

Foreign Exchange Contact Group

Frankfurt am Main, Wednesday, 12 February 2020, 13:00-17:00

SUMMARY OF THE DISCUSSION

Ms Rahmouni-Rousseau introduced herself to the Group as the new Director General Market Operations at the European Central Bank (ECB). She thanked the members for their past contributions and said she was looking forward to future discussions.

1. Introduction to ECB Operations Managers Group (ECB OMG)

Emily Witt (ECB) introduced the mandate and work programme of the ECB OMG. The plan for 2020 included priority topics such as the €STR, the Securities Financing Transactions Regulation (SFTR), the settlement discipline regime of the Central Securities Depositories Regulation (CSDR), operational risk management, digitalisation and technological innovation for back-office environments. In the discussion, artificial intelligence/machine learning and blockchain were mentioned as technologies with a potentially large impact on settlement activities and risk management.

2. Structural developments in the foreign exchange swap market

Alexandre Dewhurst and Andrew Sacre (both Société Générale) gave a presentation on foreign exchange (FX) swap market developments and Christoph Hock (Union Investment) presented an asset manager's perspective on the FX swap market.

FX swaps represented nearly 50% of overall FX turnover with swaps and forwards having constituted 75% of growth in overall FX trading between 2016 and 2019, according to the 2019 Bank for International Settlements (BIS) Triennial Survey. The main drivers for FX swap usage were seen to be: (i) balance sheet-related funding needs, (ii) hedges offsetting the risk of existing positions and (iii) cash-flow hedges. Hedging was seen as the main use.

Members discussed the lack of electronic and automated trading in the interbank FX swap market, which was considered a reflection of the usually large transaction sizes, complex pricing and the credit risk involved in FX swaps. As these products are also balance sheet-intensive, banks are averse to providing continuous interbank streaming prices, preferring bilateral trading instead. During the discussion, members raised two main features of the dealer-to-client FX swap business: (i) the lack of pre-trade transparency and (ii) the growing participation of regional banks using prime brokers' credit provisioning to offer swap products to clients.

The above factors have made it difficult for banks to reflect the full transaction cost (including capital charges) in swap prices. Instead, banks have "subsidised" this business with other service revenues, such as FX execution algorithms, regarding swaps as one part of a transaction package. Lately, banks have been paying more attention to account for the cost of each FX swap. Members also discussed whether FX futures may become more attractive in relation to over-the-counter derivatives with the introduction of uncleared margin rules by the end of 2020.

3. The FX Global Code and the Global Foreign Exchange Committee

Roswitha Hutter (ECB) presented the material the [Global Foreign Exchange Committee¹](#) (GFXC) published on the GFXC website following its December meeting. Members discussed the GFXC's areas of focus in the light of its ongoing three-year review.

4. Foreign exchange management and trading at MEAG MUNICH ERGO Asset Management

Elke Wenzler (MEAG MUNICH ERGO) presented the company's setup for FX management and trading. The firm acts as asset manager for Munich Re Group and provides other financial functions within the Group. The firm is active in 32 currencies and is the Group's contact point with the FX market. The FX team is covering four main areas: providing best execution in FX and derivatives; FX strategy using fundamental, market and technical analysis; currency risk management with systematic and discretionary strategies; and FX structuring and advisory services.

5. ECB launches review of its monetary policy strategy

The [ECB Press Release²](#) on the launch of the ECB monetary policy strategy review of 23 January included information on the main issues to be covered as well as an open request for feedback, which was extended to the Foreign Exchange Contact Group (FXCG). Members' feedback on the ECB's strategy review included considerations of the inflation measurement, views on the side effects of negative interest rates and unintended consequences for asset prices. Members also highlighted the importance of considering exit strategy risks in terms of market liquidity, the relationship between monetary and fiscal policies and central bank digital currencies.

Lastly, members thought that the communication of the strategy review outcome, including its timing and sequencing, merited consideration due to its potential impact on financial markets. Environmental, social and governance (ESG) aspects were also mentioned as important even though they should not divert attention away from core monetary policy issues.

6. FX Outlook – Review of FX market developments and outlook

Stefanie Holtze-Jen (DWS) gave a presentation on the FX market outlook, focusing on developments that had taken place since the last FXCG meeting on 19 November. With regard to the market outlook, the resilient US economy and the Trump administration's policies were seen as supporting the US dollar, despite a moderation in headline growth. Most market analysts have consequently revised down their EUR/USD expectations in recent months.

Members discussed the potential implications of the coronavirus outbreak for the economic outlook. Some members expected a swift recovery whereas others predicted a protracted negative impact on the global economy. Most members were of the view that the Chinese authorities would take the necessary measures to support the economy and noted that several Asian central banks had already eased their monetary policy in the aftermath of the outbreak. At the same time the reaction of central banks in other regions has been more cautious. Another general concern was the continued very low-volatility environment despite persistent uncertainties.

Finally, members highlighted that ESG standards are starting to become a factor in financial products, now also including also FX products, e.g. cross-currency swaps and potentially could impact liquidity in Emerging Markets currencies if ESG standards were applied rigorously.

¹ <https://www.globalfxc.org/>

² See ECB Press release 'ECB launches review of its monetary policy strategy', dated 23 January 2020