Table of Contents

Abstract

This paper defines the meaning of foreign exchange (FOREX), foreign exchange rate and foreign exchange market. Also, this paper has outlined the basis of foreign exchange transactions and the functions of the Forex market. Furthermore, the paper discusses the cross rates determination based on the currency exchange rate. Finally, the paper has analyzed key forex market participants.

Introduction

The foreign exchange market is mainly focus on the currencies trading that from different foreign countries. It is the largest market across the globe. Most of the FOREX turnover is accounted for by a small number of currencies such as YEN, Swiss franc, Canadian dollar, U.S. dollar, Euro, Pound Sterling as well as Australian dollar (Cristian & Genoveva, 2018). FOREX market is an over-counter market meaning that there is no physical marketplace. The FOREX market is a worldwide network that includes inter-bank traders, which the global network used by financial institutions towards trading currencies between themselves.

Foreign Exchange

Forex market is the largest financial market across the globe (Todorov, 2018). Forex trade occurs between more than two residents of two sovereign nations that have their set currency as well as regulations. FOREX is a mechanism that a nation's currency is changed into another nation's currency. Such conversion is done through banks dealing in foreign exchange. FOREX market is open throughout the day, with an estimated turnover of $1.2 trillion daily (Galeshchuk & Mukherjee, 2017). This substantial turnover represents more turnover for all stock markets in the world in a single day. This has created a liquid market hence a desirable market towards trade. unlike other securities, the FOREX does not have a fixed exchange rate. Forex is mainly traded via banks, dealers, brokers, private individuals as well as financial institutions. Additionally, currency trades are mainly executed through the internet and telephonic communication.

Foreign Exchange Market

FOREX market is defined as over the counter market, which means this market does not has physical place for participants to meet and execute deals (Todorov, 2018). The foreign exchange market is an informal arrangement between brokers and banks that operates in a financing center buying as well as selling currencies. Banks and brokers are connected to each other via Telecommunication. Unlike commodity market, foreign exchange market contains no specific locations. The currency aspects of different transactions involve the use of FOREX markets. This form of market exists even in remote areas where people approach banks to have their currencies converted. In this extent, foreign exchange market exists across the globe.

Market Size

Forex market is considered as the largest financial market that has a day to day turnover of more than $ 2 trillion (Galeshchuk & Mukherjee, 2017). FOREX markets were developed mainly towards facilitating settlement of debts that arise due to international trade. Moreover, these markets have developed so much as 3 days turnover in FOREX is equal to the size of world trade. The largest forex market includes London, New York, Tokyo, Zurich as well as Frankfurt (Todorov, 2018). Additionally, the business in forex market across the world has shown a steady increase due to increase in the foreign trade volume of different countries, communication systems improvement as well as greater access towards the international exchange markets. Much of the country's external trade is designated in leading world's currencies which include US dollar, Euro, Swiss franc, VIZ, Japanese yen as well as pound sterling. The above currencies are the main trade in the forex market across the world.

Forex market participants

There are several different participants trading in forex market, such as commercial banks, central banks, corporates, and exchange brokers.

Corporates

The international investor and MNC may operate in the market towards meeting their real trade and investment requirements. Also, they may purchase or sell currencies with a view of speculating or trading in currencies to the extent allowed by the foreign exchange regulations. In this case, it mainly operates by placing orders with commercial banks, deals between banks, as well as their clients, form the retail component of the forex market (Galeshchuk & Mukherjee, 2017).

Commercial Banks

Commercial banks are the major players in the forex market (Cristian & Genoveva, 2018). Commercial banks purchase and sell currencies for their clients, and in some cases, they operate on their own. Commercial banks are a vital part of the forex market as they trade on their behalf and also for their clients. Also, they provide a channel whereby all participants that able to trade smoothly. Commercial banks have exceptional knowledge of the market and the ability to monitor the activities of other participants. For many years, commercial banks have been at the core of the forex market. Its role has remained the same all through the time. The commercial banks account for a large part of trading of a commercial as well as speculative nature and operate within the interbank market.

Exchange Broker

Exchange brokers help in facilitating a deal between banks (Todorov, 2018). Without exchange brokers, banks are required to contact other banks for quotes. Exchange brokers ensure that favorable quotations are obtained at low costs. The banks may leave with the broker and the rate at which it purchases or sells the foreign currency. Exchange brokers tend to specialize in exotic currencies and they could handle all major currencies. In the United States, banks may deal directly and through recognized exchange brokers. Moreover, authorized exchange brokers are allowed to contract exchange business on behalf of an accredited dealer in forex.

Central Bank

The central bank intervenes in the forex towards influencing the exchange rate as well as changing it from that would be caused by private demands and supplies. The central bank may transact in the forex market on its own. Also, the central bank may transact on behalf of the government when buying or selling bonds and help to settle other transactions that may involve forex payments as well as receipts.

Factors determining foreign exchange rate

Interest Rates

Interest rates affect the currency value as well as the dollar exchange rate, forex rates, interest rates, and inflation rate. Increase in one of the above rates causes a nation's currency to rise since higher interest rates offer higher rates to creditors hence leading to more foreign capital that is likely to cause an increase in exchange rates. (Todorov, 2018)

Public Debt

Nations are likely to participate in large-scale shortfall financing towards paying for governmental funding as well as public sector projects. Government debt is described as public debt held by the central government. In this research, a country with public debt is less likely to purchase foreign capital, and foreign investors sell their bonds if the markets predict public debt within a particular nation (Todorov, 2018). Hence, what is likely to follow in this case is a decrease in the exchange rate value.

Political Stability

According to Galeshchuk & Mukherjee (2017), a nation's political state, as well as economic performance, can impact the strength of the currency. Moreover, a nation with fewer risk for political uncertainty is more attractive to foreign investors. Foreign capital increase results in an appreciation in its domestic currency's value. Also, a nation susceptible to political instability may lead to a decrease in exchange rates.

Inflation Rate

Market inflation variation may cause changes in the rates of currency exchange (Cristian & Genoveva, 2018). A nation with a lower rate of inflation is likely to cause an appreciation of the currency's value. Thus, the prices of products increase at a lower rate as inflation goes low. Also, a nation with a lower rate of inflation results in increasing currency value and a nation with a higher rate of inflation lead to depreciation of its currency hence higher interest rates (Galeshchuk&Mukherjee, 2017).

Balance of Payments

The current account of a country reflects earnings on foreign investment as well as the balance of trade (Cristian & Genoveva, 2018). It consists of all transactions such as debt, imports, and exports. The current account refers to a trade balance between a nation and its other trading partners, which reflects payments between nations for goods, interest, dividends, and services. In this case, a deficit in the current account indicates that the nation spends more on foreign trade compared to its earning hence being forced to borrow capital from foreign sources (Galeshchuk & Mukherjee, 2017). The foreign currency demand lowers the nation's exchange rate.

Functions of the Forex market

The forex market refers to a market where foreign exchange transactions are performed. There are various functions that the forex market has across the world.

Purchasing Power Transfer

The core function of a forex market is the purchase power transfer from one nation to another as well as from one currency to another. Also, international clearing role performed by forex markets plays a vital role to facilitate capital movement as well as international trade.

Credit Provision

The credit role performed by forex markets plays a vital function in foreign trade growth, for international trade relies on credit facilities.

Hedging facilities provision

The major importance of the forex market is to offer hedging facilities. Hedging can be described as covering foreign trade risks as well as providing a mechanism to importers and exporters towards guarding against losses that arise from changes in exchange rates (Cristian & Genoveva, 2018).

Conclusion

The forex market is the market where currencies are acquired and sold against each other. It is the largest market across the globe. The market has no physical place for participants to meet and execute deals (Todorov, 2018). The foreign exchange market is an informal arrangement between brokers and banks that operates in a financing center buying as well as selling currencies.

Recommendation

To increase the satisfaction level of banks' customers, some of the recommendations for the company is that the banks should develop effective systems to analyze forex business. Also, for customer's convenience, banks should have more personnel towards delivering faster services to their clients. Also, for an effective forex market services, the proper communication system of equipment such as a computer, phone among others should be ensured. Moreover, effective strategies should be undertaken against defaulters.

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