

## Unit -3

### Foreign exchange market and exchange rates

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#### 1. What is a foreign exchange Market?

Ans: The foreign exchange market or Forex market is a global online network where traders buy and sell currencies. It has no physical location and operates 24 hours a day. In this market the buyers and sellers are involved in the sale and purchase of foreign currencies. In other words, a market where the currencies of different countries are bought and sold is called a foreign exchange market.

#### 2. What is the structure of a Forex Market ?

Ans : The foreign exchange market constitutes central banks, commercial banks, brokers, exporters and importers, immigrants, investors and tourists. It is divided into various levels of access. At the top is the interbank foreign exchange market, which is made up of the largest commercial banks and securities dealers. The different participants of the Foreign Exchange markets are discussed below.

- a) **Central Banks:** National central banks play an important role in the foreign exchange markets. They try to control the money supply, inflation, and/or interest rates and often have official or unofficial target rates for their currencies. The central bank has the power to regulate and control the foreign exchange market so as to assure that it works in the orderly fashion. One of the major functions of the central bank is to prevent the aggressive fluctuations in the foreign exchange market, if necessary, by direct intervention.
- b) **Foreign Exchange Brokers:** These brokers function as a link between the central bank and the commercial banks and also between the actual buyers and commercial banks. They are the major source of market information. These are institutions who do not themselves buy the foreign currency, but rather strike a deal between the buyer and the seller on a commission basis. Usually they are of the following types-
  - I) Retail or Individual Foreign Exchange Traders.
  - II) Non Bank Foreign Exchange Companies.
  - III) Money Transfer or Remittance Companies.
- c) **Commercial Banks:** The **commercial banks** are the second most important organ of the foreign exchange market. The banks dealing in foreign exchange play a role of “**market makers**”, in the sense that they quote on a daily basis the

foreign exchange rates for buying and selling of the foreign currencies. Also, they function as **clearing houses**, thereby helping in wiping out the difference between the demand for and the supply of currencies. These banks buy the currencies from the **brokers** and sell it to the buyers.

- d) ***Individual Buyers:*** They are the most important component of the Forex markets. The actual buyers and sellers of the foreign currencies constitute exporters, importers, tourist, investors, and immigrants. They are actual users of the currencies and approach **commercial banks** to buy it.