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Contents

Forex Market Structure

For the sake of comparison, let us first examine a market that most folks are probably very familiar with: the **stock market**.

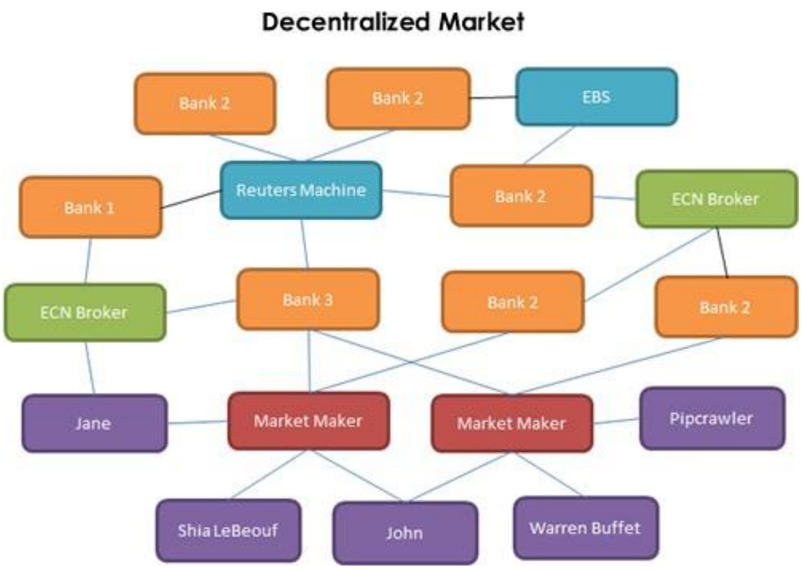
This is how the structure of the stock market looks like:

By its very nature, the stock market tends to be very monopolistic. There is only one entity, one specialist that controls prices. All trades must go through this specialist. Because of this, prices can easily be altered to benefit the specialist and not traders.

How does this happen?
In the stock market, the specialist is forced to fulfill the order of its clients. Now, let's say the number of sellers suddenly exceeds the number of buyers. The specialist, which is forced to fulfill the order of its clients, the sellers, in this case, is left with a bunch of stock that he cannot sell-off to the buyer side.
In order to prevent this from happening, the specialist will simply widen the spread or increase the transaction cost to prevent sellers from entering the market. In other words, the specialists can manipulate the quotes it is offering to accommodate its needs.

Trading FOREX is Decentralized

Unlike in trading stocks or futures, you don't need to go through a centralized exchange like the Bombay Stock Exchange with just one price. In the forex market, there is no single price that for a given currency at any time, which means quotes from different currency dealers vary.



This might be overwhelming at first, but this is what makes the forex market so transparent.
The market is so huge and the competition between dealers is so fierce that you get the best deal almost every single time.
Also, one cool thing about forex trading is that you can do it anywhere.

FOREX Market Players

Now that you know the overall structure of the forex market, let's delve in a little deeper to find out who exactly these people in the ladder are.

It is essential for you that you understand the nature of the forex market and who are the main forex market players.

Until the late 1990s, only the large institutions could play this game. The initial requirement was that you could trade only if you had about ten to fifty million dollars to start with. Forex was originally intended to be used by bankers and large institutions, and not by retail investors. However, because of the rise of the internet, online forex brokers are now able to offer trading accounts to "retail" traders like us.

Without further ado, here are the major forex market players:

1. The Super Banks

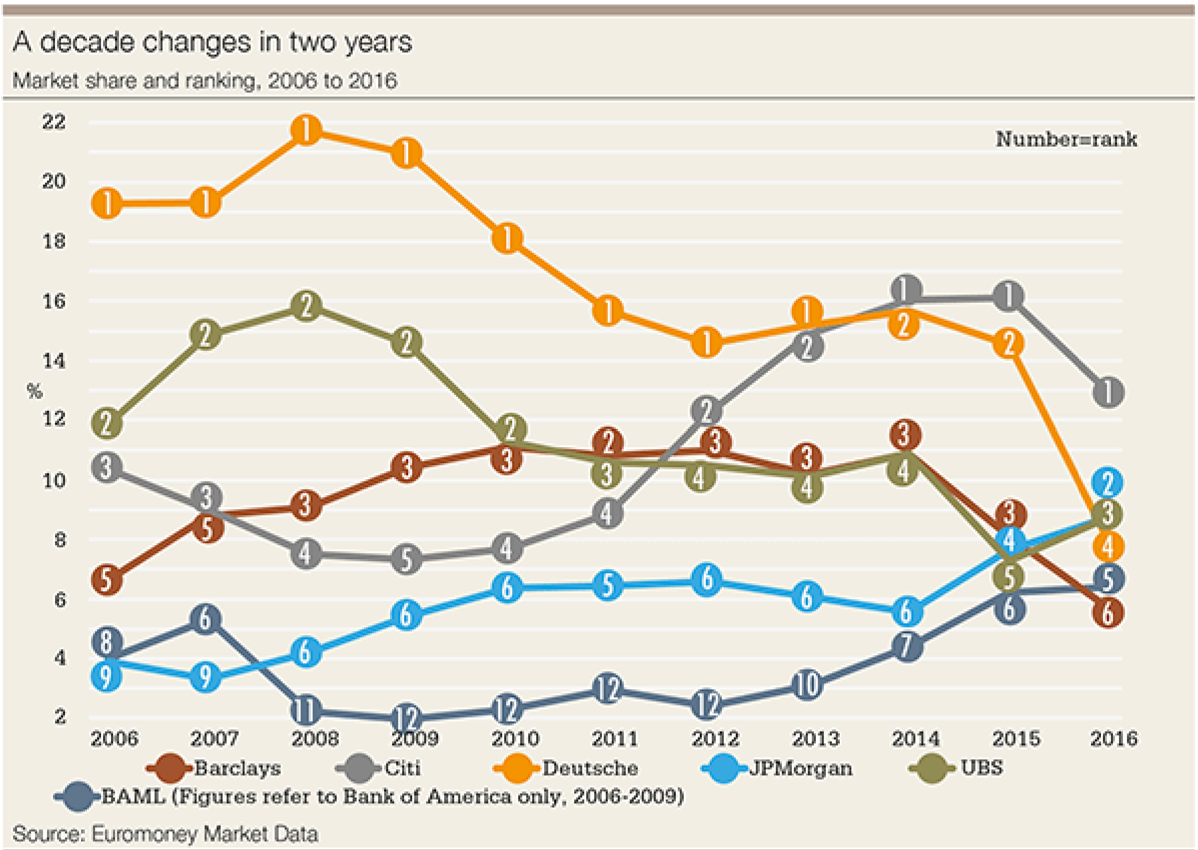
Since the forex spot market is decentralized, it is the largest banks in the world that determine the exchange rates. Based on the supply and demand for currencies, they are generally the ones that make the bid/ask spread that we all use.

These large banks, collectively known as the interbank market, take on a large amount of forex transactions each day for both their customers and themselves.

They are known as "**flow monsters**".

For these flow monsters, the name of the game is volume and capturing their share of the trading flow of currencies.

A couple of these flow monsters include **Citi, JPMorgan, UBS, Barclays, Deutsche Bank, Goldman Sachs, HSBC, and Bank of America**.



2. Large Commercial Companies

Companies take part in the foreign exchange market for the purpose of doing business.

For instance, Apple must first exchange its U.S. dollars for the Japanese yen when purchasing electronic parts from Japan for their products. Since the volume they trade is much smaller than those in the interbank market, this type of market player typically deals with commercial banks for their transactions.

3. Governments and Central Banks

Governments and central banks, such as the European Central Bank, the Bank of England, and the Federal Reserve, are regularly involved in the forex market too. Just like companies, national governments participate in the forex market for their operations, international trade payments, and handling their foreign exchange reserves.

Meanwhile, central banks affect the forex market when they adjust interest rates to control inflation. By doing this, they can affect currency valuation.

There are also instances when central banks intervene, either directly or verbally, in the forex market when they want to realign exchange rates. Sometimes, central banks think that their currency is priced too high or too low, so they start massive sell/buy operations to alter exchange rates.

4. The Speculators (Retail Traders)

Currency speculation is the act of buying and holding foreign currency in the hopes of selling that currency at a higher exchange rate in the future. This is in contrast to those who buy currencies to finance a foreign investment or to pay for imported products or services.

Speculation in the forex market involves the buying and selling of currencies with the view of making a profit. Speculators are focused on price fluctuations. It is called speculation because of the uncertainty involved since no one can know for sure whether a currency pair's price will go up or down. Traders assess the likelihood of either scenario before placing a trade.

Comprising close to 90% of all trading volume, speculators as forex market players come in all shapes and sizes.

Some have large capital, some use leverage, but all of them engage in the forex simply to make bucket loads of cash.

Know your FOREX History

At the end of World War II, the whole world was experiencing so much chaos that the major Western governments felt the need to create a system to stabilize the global economy. Known as the "Bretton Woods System," the agreement set the exchange rate of the US dollar against gold. Which allowed all other currencies to be pegged against the US dollar. Soon the currency market evolved to a free-floating one, where exchange rates were determined by supply and demand.
At first, it was difficult to determine fair exchange rates, but advances in technology and communication eventually made things easier. Once the 1990s came along, thanks to the booming growth of the internet banks began creating their own trading platforms.
These platforms were designed to stream live quotes to their clients so that they could instantly execute trades themselves.

Meanwhile, some brokers introduced internet-based trading platforms for individual traders. Known as "retail forex brokers", these entities made it easy for individuals to trade by allowing smaller trade sizes.
Unlike in the interbank market where the standard trade size is one million units, retail brokers allowed individuals to trade as little as 1000 units!

Retail Forex Brokers

In the past, only the big speculators and highly capitalized investment funds could trade currencies, but thanks to retail forex brokers and the Internet, this isn't the case anymore.

With hardly any barriers to entry, anybody could just contact a broker, open up an account, deposit some money, and trade forex from the comfort of their own home.

Brokers basically come in two forms:

1. Market makers, as their name suggests, "make" or set their own bid and ask prices themselves

2. Electronic Communications Networks (ECN), who use the best bid and ask prices available to them from different institutions on the interbank market.