

Business Cycles Affect Currency Market Cycles

We Tend to View Life as Linear but Life Contains a Group of Cycles

Early in life we discover the meaning of past, present and future in linear terms, and we structure our life around those words, but most of the events we experience in daily life occur in cycles. There are several obvious examples. The four seasons, weather patterns, and business transactions, affect our present linear life just like the past and the future are always experienced in the present.

A [business cycle](#) is defined as the growth and contraction of our economic life. Various business cycles determine global economic trends, and in order to successfully understand and participate in any kind of monetary trading system it's important to identify a certain business cycle, and the trends it creates. The business cycle is a vital factor in the growth or the shrinkage of the money supply; the more currency in a given market, the less value it has, so the forex market, and the cycles within it, always responds in some way to a business cycle. A Business cycle can define consumer demands, unemployment, the availability of credit, industrial production, and these issues impact international capital, so it either fortifies or depreciates a country's currency.

When a nation is going through a business cycle boom international capital flow increases; traders are always looking for better returns on their investments through international loans or foreign direct investments. An increase in capital flow will cause a country's currency to appreciate, but if a country is going through the bust cycle of the business cycle, capital investments will disappear and currency values depreciate. The business cycle continues in one direction or another until it's saturated through market developments or government action.

Understanding how the business cycle works gives currency traders the opportunity to short the currencies of nations that are in the bust phase of the business cycle, and long the currencies of nations entering the boom phase. The key to turning these trades into profits is identifying market cycles with some help from forex analysis tools and [forex charts](#), and then using a forex strategy that flows with them.

There are Three Major Currency Market Cycles

It doesn't matter what financial market you're investing in; financial markets only move in three cycles. The major [market cycles](#) are: Trending, Consolidation and Breakout.

The trending cycle is when a currency's value consistently moves in the same direction; either up or down. A forex trend is defined as progressively higher highs and higher lows. Since currency values usually don't move in a straight line up or down, it can be hard to identify a trend without some kind of help.

A consolidation cycle is also known as Non Trending; it looks like a horizontal line of bars on a forex chart. When the value is stuck between two horizontal supports and resistance levels can't break these supports for at least seven bars, the consolidation cycle is in motion.

Moving averages or other technical indicators will help determine if the market is trending or consolidating. The moving average line will almost be horizontal in a consolidating market.

The breakout market cycle occurs when the currency has been in the consolidation market for at least seven bars, and then the price breaks out of this ranging market and creates a new high or low. Most forex traders only have a forex strategy for one or two market cycles. The most popular strategies are for breakout and trend cycles.

You Need More Than One Strategy to be Successful in all Three Market Cycles

Recent research on market cycles shows that on average the forex market is only in the trending cycle thirty percent of the time; it's in a breakout cycle ten percent of the time, and is in the consolidation cycle sixty percent of the time. If you only have a strategy for the trending cycle, you're only trading thirty percent of the time. If you have a breakout strategy along with a trending strategy that only increases your trading time to forty percent. That means if you only incorporate those two market cycle strategies into your forex system, you will be sitting on the trading sidelines sixty percent of the time.

Some traders do get sucked in and make trades using the wrong strategy when the market is in the consolidation cycle, and they experience the painful results of that decision, so it's crucial to have a strategy for each cycle. The bottom line for profitable trades is to identify market cycles as early as possible, and then use the correct forex trading strategy so you flow with the cycles as they change.

About the Author

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