

## The Forex Market and Understanding Foreign Exchange Rates

Unlike the stock exchange, the Forex Market (foreign exchange market) is a relatively new player to the investment world. Today's current Forex market model started in the early 1970's, and today it represents the biggest financial market around, even surpassing the stock market. With trading surpassing \$2 trillion dollars per day, the Forex market attracts more and more investors all the time. Before an investor starts trading on the Forex market, he should grasp the fundamentals of how exchange rates work.

### Exchange rates

Basically, the exchange rate represents the rate of exchange between two currencies. Most currencies are traded, or paired up against the dollar. The five most common currencies traded on the market are the dollar (USD), euro (EUR), the yen (JPY), the British pound (GBP), and the Swiss franc (CHF). Some other currencies that are traded are the Australian dollar, the Canadian dollar, and the Hong Kong dollar.

In the exchange rate or ratio, the numerator represents the quote currency and the denominator the base currency, which always equals one.

Let's say that an investor wants to exchange euros for dollars. In this case, the euro currency is the quote currency, or how much currency you have to exchange. The base currency is the dollar. The investor researches the current exchange rate (euros converted into dollars) either on the Internet, through the bank, broker, etc., and then multiplies that amount by the number of euros to exchange. Let's say that the exchange rate is 1.57959. That means that 1.57959 euros must be paid to receive one dollar. If he has 1000 euros to exchange, then he can receive \$1,579.59 ( $1000 \times 1.57959$ ).

On the flip side, the exchange rate can also tell the investor how much he'll receive if he converts dollars back into euros. If he has \$1000, he can either divide that amount by the same euro to dollar exchange rate ( $\$1000/1.57959 = 633.07$  euros), or look up the conversation rate for dollars to euros on the Internet, etc. (i.e. .633072) and multiply it by the amount of dollars to exchange ( $\$1000 \times .633072 = 633.07$  euros).

Once the exchange rate concept is understood, the investor can feel more confident in investing in the Forex market.

### About the Author

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