

ACI's contribution to their members and the financial markets in 2008

by Manfred Wiebogen, ACI The Financial Markets Association

THE MAIN FINANCIAL HEADLINES DURING 2007 WERE:

- 'SUB PRIME – FINANCIAL TURMOIL IN THE DEVELOPED MARKETS IN EUROPE AND AMERICA'
- 'BIS REPORTS SHARP INCREASE OF THE FX VOLUME (+71%) IN DAILY CURRENCY TRADING'
- 'THE PETRODOLLAR PHENOMENON'
- 'MONETARY RESERVES – THE ASIAN STRENGTH'
- 'US-DOLLAR – *QUO VADIS?*'

THIS IS A LOT OF WORK FOR THE TREASURY AND OUR TRADER'S ASSOCIATION AROUND THE GLOBE.

Traders keeping up the market liquidity

Not only market developments but also regulators, authorities or politicians are challenging our financial markets industry. Besides the above headlines, key words like MiFID, Basel II, SEPA or others are nearly forgotten. But we should not forget the countless individual traders, sitting on the front desk. They do have to fulfil their budget (of course an annually increased budget), they do have to work in different working groups within their institutions to implement the variety of regulations asked for and they do have to keep an eye on their markets, but also on the overall economic or political changes, or outlook – just to survive and to maintain a functioning financial market. Their role involves a wide range of activities.

Each single trader keeps up the liquidity in the market. Of course, the current sub prime crisis stifled the emphasis to Central Banks as 'lender of last resort', but in daily business their power is limited and again traders have to maintain a well balanced and

working market environment. The past years regulators were focused on Basel II or other adjustments, while developments such as those in the mortgage sector were forgotten.



Manfred Wiebogen, President

ACI The Financial Markets Association

tel: +43 (50) 4004 3668

e-mail: manfred.wiebogen@volksbank.com

The current liquidity crisis reveals the past market streaming; over the last couple of years we have seen an erosion of cash liquidity. While 10 years ago traders used to have diversified money market positions, this liquidity has mainly gone in the daily interbank market. Banks' and traders' behaviour changed; there is mistrust among banks and they are less willing to lend each other cash in the daily trading operations on a short to medium-term money market basis. Cost and risk factors for holding or providing cash liquidity might be some of the reasons too. A huge portion of the daily refinancing for retail or corporates is via roll-over loans (mainly three-month-based). Again, due to lack of cash liquidity, the traders' positions are quiet and often hedged with derivatives, and are mainly financed on the very short end. In my previous trading years my bank gave me very strict limitations on the building-up of so-called 'passive risks', meaning positions which need a cash liquidity for future settling out. Now, with the new generation of traders and electronic trading platforms, those risks are undervalued or nearly forgotten. Financial markets are building up enormous volumes of short settlement (risk), which will need to be carefully examined in

the future by regulators and authorities. What lessons have we learned from the former Herstatt crisis in 1974?

One of the challenges for ACI the Financial Markets Association will be to discuss and to interpret, with our market participants, consequences and future behaviour. Do we need new money market instruments for future liquidity balancing?

Foreign exchange – the origin of our financial markets association

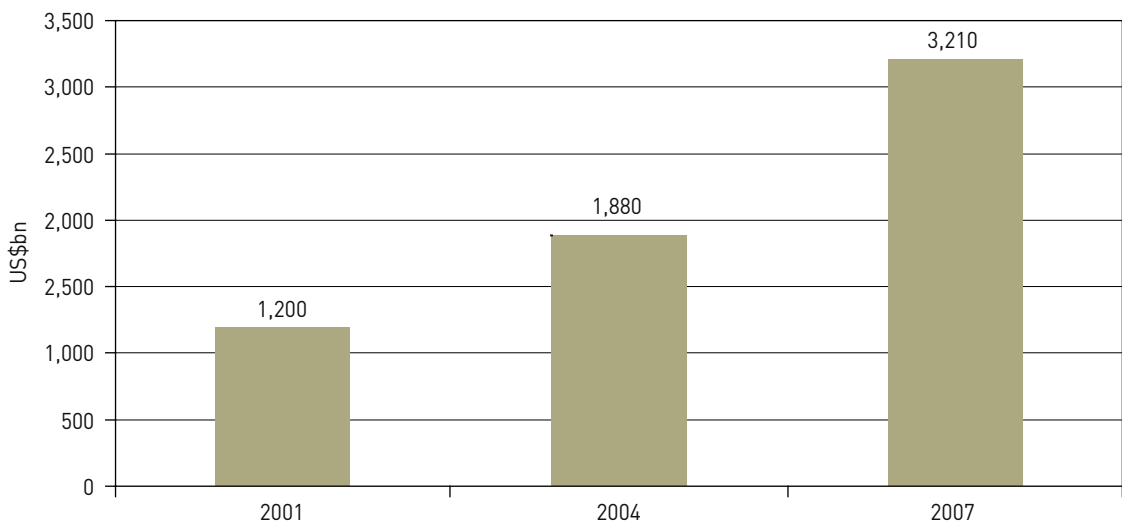
FX is a great business; the latest BIS report shows that FX is more alive than ever. It is the most liquid and largest unregulated market in the world – and it is working perfectly. The markets are open 24 hours a day and tradable nearly six days a week.

The BIS report from September 2007 shows a sharp increase of the daily volumes by 71% over the last three years (April 2004: US\$1.880bn per day – April 2007: US\$3.210bn per day)!

But what is the hidden side of this business? Where do we need to pay extraordinary attention in the very near future?

Global foreign exchange market turnover by BIS (in US\$bn)

Exhibit 1



Source: Daily Global FX turnover by BIS

- e-trading counts for more than 50% of daily business;
- the importance of algorithmic trading increases dramatically;
- the US trade deficit might influence the current dollar development;
- a shift of monetary reserves might confuse the currency structure; and
- may we see an end of the petrodollars (what are the consequences)?

Those are just a few thoughts. We can all attempt to identify what massive impacts we might face in the future FX markets.

E-trading has lowered the barriers to enter into the FX markets. The markets are open for a broad range of participants (nearly everybody) – market professionals, but also retail! Algorithmic trading on the other hand was in demand from the very large players. Automated trading strategies, anonymity and improved quality of execution will further force these developments. We shall see a further increase in e-trading.

Since 1971, the US has run a consistent and increasing trade deficit. The enormous size of the trade deficit over the last several years raises the possibility of a severe economic/financial crisis. Is a bomb ticking and are the problems in the US underestimated?

But we also have to recognise that the euro has become a reserves-currency. By the end of 2006 some 65% of the world monetary reserves were held in US dollar and some 25% in euro. Several Central Banks announced they will further diversify their reserves. But we also might see a shifting from petrodollars payments into euro billings or other currencies all over the globe. The members of the Gulf Cooperation Council (GCC) are also rethinking their exchange rate policies. Could this result in a decreased demand for US dollar and for dollar-denominated assets?

Furthermore we should take a look into the distribution of monetary reserves held by countries or monetary authorities. The picture dramatically changed for the so-called ‘western world’. By the end of September 2007 the list was headed by China (US\$1.434bn), followed by Japan (US\$954bn) and Russia (US\$455bn). The ranking carries on with India, Taiwan, South Korea, Brazil, Singapore and Hong Kong!

The industry needs to watch the developments in these areas very carefully. They could have a big impact on the currency structure, but also on interest rates. Again, sub prime has recently shown how markets behave in times of crisis or mistrust. But once a crisis emerges, it will be traders who have to persist in the markets – either in liquidity or in FX terms. They have to protect their banks and their engagement; so in the end it will be mostly the trader’s fate to communicate in the financial markets and to absorb as much risk as possible.

What is the challenge of the financial markets for ACI?

The members of our association, mainly traders, are doing much more than purely speculating via trading or arbitrage. Traders are guarantors for innovation in the markets (solution management) but also for providing liquidity through permanent price quotation to the whole industry (interbank, corporate, hedge funds etc.).

ACI is much more than a traders’ association seeking profit optimisation for each individual. ACI is a standard of the international financial markets. A standard for traders and their banks in terms of:

- market behaviour;
- best market practice;
- market liquidity provided by the traders;
- giving advice and offer arbitrations services on professional disagreements;
- third party certification (ACI Dealing Certificate, ACI Operations Certificate and the ACI Diploma); and
- personal and company networking.

To enable efficient and smooth operations in the trading rooms, ACI’s tasks will be in the strengthening of:

- training and education of traders;
- supporting a level playing field in our mostly unregulated markets; and
- being the academic conscience in the industry in times of market imbalances.