

Title:

Foreign currency trading

Word Count:

625

Summary:

Foreign currency trading is done in a foreign exchange market where one type of currency is exchanged or traded for another type of currency.

Keywords:

currency trading, FOREX trading, exchange market

Article Body:

Foreign currency trading is done in a foreign exchange market where one type of currency is exchanged or traded for another type of currency. Currency trading is regarded as the largest financial market in the world. Players participating in currency trading within a FOREX market are the large banks like Citibank and Deutsche bank, nationalized and government banks, multinational firms, financial institutions and investment companies. The daily volume of the present global forex market is around US \$3 trillion. Given the huge size and high liquidity of the markets worldwide, small players cannot easily do trading in a FOREX market.

Trading within a market is done in levels, where a player in a level doesn't have access to other levels. The top level is the inter-bank market comprised of large banks like Deutsche bank, Citibank, Union bank of Switzerland and other banks across the world. The top ten players sweep off 70% of the total business done in the FOREX trading. In the top level, the difference between the bid and ask price known as Spread is very minute and is not available to other circles outside. As the levels descend, the difference increases mainly due to the volumes traded. Level of access for a player is determined by the 'line', the money with which one is trading. Currency trading has almost doubled today since 2001 mainly because of the recognition of FOREX trading as an investment and asset class and also an increase in the fund management assets of pension funds and hedge funds.

Commercial companies do currency trading mainly to pay their customers for their good or services and trade in small amounts compared to large banks. Investment management companies do trading to manage the pension or endowment or investment portfolio of their customers and are usually in large amounts, because they have to invest in foreign equities for which they need to exchange currency to buy

those equities.

Let us see the typical characteristics of a FOREX currency trading. Due to the over-the-counter nature, the currency markets doesn't trade in a single dollar or a euro rate, but rather a different number of rate applicable only to that particular market. There is no central house or hub or exchange or clearing house as traders deal directly with each due to this OTC nature. Usually these rates are close to each other; otherwise special traders called arbitrageurs take advantage of the difference in the rates and make huge profits out of it. Main trading centers across the world are in London, New york, Tokyo and Singapore. As the time zones differ, trading is done almost 24 hours a day. Fluctuations in the rate occur due to changes in the inflation, interest rates of banks, GDP growth, trade deficits and surpluses, cross-border M&A deals, economic situations, financial health and some other macro economic conditions.

Currencies are traded for each other and each pair of currencies is a separate and unique product and usually denoted by XXX/YYY. During creation, the XXX is known as base currency is the strongest and YYY the weakest. Today the US dollar is in almost 88% of the transactions followed by Euro (37%) and yen. The most traded pairs are Euro/US dollar, US dollar/Yen and GB pound/US dollar.

Trading is done through different kinds of instruments like derivatives, spot transactions, forward transactions, options and futures, swaps and exchange-traded funds. Currency speculation is done by speculators who do an important job of transferring the risk from those who can't bear to those who can bear it. Speculators always face controversies due to the risk they take up. Currency trading is affected by some factors like economic and financial situations, political scenarios, and other psychological issues related to the markets.