

The market in foreign exchange in London

This article⁽¹⁾ sets out the results⁽²⁾ of the first comprehensive statistical survey of the volume and composition of foreign exchange business transacted by banks⁽³⁾ and brokers operating in London.⁽⁴⁾ The survey, which was conducted by the Bank of England in March of this year, showed that:

- *banks' average total turnover was equivalent to US\$115 billion per day: adjusted for the double reporting of transactions between banks in the United Kingdom, the average volume totalled US\$90 billion per day;*
- *the major share of trading was between the US dollar and sterling (30 per cent), closely followed by US dollar/deutschemark business (28 per cent);*
- *virtually all business was in spot contracts (73 per cent) or in forward contracts of no more than one year's maturity (26 per cent): foreign currency options and futures contracts formed a relatively insignificant part of the market;*
- *the market was largely interbank (89 per cent), with a major share of banks' reported business (43 per cent) conducted through brokers.*

The Bank of England's survey of the London foreign exchange market was conducted over the first ten business days of March 1986 and coincided with the first part of similar surveys for the whole of March conducted in the United States by the Federal Reserve Bank of New York and in Japan by the Bank of Japan. A total of 347 banks and 8 recognised brokers in foreign exchange and/or currency deposits were asked to complete a special questionnaire prepared by the Bank of England after consultation with the Joint Standing Committee⁽⁵⁾ and with the Foreign Exchange Committee of the British Bankers' Association. The Bank of England also completed a questionnaire. The particular banks approached were mainly those which report regularly to the Bank of England in respect of foreign exchange exposures; all brokers recognised by the Bank for the purpose of offering a service in the United Kingdom in foreign exchange and currency deposits, and one recognised currency deposit broker active in foreign currency options, were included in the survey. Returns were received from all those approached. The large number of non-bank institutions dealing in foreign exchange in London were not directly included in the survey (although their transactions with banks in the United Kingdom or through brokers were reported by these institutions).

The questionnaire

Survey respondents were asked to determine, for the ten business days of the survey period, their *gross turnover* in foreign exchange, broken down in terms of specified categories of currency, transaction and counterparty. Deposit business was specifically excluded from the survey. Gross turnover was defined as the absolute total value of all deals contracted, ie the sum of all foreign exchange transactions calculated without netting purchases from sales of the same currencies. Data were requested in terms of US dollar equivalents, rounded to the nearest million.

In the currency analysis, details were requested of turnover between the US dollar and each of seven specified major currencies; between the US dollar and any currency other than those specified; between the ECU and any currency; and in 'cross-currency' transactions, ie between two currencies where neither is the US dollar and the exchange is direct—specifically, between sterling and the deutschemark; between sterling and any other currency other than the US dollar or the deutschemark; and cross-currency transactions not involving sterling.

The transaction analysis requested was broadly between business for *spot* value (ie for settlement no more than two

(1) Prepared in the Bank's Foreign Exchange Division, mainly by R D Comotto.

(2) The results of the survey were first published by the Bank of England in a press notice released on 20 August 1986. This article is an expanded version of that press notice.

(3) Unless otherwise indicated by the context, reference to 'banks' in this article includes not only recognised banks but also licensed deposit-taking institutions (LDTs).

(4) There is no significant foreign exchange market in the United Kingdom outside London.

(5) The Joint Standing Committee was established in 1973, principally as a forum for discussion of developments in market practices with a view to identifying problems and, where possible, recommending solutions. It comprises four representatives of banks active in foreign exchange in London and four representatives, including the Chairman and Deputy Chairman, of the Foreign Exchange and Currency Deposit Brokers' Association. The Chairman and the Secretary of the Committee are provided by the Bank of England.

business days after a deal was contracted); for *forward* value (ie usually for settlement more than two business days after dealing); in foreign currency *options* contracts (ie agreements which give the right to, but do not impose the obligation on, the holder of the contract to buy or sell particular foreign currencies at agreed exchange rates at agreed dates in the future); and foreign currency *futures* contracts (ie standardised contracts representing commitments to buy or sell fixed amounts of foreign currency at agreed exchange rates on specified dates in the future). Forward contracts included 'outright forwards' (ie single sales or purchases of foreign currency for value more than two business days after dealing), 'swaps' (ie spot purchases against matching outright forward sales, or vice versa) and 'forward/forwards' (swap transactions between two forward dates rather than between spot and forward dates). With regard to swap and forward/forward deals, respondents were asked to count only one of the two transactions involved; for options and futures contracts they were requested to record the full principal amount of such contracts.

In the counterparty analysis, the broad categories requested from banks were deals with other banks, deals through brokers, deals with 'other market participants' (ie non-bank financial institutions, such as securities houses and commodity traders, which are active participants in the wholesale foreign exchange market, often on terms similar to those available to banks) and deals with customers. Brokers were also asked to indicate the volume of their business channelled through other brokers located abroad.

In addition to statistical data, respondents were asked to answer some supplementary questions, the main objectives of which were: to indicate whether business in the survey period was considered to be in line with longer-term trend levels; and to determine if there were correlations between individual categories of the three analyses, so that allowance could be made when adjusting for the reporting of the same transaction by two respondents (eg if banks in the United Kingdom transacted a larger proportion of the business between sterling and the US dollar than between other currencies, an above-average adjustment for double reporting would be indicated for sterling/US dollar turnover—see below).

The results of the survey

The survey revealed that gross foreign exchange turnover by respondents averaged the equivalent of US\$115 billion per day for the survey period. In addition, US\$2 billion of business between banks abroad was intermediated by brokers in London. About 70 per cent of respondents considered overall turnover during the survey period to be normal in terms of being close to trend; 21 per cent considered business below normal.

If adjustments are made to the figures for gross turnover to allow for the double reporting of transactions between banks in the United Kingdom (where each transaction

would have been reported by both the banks involved), the average volume of banks' total gross business in London was US\$90 billion per day. Turnover data covering transactions between banks in the United Kingdom on the one hand and banks overseas or non-bank institutions on the other hand would only have been reported once in the survey (by the banks in the United Kingdom involved in such transactions) and so do not have to be adjusted for double reporting. Of the adjusted average banks' turnover of \$90 billion, brokers (in the United Kingdom and abroad) intermediated 43 per cent.

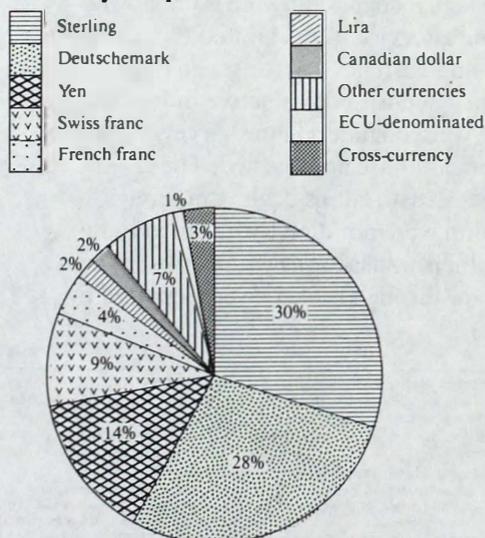
Currency composition

The survey suggests that the bulk of banks' activity in London is in sterling/US dollar and US dollar/deutschemark transactions. The former accounted for 30 per cent of banks' total gross turnover during the survey, the latter for 28 per cent. Substantial volumes of business also took place between the US dollar and the yen (14 per cent of the total) and between the US dollar and the Swiss franc (9 per cent). Smaller but still significant volumes were seen between the US dollar and the French franc (4 per cent), the lira (2 per cent) and the Canadian dollar (2 per cent). Transactions between the US dollar and other currencies amounted to 7 per cent of the total: most of this was probably accounted for by the Australian and New Zealand dollars, the Netherlands guilder, the Belgian franc and Scandinavian currencies. Business not involving the US dollar ('cross-currency') was quite small (3 per cent) and was largely between sterling and the deutschemark (1 per cent of the total). ECU-denominated turnover constituted about 1 per cent of the total (Chart 1).

Type of transaction

Over the period of the survey, the bulk of foreign exchange business transacted by banks in London (73 per cent of banks' gross total) was for spot value. Almost the whole of the balance was represented by forward contracts; less

Chart 1
Currency composition—banks' turnover

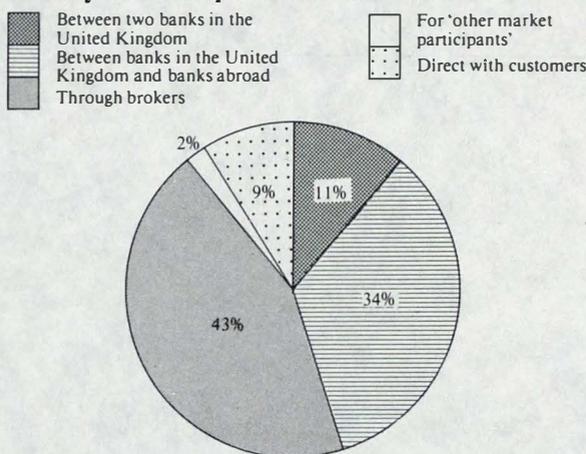


than 1 per cent of banks' total turnover was represented by forward maturities of more than one year. A major part of turnover in swaps was probably for 'short-dated' periods, ie where the maturity of the outright forward component was for less than one month, including periods less than the two business days normally used to delineate spot value. Foreign currency options and futures contracts were relatively insignificant (well under 1 per cent of business in total), although the survey may have missed a proportion of respondents' business in these instruments, which is frequently conducted through related companies.

Counterparties

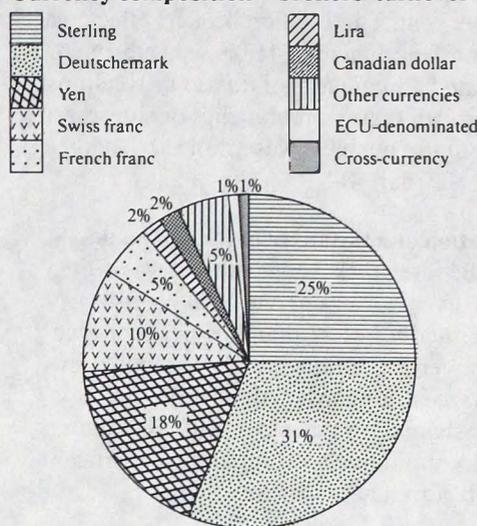
Activity in the foreign exchange market over the survey period was predominantly interbank. Business directly between banks in the United Kingdom accounted for 11 per cent of banks' total reported turnover. Transactions made by banks in the United Kingdom directly with banks overseas as the other counterparty generated 34 per cent. Deals arranged through brokers with a bank as a counterparty produced about another 43 per cent. Some 2 per cent of banks' total business was with other market participants. Banks' business directly with customers accounted for 9 per cent of their total turnover (Chart 2).

Chart 2
Identity of counterparties—banks' turnover



Although only a modest part of the total business transacted by banks was for their customers, such business probably generated a large part of the turnover in the interbank market. Transactions with customers may leave banks with unwanted exposures, and—especially in nervous markets—a series of interbank transactions may have to be undertaken before all positions are voluntarily held. Market practices, such as dealing through the US dollar and executing an outright forward order from a customer by means of a swap and a matching spot transaction, also add to recorded business between banks. For example, a bank that wished to cover a sale to a customer against sterling of a foreign currency other than the US dollar, and for a forward date, would need to undertake at least four additional transactions, ie spot and swap deals in both sterling/US dollar and US

Chart 3
Currency composition—brokers' turnover



dollar/foreign currency, each of which would have been included in the survey.

Brokers

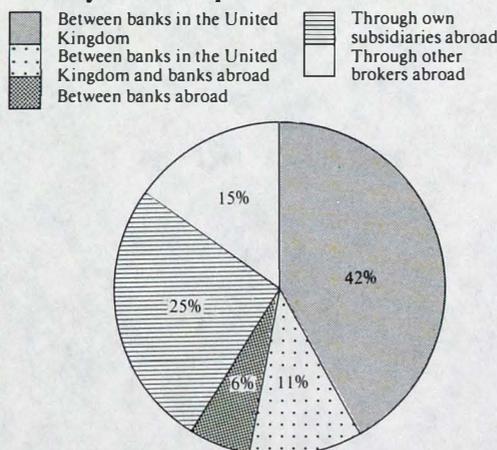
As noted above, brokers (including brokers located outside the United Kingdom) arranged 43 per cent of the total gross business reported by banks in the survey.

The most important currencies for London brokers were US dollar/deutschemark (31 per cent of brokers' aggregate turnover during the survey period) and sterling/US dollar (25 per cent). US dollar/yen (18 per cent) and US dollar/Swiss franc (10 per cent) were also important (Chart 3).

Virtually all of the business arranged by London brokers was spot (56 per cent) or forward (43 per cent); nearly all of the latter was for maturities of up to and including one year. Turnover in foreign currency options and futures contracts was minimal.

Broking between banks in the United Kingdom generated 42 per cent of the London brokers' gross activity. Transactions between banks in the United Kingdom and

Chart 4
Identity of counterparties—brokers' turnover



counterparty banks abroad gave rise to 11 per cent of brokers' turnover; business entirely between banks abroad accounted for 6 per cent. The London brokers effected a large proportion of their business (41 per cent) through other brokers located abroad and, of this activity, almost two thirds was through their own branches or subsidiaries. A very small amount of business was arranged for other market participants (Chart 4).

Market concentration and the share of foreign banks

Participation in the foreign exchange market was quite widely dispersed. Twenty four out of the 348 bank respondents accounted for more than one per cent each of total gross turnover and, of these, only ten took more than two per cent: these ten most active banks held a combined overall share of some 36 per cent. Less than half-a-dozen banks maintained a comparably significant presence across all currency categories.

However, concentration was very much higher for some less widely-traded currencies. Thus, whereas the ten most

active banks in each category accounted for only 40 per cent of total sterling/US dollar turnover, 38 per cent of US dollar/deutschemark and 46 per cent of US dollar/yen, the percentage was 57 per cent for US dollar/Swiss franc; 70 per cent for US dollar/French franc; 80 per cent for US dollar/lira; and 77 per cent for US dollar/Canadian dollar.

Foreign banks in London accounted for the greater part of banks' aggregate turnover in London (78 per cent). The most sizable presence was that of North American banks, which accounted for about 41 per cent. Other EC banks took 16 per cent. Japanese banks held a 7 per cent share. Banks from other developed countries secured 10 per cent and banks from developing countries, 4 per cent.

British and North American banks in aggregate accounted for the greater part of business in nearly all currency categories. Japanese banks tended to be relatively concentrated in US dollar/yen business and other nationality groups similarly tended to be concentrated in the currencies of their countries of origin (see the table).

Banks' shares of the London market in different currencies; by country grouping

Percentages

Nationality of bank	US dollar against:							Sterling against:		Other cross-currency	ECU-denominated	
	Sterling	Deutschemark	Yen	Swiss franc	French franc	Lira	Canadian dollar	Other currencies	Deutschemark			Other
United Kingdom	32	17	13	15	23	11	16	23	62	63	17	46
Other EC	12	18	4	14	53	78	4	18	16	15	30	34
North America	41	48	42	42	22	11	79	25	18	12	36	15
Japan	3	3	34	1	—	—	—	—	—	2	3	—
Other developed countries	9	9	5	24	—	—	—	20	4	6	10	5
Developing countries	3	5	2	4	2	—	1	15	1	3	4	—