Analysts: Spot / Forward FX Spreads Widen Also On Credit Crunch 16:27 EDT / Aug 15

By Vicki Schmelzer

NEW YORK, Aug 15 (MNI) - The recent credit crunch spawned problems for the FX market, where spreads on both spot and forward currency prices have been widening in recent sessions.

"Typically, I can see $15 dollars, 2 points wide," said one yen trader of the spread and amounts on the bid and offer in dollar-yen on the electronic trading machines.

"Now, the same portal is 3 points wide on $10," he said.

In forward yen, the one-year forward spread, typically only three-quarters of a point wide, is now one and a half points.

In forward Canada, the three-month forward spread has gone from two pips to almost a point and the six-month spread has gone from about 1 to 2 points.

Other traders, in both G-10 and emerging market currencies, back up the fact that spreads in both spot and forward have be getting wider.

"Liquidity is tricky as the price action is a lot choppier than usual," one Canadian trader said.

Just as lending requirements have become tighter on loans to more accurately reflect credit risk, the past few weeks FX volatility has prompted currency traders to seek an insurance policy also.

"Across all asset classes things are becoming less liquid," observed David Mozina, head of foreign exchange strategy at Lehman Brothers in New York.

Those making prices need a bit more of a "cushion" and this has worked its way "even into liquid markets," he said.

"If you want something -- you have to pay for it," Mozina said of the current market thinking.

In FX, those making prices on the various electronic currency platforms have tried to adjust their style.

"Prices have definitely widened in the last 10-15 days," said Josh Levy, managing director at Tactical Asset Management.

Market makers who have increased the bid/ask spread in FX have had a harder time of it than those with tighter spreads, he said.

"The reason is that when five banks compete with each other in a multi-bank setting for deal flows, those with tightest two-way prices win the most trades and so benefit the most over time," Levy said.

The price-maker with a wider spread will only win deals when there is an extreme one-way move in the market, he noted.

"Therefore, they are most likely to suffer great losses during these moves without ever having the opportunity to earn back their losses in bid/ask spread trading during normal market conditions," Levy said.

While currency spreads have widened, so far there has been no sign of bank credit departments asking players to adjust credit limits on the electronic trading machines.

However traders started to note some FX price inversion, with a good credit name being able to execute a deal at a bit better price than an iffier credit name.

FX corporate credit limits have not yet been adjusted, but spreads to corporate clients are also getting wider in line with the expansion in the underlying bid/ask spread, corporate strategists said.

Despite wider spreads, FX volume continues to grow as market players exit and enter positions.

Chicago Mercantile Exchange (CME) reports that roughly $96 billion in currencies changed hands Wednesday (final figures pending), well above the $77 billion average daily volume seen in July.

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