The Future of Forex

The Foreign Exchange (Forex) market is considered the largest and most liquid financial market in the world, trading a staggering 5.3 trillion US dollars every single day.

That astounding volume was reported in the "Central Bank Survey of Foreign Exchange and Derivatives Market Activity" which was conducted by the Bank for International Settlements (BIS), an organization that acts as a central bank for the world's monetary authorities. The survey was conducted over 53 jurisdictions and results were announced in September 2013.

This high profile survey started in 1989 and is conducted once every three years. In April 2007, the daily Forex volume was USD3.3 trillion. In April 2010, this volume increased to USD4 trillion. By the time the survey was done in April 2013, the daily volume had surged to USD5.3 trillion daily. The majority of the volume was focused in four areas: UK, US, Singapore and Japan. In fact, these four places alone intermediated 71% of the total 5.3 trillion daily volume, up from 66% in 2010.

Amidst a backdrop of global uncertainty from US to Europe and Asia, the results from the BIS survey are clear: Forex trading is here to stay.

Singapore: Third Largest Forex Centre in the World

The survey ranked Singapore as the third largest Forex centre globally after London and New York and the largest Forex centre in Asia, ousting Japan for the first time from the top Asian spot.

Foreign-exchange trading in Singapore is one-seventh the size of that in the U.K. and less than a third of the U.S. total. According to BIS, the record-keeper of the world's central banks, the U.K. has 41 percent of the global market, followed by the U.S. with 19 percent, according to the BIS, Singapore has a 5.7 percent share, followed by Japan's 5.6 percent and Hong Kong's 4.1 percent.

In Singapore alone, volumes grew 44% to USD383 billion in April 2013 compared with USD266 billion in April 2010. Singapore's average daily interest rate derivatives turnover volume also grew 6% to register USD37 billion in April 2013, the second largest volume in Asia, behind Japan.

The Singapore Foreign Exchange Market Committee (SFEMC) also carries out a semi-annual FX survey of the top 30 trading banks in Singapore. This survey is conducted based on the location of the trading desks. The most recent FX survey done in April 2014 recorded an average daily turnover of USD291 billion, a 2.96% increase compared to the last survey in October 2013. Average daily reported turnover in OTC foreign exchange derivatives was USD79 billion, a 28.83% increase compared to October 2013.

There are three main reasons why Singapore has established itself as a serious hub for foreign exchange trading. Here they are:

1) ***Singapore's AAA status***

Having the proud tag of being Asia's only country with a AAA credit rating from all three international credit rating agencies, Standard & Poor's, Moody’s and Fitch, Singapore continues to draw many global multinationals who choose Singapore as a regional treasury centre.

Even the Swiss National Bank, Switzerland's central bank, opened its branch in Singapore in July 2013 - it's first overseas office in the bank's 107 year history. The purpose of the branch is to manage its foreign reserves and monetary policy.

2) Rising importance of Asia Pacific currencies

According to the 2012 Singapore Asset Management Industry Survey conducted by the Monetary Authority of Singapore, total assets managed by Singapore-based asset managers that responded to the survey grew by

21.5% to SGD1.63 trillion at end-2012 compared to SGD1.34 trillion at end-2011. This represents a 5-year average Assets Under Management (AUM) growth rate of 9% per annum, underscoring the resilience and dynamism of the fund management industry in Singapore.

The survey further showed that the Asia Pacific region continued to be the key investment destination for Singapore-based asset managers, accounting for 70% of total AUM in 2012, an increase from 60% in 2011. This showed strong investor interest in the region.

In February 2014, PricewaterhouseCoopers predicted that assets under management (AUM) in the Asia-Pacific region would rise to USD16.2 trillion by 2020, from a 2012 total of USD7.7 trillion.

This represents a compound annual growth rate (CAGR) of 9.8%, and compares favourably against Europe and North America which are expected to experience a CAGR of 4.4% and 5.1% respectively, although both come from a much higher AUM base.

3) Singapore as an offshore Renminbi (RMB) hub

There were three announcements in 2013 which cemented Singapore as a top contender in offshore yuan trading.

- In March 2013, China and Singapore doubled a currency swap agreement to 300 billion yuan, the second largest amount for offshore hubs, trailing only Hong Kong’s 490 billion yuan. A currency swap facility allows central banks to exchange currencies with one another. This meant the Monetary Authority of Singapore could obtain yuan funding from the People's Bank of China and to provide it to local banks as an emergency source of liquidity.

- In May 2013, Singapore became the third offshore yuan clearing hub after Hong Kong in 2004 and London in 2011. ICBC Singapore, which was designated as the yuan clearing bank in Singapore, reported that 49 banks from Singapore and elsewhere opened accounts with it to become participating banks. It cleared 53 transactions worth a total of 1.61 billion yuan on the first day of trading. In just seven months thereafter, the volume reached about 2.6 trillion yuan by the end of 2013. In the first two months of 2014, the amount swelled to 4.2 trillion yuan.

- In October 2013, China and Singapore agreed to allow direct trading between their currencies. This meant that the Singapore dollar became only the fifth currency to have direct trading links with the Chinese yuan, trailing only the US dollar, the Japanese yen, the Australian dollar and the British pound.

In March 2014, Assistant Managing Director of the Monetary Authority of Singapore, Mr Leong Sing Chiong announced that Singapore's total yuan deposits as of end-December 2013 stood at RMB 200 billion, a 70% increase over deposit levels a year earlier.

Retail Forex

Now that we have pretty much covered the global Forex landscape, key markets and institutional volumes, let's take a look at a segment that impacts the man-on-the-street - the retail Forex arena.

Here's some interesting facts.

One highlight of the BIS survey was the inclusion of retail data. For the first time, the FX survey included statistics of retail volumes, and measured primary dealer volumes with retail driven counterparties. This volume is primarily liquidity that was being sourced for brokers targeted for retail order flow. The survey indicated that USD185 billion, or 3.5% of the USD5.3 trillion daily volume, was retail flow.

One of the highlights in the retail world has been that of social trading. Social trading allows traders to trade online with the help of others. It shortens the learning curve because traders can interact with others, watch others take trades, then duplicate their trades and learn what prompted the top performer to take a trade in the first place. By trade copying, traders can learn which strategies work and which do not, without risking their entire portfolio.

The entire social trading industry is currently estimated to host about 235,000 users with a combined total of USD240 million of customer funds. In fact, over a five year period, 600,000 clients used social trading, and the largest markets are Japan, which accounts for 30% of the entire social trading market, followed by Europe and Russia representing 15% each.

Future Trends

The sharp rise in FX activity over the years is attributed to three main factors:

- Market Volatility
- Acceptance of Forex as an asset class
- Global distribution of the product

In March 2014, Bloomberg published an article which said that 74% of global currencies trading volume was executed through electronic systems last year. The research was conducted by a company called Greenwich Associates.

Even banks are shifting more activity onto electronic platforms as profit margins shrink and clients demand greater transparency in pricing and transaction charges.

The move has been hastened by a widening probe of the market that has seen the dismissal or suspension of more than 21 currency traders from the world's biggest foreign exchange traders, including Deutsche Bank AG and Citigroup Inc.

The Greenwich report said retail brokers contributed to most of the expansion in electronic trading as volume rose to 98 percent in 2013 from 92 percent the year before.

Over the next few years, I expect the volume of retail Forex trading to rise even further. The markets which would rapidly gain market share include Latin America, Middle East, Asia and Africa. The market that would record the biggest drop in volume would be USA. The primary reason for this would be the tight regulatory capital requirements meted out on Forex brokers by the industry watchdog, the National Futures Association (NFA).

As legendary ice hockey champion Wayne Gretzky said, "I don't go to where the puck is. I go to where the puck may be."

The "Forex puck" is going to be in Latin America, Middle East, Asia and Africa. If you are in any of these regions, you are smack in the middle of all the trading action!

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