TRADING —IN THE— GLOBAL CURRENCY MARKETS

— CORNELIUS LUCA —

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hanced the traders's confidence in their ability to both generate profits and properly handle the exchange risks. Therefore, trading sophistication lead toward volume increase.

Developments in Telecommunications

In the 1970s and early 1980s, foreign exchange was mostly conducted via telephone, and to a much lesser extent on the telex machine. Both mediums are slow and error-prone. The introduction of automated dealing systems in the second half of the 1980s completely altered the way foreign exchange was conducted. The dealing systems are on-line computer systems which link market players on one-on-one basis. They are reliable and much faster. allowing traders to conduct four simultaneous trades, rather than one, or a maximum of two on the phone. They are also safer, as players are able to see the deals which they execute. Finally, the dealing systems have many other features which facilitate trading which will be presented in detail in Chapter 3. The dealing systems had a major role in expanding the foreign exchange business due to their reliability, speed and safety. Although it may be difficult to recall the days before the fax machines were introduced, it is only fair to mention their share into helping foreign exchange. In an industry where the speed of transfer of accurate information is paramount, faxes are currently commonplace.

Computer (Hardware and Software) Development

Computers have a significant role at many stages of conducting foreign exchange. In addition to the dealing systems, matching systems simultaneously connect all players around the world, electronically duplicating the brokers market.

The new front end-back office systems provide full accounting coverage, ticket writing, back office processing and risk management implementation at a fraction of the cost.

Unlike the limited technical analysis of the early 1980s, advanced software now makes it possible to generate all types of charts, augment them with sophisticated technical studies and put them at the traders' fingertips on a continuous basis at a rather limited cost.

Also, currency options can hardly be traded professionally without the aid of computers, because complex strategies require the help of advanced software for pricing.

Chapter 2

Historical Development of Foreign Exchange

Foreign exchange is a relatively new industry, having started only in 1973. However, it occured in ancient times, as coins started to be exchanged among traders. This chapter deals with the more recent developments which shaped foreign exchange into the vibrant and complex market of today.

A Historical Perspective

Foreign exchange as we know it, began in earnest in 1973. Money, though, goes back a long time, over 4500 years, when the Egyptians coined the first metal money, and the Babylonians wrote the first bills and receipts. The incipient foreign exchange markets can be traced back to the ancient Middle East, where money changers initiated the exchange of coins. Later, during the Middle Ages, as the number of travelers increased, people realized that metal coins may be impractical. Due to highway robberies and the sheer weight of the coins, foreign exchange started to take shape. International merchant bankers devised bills of exchange, which were transferable third party payments which allowed flexibility and growth in foreign exchange dealings.

Chapter 7

Price Structure and Foreign Exchange Terminology

This chapter presents the typical terminology in foreign exchange, from bids and offers in different instruments to the leave orders left by corporations and in the interbank market. Whereas the definitions of bids and offers are very basic and generally known in the spot market, they may change in the case of other instruments. These differences will be explained.

Spot Market

A *spot deal* takes place between two parties who deliver a certain amount of different currencies to each other, based on an agreed exchange rate, within two business days of the deal date. The exception is the Canadian dollar, in which the spot delivery is executed within one business day.

Let's take an example in the spot market. A bank quotes the USD/CHF at 1.4955/60 on a monitor. In this case, the bank's *bid* is 1.4955 (left side), which means that the bank is interested in buying USD/CHF at this price. The bank's *offer* is 1.4960 (right side), which means that the bank is interested in selling USD/CHF at this price. The difference between the bid and offer is called *spread*. In our example, the spread between