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The role of East Asian countries in the global foreign exchange market

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The financial markets and institutions facilitate the international flow of funds between countries, they reduce the risk and provide the liquidity. Moreover, efficient financial markets and institutions tend to lower search and transactions costs in the economy. By providing a large array of financial products, hedging risk and diversifying pricing structures a well-developed financial system offers products to participants that provide borrowers and lenders with a close match for their needs. In many developing countries limited financial instruments and financial institutions, as well as poorly defined legal systems, may make it more costly to raise capital and may lower the return on savings or investments.

Today in the process of globalization of financial markets, both technological advances and financial innovation play a key role. In the past few decades, information systems have become able to compute and store more data much more rapidly. As a result, cross-border financial deals have become both easier and more secure, effectively lowering the barrier constituted by distance, be it determined by geography or any other factors. Moreover, particularly over the last two decades, financial markets have become breeding ground for a wide array of rapidly evolving financial products, often described generically as "derivative"instrument These products make it possible for borrowers and lenders to customize their risk exposures and to adjust them over time. With derivative products, borrowers and lenders can therefore mitigate some of the problems associated with asymmetries of information in financial markets, which are particularly acute in the international context.

What is the niche of the foreign exchange market in the whole financial system? The foreign exchange market is the financial system and trading of currencies. The foreign exchange market is the largest, the fastest developing and the most liquid market in the world with an average traded value that exceeds $5 trillion per day and includes all the currencies in the world.

The forex is characterized, first of all, by the fact that there is no central marketplace for currency exchange - the trade is conducted over the counter.

Secondly, the technological advances have permitted the Forex markets to make develop and grow in the fastest manner. Since the early 1970s the Forex market has grown in size, structure, and changed the way it operates.

Thirdly, the power and liquid currency market is highly unstable and sensitive to the economic and political events in the world. The exchange rate between the currencies is the subject of great influence of such economic indicators as the GNI, the GDP, the trade balance, the unemployment rate, the industrial production and capacity utilization, retail sales and many others.

Fourthly, since the late 1970s the forex market has seen an influx of financial entities, such as banks, hedge funds, and broker trading houses, as well as individual traders enter the forex arena. Today, instead of being controlled by national banks and governments, the main factor that drives today's forex markets is supply and demand.

In this work the special attention will be paid to the South East Asia as a rapidly growing and a very important market in the world as well as Japan which has always stood apart from the Asian region and which is highly influential in the global economy and in the currency market being the third largest currency traded up-to-date.

It is undoubted that the Asian region becomes an increasing force in the global economy. According to the latest Bloomberg brochure on indexes as of 12/31/2012[1] the most important Asian currencies are Japanese yen, Chinese yuan, South Korean won and Singapore Dollar. The last three are included in both Bloomberg Currency Index and in Bloomberg JP Morgan Asia Currency Index. The turnover of the Japanese yen increased significantly between the 2010 and 2013 and the Chinese renminbi entered the list of the top 10 most traded currencies.

Asia is a High Growth Market: within the span of a single generation several Asian countries managed to transform their societies from poor nations to the equivalence of those of advanced, developed economies. Openness to trade helped to accumulate more capital and due to favorable government policies the newly acquired wealth created the well-educated workforce and provided the sustainable growth over the last decades. Strong economic performance, stable stock markets and high savings rates across the continent have all helped increase fortunes in Asia. Moreover, by 2020, the number of middle-class households in emerging countries will more than double, overtaking the US and Euro-zone bringing nearly 150 million new consumers[2].

One of the crucial points in understanding the pace of the East Asian foreign exchange market development is the freedom from regulation. It's important to mention the Asian currency crisis of 1997-1998 and how the East Asian countries have successfully recovered from it. Economies in the region have amassed large foreign currency reserves as well as substantial sovereign wealth funds. This enabled such countries as South Korea, Malaysia, Singapore and Indonesia to both manage their own currencies in case they feel them to be overvalued and also to invest in foreign assets to protect their value against the local market downturns.

Another important characteristic of the South East Asian market is the structure of the local financial system which influences the relative importance of different market participants.

Banks in a few Asian jurisdictions rely on foreign exchange markets for short-term funding to a greater extent than banks in some other financial systems. In particular, the local affiliates of foreign banks often find FX swaps to be a more attractive vehicle for raising local currency financing than interbank loans. One indication of the importance of the FX swap market as a source of interbank funding is the use of swap-implied rates as the reference rate in interest rate swap (IRS) contracts instead of interbank rate fixings as used in US dollar, euro and Japanese yen (JPY) markets. The floating rate leg of Singapore dollar (SGD), Thai baht (THB) and Philippine peso (PHP) IRSs is linked to the interest rate implied by FX swaps.

Financial customers' share of total turnover rose by about 10% between 1998 and 2007, to 27%, while non-financial customers' share declined to 16%. Interdealer activity remained high and stable at 57% of Asian currencies' turnover[3]. Consequently, the balance of turnover in

Asian currencies is shifting towards asset-related transactions at a much more gradual pace than that of internationalized currencies.

After the financial crisis of 2008 the forex has been a very interesting asset class for banks and investors due to its liquidity and diversity. Therefore, it became more competitive. Furthermore, as Asian banks were considered as very reliable ones, they have benefited from an influx of money, especially in Singapore and in Hong Kong. Investors believe these city-states to be safe havens, so more banks setup headquarters in either Singapore and Hong Kong. Notably, interdealer activity has remained stable in Asian markets even while it has declined elsewhere. Among internationalized currencies interdealer transactions fell from 67% of total turnover in April 1998 to 42% in April 2007[4]. By contrast, among Asian currencies interdealer activity was unchanged over the same period, at around 56%. The FX swap market is an especially important source of interbank funding for the currencies of Hong Kong and Singapore, Hong Kong dollar (HKD) and Singapore dollar (SGD).

Asian foreign exchange market becomes more and more influential on the world Forex arena. The growth has been seen between 20%-40% year-on-year in the amount of foreign exchange business that is conducted vie the electronic channels. In South East Asia there is much more acceptance of e-trading FX[5] as a beneficial way of conducting business that is also complementary to traditional telephone business. Secondly, there is more pricing and functional sophistication available via single bank and multibank portals that will cater for the many needs of clients. And thirdly, as the money inflow into the Asian region increases, FX has become a much more attractive asset class to investors as some clients move away from other investment products.

Today the regulations and the technology are the two leading features that influence the most the market of FX and which are going to remain the main forces in the foreseeable future. They are the reasons why Asian region had expanded so fast on the FX arena in the recent years. The regulations in the region provide safety and a constant inflow of funds into the Asian countries.

China and South Korea follow the global economic trends by establishing and developing their banking systems as well as the foreign exchange market. The foreign exchange market still needs to improve the legislation and ease some restrictions in order to operate more freely. Foreign exchange market forms an important segment of the national economy of China. With the recent growth of international trade in China, the yuan is also being traded as an important currency in the forex market in a substantial volume.

Other markets such as Malaysia, Philippines or Indonesia have a great scope of growth. The local regulations in these countries have become much more relaxed and this will also lead in future to the higher liquidity in their currency markets.

The yen is regarded as one of the most accepted reserve currency in the global foreign exchange market along with the US dollar, Euro and Great Britain Pound Sterling. The factors that had a great impact on the Japanese Forex Market are the positive trend employment generation, expansion in the index measuring the consumption of the household sector, trade surplus along with surplus in the current account of the balance of payment.

Hong Kong has one of the highest concentrations of international banks in the world. The following are the reasons for the excellent performance of the foreign exchange market in Hong Kong: brilliant infrastructure, political stability, the financial and trade tie ups with China, free business environment, no foreign exchange and capital controls, low operation costs.

Singapore overtook Japan as Asia's biggest foreign-exchange center for the first time as trading surged in the past three years. In 2013 Its share of daily global forex market turnover is 5.7% with the volume of US$383 billion. The Singapore Dollar is one the best examples of how currencies are managed. If counted together, Singapore and Hong Kong would account for almost 10% of daily turnover amounting to the third largest foreign exchange market behind the UK and the USA. This indicates how important Asia has become in the global forex market and how this influence is growing.

[1] http://www.bloombergindexes.com/files/2013/05/Currency-Indexes-Overview-Brochure.pdf

[2] http://www.ey.com/Publication/vwLUAssets/Rapid-growth-markets-forecast-summer-2012/$FILE/Rapid-growth-markets-forecast-summer-2012.pdf

[3] http://www.boj.or.jp/en/research/wps_rev/wps_2008/data/wp08e05.pdf

[4] http://www.bis.org/publ/rpfx13fx.pdf

[5] http://www.360t.com/download/01-2012_e-FOREX_Regional_e-FX_perspective_on_Sout

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