Issues and solutions in China's foreign exchange market

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Abstract. The foreign exchange market, as a commercial location for all sorts of foreign exchange transactions, is the product of the monetisation of the commodity economy and expansion to the world. The Chinese foreign exchange market has only just begun, compared with the norms of international foreign exchange market, and the larger gap, still is not perfected in some aspects, for example, size, market trading volume, trading subject, currency structure, management and regulation mechanism, laws and regulations, the lack of a unified foreign exchange market. Therefore, appropriate development strategies should be adopted for foreign exchange trading subjects, i.e., trading varieties, trading costs and trading methods.

Keywords: Foreign Exchange Market; Transaction Variety; Transaction Cost; Transaction Mode; Transaction Subject.

1. Introduction

International trade is an international instrument for settling creditors' rights and debts. However, over the past decade, the volume of foreign exchange has doubled and doubled, and significant changes have occurred, for the most part. Foreign currencies are no longer a tool of international commerce but have become the most important financial product in the world， resulting from international trade account for less than 1% of the total foreign exchange transactions. It can be said that the bulk of foreign exchange trade is investment, aimed at making profits in fluctuating exchange rates.

Foreign exchange operations may be broken down into cash, spot, contract spot, futures, options, forward, etc. The spot trading contract, also called foreign exchange margin trading, refers to the investors and the specialty is engaged in the foreign exchange buying and selling of financial companies, dealers or brokers (bank) signed between buying and selling foreign exchange contracts, as long as pay a certain percentage of margin trading, can be in a certain financing business thousands, hundreds of thousands or even millions of foreign currency, This type of contract trading involves making a written or oral undertaking in favour of a certain price. and then waiting for the exchange rate to increase or drop to the desired level before settling on a transaction volume basis, reflecting gains or losses from changes in the exchange rate [1].

The foreign exchange market, as an international market for speculating on capital, is much shorter than the stock, gold, futures and interest markets. However, it is growing quickly at an incredible speed. Foreign exchange margin, which is referred to as "the pinnacle of personal finance" in the financial commodities of Europe, America and Japan, has gradually replaced stocks and futures as the mainstream commodities in the world finance with the promotion of financial globalization.

In North America and other developed financial markets, foreign exchange margin trading is a necessary hedging weapon for investors. In addition to making profits through direct trading, it also has many functions such as hedging and hedging. Some traders mix it with stocks, gold and agricultural commodities.

There are currently more than 30 significant foreign exchange trading centers worldwide, with London, Frankfurt, Zurich, and Paris in Europe, New York and Los Angeles in the Americas, Sydney in Oceania, Tokyo, Singapore, and Hong Kong in Asia ranking as the most significant. The foreign currency markets are interconnected by sophisticated communication technology and computer networks even though they are spread across many time zones and operate at various hours, enabling smooth flows of foreign exchange funds. There is little difference in exchange rates between the markets.[2]

Foreign exchange margin trading is an integral component of the financial market. The foreign exchange market of major western developed countries is very open and formal and has strict legal supervision system and professional regulatory agencies, such as NFA from the USA, FCA from the UK, ASIC from Australia, FSP of New Zealand, MSB of Canada and similar securities regulatory Commission. The rights and interests of investors can be well protected; The behavior of the participants is well regulated. However, in China, foreign exchange margin trading has not been fully opened. As the largest world trading economy, the Chinese currency market is of particularly interest. Thus, in this paper, the market has been comprehensively analyzed.

2. Problems in the Chinese foreign market

The Chinese FX market is an important element of the Chinese capital market. It has played an irreplaceable role in the improvement of the exchange rate formation mechanism, the promotion of RMB convertibility, at the service of financial institutions, promoting the transformation of macroeconomic control and the improvement of the financial market system. At present, the development of China's foreign exchange market is first confronted with a new situation: with the further acceleration of China's market opening, significant changes have been carried out in the total volume, flow direction and structure of foreign trade, exerting an impact on exchange rate supply and demand in the marketplace.

On the one hand, the scale of external trade and direct investment has increased considerably, and foreign exchange supply and demand have reached an unprecedented level of quantity, currency and transaction subjects. On the other hand, foreign exchange risks increase with the expansion of foreign exchange scale, and businessmen urgently need to avoid and solve the risks through the foreign exchange market. Second, information technology promotes the integration of financial markets. A new trend in the development of international finance is that the internationalization of economy and financing facilitates the integration of financial markets. The development of Internet technology will accelerate the process of integration, and financial markets will become much more electronic. However, there are still some deficiencies in the Chinese currency market. It will be analyzed from the aspects of transaction varieties, market subjects, transaction costs and transaction modes.

2.1 Trading varieties

According to the products released by the China Foreign Exchange Trading System, China's foreign exchange trade products currently include RMB foreign exchange spot, RMB foreign exchange forward, RMB foreign exchange swap, RMB Foreign Exchange Contract, RMB Foreign Exchange Option, Foreign Currency Loan, Foreign Currency Borrowing and Foreign Currency Counterparty.

However, in the actual trading structure, there are some problems that the focus of market trading and investment is concentrated, and many varieties are ignored. Spot and swap are the most active. The main reason is that China's foreign exchange market transactions are mainly based on the actual demand of the real economy, and banks are relatively flat in the interbank market according to the direction of foreign exchange settlement and customer sales. The centralization of market trading center shows that the market still has huge development potential and space.

2.2 Market entities

According to the regulation, approved by the State Exchange Service of domestic financial institutions prompt settlement business qualifications, or cross-border foreign exchange current account pay $2.5 billion last year, or merchandise trade in exports more than $2 billion and other conditions conforming to the non-financial companies, can apply to the China foreign exchange trading center for trade spot members of the yuan on foreign exchanges. Market access rules are relatively strict.

The main body structure of foreign exchange transactions in the interbank market is relatively single and all financial institutions are dominated by banks. On the other hand, the trading volume distribution of transaction subjects is also concentrated in large state-owned banks. With the intensification of market competition, the market share of share-based banks and foreign banks is rising, and the monopoly situation of large state-owned banks has not been broken [3]. In recent years, the liberalization of foreign ex-change license for securities brokers has become a hot market. Banks' FICC divisions, which include fixed income, currencies and commodities, account for more than 50 per cent of investment banking revenues based on international experience, and foreign exchange settlement and foreign exchange are an important part of FICC operations [4]. Due to historical reasons, Chinese brokerages were excluded from the foreign exchange market, and this restriction was broken in 2014. It is expected that other brokerages will also enter the exchange settlement market in an orderly manner. However, considering that the development of securities firms in the foreign exchange market is not mature until 2014, there will still be some differences between Chinese securities firms and foreign investment banks in the foreign exchange business. Moreover, the designated foreign exchange banks are the real players and major intermediaries in the foreign exchange market. They occupy a central position and carry out transactions on customers and for own account. However, excessive central bank intervention on the Chinese foreign exchange market makes the designation of banks for macroeconomic supervision more difficult. The central bank has thus become the biggest and only buyer on the market [5].

2.3 Method of transaction

In China's interbank foreign exchange market, there are two ways of foreign currency trading: click on the deal quotation and inquiry quotation. Click quote means that a trader on one side posts an intended quote to the market according to his own expectation and judgment on the exchange rate, and a trader on the other side can click the quote to directly conclude a deal at this price and quantity on the premise of accepting the quote. In the Chinese FX market, all participants choose the most favorable trading partner. However, in the present commercial market of China, the bank exchange is obliged to make an offer on the stock exchange, where only members can participate. These institutional requirements directly hamper the free choice of market participants and prevent them from participating in foreign exchange competition as they wish, which does not enhance the effectiveness of the market.

2.4 Transaction costs

First and foremost, the ground market is more complicated than free trade. Maintaining normal operating exchanges, and a central trading and settlement pair, entails an enormous cost. Secondly, all foreign exchange transactions be-tween banks must be carried out by the China Foreign Exchange Center. This makes the commercial exchange center of China a monopoly of the foreign exchange market between intermediary institutions. In the absence of competition, commercial center, there is no economic incentive to cut costs. Given the above factors, the Chinese market organization cost is relatively high. The cost of organizing the Chinese foreign exchange market is estimated to be about 10 times greater than that of intangible foreign markets. Thirdly, the transaction cost of foreign exchange transaction includes direct transaction cost and indirect transaction cost. Direct transaction costs mainly include foreground transaction costs, background settlement costs, settlement waiting time, etc. Indirect transaction costs include bid-ask spreads and forced price concessions due to volume. The former is influenced by the rules of the market system, while the latter depends on the liquidity of the market itself. In terms of direct transaction costs, foreign exchange transaction costs also remain high. Take RMB foreign exchange spot bidding transaction as an example, market makers apply for trading terminals from the Foreign Exchange Trading Center, and the monthly cost for each terminal is 20,000-40,000 YUAN, while other members apply for trading terminals, and the monthly cost for each terminal is 1,000-3,000 yuan. In addition, both sides of the transaction have to bear the transaction cost of a single transaction, that is, 3/100,000th of the transaction amount. Foreign exchange settlement speed, the liquidation rate in the interbank market are usually T + 2 (c for T + 1), such as considering the domestic enterprise through bank acting out, according to China's large commercial Banks internal trading rules, branch after written guarantee with the enterprise, also need to flat with head office, so the link of capital turnover is more. To a certain extent, it reduces the efficiency of foreign exchange transactions. Therefore, on the whole, there is still room and need to reduce the transaction cost of foreign exchange transactions.

3. Solutions to the Chinese foreign exchange problem

From a normative perspective, the basic aim of the central bank's intervention on the foreign exchange market is to modify the supply and demand of the foreign exchange market at that time and influence the expectations of market participants according to the needs of macro-financial regulation policies. The Chinese central bank interferes too much with the market, which hampers the growth of the financial market. In order to meet the global process of reform of the economic system and the real needs of economic development, and the internal requirements of the stable operation of the foreign exchange market, the functions of the central bank must be improved, which is related to macroeconomic and financial stability [6]. With the further opening of the financial industry, the competition between financial institutions will be more intense, and the risks of the financial industry will be further increased. The inherent fragility of the financial industry makes the crisis of a single financial institution likely to trigger the crisis of the whole financial system and even the whole economic system. This requires the central bank's financial supervision level to be higher and requires the central bank to be able to face the increasingly complex financial crisis. Actively cultivate and gradually expand foreign exchange market players, improve and develop inter-bank foreign exchange market. In order to change as quickly as possible, the situation of a few commercial players in the Chinese foreign exchange market, increase the number of market participants, activate the market atmosphere, make the exchange rate more representative of the evolution of supply and market demand and ensure that the funds for payment and sale of foreign currency by grassroots banks can be timely provided, the following measures may be considered:

(1) Allow more branches of state-controlled banks to enter the market for transactions. To be specific, on the basis of the guarantee of a market player and a subject of interest, each branch may take part in transactions on the foreign exchange market within the framework authorised by its head office.

(2) Branches are permitted access to the local Foreign Exchange Mall to conduct self-trading and adjust their foreign exchange positions at their own risk.

(3) While progressively liberalizing financial institutions' activities in RMB, foreign financial institutions should be allowed to exchange currencies in their own markets, and more non-bank financial institutions more non-bank financial institutions that have strong credit should be permitted into the market and various restrictions should be relaxed so that they can compete on an equal footing with designated foreign exchange banks [7].

(4) Since designated foreign exchange banks are the major force in the market, they should have a greater right to independently trade foreign exchange. In short, in line with the improvement of the above foreign exchange settlement and sale system, the functions of the inter-bank foreign exchange market should be changed, the interbank forex market and the adjustment market should be merged into one market, and the main problems existing in China's foreign exchange market in the foreign exchange trading center and designated foreign exchange banks should be gradually brought into play and countermeasures should be taken. The modification of the central bank's dominant position on the foreign exchange market enables the designated foreign exchange banks to participate fully in foreign exchange operations, act as a means of exchanging currencies, allocating capital and financing, and make designated foreign exchange banks become real market players and market makers.

In terms of trading varieties, we should increase the trading currencies on the forex market, enrich commercial varieties, develop forex market activities and improve the function of the forex market.

We will improve the infrastructure of the FX market. First, market trading varieties should be increased; The second is to create a fair market trading environment and improve the market participation of small and middle-scale banks and "non-enterprises"; The third is to establish an external rating system for financial institutions, establish bilateral or multilateral credit granting on the basis of credit rating and speed up the establishment of synchronous settlement and settlement system to shorten the settlement time [8]. The fourth is to accelerate the development of the money market and to shape as quickly as possible the reference interest rate on the money market.

In terms of trading methods, regulations on foreign exchange trading market shall be established and improved. At present, the relevant rules on the foreign exchange market is not perfect in our country, country should be formulated and promulgated the foreign exchange market exchange act as soon as possible, the foreign exchange market practitioners code, the Exchange Rates Act of the People's Republic of China and other statutes and regulations [9]. It is necessary to speed up the settlement of foreign exchange settlement, to eliminate crime from personnel of course of study, gradually improve the foreign exchange market, and make it develop steadily. Specification and improvement of large foreign exchange trading agent, the international forex market, in order to continue to promote foreign exchange trading agent at the same time, can stipulate the agent bank foreign exchange market between trade is given priority to with large, small foreign exchange can be realized through the Banks out of business, so that the bank between the foreign exchange market really become wholesale market, improve the efficiency of deals.

In terms of transaction costs, the establishment of foreign currency interbank lending market and capital foreign exchange market will help improve the unreasonable use of capital foreign exchange in China [10]. The interest rate formed in foreign exchange interbank lending market can fully reflect the supply and demand of China's short-term foreign exchange, which is convenient for the central bank to take appropriate policy measures to fine-tune the market. At the same time, it will also reduce the central bank's passive F prediction, which is conducive to improving the RMB exchange rate formation mechanism. We will further promote trials of forward foreign exchange settlement and sales and establish forward foreign exchange markets. Forward foreign exchange business helps market participants avoid remittance risks, and the central bank helps improve mechanism for exchange rate formation and macro control of foreign exchange market.

4. Conclusion

The Chinese foreign exchange market is still at its beginnings, with investment focused on certain types of exchange and no attention paid to others. Transaction subject structure is single and central bank intervention is more. Trading is done on a membership basis, limiting the free choice of market participants. Exchange trading is more complex and costly. Therefore, it is necessary to rise the varieties of foreign exchange market, perfect the market infrastructure and create an equitable market environment. Increase the participation of businesses and banks. State commercial banks would have to be able to penetrate the market. for trading, and restrictions should be relaxed to ensure equal competition. Designated foreign exchange banks are allowed to participate freely in foreign exchange transactions. Improve laws and regulations to ensure steady development of the foreign exchange trading market. Establish interbank lending market to improve the unreasonable use of China's capital and foreign exchange.

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