

André Cappon looks at the latest moves by Latin American derivatives exchanges towards joining in the globalisation process

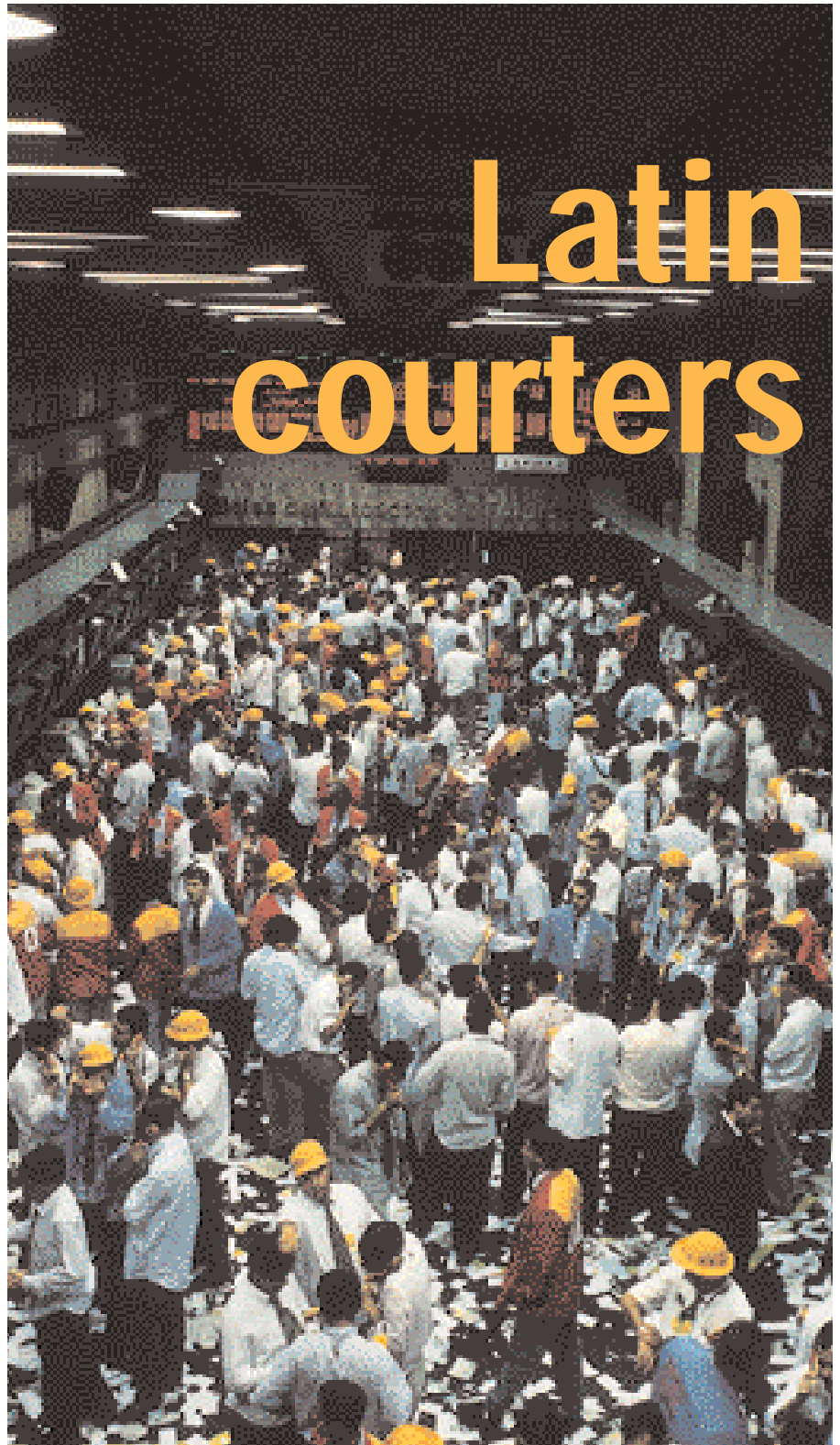
Latin courters

The latest instalment in the ongoing global consolidation of derivatives exchanges is being played out in Latin America. Brazil's Bolsa de Mercadorias & Futuros (BM&F) has recently announced its intention to join the Globex Alliance, and further hopes to become a major international agricultural futures player.

The internationalisation of BM&F is a major event, and will set the tone for the development of derivatives markets in the Latin American region. It will reinforce BM&F's position as the leading exchange in the area and support its regional and global goals.

To understand the importance of the BM&F announcement, it is necessary to place it in the context of the geopolitics of derivatives exchanges. In the last two years, the world's derivatives exchanges have begun a process of consolidation into global coalitions. This was triggered by the success of electronic trading and the dramatic growth of Eurex.

The Eurex strategy of placing as many terminals on as many desks as possible, world-wide, making exchange membership inexpensive and broadly accessible to all players (be they 'sell-side' or 'buy-side'), and reducing trading



BM&F — total volumes

Month	1998	1999
Jan	5,410,444	3,998,966
Feb	5,620,550	2,683,649
Mar	8,582,239	4,476,640
Apr	9,041,280	3,777,621
May	10,402,241	5,025,316
Jun	9,034,378	4,783,995
Jul	7,108,733	4,487,333
Aug	9,585,783	5,542,574
Sep	7,209,687	
Oct	4,816,938	
Nov	5,277,659	
Dec	4,925,118	

MEXDER — total volumes

Month	1998	1999
Jan	0	4,870
Feb	0	4,850
Mar	0	4,200
Apr	0	16,158
May	0	25,226
Jun	0	46,462
Jul	0	105,265
Aug	0	91,258
Sep	0	
Oct	0	
Nov	0	
Dec	1,507	

SPSE — total volumes

Month	1998	1999
Jan	2,533,095	1,974,407
Feb	3,874,796	1,239,512
Mar	3,020,066	1,769,854
Apr	3,419,845	2,567,813
May	3,131,241	2,301,748
Jun	4,274,414	1,953,279
Jul	2,707,911	1,181,422
Aug	3,163,464	1,609,859
Sep	6,226,089	
Oct	2,621,629	
Nov	2,029,401	
Dec	2,705,263	

costs, was wildly successful. Eurex took the Bund away from Liffe, and through its proposed alliance with CBoT threatened the US market. It threatened in particular the brokers and locals, hence the on-again, off-again nature of its alliance with CBoT. But whether or not the CBoT alliance eventually works, it is clear that the Eurex strategy radically dilutes the value of exchange memberships.

The Globex Alliance is the response of the broker-driven exchanges, even dwarfing the volume of contracts traded on the Sao Paulo stock exchange (SPSE) (see tables, p60 & p63. The members of the Globex Alliance, CME in the US (and as a consequence, in a way Liffe, which has a bilateral deal with CME), SBF ParisBourse in France, Spain's Meff, Italy's Mif, Simex in Asia and now BM&F in Latin America have both common interests and face common challenges.

Their common interests are to preserve the role of the broker, although the functions of brokers will clearly change and the sell-side will experience further consolidation. The common challenges are the transition to electronic trading (since some of the coalition members still have open outcry floors), membership reform, demutualisation and/or privatisation and the crafting of an effective global coalition (the governance challenge increases rapidly with the size of the coalition...). Down the road, clearing will become the next major challenge, as investors and members will demand efficient global clearing arrangements.

The Globex Alliance has now reached the critical mass it needs to succeed. It has a good probability of success, given the combined memberships of its exchanges and the management talent it assembles.

In Latin America, BM&F already is, by far, the leading derivatives exchange (see volume figures page 61). So far, BM&F's business has been primarily domestic, due to a large extent to constraints on cross-border capital flows imposed by Brazilian regulators.

The volatility of Brazilian markets as well as the regulatory constraints has stimulated the creativity of the country's financial institutions and spawned one of the most vibrant derivatives markets in the world. For instance, BM&F was the first exchange to list swap products, and it was a pioneer in the use of flex options. With the help of the Globex Alliance, BM&F can take this creativity global.

As mentioned above, the exchange's initial thrust will be with agricultural products. These will be very important, for several reasons:

■ Brazil and the Mercosur region are among the world's leading producers of soybeans, wheat,

BM&F — 1999 contract volumes

			1999	Jan -
			August	August
Contract		Type		
Corn	Future	Agrics	751	7,241
Corn	Option	Agrics	0	16
Live cattle	Option	Agrics	0	0
Live cattle	Future	Agrics	12,376	76,974
Live cattle exercise	Option	Agrics	0	0
Soybeans	Future	Agrics	1,029	9,066
Soybeans	Option	Agrics	0	3
Flexible currency	Option	Currency	69,222	485,142
Floating US\$ futures	Future	Currency	0	0
Mini US dollar	Future	Currency	73	110
US dollar/Real	Option	Currency	52,390	490,202
US dollar/Real	Future	Currency	1,372,026	7,455,604
US dollar/Real exercise	Option	Currency	4,360	30,661
1 day Interest rate	Future	Interest Rates	2,164,555	13,843,950
1 day Interest rate	Option	Interest Rates	48,201	497,863
C-Bond	Future	Interest Rates	0	502
EI-Bond	Future	Interest Rates	213	1511
Exchange rate swap	Future	Interest Rates	0	0
FRB	Future	Interest Rates	0	0
ID x US dollar spread	Future	Interest Rates	192,217	1,247,798
Interest rate exercise	Option	Interest Rates	0	12,461
Interest rate swap	Future	Interest Rates	768,914	4,841,531
Interest rate x FGV-100 swap	Future	Interest Rates	0	0
Interest rate x Ibovespa swap	Future	Interest Rates	7	15
Interest rate x basic fin r.s.	Future	Interest Rates	1715	16,048
Interest rate x exch rate swap	Future	Interest Rates	228,178	1,416,238
Interest rate x gold swap	Future	Interest Rates	0	3,160
Interest rate x price swap	Future	Interest Rates	0	7,875
Interest rate x ref rate swap	Future	Interest Rates	9,259	48,449
Interest rate x stock basket 1	Future	Interest Rates	16	15,426
Price index x exch rate swap	Future	Interest Rates	0	0
Ref rate x price swap	Future	Interest Rates	0	0
Reference rate x exc rate swap	Future	Interest Rates	0	0
Gold	Option	Metals	7,488	94,068
Gold (1kg)	Future	Metals	0	0
Gold (250g)	Future	Metals	7,447	112,766
Gold exercise	Option	Metals	0	23,938
Arabica coffee	Option	Softs	6,051	35,629
Arabica coffee	Future	Softs	28,309	191,401
Arabica coffee exercise	Option	Softs	752	4,676
Cotton	Future	Softs	235	4,601
Robusta coffee	Future	Softs	0	0
Sugar crystal	Future	Softs	2,225	16,761
Bovespa	Future	Stock Indices	527,732	3,626,792
Bovespa	Option	Stock Indices	0	17140
Bovespa exercise	Option	Stock Indices	0	210
Flexible Bovespa Stock opt	Option	Stock Indices	36,833	140,242
Total			5,542,574	34,776,070

Source: FOW TradeData

corn, coffee, and sugar. There is therefore natural demand in the region for agricultural derivatives, which today is handled by CBoT and CSCE.

■ Southern Hemisphere agricultural derivatives are a good idea, due to the difference in crop cycles: hedging Southern Hemisphere crops with Northern Hemisphere-driven derivatives (eg CBoT) introduces unnecessary basis risk.

■ The Brazilian government supports agriculture, and is willing to relax its constraints on capital flows when agriculture is involved. BM&F has obtained the authorisation to set up a clearing and settlement facility offshore which will make it easy for international investors, eg hedge funds, to trade at BM&F.

■ Within the Globex alliance, BM&F's agricultural derivatives do not conflict with the products of other partner exchanges, and in fact help the Alliance compete with the agricultural product set of CBoT.

■ BM&F is thus well-positioned to become a leader in agricultural products, both in the Southern Hemisphere and within the Globex Alliance world.

Financial products will undoubtedly follow the agricultural contracts. There is tremendous interest world-wide in Brazilian equity and interest derivatives. However, for the time being, cross-border transactions in these products are still constrained by many government restrictions aimed primarily at discouraging foreigners from speculating on Brazilian interest rates and exchange rates. BM&F's internationalisation in this area will be driven to a large extent by the pace at which the Brazilian government relaxes these constraints.

By joining the Globex Alliance, BM&F has taken a decisive step on the road to globalisation. Although it still has to live with the constraints of Brazilian regulations, it is now clearly an equal partner of some of the most prominent global exchanges.

The other major economy in South America, Argentina, does not have a viable derivatives exchange (there are two agricultural markets, in Buenos Aires and Rosario, but they play a narrow role). There has been for several years a project to establish an Argentine market for futures and options, in co-operation with the CBoT. This project has encountered a number of difficulties (many related

MEXDER — 1999 contract volumes

Contract	Type		1999 August	Jan - August
US dollar	Future	Currency	39,863	133,828
Interbank equilibrium	Future	Interest Rates	41,320	109,777
Zero coupon bond (Cetes 91)	Future	Interest Rates	-	-
Banacci O	Future	Equities	1,400	1,990
Cemex CPO	Future	Equities	-	-
Femsa UBD	Future	Equities	-	-
GFB O	Future	Equities	-	-
Gcarso A1	Future	Equities	-	-
On Telmex L	Future	Equities	-	-
Mexican IPC	Future	Stock Indices	8,675	22,466
Total			91,258	268,061

SPSE — 1999 contract volumes

Contract	Type		1999 August	Jan - August
Debentures	Option	Interest Rates	-	49,116
Bovespa	Option	Stock Indices	-	12,200
Equities	Option		1,609,859	14,536,578
Total			1,609,859	14,597,894

precisely to the turmoil caused by the turbulent relationship between CBoT and Eurex) and has yet to get off the ground.

Most of the other countries in the region such as Chile and Uruguay have not shown any interest in establishing derivatives exchanges. The two notable exceptions are Venezuela, which suspended trading in November 1998 and is yet to restart, and Mexico, which only began trading last December (see box table above).

Brazil is thus way ahead of the other South American countries in terms of listed derivatives. It certainly has the ability to introduce derivative products for the region, be they stock indices, exchange rates or interest rates. With the support of the Globex Alliance, Brazil is in a very strong position to become the central hub for listed derivatives for the region.

BM&F's entry into the Globex Alliance represents a major coup. With BM&F, the Alliance has finally reached global coverage: Europe, the US, Asia and now Latin America. The next challenge for the Globex Alliance will be to define an effective global strategy and governance mechanism. ❖

André Cappon is president of The CBM Group, a New York-based management consulting firm specialising in capital markets.

Copyright © 1999 The CBM Group, Inc.

Source: FOW TradeData