



EUROPEAN CENTRAL BANK

EUROSYSTEM

## **Foreign Exchange Contact Group**

Frankfurt, Tuesday 6 May 2014, 13:00-17:00 CET

### **SUMMARY OF THE DISCUSSION**

#### **1. Regulatory developments in the EU**

Marek Svoboda (ECB) reviewed the latest regulatory changes since the last FXCG meeting in particular related to the Markets in Financial Instruments Directive (MiFID2), the Markets in Financial Instruments Regulation (MiFIR), the Central Securities Depositories Regulation (CSDR) and Market Abuse Regulation (MAR). The 30 April rejection by the European Court of Justice of the UK challenge to the FTT was also mentioned.

The presentation attracted some questions and comments in particular on the FTT. Members expressed concerns that the FTT, in its current formulation, would curb hedging and put euro area banks and institutions at a competitive disadvantage compared to their peers, also noticing that the current proposal could classify some investors as taking proprietary positions when providing two-way liquidity and be subject to FTT. Members also voiced concerns that the proposed FTT and the proposed regulation on bank structural reform to limit risk taking may curb the liquidity of the market and in turn hurt end-users by making hedging more expensive.

#### **2. Meeting the new ACI President**

The newly appointed ACI International President Marshall Bailey reviewed the activities of the association and presented its main focus going forward. The ACI is a non-profit market association in foreign exchange, money markets and derivatives area, with individual membership of 13.000 members, present in 64 countries with regional associations as well as an international body. As far as global codes of conducts are concerned, the ACI issues and maintains the Model Code, which is adopted by the ECB Foreign Exchange Contact Group, as well as by the Australian Foreign Exchange Committee. It also organises educational courses and exams/certificates that are recognised in several countries. It recently decided to have a full-time paid President to further foster the professionalization of the association.

Looking forward, the ACI is looking to expand further its membership, in particular to the buy side, and the coverage of the financial industry, in order to represent the industry in a broader sense. The ACI is also looking to interact with market participants to review and update the ACI Model code. The discussion focused on the specificity of the ACI compared to other industry groups, with the ACI relying on an individual membership system and a broad geographical and industry coverage.

#### **3. Debriefing of the 2014 Global FXC meeting in Sydney**

Guy-Charles Marhic debriefed the Group on the latest Global Foreign Exchange Committees (FXC) meeting in Sydney. Each year, the Global FXC meeting brings together the representatives from the major foreign exchange committees to discuss market developments and coordinate their work. The meeting was chaired this time by the chair of the Australian Foreign Exchange Committee and

attended on the ECB side by the FXCG Chairman, Secretary and one member of the Group. The topics discussed included the changes in market structure and the result of the latest BIS Survey, the introduction of trade reporting requirement for OTC derivatives, the use of FX reference rates. The codes of conduct, the market implication of the implementation of Swap Execution Facility (SEF) and the focus of individual FXC's work in the coming year were also discussed and reviewed. On the issue of codes of conduct in the foreign exchange industry, the various committees considered ways to further harmonise them, continuing the work carried out in the last few years, which culminated in the issuance of the joint statement on "Codes of Best Market Practice and Shared Global Principles" by the Global FXC in 2013<sup>1</sup>. Inter alia, high level principles of ethical behaviour in the conduct of foreign exchange activities could be summarised in a further joint statement by the Committees.

#### **4. Market review and discussion**

Jorge Sicilia (BBVA) talked about the recent macroeconomic and market developments. Euro area growth is gaining momentum led by stronger domestic demand and positive external developments, although some uncertainty exists related to Chinese growth and the level of the euro exchange rate. In his view, inflation is expected to pick up and risk of deflation is assessed as limited although less so in the periphery. Having said that, inflation is very likely to be below the ECB's target for quite some time yet. Additionally fragmentation remains above pre-crisis level requiring further impulse. Some preliminary findings on the impact of quantitative easing in the euro area were also presented. Looking forward, some challenges are looming beyond the moderation of growth in important emerging economies: the euro area cycle lags the US one and the Fed will eventually hike its rates, thus possibly challenging the current decoupling of European yields vis-à-vis the US yields. It remains to be seen if the Fed exit will be sufficient to curb the euro strength.

Johannes Gräß (ECB) reviewed the recent developments in emerging markets (EM). EM currencies initially depreciated driven by global factors up to September 2013. Since then, idiosyncratic and local factors have dominated. In particular, currencies with the largest current account deficits have encountered the largest depreciation, which in some cases triggered large foreign exchange interventions by domestic central banks. The weakness in EM currencies may have contributed to the euro strength. Recently, volatility has dropped markedly for all the major currencies with the exception of the Chinese renminbi and the Russian rouble.

The discussion centred in particular on the resilience of the euro and the current low volatility environment. Members indicated that the euro remains supported by investment and trade flows at a time when risk taking is constrained by regulation and deleveraging, limiting risk positions and arbitrage possibilities. Against this backdrop, expectations of diverging monetary path have limited impact and currencies are mostly driven by trade and investment flows. Some members added that market participants have reportedly little appetite for establishing new short positions in the euro after several unsuccessful recent attempts. Some members also noted possible diversification out of the US dollar into euro from some central banks and inflows based on concerns over strong US sanctions on Russia related to Ukraine. In the meantime, the unprecedented actions by central banks are capping volatility in financial markets. Algorithmic execution and growing internalisation of FX flows by banks were also mentioned as factors contributing to the low volatility environment. It was mentioned that hedge funds do not substitute the reduced risk taking by banks because they also have tighter risk limits when banks cannot warehouse or fund large positions.

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<sup>1</sup> <http://www.ecb.europa.eu/paym/groups/fxcg/html/index.en.html>