

Forex Trading History

In 1967, a Chicago bank refused a loan in pound sterling sought by a college professor by the name of Milton Friedman. He had intended to use the funds to short the British currency. Mr. Friedman had perceived sterling to be priced too high against the dollar, and wanted to sell the currency, then later buy it back to repay the bank after the currency declined, thus pocketing a quick profit. This is what's known as 'Selling Short'. The bank's refusal to grant the loan was due to the Bretton Woods Agreement, established twenty years earlier, which fixed national currencies against the dollar, and set the dollar at a rate of \$35 per ounce of gold.

The Bretton Woods Agreement, set up in 1944, aimed at installing international monetary stability by preventing money from fleeing across national borders, and restricting speculation in the world currencies. Prior to the Agreement, the gold exchange standard--prevailing between 1876 and World War I--dominated the international economic system. Under the gold standard, currencies gained a new phase of stability as they were backed by the price of gold. It abolished the arbitrary practice used by kings and dictators of arbitrarily debasing money and triggering inflation.

But the gold standard wasn't without faults. As an economy strengthened, its imports would heavily increase until it ran down the gold reserves required to back its money. This would cause the money supply to shrink, interest rates would rise and economic activity could slow to the extent of recession. Eventually, prices of goods had to hit bottom, and become attractive to other nations, which would rush into buying frenzies that injected the economy with gold until it increased its money supply, thus driving down interest rates and recreating wealth in the economy. Such boom-bust patterns prevailed throughout the gold standard until the outbreak of World War I interrupted trade flows and the free movement of gold. This of course was followed by 'The Great Depression', which arguably was ended by World War II.

After the Wars, the Bretton Woods Agreement was established, whereby participating countries agreed to try and maintain the value of their currency with a narrow margin against the dollar and a corresponding rate of gold as needed. Governments were prohibited from devaluing their currencies to their trade advantage and were only allowed to do so for changes of less than 10%. Through the 1950s, the ever-expanding volume of world-wide trade led to massive capital transfers generated by post-war construction. This destabilized foreign exchange rates that had been set up in The Bretton Woods Agreement.

The Bretton Woods Agreement was finally abandoned in 1971, and the gold window was closed on the US dollar. By 1973, currencies of major industrialized nations became more freely floating, mainly controlled by forces of supply and demand acting in the foreign exchange market. Prices were floated daily, with volumes, speed and price volatility increasing through the 1970s. These fluctuations gave rise to new financial instruments, market deregulation and trade liberalization.

Beginning in the 1980s, international capital movements accelerated with the explosion of computer technology and high speed communications. The world wide markets became virtual 'local market' through Asian, European and American time zones. Transactions in FOREX zoomed from about \$70 billion a day in the 1980s, to more than \$1.5 trillion a day two decades later.

THE EUROMARKET

A major catalyst to the increase in foreign exchange trading was the rapid development of the Eurodollar market, where US dollars are deposited in banks outside the US. Similarly, Euro markets are those where assets are deposited outside the currency of origin.

In the 1950s Russia's oil revenues-- all in dollars -- were deposited outside the US in fear of being frozen by US regulators. This gave rise to a vast offshore pool of dollars outside the control of US authorities with the attendant creation of The Eurodollar market. The US government imposed laws to restrict dollar lending to foreigners. Euro markets were particularly attractive because they had far fewer regulations and offered higher yields. From the late 1980s onwards, US companies began to borrow offshore, finding Euro markets an advantageous center for holding excess liquidity, providing short-term loans and financing imports and exports.

London was the principal offshore market, as it remains even now. In the 1980s, it became the key center in the Eurodollar market when British banks began lending dollars as an alternative to pounds. This allowed them to maintain their leading position in global finance. London's convenient geographical (Time Zone) location (operating during Asian, Pacific and American markets) is also instrumental in preserving its dominance in the Euromarket.

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