

Foreign Exchange Contact Group

Frankfurt am Main, Tuesday, 19 March 2024, 13:00-17:00

SUMMARY OF THE DISCUSSION

1. Review of the recent foreign exchange developments and outlook

Neehal Shah (BNP Paribas) reviewed recent developments in the global foreign exchange (FX) market.

Since the last FXCG meeting in November 2023, liquidity conditions and market functioning in the foreign exchange (FX) market have remained orderly. Realized EUR/USD FX volatility has continued to fall, following strong convergence in central banks' policies, and suggesting a balanced outlook for EUR/USD. Some members mentioned possible desynchronisation of central banks' actions as potentially increasing volatility and the focus shifting from inflation to growth. Looking ahead, members highlighted the heightened US election as a major risk event but showed that it is already priced in by the EUR/USD FX option markets, in contrast to other asset classes. Geopolitical tensions and persistent inflationary pressures were identified as two other main risks whereas risks related to uncertainties stemming from central banks' decisions were seen as moderate.

Members perceived the recent monetary policy adjustments by the Bank of Japan (BoJ) as a non-event. This was primarily attributed to the BoJ's patient and gradual communication strategy in policy normalisation and the prevailing market sentiment that the BoJ was lagging in its policy adjustments. In this respect, most members expected the Japanese yen to remain a funding currency utilised for carry trades. However, one member emphasized the increased risk of building such positions in one direction in case BoJ hike rates more actively going forward.

China's subdued economic recovery was perceived as having minimal impact on global FX markets whereas one member stressed that the US elections were a key risk for China.

2. Future of FX with central bank digital currencies, stablecoins, and crypto assets

Holger Neuhaus (ECB) updated the group on the Eurosystem's considerations of how wholesale financial market transactions could potentially continue to be settled in risk free

central bank money in the presence of new technology and in particular distributed ledger technology (DLT). Increased interest within the financial industry for an automated delivery- or payment-versus-payment (DvP and PVP) settlement and ease of reconciliation through DLT initiated also Eurosystem to analyse the potential impact of emerging technologies¹. The Eurosystem will soon offer trials (with actual settlement in central bank money) and experiments (mock settlement) for security-transactions, PVP FX transactions and automated payments in central bank money that are linked to transactions in commercial bank money tokens recorded on DLT networks. The [call for expression of interest](#) is open until 30 April 2024.

Christoph Hock (Union Investment) provided an investor view of the advantages of more automation in general and the use of DLT technology specifically.

The discussion on the benefits of DLT for market functioning brought up a range of opinions. Some members shared their positive experience with real-life pilot projects and how to use DLT e.g. for cross border settlement of FX transactions. Other members expressed scepticism on such pilot projects leading to a broad business adaptation in a near future as most members agreed that a general move to DLT would require standardisation and interoperability standards to achieve broad-based automation and efficiency gains. One challenge lies in establishing robust linkages between DLT solutions and existing legacy systems. Overall, despite concerns, there were a few members who felt that DLT will occupy a central role in upcoming market infrastructure reforms.

3. Decreasing role of primary venues and increasing role of futures markets

Jens Quiram (Eurex) and Phil Hermon (CME) kicked off a discussion around the role and value of FX primary venues in the over-the-counter (OTC) market versus the role of FX futures markets and their importance in price discovery².

Despite declining trading volumes, FX primary venues remain an integral part of the FX market in providing valuable price transparency for the fragmented FX market. The shift of trading volumes from primary venues to other OTC trading platforms (e.g. secondary venues) and FX futures markets was seen as a natural evolution of a markets to seek more efficient in executing FX transactions. Higher internalization ratios, the use of so-called “dark pools” - trading venues with no regulatory pre-trade transparency requirements - and the proliferation of trading platforms were seen as main drivers of the trend in declining primary

¹ See ECB Economic Bulletin, '[Central bank money settlement of wholesale transactions in the face of technological innovation](#)'

² Price discovery is the process through which prices of assets are determined and set.

venue volumes. Exchange traded currency futures have emerged as a complementary source for price discovery amid steadily increasing FX trading volumes and continued rise in the number and diversity of market participants. Overall, a combination of factors including regulatory changes in the OTC FX market and market liquidity created by a very diverse ecosystem of market participants make FX futures markets a compelling choice for market participants alongside the OTC market.

The group also discussed the emergence of hybrid trading models and platforms to link OTC and listed FX markets products, which provide users with greater choice and give more users access to FX futures products.

4. Triennial FX Global Code Review

The Group was informed about the Global Foreign Exchange Committee's (GFXC) priorities of the forthcoming triennial review of the FX Global Code ('Code'). Feedback collected from market participants and local Foreign Exchange Committees around the globe suggested that the Code does not require a comprehensive revision. Three target areas for further work were identified and working groups will be focusing on mitigating settlement risk in FX transactions, further promoting adherence to the Code and examining FX data access with an aim to enhance transparency of FX transactions.