Market review

FXCG, 9 February 2017

Disclaimer: The views expressed in this presentation are those of the author and do not necessarily represent those of the ECB or the Eurosystem.
Market review and outlook

• Market developments since last FXCG meeting
• Currency outlook and key risks ahead

Lessons learnt

• US dollar funding at year end/quarter end
Global equity and bond fund flows

Substantial net inflows into US equity investment

Global equity fund flows

Global bond fund flows

Source: EPFR, ECB calculations
Effective exchange rates across major economies

Effective exchange rates – indexed January 2016

Source: Bloomberg and Bank of England
Mexican peso one of the favourite shorts in EMFX

Source: Deutsche Bank
Flows across asset markets

Flows at the beginning of this year

Source: State Street Global Markets, most recent 20 days of flows.
Flows across asset markets

Overall investors have been net buyer of euro

Source: Deutsche Bank
Political events

FX options skew ahead of key votes

Source: State Street Global Markets, Bloomberg
Discussion points

1. Could we see a global shift back from equities into bonds, which repercussion for the euro area? What would that mean for the FX market?

2. Has the risk rally discounted too much good news too soon?

3. Is the earlier consensus interpretation of the key macro trades still valid?
   a) Higher yields and a stronger US dollar?
   b) What is the path forward for EM currencies?

4. Market focus going forward - Political, structural, cyclical drivers?
   a) Event risks (French election, German election)?
   b) Brexit?
   c) Central Bank policy meetings?

5. How is the market positioned? Which key indicators should be monitored?
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Lessons learnt

• US dollar funding at year end/quarter end
Cross-currency basis: a puzzle
Why is it non-zero without a financial market crisis?

Sources: Bloomberg, Commerzbank Research
The basis cannot be explained by counterparty risk. OIS-based basis is even larger.

3M EUR basis
Based on LIBOR and OIS rates; in basis points

Sources: Bloomberg, Commerzbank Research
Dysfunctional money markets
Strong monthly seasonality

EONIA vs. Fed funds rate
Percent

Fed funds  EONIA

BoJ overnight rate vs. Fed funds rate
Percent

Fed funds  BOJ overnight

Sources: Bloomberg, Commerzbank Research
Dysfunctional FX forward markets
Strong monthly/quarterly seasonality

1M EUR basis
Basis points; vertical lines indicate month-change in settlement

1M JPY basis
Basis points; vertical lines indicate month-change in settlement

Sources: Bloomberg, Commerzbank Research
Co-movement of EUR-USD and EUR basis

EUR-USD spot and 3M EUR basis
Basis in basis points

Sources: Bloomberg, Commerzbank Research
LIBOR-OIS spread (LOIS): Counterparty risk or dysfuncionality indicator?

**USD 3M LOIS**
Basis points

50

40

30

20

10

0

Jan 15 Jul 15 Jan 16 Jul 16 Jan 17

**EUR 3M LOIS**
Basis points

50

40

30

20

10

0

Jan 15 Jul 15 Jan 16 Jul 16 Jan 17

Sources: Bloomberg, Commerzbank Research
Discussion points

• What are the lessons learnt?