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High-Tech Trading Invades Emerging Market Currencies

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Emerging-market forex trading attracts algo traders
Mexican peso trading likely to be become more high tech
Less liquid emerging-market currencies riskier to trade electronically

NEW YORK (Dow Jones)--High-speed and automated trading technologies, by now a well-established piece of the capital market architecture in advanced countries, are making their way into emerging-market currency trading.

If it takes off, this trend could transform a growing market with a legacy of liquidity constraints. But until then, the illiquidity will also expose such traders to risks.

For years, emerging-market currencies were traded via the phone through dealers, precisely because thin trading volumes precluded the development of multiparticipant electronic trading platforms common to the G10 major currencies. Now, as emerging-market currency trading increases in sophistication and volumes, electronic trading is picking up. And with that come the high-speed, automated trading systems.

Mexico, whose currency is one of the most actively traded in the emerging-market universe, is leading the way. Derivatives exchange MexDer is boosting its links with U.S. futures exchange operator CME Group (CME) and that is expected to entice high-speed traders to search for arbitrage profits by making intramillisecond trades based on small differences in prices and spreads between Chicago and Mexico City.

All this will "generate a new breed of traders in Mexico in the forex space," said Jorge Alegria, Chief Executive of MexDer, who sees Mexican banks following U.S. high-speed traders into the sector.

The more advanced emerging regions will follow into developing electronic trading and algorithms, said Sreekrishna Sankar, analyst with financial research firm Celent. His firm estimates that global information technology spending in foreign exchange will run to $1.4 billion 2011 and continue to grow after that.

High-tech trading in emerging-market currencies is seen as a natural progression from a broader global trend in which investors are turning to high-growth emerging markets like Thailand or Indonesia in their hunt for returns.

"When you look at the Thai baht, Indonesian rupiah or Singapore dollar, what [attracts] an algorithmic trading operation like ours is the volatility," said Josh Levy, managing director at Tactical Group Holdings, a fully automated proprietary trading operation. Those bigger upward price swings can lead to quicker gains, he said.

Overseas investors have restricted access to many emerging market currencies--including the Brazilian real--and must mainly trade them through nondeliverable forwards. But that asset class is also now opening up to electronic platforms. Such changes, as well as those in the spot market, could eventually propel emerging-market currencies onto more of an even plane with advanced country currencies.

"There'll be more transparency and spreads will get driven lower again," said Yaacov Heidingsfeld, chief executive of TraderTools Inc., which licenses forex trading technology. Emerging-markets will "be established markets," he added.

Still, many remain a long way from being ready for electronic trading--the low-volume Russian ruble market, for one. Their thin trading conditions will continue to pose risks for high-speed traders if you want to "cut your losses and get out very quickly," says Tactical's Levy.

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