1. Regulatory developments in the US and EU

James Kemp from the Global Foreign Exchange Division (GFXD) of the Global Financial Market Association (GFMA) presented the latest upcoming challenges for the foreign exchange industry in terms of regulation. In Europe and as required by the European Market Infrastructure Regulation (EMIR), trade reporting will enter into force on 12 February 2014 and it seems that most GFXD members will use Deposit Trust and Clearing Corporation (DTCC) as their European trade repository. GFXD and some members of the Contact Group deem that some key issues remain unresolved and that some rules leave room for interpretation. For instance, dual reporting in the European Union – as opposed to the one sided reporting in force in the US under the Dodd Frank Act – raises serious challenges, with some members again noting that many small financial entities and corporates are not ready yet to implement the rules.

Although members highlighted that delegated reporting is possible, it also poses some legal challenges, as each trading entity – including non-financial ones- will remain responsible for ensuring the proper reporting of their own transactions. Therefore responsibilities need to be clarified beforehand between parties to a transaction in case of delegated reporting.

Members also reported that the Unique Trade Identifier (UTI) raises some challenges, as it remains unclear who has the responsibility to generate the number and how it is defined. UTIs have to be matched before transaction data reach trade repositories, raising the risk of unmatched trades. Finally, the difference in legislation between jurisdictions (e.g. in Europe, US and Asia) poses also some challenges with conflicting and/or different reporting requirements. Finally, members reported that national supervisors - who are in charge to enforce the EU legislation - are aware of the reporting challenges. On EMIR Clearing, GFXD reported that it is working to ensure FX swaps and forwards are not included within the EMIR clearing mandate, as it is the case in the US, so as to ensure a consistent efficient global market.

Mr Kemp also spoke about the Market in Financial Instruments Directive (MiFID), which provides a definition of financial instruments that are included in EMIR, CRD IV and the proposed financial transaction tax (FTT). He advocated carving out FX transactions related to securities transaction across the European Union, mirroring US and Canadian positions. Finally, the recent developments in the FTT were also described.

2. Retail aggregators

Bapi Maitra (Citibank) provided an overview of retail foreign exchange trading. Retail FX volumes have increased markedly from around 10% of total global FX spot volumes in 2008 to around 20% in 2012. FX retail trading has been popular in Japan for some years, but has developed recently in Europe and the Middle East in particular. The increase in retail FX trading has resulted in a decrease of the average trade sizes in the FX spot market. Retail investors seem to be attracted by FX trading because many of its providers require limited initial capital and enable large amounts of leverage. Following the Japanese example, most countries are introducing or currently discussing limitations on the allowed extent of leverage. The increased regulation has led to a consolidation among retail FX brokers, but also to the domiciliation of brokers in less regulated jurisdictions. Discussion focused on
the increased use of technology and aggregation on FX flows and the increased correlation of retail flows.

3. The 2013 International Role of the Euro report

Roland Beck (ECB) presented the July 2013 report on the International Role of the Euro and some more recent data. Since its inception in 1999, the euro became the second-most important international currency and the second-most important reserve currency. The euro has, however, a limited role as a global vehicle currency in international trade. Compared to the last survey, the euro had a declining share in most international markets on account of the sovereign debt crisis. Since then, survey data point to a gradual return of confidence and an improvement in several measures of international role.

4. Update on the Chinese renminbi

Lee Beng-Hong (Deutsche Bank) provided an overview of the offshore and onshore renminbi (RMB) market. Chinese authorities have fully liberalised the use of RMB for cross border trade settlement in March 2012. Most capital account controls have been gradually liberalised on a quota basis (e.g. QFII, RQFII). Since July 2013, corporates are allowed to lend to offshore entities. Authorities have also introduced RMB clearing in 2013 in Taiwan and Singapore and expanded RQFII quotas from Hong Kong to Taiwan, London and Singapore. Chinese authorities are expected to relax further FX conversion quotas in 2014. The RMB market has exhibited a rapid growth, with RMB trade settlement accounting for 17% of China’s global trade in 2013 (or around RMB 4 trillion) and RMB offshore deposits reaching RMB 1.4 trillion. The offshore fixed income market has also grown substantially to reach around RMB 513 bn, out of which around 200 bn were issued in 2013. A further RMB 300 bn issuance is expected in 2014.

Members considered the relatively short tenor of the CNH issuance, which may be explained by investor expectations of currency appreciation and by the fact that banks remain the largest investors. Members also discussed the introduction of new currencies against which the RMB is quoted directly in Shanghai, but noticed that the US dollar remains the most traded currency pair also on the Shanghai direct trading platform. Looking forward, participants expect Chinese authorities to concentrate on the further liberalisation of domestic financial markets (interest rates, deposits, etc…) and, in foreign exchange, to focus on the relaxation of conversion quotas and work on the extension of off-shore centres for RMB trading. A new clearing system should also be introduced: the China Interbank Payment System.

5. Market review and discussion

Steven Saywell (BNP Paribas) discussed the outlook for the foreign exchange market. He expects the Fed tapering and higher US Treasury yields to support the US dollar against the G10 currencies in 2014. The recovering UK economy and the expected shift in the policy stance by the Bank of England should also underpin the British pound. Meanwhile, the euro may depreciate against the major currencies, as BNP Paribas expects further easing by the ECB and some of the recent supporting factors to gradually dissipate (e.g. capital inflows, current account surplus). The commitment of the BoJ to maintain a very loose monetary policy and the expected investment outflows by domestic investors should weigh on the Japanese yen against the major currencies. Members also discussed the outlook for the Swiss franc, with some expecting the franc to depreciate amid an unwinding of safe haven flows. Finally, members discussed the forward guidance implemented by the major central banks.