

Currency Conversion example

Currency Pair: USD/CAD (U.S. Dollar to Canadian Dollar)

Exchange Rate: Let's assume the current exchange rate is **1 USD = 1.25 CAD**.

Bid and Ask Prices:

- Bid Price: 1 USD = 1.24 CAD (The price a buyer is willing to pay for 1 USD)
- Ask Price: 1 USD = 1.26 CAD (The price a seller is willing to accept for 1 USD)

Execution of Trades:

- Let's say a trader wants to convert 1,000 USD to Canadian Dollars.
- The trader checks the current exchange rate and decides to execute the trade.

Calculation:

Using the Ask Price (Buy):

- If the trader uses the Ask Price of 1 USD = 1.26 CAD, the calculation is
- $1,000 \text{ USD} \times 1.26 = 1,260 \text{ CAD}$

The trader would receive 1,260 CAD by buying Canadian Dollars.

Using the Bid Price (Sell):

- If the trader uses the Bid Price of 1 USD = 1.24 CAD, the calculation is
- $1,000 \text{ USD} \times 1.24 = 1,240 \text{ CAD}$.

The trader would receive 1,240 CAD by selling U.S. Dollars.

Transaction Costs:

- The difference between the Bid and Ask prices (spread) represents the transaction cost. In this example, the spread is
- $1.26 - 1.24 = 0.02 \text{ CAD}$.

Execution:

- The trader decides whether to execute a "buy" or "sell" trade based on their needs and the prevailing market conditions.

Considerations:

- In a real-world scenario, traders should also account for transaction fees or commissions imposed by the forex platform or financial institution facilitating the trade.

This example illustrates the conversion process using a currency pair (USD/CAD), exchange rates, bid and ask prices, and the execution of trades. It emphasizes the bid and ask prices, which represent the costs associated with buying and selling currencies in the foreign exchange market.

In the foreign exchange market, the execution of a trade can be done either on the ask price or the bid price, depending on the nature of the trade:

- The bid price is the price at which buyers are willing to purchase a currency pair. It represents the maximum price a buyer is willing to pay.
- The ask price (or offer price) is the price at which sellers are willing to sell a currency pair. It represents the minimum price a seller is willing to accept.

So, if Canada is buying USD (base currency) in the USD/CAD currency pair, it would typically transact at the bid price of 1.24 CAD. On the other hand, if someone is selling USD, they would typically sell at the ask price of 1.26 CAD.

Example:

Consider the USD/CAD currency pair with an ask price of 1.26 CAD and a bid price of 1.24 CAD.

- If a trader wants to buy the USD/CAD pair, they would execute the trade at the ask price of 1.26 CAD.
- If a trader wants to sell the USD/CAD pair, they would execute the trade at the bid price of 1.24 CAD.

It's important to note that there is a spread between the bid and ask prices. The ask price is typically higher than the bid price, and the difference between them represents the transaction cost or the profit margin for the broker facilitating the trade.

