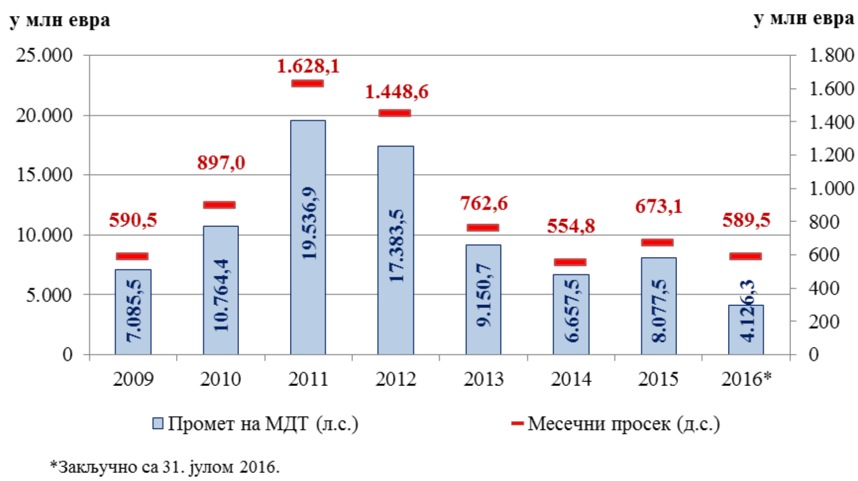
TRADING VOLUMES IN THE INTERBANK FOREIGN EXCHANGE MARKET – REALITY AND ILLUSIONS

ANALYSIS OF TRADING VOLUMES IN THE INTERBANK FOREIGN EXCHANGE MARKET IN 2009–2016

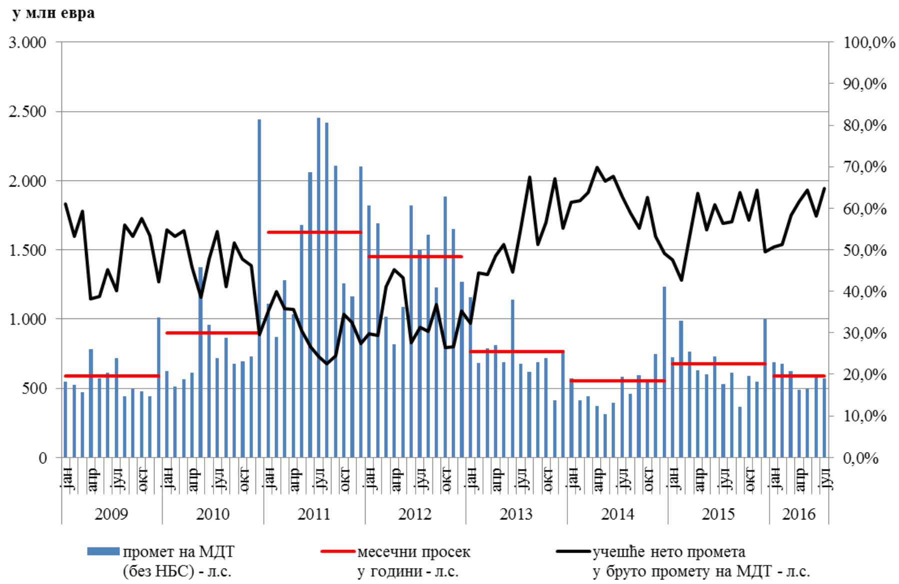
Excluding NBS interventions, total trading volumes in the interbank foreign exchange market (IFEM) amounted to EUR 4.1 billion in 2016 (as at 31 July). In the first 16 days of August, trading volumes were EUR 171.9 million. In the first seven months of 2016, average monthly trading volumes equalled EUR 589.5 mln and were at the levels of 2009 and 2014 average. Somewhat (though not significantly) higher averages were recorded in 2013 and 2015. The 2010–2012 period stands out as monthly average trading volumes ranged from EUR 897 million to EUR 1,628.1 million (Chart 1).

Chart 1: IFEM trading volumes by year (2009–2016)



It is particularly noteworthy that trading volumes in the IFEM *per se* are not indicative of market development or possibly “suffocated” trading through central bank interventions. On the contrary, as it is theoretically known and has been proven in practice as well, trading volumes can be “artificially inflated” with speculative transactions of market participants who, by buying and selling foreign currency in the IFEM, do not meet the real needs for foreign currency – neither their own nor of their clients (residents and non-residents), but instead try to make arbitrage profit by increasing trading volumes. That was the primary reason for the significantly higher trading volumes in 2010–2012, which was no longer present in the subsequent period.

Chart 2: Total and average trading volumes in the IFEM by month (2009–2016)



Supporting the above fact is the share of net FX purchase/sale in the IFEM in total (gross) trading volumes (Chart 2). In the 2010–2012 period, the share of net in gross trading volumes was low (around 30% on average). It was significantly lower than in other years particularly as of the second half of 2013 when it stood at around 60%. These data (including the difference of almost 30 percentage points) in different periods are indicative of the high degree of speculative transactions of market players. Net trading volumes are the main indicator of real needs for foreign currency in the IFEM. The difference between client FX demand and supply is satisfied to the largest extent by FX purchase/sale from/to other banks in the IFEM. Net FX purchase/sale in the IFEM illustrates that difference. However, during 2010, 2011 and 2012, "psychological factors" in the IFEM, i.e. speculative transactions and the resulting panic in the FX market increased significantly overall trading volumes.

All this leads to the conclusion that IFEM trading volumes, *per se*, are not an indicator of the degree of market development, particularly not of its stability. It is precisely through timely and amount-wise well-measured interventions that the NBS, from 2013 onwards, has managed to bring about several positive effects:

- quite smaller interventions compared to an earlier period have ensured incomparably greater stability in the FX market, which restored confidence of both the citizens and foreign investors in the dinar and created room for further macroeconomic advancement (taming inflation, monetary policy easing and a reduction in costs of borrowing, greater certainty in terms of business operation and more successful implementation of fiscal consolidation measures),
- "psychological factors" that used to create pressures in the FX market without a real reason (chiefly a higher exchange rate) have been remedied and all market participants were sent a clear signal that the NBS does not target any level of the exchange rate, but that it will not allow excessive shot-term volatility of the exchange rate, i.e. that it will prevent any threats to financial stability.
- in days when it was estimated that IFEM trading volumes were low, NBS interventions did not "suffocate" the market, but rather encouraged an increase in IFEM trading.

Another factor that contributed to lower IFEM trading volumes from 2013 onwards is the reduction in the current account deficit. Better balanced external trade flows narrowed the difference between FX demand and supply from bank clients, and so a part of the trading volumes, previously closed by each bank in the IFEM (in transactions with other banks), is now increasingly covered through matched FX supply and demand in direct transactions between banks and clients (Chart 3).

Chart 3: FX net purchase (+) / net sale (-) to clients – monthly averages (2009–2016)