



There are questions as to whether the FTT will be levied on the exchange of collateral but at the moment there is no clear exemption. Given that many FX transactions are regularly collateralized, in some cases with the exchange of variation margin on a more than a daily basis, this could involve a substantial increase in transaction costs. If the FTT was levied on initial margin, this would also increase costs.

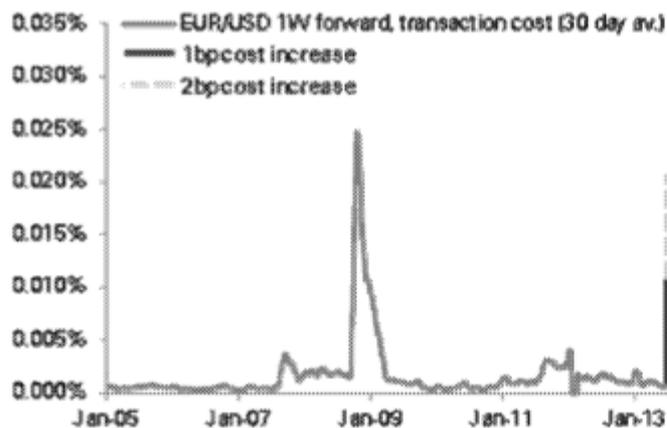
The FTT would dramatically increase current transaction costs for FX markets. In research carried out for the Global FX Division of the Global Financial Markets Association, Oliver Wyman estimated that the FTT would result in price increases of up to 1790% at the short end of the FX swap market (1 week EUR/USD swap) and 270% at the long end (6 month EUR/USD swap).

These extremely large increases in transaction costs are the result of the very small bid-offer spreads quoted by liquidity providers. In the most liquid FX swaps, such as a 1 week EUR/USD swap, spreads are often lower than one tenth of a basis point. The FTT would therefore introduce a permanent cost to transactions magnitudes higher than is typical for these markets. Indeed, looking over average transaction costs for FX swaps over recent years, the impact of the FTT can be compared to the Lehman liquidity crisis in terms of its impact on transaction costs.

These costs would be magnified by the FX market's high turnover and deal velocity. The BIS estimates the total daily turnover in the swaps and forwards market alone to be USD 2.24 trillion, more than seven times that of all global equity markets.

Much of this liquidity is concentrated in shorter tenors. According to the BIS, more than 40% of global market turnover is concentrated in tenors of 1 week or less for FX forwards. For FX swaps, this figure is 70%. FX swaps and forwards are rolled over on a daily or weekly basis by a wide range of market participants in order to meet a broad range of objectives. These include liquidity management, asset-liability matching and short term funding. These transactions would be hit each time by the tax. Additionally, the impact of the FTT on short-dated instruments is much greater than on long-dated instruments.

Figure 2: The FTT Impact Similar to Global Financial Crisis on Transaction Costs



Source: Deutsche Bank, * existing transaction costs are calculated as the bid-offer spread for FX forward points expressed as a percentage of the FX market rate. Data from Bloomberg Finance LP.