Foreign Exchange Market

It refers to the organizational settings within which individuals , businesses , governments and banks buy and sell foreign currencies . It is an over the counter market which consists of trading desks at major agencies dealing in foreign exchange throughout the world connected by telephone , telex and so on . Again , it is the round the clock market , meaning that the transactions can take place any time within 24 hours of the day . Most markets have an electronic system for transfer of funds which saves time and energy . The system existing in New York is known as the Clearing House Inter - bank Payment System (CHIPS).

The foreign exchange market is not confined to a specific building or location where traders exchange currencies. Currencies are generally exchanged for one another by traders exchange currencies Business firms over a telecommunication network . Trading in the foreign exchange market has historically taken place by telephone , telex or the Society for Worldwide Inter - bank Financial Telecommunication (SWIFT) system . In November 2007 , SWIFT opened its first office in India at Mumbai . The most important trading centres are London (31 percent of activity) . New York (19 percent of activity) , Tokyo (8 percent of activity) , and Singapore 15 percent of activity) . Major secondary trading centres are Zurich , Frankfurt , Paris , Hong Kong and Sydney . Commercial banks of a country operate as clearing houses for the foreign exchange demanded and supplied for foreign transactions by the country's residents . In the process , banks of a country will have over supply of some of the foreign currencies whereas they would have shortage of others . This imbalance in demand and supply of foreign currencies would be overcome by the commercial banks by selling and buying from each other through the intermediary of foreign exchange brokers . Bank for International Settlements (BIS) is the principal financial institution that acts as the prime counterparty for central banks in their financial transactions and serves as the bank for central banks . The BIS was established on 17 May , 1930 headquartered in Basel , Switzerland and there are two representative offices in the Hong Kong SAR and Mexico city.

Types of Foreign Exchange Markets

1. **Inter - bank or wholesale market**
   A bank can purchase a foreign currency from other banks if there is a shortage. Such trading between banks is termed as the inter - bank market , wherein banks can get quotes, or they can contract brokers who sometimes act as intermediaries , matching a bank desiring to sell a given currency with another desiring to buy that currency. Thus, the inter-bank is the wholesale foreign exchange market in which major banks trade currencies with each other .
2. **Retail Market**
   Transaction size of retail foreign exchange market is very small whereas the spread between buying and selling prices is large . It consists of travellers and tourists who exchange one currency to another in the form of traveller's cheques or currency notes

Types of Market Participants in Forex Market

The participants in the foreign exchange market are individuals , firms , banks , the government and occasionally , international agencies. Individuals are normally tourists who exchange currencies . They are also migrants sending a part of their income to their family members living in their home country . Firms that participate are general importers and exporters . Exporters prefer to get the payments in their own currency in a strong convertible currency . Importers need foreign exchange for making payment for the import . When firms and individuals approach the local branch of a bank , the local branch , in turn, approaches the foreign exchange department in its regional office or head office . The latter deals in foreign exchange with other banks on behalf of the customers . Thus , there are two tiers in the foreign exchange market . One tier involves the transactions between the final customers and banks . The other tier consists of transactions between two banks . It is the second tier of the market that accounts for the largest segment of the total foreign exchange transactions in the market . The reason is that the purpose of inter bank transactions is not only to meet the foreign exchange demand of the final customers but also to reap gains out of movement in foreign exchange rates . Commercial banks dominate the foreign exchange market . Monetary authorities also participate in the market with the aim to stabilize the value of the domestic currency .

The $ 4 trillion dollar Forex market witnesses a lot of market participants . However , all of these participants have different motives . An understanding of these motives is required to predict their behavior in the markets . Also , some of these participants have deeper pockets , better information and are more active than the others . Therefore , any student of Forex trading must be aware of the different kinds of participants that they are likely to come across when they trade in this market .

1. **Forex Dealers**

Forex dealers are amongst the biggest participants in the Forex market . They are abo known as broker dealers . Most Forex dealers in the world are banks . It is for this reason that the market in which dealers interact with one another is also known as the interbank market . However , there are some notable non - bank financial institutions also that deal in foreign exchange . These dealers participate in the Forex markets by providing bid - ask quotes for currency pairs at all times . All brokers do not participate in all currency pairs . Rather , they may specialize in a specific currency pair . Alternatively , a lot of dealers also use their own capital to conduct proprietary trading operations . When both these operations are combined , Forex dealers have a significant participation in the Forex market .

2.Brokers

The Forex market is largely devoid of brokers . This is because a person need not deal with brokers necessary . If they have sufficient knowledge , they can directly call the dealer and obtain a favourable rate . However , there are brokers in the Forex market These brokers exist because they add value to their clients by helping them obtain the best quote . For instance , they may help their clients obtain the lowest buying price of the highest selling price by making available quotes from several dealers . Another major reason for using brokers is creating anonymity while trading . Many big investors and even Forex dealers in the services of brokers who act as henchmen for the trading operations of these big players .

3. **Hedger**

There are many businesses which end up creating an asset or a liability priced in foreign currency in the regular course of their business . For instance , importers and exporters engaged on foreign trade may have open positions in several foreign currencies . They may therefore be impacted if there is a fluctuation in the value of foreign currency. As a result , to protect themselves against these losses , hedgers take opposite positions in the market . Therefore if there is an unfavourable movement in their original position , it is offset by an opposite movement in their hedged positions . Their profits and losses and therefore nullified and they get stability in the operations of their business .

4. **Speculators**
   Speculators are a class of traders that have no genuine requirement for foreign currency . They only buy and sell these currencies with the hope of making a profit from it . The member of speculators increases a lot when the market sentiment is high and everyone seems to be making money in the Forex markets . Spectators usually do not maintain open positions in any currency for a very long time . Their positions are transient and are only meant to make a short term profit .
5. **Arbitrageurs**
   Arbitrageurs are traders that take advantage of the price discrepancy in different markets to make a profit . Arbitrageurs serve an important function in the foreign exchange market . It is their operations that ensure that a market as large , as decentralized and as diffused as the Forex market functions efficiently and provides uniform prior quotations all over the world . Whenever arbitrageurs find a price discrepancy in the market , they start buying in one place and selling in another the discrepancy disappears .
6. **Central Banks**
   Central Banks of all countries participate in the Forex market to some extent . Most of the yes , this participation is official . Although many times Central Banks do participate in the market by covert means . This is because every Central Bank has a target range within which they would like to see their currency fluctuate . If the currency fails out of the given range , Central Banks

conduct open market operations to bring it back in given range. Also, whenever the currency of a given nation is under speculative attack, central bank participate extensively in the market to defend their currency. Banks participate extensively in the market to defend their currency .

7. **Retail Market Participants**

   Retail market participants include tourists , students and even patients who are traveling abroad . Then there are also a variety of small businesses that indulge in foreign trade . Most of the retail participants participate in the spot market whereas people with long term interests operate in the futures market . This is because these participants only buy/sell currency when they have a personal / professional requirement and dealing with foreign currencies is not a part of their regular business . The participants have been listed in descending order . This means that dealers are the most active traders in the forex markets , followed try brokers and so on . It would also be fair to say that dealers have the maximum information about the market , followed by brokers and so on.