FX Education Series:

How Do FX Markets Work?

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The foreign exchange market is typically used to settle cross-currency payments and hedge currency risk. Given its global nature, the FX market is effectively open 24 hours a day, five days a week. This highly liquid, over the counter market, generates an estimated average daily turnover of more than $5 trillion.

The exchange rate at which a currency pair can be bought or sold, generally for delivery within two settlement days, is called the FX spot rate. Quotes are based on a two-way price or bid offer spread. The bid is the rate at which you can sell the base currency and the offer is the rate at which you can buy it.

The size of the spread reflects the liquidity of the currency, the size of the deal, and the time of day. Principle drivers of foreign exchange rates for any specific currency pair involve a variety of micro and macro-economic factors between the regions, including interest rates, current account deficits, public debt, terms of trade, economic performance, and political stability.

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