Reading a Forex Quote

Total newbies to the foreign exchange market can find reading a Forex quite intimidating (even baffling) at first. In fact, this is the most common initial hurdle. The quote is brief, but it packs in a great deal of useful information. And although it doesn't make a lick of sense to a newcomer, here's a quick, simple explanation of what it means.

A Forex quote is always based on a pair of currencies, where you're simultaneously selling one currency and buying another. And there are two prices, one for selling and the other for buying (bid price and ask price). When reading a Forex quote, it might typically look like this: USD/JPY 106.52/56

The first currency is called the base currency and the other is the quote currency. The base currency value is always 1 (in this case 1 US dollar). The number in the quote tells you how many of the quote currency (Japanese yen) you can buy with one US dollar.

And that number - 106.52/56 - is a shortened version of two numbers (106.52 and 106.56). The lower number is the bid price; the other is the ask price. The bid price shows how much a dealer will buy the base currency for. The ask price shows how much a dealer is willing to sell it for.

If you saw 106.52/56 when reading a Forex quote, it would mean that you could sell US dollars and receive 106.52 yen per dollar. On the other hand, if you wanted to buy US dollars, you would have to pay 106.56 yen for each dollar.

The difference between the bid price and the ask price in a Forex quote is called the "spread," and each tiny 0.01 unit is called a "pip." In our example, the spread for our USD/JPY quote is four pips. The spread for the most commonly traded currencies is usually that small. In general, you'll do most of your trading in US dollars, Japanese yen, Great Britain pounds, Euros, Swiss francs or Australian dollars. Also please keep in mind that when the competition really heats up some spreads will be as small as one pip.

On the other hand, for less heavily traded currencies, you may run into much larger spreads. But don't think that a small spread means tiny profits (or losses). When you're trading hundreds of thousands of units, even that one pip spread can mean big money.

Let's say you're dealing with just 100 US dollars. Selling your hundred dollars for 10,652 yen and buying them for 10,656 yen only amounts to a four yen difference. But most Forex traders will be dealing with amounts of 100,000 US dollars (or many multiples). So now we know, when reading a Forex quote, that even such an unimpressive little four-pip spread amounts to considerably more (at 4,000 yen, and probably several multiples of that).

And of course, similar trades may be repeated throughout the day and the week. This means that anytime you're reading a Forex quote, you'll recognize that this tiny little spread is more important than its meager size at first suggests.

About the Author

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