strong upward price movements when their central banks increase interest rates.

Assessing Risks Associated with Carry Trading

Although earning interest on a trade can be a straightforward approach to generating profits, there are several risks that can undermine the effectiveness of the carry trade strategy.

Impact of Interest Rate Changes

The profitability of carry trades is heavily reliant on the interest rates provided by each currency. If a currency with high-interest rates experiences a reduction in its interest rates, the carry trade will become less lucrative. This could result in traders exiting their carry trades and moving into other positions that offer higher yields. Therefore, it is crucial to monitor interest rate levels and any factors that could potentially impact them in the near future.

Possibility of Price Moving Against You

When a currency's interest rates continue to rise, it usually attracts more traders and strengthens the currency. This scenario can provide a profitable situation where you can benefit from the interest rate differential and capital gains.

However, there is a downside to this strategy, which is when the price of the currency moves against you. In this case, potential losses from the unfavorable price movement may outweigh any profits earned from the interest rate differential.

Identifying the Optimal Currency Pairs for Carry Trading

Keeping abreast of current interest rates and identifying the currency trades that offer the highest yields is vital to a profitable carry trade strategy. The following chart displays interest rates and average yields for each currency.

It's worth noting that different brokers offer varying yields for each currency, so it's essential to choose a broker carefully when utilizing the carry trade. The most promising pairs for carry trading are those with higher interest rates, but they are typically associated with smaller currencies that are more prone to price volatility.

Carry Trade		Broker Average		Highest Yield		Daily Income
USDCHF	Long	0.18%	1.09%	Alpari	0.48%	\$1.31
AUDCHF	Long	0.13%	1.05%	Alpari	0.50%	\$0.98
NZDCHF	Long	0.06%	1.33%	AAAFX	0.47%	\$0.85
GBPCHF	Long	0.00%	1.03%	Alpari	0.30%	\$1.12
EURUSD	Short	-0.04%	0.89%	AAAFX	0.35%	\$1.13
EURNZD	Short	-0.14%	1.07%	AAAFX	0.35%	\$1.15
CADCHF	Long	-0.14%	1.26%	SIMPLEFX	0.55%	\$1.13
EURCAD	Short	-0.15%	1.00%	SIMPLEFX	0.33%	\$1.07
EURAUD	Short	-0.21%	1.00%	AAAFX	0.34%	\$1.11
EURGBP	Short	-0.24%	0.89%	AAAFX	0.29%	\$0.94

Leveraging a Carry Trade Calculator

One of the simplest ways to determine whether a carry trade may be profitable is by using a carry trade calculator. The provided image displays a carry trade calculator that can be used to calculate potential gains or losses. Once you have chosen your currency pair, specified whether you are going long or short, and entered the relevant interest rate levels, the calculator will provide an estimate of the amount you could potentially earn or lose with the carry trade.

Carry Trade Calculator f t e

Account Currency:

Currency Pair:

Action: Buy/Long Sell/Short

Lend Rate (%):

Borrow Rate (%):

Trade size:

Days Held:

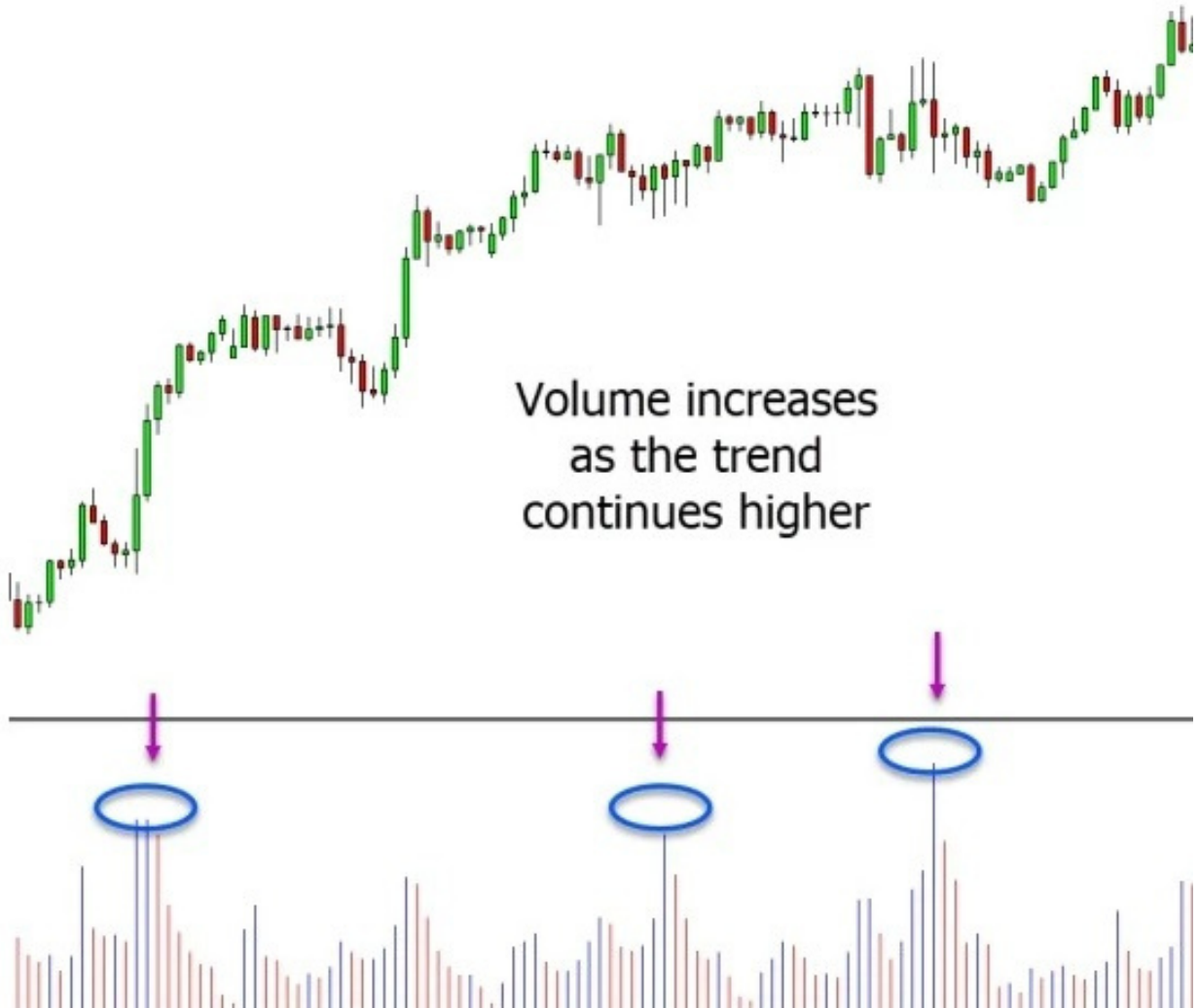
➔ Calculate

Interest Earned (USD)	Standard Lot	Mini Lot



Volume Spike in a Trend

It is essential to monitor volume levels as prices fluctuate during a day or session. In a robust trend, volume levels tend to spike continually as the trend gains momentum, regardless of whether it's an uptrend or downtrend. For instance, if the price is in an upward trend, traders should observe the volume levels, which are likely to increase as the trend progresses higher, as depicted in the example below.



Volume Trading Strategy for Intraday

Numerous volume indicators are utilized in daily charts, yet certain indicators excel at revealing intraday spikes or declines in volume.

Best Volume Indicator for Intraday

Joseph Granville developed the on balance volume indicator in the 1960s. This indicator calculates higher and lower volume levels to aid in identifying breakouts or fadeouts accurately. It is useful in gaining insight into the actions of significant market players during each session. This indicator adds an oscillator that fluctuates up and down to your chart and is readily available in the indicators section of Meta Trader charts.

The underlying concept of this indicator is that volume information typically precedes price movements. Primarily, on balance volume is utilized to detect significant spikes in volume when prices fail to make corresponding large movements, providing clues as to where prices may head next. Typically, major market participants prefer to enter the market when volume levels are low to obtain the best prices, and increased volume may signify an upcoming move.