



## Foreign Exchange Contact Group

Frankfurt am Main, Wednesday, 24 September 2025, 14:00-16:00

### SUMMARY OF THE DISCUSSION

#### **1. Review of the recent foreign exchange developments and outlook**

Following the presentation by Gary Prince (ING) the group discussed developments in the global foreign exchange (FX) markets since the last FXCG meeting in June 2025.

**Members highlighted that liquidity conditions and market functioning remained robust since the last FXCG meeting, following the episode of high volatility in early April.** FX trading volumes have also modestly declined during the summer months with spreads remaining relatively stable. One member noted that the diminished quantum of non-speculative FX hedging flows by investors in the third quarter compared to the second contributed to the contained US dollar weakness. This has been attributed to the high cost of holding US dollar hedges and a lack of compelling catalysts for further depreciation of the US dollar. Members concluded that the market perceives the risk of genuine challenge to the Fed independence as low and any political pressure on the Fed would likely affect rate decisions only marginally and would not constitute a fundamental governance change.

**The performance of US relative to European assets was identified as another factor supporting the US dollar and preventing further depreciation.** One member pointed out that earlier optimism about European growth and asset performance as well as an increasing dominance of the Euro has dissipated and lost momentum, with US equities and bonds outperforming their European counterparts in recent months. This dynamic has led to sustained flows into US assets, reinforcing US dollar resilience. However, members raised concerns about the US equity increase, noting its heavy reliance on big tech and AI-related expectations and warning about the dependence of valuations on anticipated earnings growth from AI investments.

**Europe's structural challenges were also discussed as a barrier to flows into the Euro.** One member highlighted the lack of European tech giants, bureaucratic inefficiencies, and an absence of alternatives to US innovation as factors that deter investment in European assets. These issues, combined with the US's dominance in innovation and technology and the sheer size of its market, make a significant shift away from the US dollar unlikely in the near term.

**For institutional investors, long-term risk asset and currency correlations drive hedging decisions.** While April's temporary breakdown in correlations led to a first wave of US dollar hedging activity but did not prompt major shifts, a sustained regime change would be required to alter hedging behaviour significantly. It was noted that a second wave of US dollar hedging may materialize in Q1-2026 due to the gradual nature of institutional investors' quarterly decision-making processes, and members unanimously emphasized that US dollar hedging would overall be facilitated by further rate cuts by the Fed. In contrast, corporates are more active in hedging, adapting dynamic/rolling strategies, option-layered hedging and scenario analyses. One member noted that market behaviour has become more short-term and responsive, with increased use of short-dated FX swaps observed in August.

**The discussion also focused on potential tail risks for the fourth quarter, with participants identifying a range of possible scenarios.** One member pointed to geopolitical risks, including the ongoing conflict in Ukraine, as a factor that could continue to support the dollar. Fiscal concerns in the UK were also flagged, particularly around the 26 November budget announcement, which is expected to generate significant market volatility. Members also highlighted political risks in Turkey and potential escalations involving Russia as additional tail risks.

**Furthermore, the discussion touched on the increasing role of gold as a diversification tool.** One member noted that corporate interest in gold is growing, driven by its utility in mitigating counterparty risks. In addition, the popularity of gold reflects a broader lack of viable alternatives to the US dollar as a reserve currency. Central banks have also contributed to this trend, further solidifying gold's role in the current market environment.

**The discussion on the Japanese yen highlighted fiscal challenges, political uncertainty, and high carry costs as key drivers of its weakness,** with parallels drawn to how G10 currencies are increasingly behaving like emerging market currencies. The upcoming LDP leadership vote was noted as a potential inflection point, with a fiscal dovish candidate likely to accelerate yen depreciation.

**Meanwhile, the Chinese renminbi's role in global trade continues to grow,** particularly in regional trade, but its tightly managed regime and geopolitical risks limit its potential as a dominant reserve currency.