Journal 1 — 20-04-2025

**How Do Foreign Currency Exchange and Forex Markets Work?**

Before focusing on our main topic I tried to understand the basic and foundational concepts in our project question.

For example:
- What is an exchange rate ?
- What is the forex market ?
- How do they relate to each other?

After getting a clear idea about these concepts, I started to delve deeper into the topic.

**Exchange rate**

It is a rate at which one nation's currency will be exchanged for another nation's currency. It is the value of a nation's currency when it is traded with another currency and affects trade and the moment of money between countries.

For example : 1 USD = 86 INR , it means we need 86 indian rupees to buy 1 US dollars

- Two types of exchange rates:

- Fixed exchange rate : Set and fixed to the value of specific countries's currency, controlled by the government.

- Floating exchange rate : Set by the market forces their values rise or fall based on supply and demand in foreign exchange market.

**Forex market**

It is a market where banks and individuals buy, sell, or exchange currencies. This is the largest financial market in the world where its daily trading is $7.5 trillion. Tourists, business, investors, traders, central banks and governments are the major participants in the forex market.

- Understanding the Forex Market

The forex market is not dominated by any single market exchange, but it involves a global network from worldwide. It acts as a market maker; it also allows you to post bids and ask for a currency pair which differs from many bids in the market.

The forex market is an over-the-counter (OTC) market. This means that the trading in this market happens without a single centralized exchange. With the support of brokers the currencies move between those who are trading. There exists a substantial amount of interbank forex trading, which helps determine swings in exchange rates. Large banks trade currencies to hedge, adjust balance sheets, and to trade on behalf of clients.

- Forex currency pairs

Exchange rate between two currencies which indicates how much of the quoted currency is needed to buy one unit of the base currency is a currency pair.

For example : currency pair - EUR/USD pair, here the euro is the base currency, and the U.S. dollar is the quote currency. If the exchange rate of EUR/USD pairs is 1.12, it means that one euro can be exchanged for 1.20 U.S. dollars.

**Relationship between Exchange Rate and Forex Market**

- The exchange rate is determined by the forex market for currencies when they are allowed to float freely.
- The supply and demand in the forex market determines the result of exchange rate
- When the demand of currency increases in the forex market, its value will rise and the exchange rate will also go up.
- When demand falls or supply increases the value of currency will go down, hence the exchange rate falls.