FOREWORD

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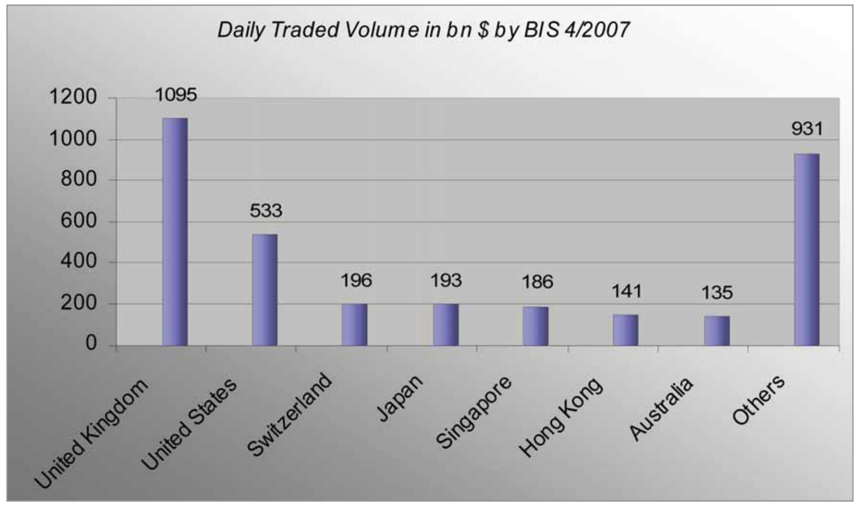
BIS confirms sharp increase of FX volume (+71%) in daily currency trading – QUO VADIS electronic trading?

During the last week of September, the BIS (Bank for International Settlements) published their report on the development of the international Foreign Exchange Markets. This report confirms my foreword in e-FOREX 7/2007 when talking of an "explosion in electronic trading".



Those seven financial centres represent approx. 73% of the daily FX turnover

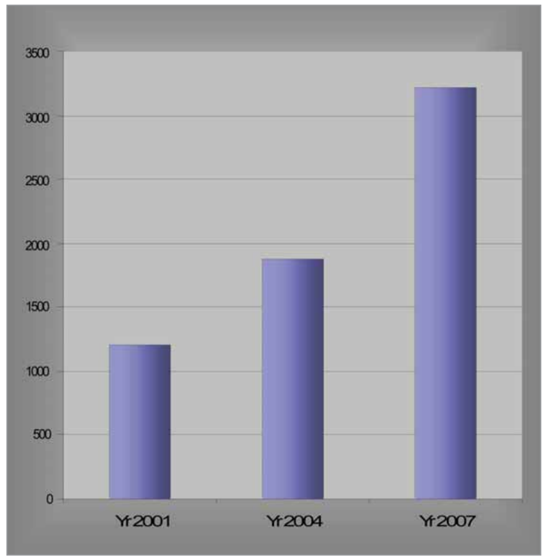
Every three years statistics from central banks and monetary authorities are compiled to watch the development in the worlds largest unregulated and most liquid market. The reviewed data comprise the traditional Foreign Exchange business: FX-Spot, Outright Forwards and Foreign Exchange Swaps whilst OTC-Derivatives are reported in a separate statistic.

The FX-industry is undergoing further expansion. In short, the daily traded FX volume increased from 1.880 billion (April 2004) to 3.210 billion in April 2007 – an increase of 71% in just three years! This increase was much stronger than the previous one between 2001 and 2004.

The U.K. (34,1% market share) and the U.S. (16,6% market share) are still the worlds largest Foreign Exchange Markets. The U.S. market share has fallen by 2,6%. The market share of United Kingdom has grown 2,8% whilst the Swiss market share has grown 3,3% to 6,1% in total. Japan now handles 6% and is down from 8,3%. Singapore is the fifth largest FX centre with a market share of 5,8%. Of interest are the developments in some countries, e.g. India. It has now reached 0,9% of the daily world turnover market share and covers some $ 34 billion by 4/2007 a day ($ 7 billion in 4/2004).

Quo vadis electronic trading?

But these developments will not be the end of the line. Eased access to the FX markets of retail investors, expansion in the activity of investor groups (including hedge funds) and shift from traditional investment behaviour by institutional investors towards FX elements will further increase these volumes.



Daily Global FX turnover

Over the last few years Foreign Exchange has been discovered as an alternative asset class to bonds and equities by institutional investors. Pension funds traditionally have kept the bulk of their money in stocks and bonds – having been the market's biggest investors. Foreign exchange exposure was often considered an unrewarded risk that was typically managed through a "defensive" hedging program. However, low bond yields and volatile stocks in recent years have forced investors into new markets. Recent developments show that FX has become an alternative investment which provides the flexibility for investors to reduce the duration and magnitude of phases of returns underperformance. But we should also consider large shifts of FX portfolios by PFMs (Pension Funds Managers) might even challenge the foreign exchange markets. One decision by an investor might influence others agent's decisions, increasing the impact on the exchange rate and its volatility accumulating into enormous volumes. It's worth noting that amongst financial institutions, Fund Managers and Pension Funds, eFX-Trading has increased by 68% in 2006.

E-trading has lowered the barriers to enter into the FX markets. A review by Greenwich Associates earlier that year shows a doubling of foreign exchange volume from $ 17 trillion in 2005 to $ 35 trillion in 2006. For the first time this development boosts the FX trading volumes through electronic platforms to more than half of global FX trading! In 2005 it was assumed, that eTrading captured less than 30% of the global FX volume.

Electronic trading involves:

- easy and cheap market access,
- flexible and fast execution,
- aggregation and increase of market liquidity,
- innovation by algorithmic trading,

but it also now provides automated trading strategies, anonymity and improved quality of execution. These may be the reasons that more and more hedge funds and proprietary traders rely on algorithms. Although we may now expect a certain level of consolidation in eTrading there still is the potential that in 2010 electronic trading will cover approx. 75% of the global traded volume!

Shade over the markets?

Now, there is no sun without shade. As happened in equities, recent developments envisage a move towards 100% Web-based foreign exchange trade at all ends! A centralized (exchange based) platform with increased regulation would minimize the risk of trading in an over-the-counter market and could be favoured one day by the authorities. Let's keep a close eye on such future movements of eFX. Nevertheless serious risks remain. Besides the usual known ones, such as any failure or malfunction of systems (e.g. inability to enter or cancel orders or system downtime) or any fault in suspension or restrictions of trading (e.g. illiquidity or market restrictions) etc. there is also a risk associated with increased FX turnover which having been asked for by the industry might bear enormous market risks for both professionals and non-professionals alike. The risk arises from the bundling of huge volumes amongst a few market makers when diversification is not available any more. Shifting of huge volumes might cause snowball effects and drive the markets which may force other participants to bail out of positions. In addition to these risks simplified access to the gigantic FX market has recently been discovered by retail traders. FX trading is rather sophisticated and demands experience. Large losses once incurred by margin traders might damage the reputation of this largely professional market.

Whilst technology changes the financial markets it also changes the behaviour of the traders or trading techniques. As we saw during the recent Sub-prime crisis – it's important to have friends in the markets, to use your personal contacts! Networking ("know your customers" or "know your partners") is, what ACI The Financial Markets stands for. We bring people together which should help all of the market participants especially in times of market/liquidity crisis.