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FX Market

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What is the FX Market?

The Foreign Exchange, or FX, market is a particular type of financial market which enables world's currencies to be exchanged across numerous participants. With an estimated daily value of transactions close to $7 trillion [(1)], the FX market is the largest financial market globally, presenting the highest amount of liquidity and volume of transactions being traded every day.

Notably, unlike other conventional financial markets (Equity, Fixed Income, Commodity), the FX market operates 24 hours per day, 5 days a week. In turn, this enables people across continents and time zones to be involved in one of the most common activities undertaken in this kind of market: buying and/or selling currencies for a profit (speculation).

Who is involved in the FX Market?

The Foreign Exchange market is made up of several different participants which, collectively, can cause price fluctuations in the underlying assets through the act of buying and selling currencies in large volumes.

The most crucial and influential market participants are central banks (Bank of England, US Federal Reserve, European Central Bank, Bank of Japan, etc.), investment banks (J.P. Morgan, Citibank, Deutsche Bank etc.) and hedge funds (Bridgewater Associates, Pershing Square etc.). Respectively, each of these entities plays a unique role and has different priorities, with central banks being responsible for issuing the currency of their nation and ensuring price stability, whereas commercial banks operate on behalf of their customers to fulfil their speculative requests.

Beyond institutional players, the FX market is also comprised of other, less powerful participants such as smaller corporations, brokers, and retail traders. Recent years have witnessed an exponential influx of the latter category of market participants (retail traders) due to the increase of online investment platforms and discount brokers which have significantly lowered barriers to entry. Today, anyone with a smartphone and an internet connection can have access to and operate in the FX market from anywhere in the world – whether this enhances or undermines the perception of the FX market is up for debate.

What is a FX pair?

When two currencies are traded against each other a Forex pair is formed, and the value expressed represents how many units of the second currency (quote currency) are needed to buy one unit of the first currency (base currency). For example, considering the exchange rate between the Euro and the US Dollar (EUR/USD) to be 1.1726, this would mean that $1.1726 are needed to purchase €1, hence indicating that the Euro is a stronger currency when compared to the US Dollar. Similarly, the current EUR/GBP rate of 0.8594 would indicate that less than one whole unit of Sterling is needed to purchase €1, suggesting that GBP > EUR.

Technical vs. Fundamental Analysis

A long-standing debate amongst market participants exists about which is the best strategy and approach to employ in order to interpret, analyse and predict future price fluctuations. Broadly, two main schools of thought can be identified which are based upon technical analysis and fundamental analysis respectively.

Each of these two philosophies find their roots in the belief that future market movements can indeed be anticipated. While technical analysts argue that such movements can be forecasted using chart patterns, price action, trend-lines and several other tools, fundamental analysts focus instead on macro-economic data such as inflation, GDP, interest rates etc. Below is an example of how each respective party would operate [2].

Technical Analysis

Fundamental Analysis

	EXPECTATIONS	EFFECT ON CURRENCY
Gross Domestic Product (GDP)	Better than expected	Positive
Consumer Price Inflation (CPI)	Better than expected	*Positive
Trade Balance	Trade deficit (imports > exports)	Negative
Central Bank benchmark rate	Increase in interest rate	Positive
ISM **Manufacturing Index**	Better than expected	Positive
PPI **Producer Price Index**	Better than expected	Positive

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[1] Segal, T. (2021) Forex Market: Who Trades Currencies and Why. *Investopedia*. Available at: https://www.investopedia.com/articles/forex/11/who-trades-forex-and-why.asp#citation-1 [Accessed September 22, 2021].

[2] Snow, R. (2019) Technical vs fundamental analysis in forex. *DailyFX*. Available at: https://www.dailyfx.com/education/why-trade-forex/technical-vs-fundamental-analysis.html [Accessed September 22, 2021].