

The market in foreign exchange in London

In March 1986, the Bank of England carried out the first comprehensive statistical survey of the volume and composition of the foreign exchange market in London. The results⁽¹⁾ of that survey aroused considerable interest and prompted the Bank to mount a further survey in April this year, when similar surveys in other centres were conducted by other central banks. This article⁽²⁾ sets out the results⁽³⁾ of the Bank of England's second survey of foreign exchange business transacted by principals and brokers operating in London.⁽⁴⁾ It compares the results with those obtained in 1986 and, in the light of results in other centres, puts the foreign exchange market in London into a world perspective.⁽⁵⁾

The survey shows that:

- *London continues to be the world's largest centre for foreign exchange trading, with an average daily turnover equivalent to some US\$187 billion (up from US\$90 billion per day in 1986).*
- *Although US dollar/sterling and US dollar/deutschemark transactions again account for most of the business, there has been a significant increase (from 3% to 9%) in cross-currency trading not involving the US dollar.*
- *Brokers continue to intermediate in a significant proportion of business in London, although their percentage share of total turnover has shown some decline.*
- *Direct transactions between principals and their customers have grown from 9% of overall turnover in 1986 to some 15% this year.*

The Bank of England's survey of the London foreign exchange market was conducted over the twenty business days of April 1989 and coincided with similar surveys conducted in other centres around the world by other central banks. A total of 356 principals (including the Bank of England itself) and 9 brokers in foreign exchange participated in the London survey. The principals approached were mainly those banks which report regularly to the Bank of England in respect of foreign exchange exposures, although, for the first time, a number of institutions listed by the Bank under Section 43 of the Financial Services Act 1986 as market makers in foreign exchange were also included. Other institutions dealing in foreign exchange were not directly involved in the survey, although their transactions with participating principals, or through brokers, would have been reported by those institutions.

The questionnaire

Survey participants were requested to complete a questionnaire prepared by the Bank of England after consultation with representatives of the Foreign Exchange Committee of the British Bankers' Association and the

Foreign Exchange and Currency Deposit Brokers' Association. For the twenty business days of the survey period, participants were asked to provide details of their gross turnover in foreign exchange, analysed by currency, type of transaction and counterparty. As in 1986, 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 during the survey period without netting purchases against 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 ten specified major currencies; between the US dollar and any other currency; between sterling and the deutschemark and sterling and any other currency; between the deutschemark and the Japanese yen, the deutschemark and the Swiss franc and the deutschemark and the French franc; between the ECU and any other currency; and between any other two currencies (ie besides those specified).

(1) Described in the September 1986 *Bulletin*, pages 379-82.

(2) Prepared in the Bank's Foreign Exchange Division, mainly by D J Fisher.

(3) The results of this year's survey were first published by the Bank of England in a press notice released on 13 September 1989. This article is an expanded version of that press notice.

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

(5) An article on page 516 of this *Bulletin* discusses the financial markets in London in a wider context.

The transactions analysis requested was broadly between business for *spot* value (ie for settlement no more than two business days after a deal was contracted); for *forward* value (ie 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 any 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). In the case of 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 principals were deals with other market principals, deals through brokers and deals with customers. Brokers were also asked to indicate the volume of their business effected through their own branches and subsidiaries abroad or through other brokers abroad.

Finally, participants were asked to indicate how foreign exchange turnover recorded by their London offices during the survey period compared with levels regarded as normal.

The results of the survey

After adjustment to allow for the double reporting of transactions between principals in the United Kingdom,⁽¹⁾ the average volume of principals' gross business in London during the survey period is estimated to have been some US\$187 billion per day (just over double the 1986 figure of \$90 billion per day). In addition, however, brokers in London intermediated in transactions averaging the equivalent of US\$12 billion per day between *principals abroad* (and not therefore included in the US\$187 billion per day figure).

About 66% of participants considered the overall level of turnover during the survey period to be normal; 30% considered business below normal; and the remaining 4% thought that their figures were above average.

With an estimated daily turnover of \$187 billion, London remains the world's biggest centre for foreign exchange dealing. However, larger percentage increases in turnover were revealed by the Federal Reserve Bank of New York

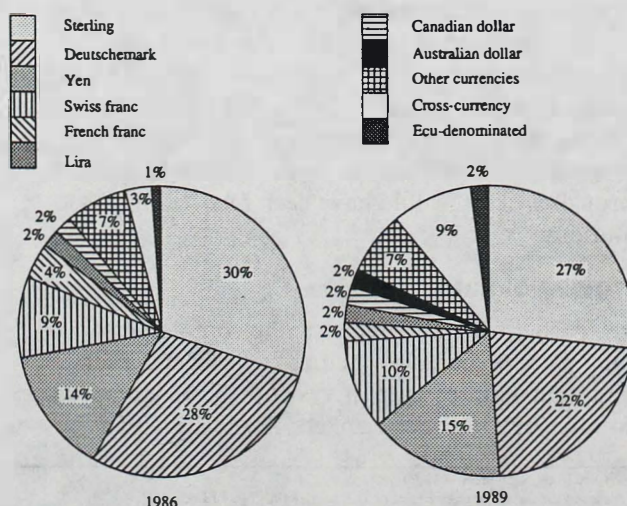
and the Bank of Japan. The volume of foreign currency trading in New York and Tokyo increased to \$129 billion and \$115 billion per day respectively (compared with \$58 billion and \$48 billion per day in 1986). Switzerland (\$57 billion per day) was the fourth largest foreign exchange centre of those which published survey results, closely followed by Singapore (\$55 billion per day) and Hong Kong (\$49 billion per day).

In all, some twenty central banks conducted surveys of their foreign exchange markets in April, compared with only four in 1986. The surveys were broadly similar, although the details requested varied according to the particular nature of each market covered. While it would be misleading simply to aggregate the individual results to produce a figure for global turnover⁽²⁾ (because of the double counting of deals between centres), there has clearly been a substantial increase in the volume of foreign exchange activity over the last three years. The increase far exceeds published estimates of the rise in the value of world trade over the period. But, at the same time, there has also been a surge in cross-border capital flows stimulated by the deregulation of financial markets and the relaxation of exchange controls, and this must have contributed to the increase in the level of foreign exchange transactions.

Currency composition

As in 1986, the survey indicated that the bulk of principals' activity in London is in sterling/US dollar (27%) and US dollar/deutschemark (22%) transactions. However, as Chart 1 illustrates, sterling/US dollar and US dollar/deutschemark's combined share of overall business was down from 58% in 1986 to 49% this year owing, largely, to business not involving the US dollar ('cross-currency'), which grew from 3% in 1986 to 9% (of which about a third was accounted for by sterling/deutschemark transactions). Substantial volumes of business also took place between the US dollar and the

Chart 1
Currency composition - principals' turnover



(1) Gross turnover averaged the equivalent of some \$250 billion per day. However, because transactions between principals in the United Kingdom would have been reported by *both institutions* involved, an adjustment is necessary.

(2) If in due course it proves possible to produce an estimate, a short postscript to this article will appear in a future issue of the *Bulletin*.

yen (15% of the total compared with 14% in 1986) and between the US dollar and the Swiss franc (10% compared with 9% three years ago). Smaller but still significant volumes (2% of total turnover in each case) were seen between the US dollar and the French franc (down from 4% in 1986), the US dollar and the lira (unchanged from 1986), the US dollar and the Canadian dollar (also unchanged) and the US dollar and the Australian dollar (not separately identified in 1986). Transactions between the US dollar and other currencies amounted to 7% of the total (the same as in 1986, but figures for this category then included Australian dollar business). Of this, US dollar/Netherlands guilder and US dollar/Belgian franc business accounted for less than 1% in each case; most of the remainder was probably accounted for by the Spanish peseta, Scandinavian and Middle Eastern currencies, Hong Kong and Singapore dollars and the New Zealand dollar. ECU-denominated turnover constituted about 2% of the total (up from 1% in 1986).

Table A
Currency composition: international comparisons
Percentages of principals' overall turnover

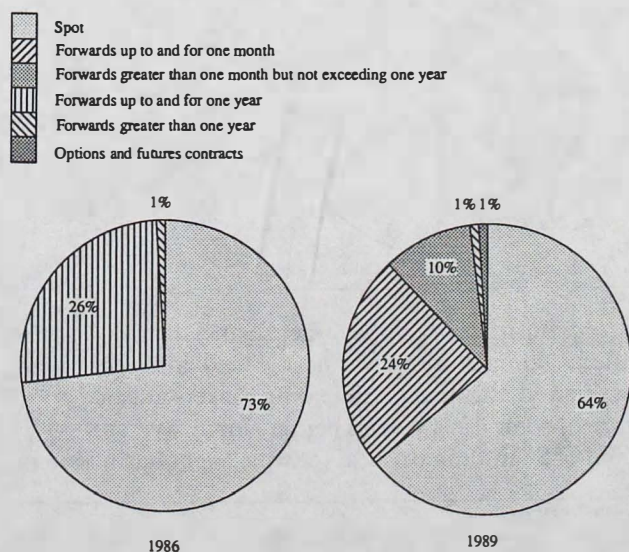
	London	Tokyo	New York
\$/£	27	4	15
\$/DM	22	10	33
\$/Yen	15	72	25
\$/Sw.Fc.	10	4	12
Other (including cross-currency)	26	10	15

A comparison with the results from other centres reveals that the foreign exchange market in London is more diversified than elsewhere. In Tokyo, for example, as much as 72% of overall turnover related to business between the US dollar and the yen; and in New York, 85% of activity was between the US dollar and the four major currencies (deutschemark, yen, sterling and the Swiss franc), compared with 74% in London.

Type of transaction

As in 1986, the bulk of foreign exchange business (64%) transacted by principals in London was for spot value.

Chart 2
Type of transaction - principals' turnover

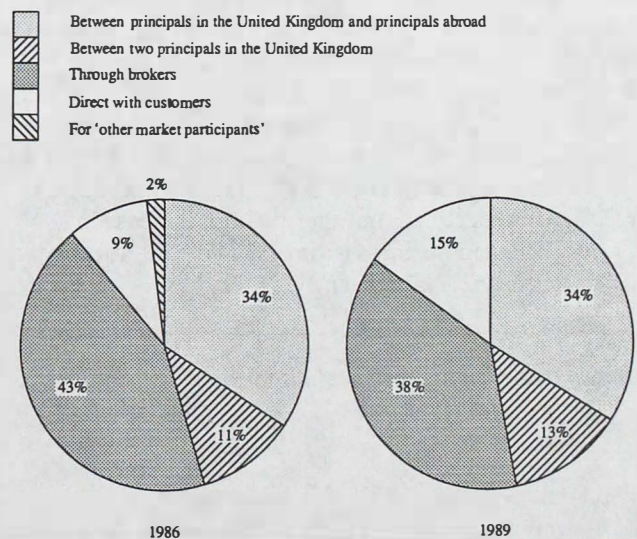


However, as Chart 2 illustrates, this was significantly less than the 73% share identified in 1986 owing, in all probability, to an increase in business in 'swaps' and the promotion of other hedging instruments in the forward market. In 1986, the remaining 27% of overall turnover was represented by forward contracts, nearly all of which were for periods up to or for one year (no more detailed breakdown was requested). This year, 24% of total turnover was for forwards of maturity up to and for one month, 10% for forwards of maturity greater than one month but not exceeding one year and 1% for forwards of maturity greater than one year. Although some survey participants were heavily involved in foreign currency options and futures, overall turnover in these instruments amounted to little more than 1%. However, as in 1986, the survey may have failed to capture all business in options and futures, which is frequently conducted through companies not covered by the survey.

Counterparties

The survey revealed an increase in the proportion of business conducted without the assistance of a broker (Chart 3). Direct transactions between principals in the United Kingdom accounted for 13% of total reported turnover (up from 11% in 1986) and there was a significant increase—from 9% to nearly 15% (9% with

Chart 3
Identity of counterparties - principals' turnover



financial institutions and 6% with non-financial institutions)—in the proportion of turnover reported to have been accounted for by transactions between principals and their customers. Business directly between principals in the United Kingdom and principals abroad accounted for 34% of overall turnover (the same as in 1986).

It should be said that part of the apparent increase in customer business could be attributable to the fact that, in this year's survey, respondents were not asked to identify deals with 'other market participants' (eg some securities houses) separately from deals with 'customers'—in 1986, some 2% of principals' total turnover was with 'other

market participants'. In spite of this increase, customer business remains low as a proportion of principals' overall turnover, but, as pointed out in the analysis of the 1986 results, it is directly responsible for generating considerable activity. One reason for this is that, in spite of the increase in direct cross-currency trading, a large number of cross-currency transactions are still executed through the US dollar, thereby involving two deals; another reason is that, in general, outright forward orders from customers continue to be executed by means of a swap and a matching spot transaction. For example, a principal who wished to cover a forward sale to a customer of a currency other than the US dollar (or the deutschemark) against sterling would probably undertake at least four additional transactions (ie spot and swap deals in both sterling/US dollar and US dollar/foreign currency). These additional transactions would have been included in the survey, helping to swell overall turnover.

Brokers⁽¹⁾

The share of principals' business reported to have been conducted through brokers declined from 43% in 1986 to 38% this year. As Chart 4 shows, US dollar/deutschemark transactions accounted for 28% of London brokers' aggregate turnover during the survey period (down from 31% in 1986), and brokers' business between sterling and the US dollar fell from 25% of overall turnover in 1986 to 23% this year. Another important currency for London brokers was US dollar/yen (up from 18% in 1986 to 19%) and, as in the case of principals, there was a marked increase in cross-currency trading (7% of overall turnover—up from 1% in 1986). Business between the US dollar and the Swiss franc (down from 10% to 9%), between the US dollar and the French franc (down from 5% to 3%) and between the US dollar and the lira (down from 2% to 1%) declined, but there was an increase in ECU-denominated business (from 1% of overall turnover in 1986 to nearly 2% this year).

Chart 4
Currency composition - brokers' turnover

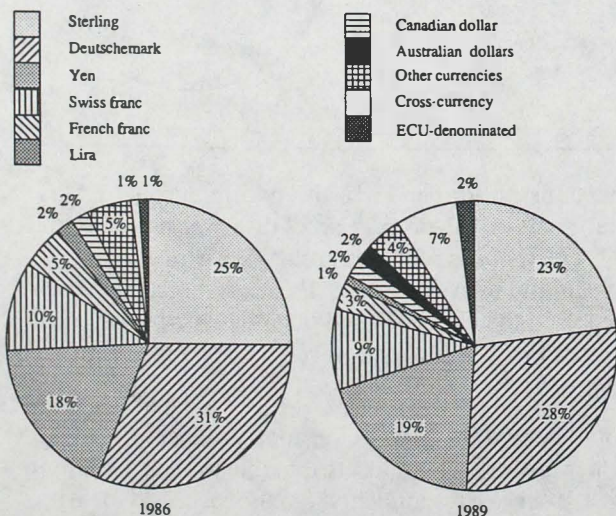
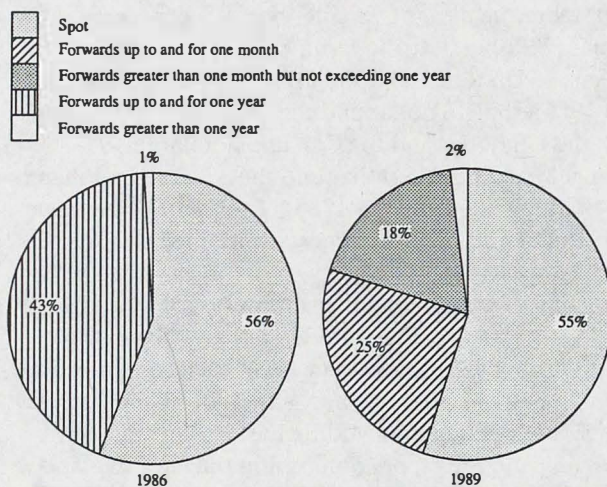


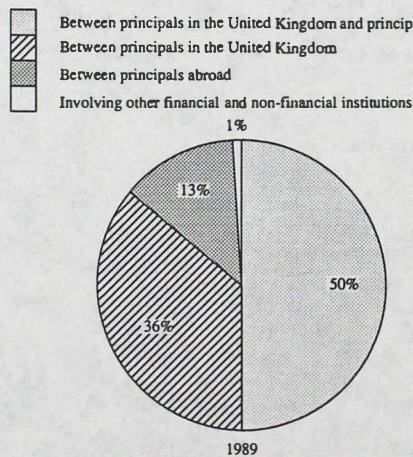
Chart 5
Type of transaction - brokers' turnover



Spot business arranged by London brokers declined slightly from 56% of overall turnover in 1986 to 55% in 1989 while forward business rose from 44% to 45% (Chart 5). Transactions of maturity up to and for one month accounted for 25%, of maturity greater than one month but not exceeding one year for 18% and of maturity greater than one year for nearly 2%. Very little turnover in foreign currency options and futures contracts was reported; these are largely broked by specialist firms not covered by the survey.

Broking between principals in the United Kingdom and principals abroad generated 50% of London brokers' gross activity. Deals involving only principals in the United Kingdom accounted for 36% and those involving only principals abroad for 13% of brokers' overall turnover

Chart 6
Identity of counterparties - brokers' turnover



(Chart 6). Business involving other financial and non-financial institutions was negligible. During the survey period, the nine participating brokers effected an average of some 12,000 deals per day for an average amount of \$7 million per deal (of which spot business

(1) The data in this section differ somewhat from those contained in the Press Notice of 13 September owing to the subsequent receipt of some revised information.

accounted for an average of around 10,000 deals per day for an average amount of \$4½ million). 37% of this business was effected either through their own branches and subsidiaries abroad or through other brokers abroad; in 1986, 40% of brokers' business was reported to have been effected in this way.

Market concentration and the share of foreign banks

Business in the London foreign exchange market continued to be quite widely dispersed. Twenty-seven of the 356 principals participating in the survey accounted for more than 1% each of total gross turnover and, of these, ten had a share of more than 2%. These ten most active principals—seven of which were among the top ten in 1986—held a combined overall share of some 35% (36% in 1986).

As in 1986, business in the most actively traded currencies was more widely dispersed than in other currencies, but there was evidence of a drift towards more broadly based trading in most currencies. The ten principals most active in sterling/US dollar accounted for only 34% of total turnover therein (down from 40% in 1986) and the corresponding figures for US dollar/deutschemark and US dollar/yen were 37% (down from 38%) and 39% (down from 46%) respectively. The top ten principals in US dollar/Swiss franc accounted for 60% of total turnover therein (up from 57%) but the corresponding figures for US dollar/French franc, US dollar/lira and US dollar/Canadian dollar were 61% (down from 70%), 74% (down from 80%) and 69% (down from 77%) respectively. In ECU-denominated business, however, the ten most active principals accounted for as much as 81% of overall turnover.

Foreign institutions accounted for 80% (78% in 1986) of principals' aggregate turnover in London. Although their share declined from 41% in 1986 to 39% in 1989, North American principals remained the major participants, followed by UK principals with 20%. EC principals

(excluding the United Kingdom) generated 16% of total turnover (as in 1986), but Japanese principals (up from 7% in 1986 to 11%) and principals from 'other developed countries' (up from 10% to 13%) increased their share of the business in London. The penetration of principals from developing countries declined from 4% to 1%.

North American principals led the field in six of the currencies surveyed, but the majority of principals continued to specialise in the currency of their country of origin (see Table B). Among the interesting facts to emerge from this table are Japanese principals' increased share in US dollar/yen business (from 34% in 1986 to 43%), which was achieved at the expense of the North Americans (whose share declined from 42% to 35%); and the increases in the North American principals' share of the market in US dollar/French franc (up from 22% to 33%) and US dollar/lira business (up from 11% to 24%), which were offset by falls in the share of UK and other EC principals.

The table also shows that UK principals no longer dominate the market in cross-currency business involving sterling to the extent they did in 1986. Their share of sterling/deutschemark business fell from 62% in 1986 to 41% this year and there was a similar fall (from 63% to 41%) in their share of sterling/other currency business.

In the case of deutschemark/yen transactions, it is interesting to note that nearly 80% of the business in London is undertaken by North American and Japanese principals. Although London's market in ECUs received a boost from last year's introduction of UK Treasury bills denominated and payable in ECUs, the results of the survey suggest that principals from 'other developed countries' have been the major beneficiaries in terms of increased business. Their share of the ECU market in London has risen from 5% in 1986 to 23% this year, while the share of UK principals has fallen from 46% to 28% and that of other EC principals remains roughly the same (35% from 34% in 1986).

Table B
Principals' shares of the London market in different currencies: by country grouping

Nationality of principal	US dollar against:										Sterling against:		DM against:			Other cross-currency		ECU-denominated
	£	DM	Yen	Sw.Fc.	FF	Lira	Can\$	DFIs	BFcs	A\$	Other currencies	DM	Other currencies	Yen	Sw.Fc.	FF		
United Kingdom	30	14	12	14	15	7	11	29	12	18	16	41	41	11	29	22	23	28
Other EC	15	19	4	9	48	68	5	29	38	3	25	21	17	6	4	41	40	35
North America	36	49	35	48	33	24	79	35	29	27	23	32	25	47	22	33	27	9
Japan	6	6	43	2	1	1	—	—	—	—	—	2	4	32	—	—	1	4
Other developed countries	11	11	7	26	2	1	3	6	19	52	30	—	12	4	44	4	8	23
Developing countries	3	1	1	1	—	—	1	—	—	—	6	—	—	—	—	—	1	—