

Foreign Exchange Contact Group

Frankfurt am Main, Monday, 14 September 2020, 10:30-12:30

SUMMARY OF THE DISCUSSION

1. FX Global Code and Global Foreign Exchange Committee

Members discussed the areas of focus of the Global Foreign Exchange Committee in the light of the ongoing three-year review of the FX Global Code.

2. Review of recent market developments and outlook

The Group discussed recent developments in market indicators in comparison with the levels prevailing before the outbreak of the coronavirus (COVID-19) in February 2020. Members confirmed that spot trading volumes had fallen below their pre-COVID-19 levels for both G10 and emerging market (EM) currencies, but much more so for the latter. Bid-offer spreads had remained wider compared with February, especially for EM currencies. Some members assessed that G10 FX market liquidity tended to evaporate quickly around key market events, but returned back to normal equally fast. In general, it was felt that FX markets reacted more quickly and forcefully to news. This could possibly be explained by the use of execution algorithms, particularly when the bid-offer spreads were wide in the second quarter of 2020, but it also seemed to reflect a longer-term trend. Members mentioned that the market had been structurally evolving towards more concentrated trading activity around news releases and other events, including month and quarter-end fixings.

Regarding major market themes, the general depreciation of the US dollar since March 2020 was highlighted, with the main drivers being the increased debt stimulus and the introduction of US dollar swap lines by major central banks, which had helped to alleviate US dollar funding pressures and restore market confidence during the COVID-19 crisis. Moreover, the erosion of the real yield advantage in the US, the declining hedging costs for US dollar assets and the partial reversal of investment flows to the United States were also seen as factors contributing to the US dollar weakness. A more detailed look showed that the US dollar depreciation occurred broadly against G10 currencies, in contrast with the more mixed performance against EM currencies. With regard to the latter, the more orthodox monetary response of EM central banks to the growth shock resulting from COVID-19, i.e. favouring policy rate cuts over currency stability, was perceived to have made EM currencies relatively unattractive and resulted in subdued investor inflows into emerging markets.

Regarding the euro, its recent resilient performance was considered to be related to the removal of two key tail risks by the introduction of the EU recovery fund and the positive outcome in the German Constitutional Court case on the ECB's public sector purchase programme. This was also reflected in the shift of market positioning from a sizeable short EUR positioning at the beginning of 2020 to a sizeable long EUR positioning now.

Looking ahead, elevated positioning in some G10 currency pairs indicated potential higher volatility in the near term. Similarly, the FX options market was pricing a significant increase in volatility in the near term. The FX option expiries in several major currencies indicated that implied volatility was concentrated around four key market events (i.e. the US presidential election, the

October EU Council meeting, the central bank meeting week in early December and the year-end deadline for the Brexit transition period), with a calmer picture otherwise.

3. Short review of developments in the gold, crypto-asset and stablecoin markets

The Group also discussed developments in the gold, crypto-asset and stablecoin markets. Gold as an investment option had attracted a growing interest from multiple investor categories, with a notable pick-up in investment by the retail community. Stablecoins had also experienced brisk growth in trading volumes in the second and third quarters of 2020 and had been increasingly used inter alia to facilitate cross-border payments and settlement in US dollars.