

Foreign Exchange Contact Group

Frankfurt am Main, Thursday, 23 March 2023, 14:00-16:00

SUMMARY OF THE DISCUSSION

1. Review of recent foreign exchange market developments and outlook

Hinrich Paul (Commerzbank) reviewed recent developments in the foreign exchange (FX) market.

Overall, the FX market has functioned well despite the recent global banking sector turmoil, also compared to the elevated volatility observed in other asset classes. While members noticed slightly higher volatility and lower liquidity conditions with wider bid-offer spreads, the overall stress was not severe with volumes remaining robust. Some members noted that the FX market was relatively isolated from stress in other asset classes due to the absence of excessive positioning, with only few exceptions like the Mexican peso. It was reported that overall positioning in the developed FX market had been reduced compared to the beginning of the year and is currently relatively balanced.

Recent action by authorities had supported market confidence, while the developments in the banking sector in the US and Switzerland were perceived as idiosyncratic. The clarification by the EU and UK authorities about the order according to which shareholders and creditors of a troubled bank should bear losses contributed to restoring market confidence. The coordinated central bank action to enhance the provision of US dollar liquidity was well-perceived by the market, although it was acknowledged that there was no acute need for such operations (as shown by the low take up) nor for additional liquidity in Swiss franc or other currencies.

Recent FOMC decision was told to have caused renewed interest in EM carry trades, rather than further demand in safe-haven FX trades. With the Fed potentially pausing its actions, some members believed there is now a clear trend for a weaker US dollar going forward and that the relatively flat FX positioning is no impediment to broader bearish trends emerging for the US dollar. Some members also discussed about increased interest in Japanese yen due to the potential change in the BoJ monetary stance and mounting inflationary pressures despite the lack of compelling carry characteristics.

2. Regulatory initiatives in the FX Market

Jose Leitao de Seabra (ESMA) and Carlo Koelzer (360T/Deutsche Boerse Group) introduced a group discussion on the regulatory changes and challenges in the FX market.

The European Securities and Markets Authority's (ESMA) Final Report and Opinion on the Trading Venue Perimeter provides guidance on when certain systems and facilities should be viewed as "multilateral systems" under MiFID II and need to be authorised as a trading venue. To ensure that firms assess their systems against the Opinion, ESMA will work with National Competent Authorities (NCAs). The Opinion does not have a particular implementation date, but its guidance applies in principle immediately. One member questioned the possibly different interpretation of the opinion among countries, which would be at odd with ESMA's objective to create a uniform interpretation of the perimeter, after an agreement among NCAs. ESMA told to provide further guidance on this matter.

The group also discussed the challenges of the rapid regulatory evolution in the FX market. Increasing regional regulation is increasing logistical complexity and creating inefficiencies in global FX markets, which will eventually lead to additional costs. This is particularly important for FX, which is a truly global asset class and deeply embedded in global trade and global economics. Increasing global regulatory fragmentation is affecting liquidity, increasing operability, costs and decreasing efficiency despite the introduction of the FX Global Code. Members called for a joint effort, including also ESMA, to preserve the global character of FX market with all its benefits. As regards Europe, there was a plea by members to regulators to assure that the FX market is harmonized and therefore no arbitrage amongst countries takes place.

3. Any other items

Stéphane Malrait (ING) reminded the group about the initiative by the Securities and Exchange Commission (SEC) to shorten the standard settlement cycle for most routine securities trades from two to one business day between trade execution and settlement (i.e. from "T+2" to "T+1"), effective as of May 2024. He emphasised the importance of the initiative for the FX market, a potential increase in FX settlement risk and overall the greater operational complexity for global participants.