

EUROPEAN CENTRAL BANK

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Foreign Exchange Contact Group

Frankfurt, Tuesday 31 May 2006

SUMMARY OF THE DISCUSSION

1. Review of market developments

As usual, the Group reviewed and discussed the latest trends in financial markets, particularly in foreign exchange markets.

2. The end of the Quantitative Easing in Japan and the market implication

Kazuki Fukunaga, BoT Mitsubishi UFJ introduced the issue with a thorough presentation on the quantitative easing policy (QEP) and the subsequent structural changes that it brought about in the money markets since it was introduced by the Bank of Japan. Kazuki Fukunaga outlined then the preparation needed for ending the QEP. The new framework for the conduct of monetary policy was also described and the recent developments of the main variables in the yen money markets have been highlighted and discussed in the group.

3. Accumulation of Foreign Reserves

Ettore Dorrucchi, ECB, presented the main findings of the Occasional Paper published by the ECB in March 2006 on the accumulation of foreign reserves. The paper, which is the result of a study that was carried out by a Eurosystem task force, goes through the evidence of reserve accumulation, the main drivers of the accumulation and alternative uses of official foreign assets. The risks and costs of the reserve accumulation was also covered and discussed during the meeting.

Henri Foch (BNP Paribas) and Joseph Hensen (Dexia-Bil) presented their joint work on central bank reserves. The presentation took a forward-looking view from a financial market angle, questioning the strong bias of reserve accumulation towards the US dollar. In addition the presentation highlighted, first, the fact that the accumulation outpaced the increase in cross-border trade, and, second, the mismatch due to the fact that the largest reserve accumulation has taken place in countries with significant trade surpluses. The discussion also reflected that market participants' increasingly expect central banks to possibly consider reserve diversification.

4. Other business

a.) Contact group webpage: update on the project

Participants were informed that the contact groups' website was on a test basis and the test pages were presented and endorsed by the Group.

b.) Information from the Operations Managers Group (OMG)

During its meeting held on Monday 29 May in Dublin, OMG addressed specific aspects related to the organisational and operational impact of Prime Brokerage. Presentations and discussions on the way banks organise operations revealed a different understanding and interpretation of the role and

responsibilities of the middle office. The group also discussed the points to consider when evaluating the possibility of outsourcing operations, such as managing the impact on own operations, selecting the right location as well as key feasibility factors. The group tried also to figure out which alternatives there may be to SWIFT in the unlikely case of problems with this communication channel. In the context of a local SWIFT failure in a country, the group put forward the advantages and disadvantages of declaring a bank holiday.

Finally, the preparations for the global conference scheduled for 23-24 April 2007 were thoroughly addressed. An overall theme and list of topics have been discussed by the Group, however further input from the FXCG was required. In particular, since the Operations Managers see themselves as a service provider for the front office, it has been considered appropriate that, to a certain extent, it could be of interest to present some front office topics during the global conference.

c.) Meeting on 7 September in Dublin hosted by Nova Scotia Bank

The next meeting is scheduled on 7 September 2006 at 16:00 in Dublin and will be hosted by Nova Scotia bank. BHF Bank, Deutsche Bank and the Deutsche Bundesbank will present the topic of the Fund of funds from various angles; tentatively the topic "Opening-up of EBS and Reuters to the buy-side" is also considered to be included in the agenda of the meeting upon confirmation from RBC.

The Chairman reminded his wish to discuss during the meeting on 29 November some of the topics of the broad item of the work programme called "The long term future of the FX market and the market model", see annex 2, and asked members to express their interest for presenting some of these topics.

Annex 1**LIST OF PARTICIPANTS**

Participant's organization	Name of participant
ABN AMRO	Mr Patrick Bartle
Bank of Tokyo-Mitsubishi	Mr Kazuki Fukunaga
BBVA	Mr José Sanchez
BHF-Bank	Mr Joerg Isselmann
BNP Paribas	Mr Henri Foch
CECA	Mr José Manuel Villaverde
Citigroup	Mr Bernard Sinniah
Credit Suisse	Mr Joe Prendergast
Deutsche Bank AG	Mr Stefan Bender
Dexia-Bil	Mr Joseph Hensen
Dresdner Kleinwort Wasserstein	Mr Alex Finos
JP Morgan	Mr Adam Burke
Nordea AB	Mr Morten Tysnes
RBC Capital Markets	Mr Tony Botting
Royal Bank of Scotland	Mr Roger Hawes
The Bank of Nova Scotia	Mr Barry Wainstein
European Central Bank	Mr Francesco Papadia - Chairman
European Central Bank	Mr Werner Studener
European Central Bank	Mr Etienne Port - Secretary
Banque Nationale de Belgique	Mr Joris Bernagie
Deutsche Bundesbank	Mr Peter Griep
Bank of Greece	Mr Panagiotis Pliatsikas
Banco de España	Ms Marta Sáinz
Banque de France	Ms Valerie Bour
Central Bank and Financial	Mr William Molloy
Services Authority of Ireland	Mr Patrick Hogan
Banca d'Italia	Mr Antonio Marras
Banque centrale du Luxembourg	Mr François Zenner
De Nederlandsche Bank	Mr Jaap Teerhuis
Oesterreichische Nationalbank	Mr Reinhold Wanka
Banco de Portugal	Mr Jorge Alves
Suomen Pankki	Ms Päivi Heinäaro-Ehgartner

Annex 2**ECB FOREIGN EXCHANGE CONTACT GROUP****WORK PROGRAMME 2006****Remaining items**

1. How important is prime brokerage? Is the market comfortable that the operational infrastructure surrounding prime brokerage is robust? If not, what is being done and is it enough?

The long term future of the FX market and the market model.

2. Will banks continue to act as intermediaries in FX? Could a major ECN¹ merge with a clearing house and develop an exchange model? What is the role of CLS in this scenario? What would be the implications of this for the industry?
3. As margins narrow, is the market moving towards more commission based foreign exchange trades? What impact would this have on the market environment?
4. How will these factors impact on the profitability of the different players (global banks, regional banks, non-bank trading counterparties, non-bank hedging counterparties)?
5. What will happen to price transparency and liquidity?
6. There are now a growing number of model traders in the market whose only activity is to trade anomalies in price between different ECNs and bank proprietary eCommerce systems. Is this good or bad for the market? Will the FX market follow the development of the cash equity market where algorithmic trading takes a large percentage of market share and the traditional market makers become secondary players?

¹ Electronic Communications Network.