Fundamentals

Fundamental analysis is the study of how global economic news and other news events affect financial markets. Fundamental analysis encompasses any news event, social force, economic announcement, Federal policy change, company earnings and news, and perhaps the most important piece of Fundamental data that applies to the Forex market, which is a country’s interest rates and interest rate policy.

The idea behind fundamental analysis is that if a country’s current or future economic picture is strong, their currency should strengthen. A strong economy attracts foreign investment and businesses, and this means foreigners must purchase a country’s currency to invest or start a business there. So, essentially, it all boils down to supply and demand; a country with a strong and growing economy will experience stronger demand for their currency, which will work to lessen supply and drive up the value of the currency.

Major economic events in Forex quickly going over some of the most important economic events that drive Forex price movement. Just to familiarize you with some more of the jargon that you will likely come across on your Forex journey.

Gross Domestic Product (GDP)
The GDP one of the most important of all economic indicators. biggest measure of the overall state of the economy. Comes out at 08:00am EST Last day of every Quarter Reflects previous Quarter activity Is the total monetary value of all goods and services produced by the entire Economy

Trade Balance
difference between imports and exports of tangible goods and services. country’s trade balance and changes in exports vs. imports It’s better to have more exports than imports, as exports help grow

Consumer Price Index (CPI)
The CPI widely measure of inflation. released at 8:30 am EST around the 15th of each month and it reflects the previous month’s data. CPI change in the cost of a bundle of consumer goods and services from month to month.

The Producer Price Index (PPI)
Along with the CPI, the PPI is one of the two most important measures of inflation. This report is released at 8:30 am EST second full week of each month and it reflects the previous month’s data. measures the price of goods at the wholesale level. So to contrast with CPI, the PPI measures how much producers are receiving for the goods while CPI measures the cost paid by consumers for goods.

Employment Indicators
The most important employment announcement occurs on the first Friday of every month at 8:30 am EST. This announcement includes the unemployment rate; which is the percentage of the work force that is unemployed, the number of new jobs created, the average hours worked per week, and average hourly earnings. This report often results in significant market movement. You will often hear traders and analysts talking about “NFP”, this means Non-Farm Employment report, and it is perhaps the one report each month that has the greatest power to move the markets.

Durable Goods Orders
gives a measurement of how much people are spending on longer-term purchases, these are defined as products that are expected to last more than three years. released at 8:30 am EST around the 26th of each month and is believed to provide some insight into the future of the manufacturing industry.

The Retail Sales Index measures goods sold within the retail industry, from large chains to smaller local store. released at 8:30 am EST around the 12th of the month; it reflects data from the previous month.

Housing Data
Housing data includes the number of new homes that a country began building that month. major cause of economic stimulus for a country and so it’s widely followed by Forex participants. Existing home sales are a good measure of economic strength of a country as well; low existing home sales and low new home starts are typically a sign of a weak economy.

Interest Rates
Interest rates are the main driver in Forex markets; all of the above mentioned economic indicators are closely watched by the Federal Open Market Committee in order to calculate the overall health of the economy. The Fed can use the tools at its disposable to lower, raise, or leave interest rates unchanged, depending on the evidence it has gathered on the health of the economy. So while interest rates are the main driver of Forex price action, all of the above economic indicators are also very important.

Most equity investors are aware of the most common financial data used in fundamental analysis: earnings per share, revenue and cash flow. These quantitative factors can include any figures found on a company’s earnings report, cash-flow statement or balance sheet. They can also include the results of financial ratios such as return-on-equity and debt/equity. Fundamental traders may use such quantitative data to identify trading opportunities if, for example, a company issues earnings results that catch the market by surprise.

Two of the most closely watched fundamental factors for traders and investors everywhere are earnings announcements and analyst upgrades and downgrades. Gaining an edge on such information, however, is very difficult since there are literally millions of eyes on Wall Street looking for that very same edge.

**Fundamental Data and Its Many Forms**
In particular, fundamental analysis provides insight into how price action “should” or may react to a certain economic event. Fundamental data takes shape in many different forms. It can appear as a report released by the Fed on U.S. existing home sales. It can also exist in the possibility that the European Central Bank will change its monetary policy. The release of this data to the public often changes the economic landscape (or better yet, the economic mindset), creating a reaction from investors and speculators. There are even instances when no specific report has been released, but the anticipation of such a report happening is another example of fundamentals. Speculations of interest rate hikes can be “priced in” hours or even days before the actual interest rate statement. In fact, currency pairs have been known to sometimes move 100 pips just moments before major economic news, making for a profitable time to trade for the brave.

That’s why many forex traders are often on their toes prior to certain economic releases and you should be too!

Generally, economic indicators make up a large portion of data used in fundamental analysis. Like a fire alarm sounding when it detects smoke or feels heat, economic indicators provide some insight into how well a country’s economy is doing. While it’s important to know the numerical value of an indicator, equally as important is the market’s anticipation and prediction of that value. Understanding the resulting impact of the actual figure in relation to the forecasted figure is the most important part. These factors all need consideration when deciding to trade.

Phew! Don’t worry. It’s simpler than it sounds and you won’t need to know rocket science to figure it all out. I suggest you visit Pip Diddy’s daily economic roundup every day so that you can stay in the loop with the upcoming economic releases. Fundamental analysis is a valuable tool in estimating the future conditions of an economy, but not so much for predicting currency price direction.

This type of analysis has a lot of gray areas because fundamental information in the form of reports, economic data releases or monetary policy change announcements is vaguer than actual technical indicators. Analysis of economic releases and reports of fundamental data usually go something like this:

“An interest rate increase of that percentage MAY cause the euro to go up.”
“The U.S. dollar SHOULD go down with an indicator value in that range.”
“Consumer confidence dipped 2% since the last report.”

Here’s an Economic Report, Now What?
The market has a tendency to react based on how people feel. These feelings can be based on their reaction to economic reports, based on their assessment of current market conditions. And you guessed it – there are tons of people, all with different feelings and ideas. You’re probably thinking “Geez, there’s a lot of uncertainty in fundamental analysis!” You’re actually very right. There’s no way of knowing 100% where a currency pair will go because of some new fundamental data. That’s not saying that fundamental analysis should be dismissed.
Not at all.

Because of the sheer volume of fundamental data available, most people simply have a hard time putting it all together.

They understand a specific report, but can’t factor it into the broader economic picture. This simply takes time and a deeper understanding of the data. Also, since most fundamental data are reported only for a single currency, fundamental data for the other currency in the pair would also be needed and would then have to be compared to get an accurate picture. As we mentioned from the get-go, it’s all about pairing a strong currency with a weak one. At this point, you’re probably still waiting for the answer to “Will I ever need to use fundamental analysis to become a successful forex trader?”

We totally understand that there are purists on both sides. Technical analysis seems to be the preferred methodology of short-term forex traders, with price action as their main focus. Intermediate or medium traders and some long-term traders like to focus on fundamental analysis too because it helps with currency valuation.

We like to be a little crazy by saying you should use BOTH! Technically-focused strategies are blown to bits when a key fundamental event occurs. In the same respect, pure fundamental traders miss out on the short-term opportunities that pattern formations and technical levels bring.
A mix of technical and fundamental analysis covers all angles. You’re aware of the scheduled economic releases and events, but you can also identify and use the various technical tools and patterns that market players focus on.

From: Introduction to Types of Trading: Fundamental Traders https://www.investopedia.com/articles/trading/02/100102.asp#ixzz5NcA68t8L

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