EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt, Thursday 12 November 2015, 13:30-17:00 CET

SUMMARY OF THE DISCUSSION

1. FX benchmarks

Christophe Beuve presented the main takeaway from the FSB report on the progress in implementing the September 2014 FX Benchmark Group (FXBG) recommendations. Such progress report indicated that overall good progress in implementing the recommendations was made, while recommendations had been adopted to varying degrees. As a result, regulators and FX markets participants should remain focused on achieving a more complete implementation. In particular, bid-offer spread and fixed fee, or a combination of both, as well as the separation of fixing orders should be applied by all sell-side institutions to all benchmarks. Data analysis indicates that market participants are increasingly using algorithmic execution for transacting benchmark orders, as volumes are evenly distributed within the 5 minute window, tickets are smaller and less front-hedging is observed. The report also noted that the recommendations related to market conduct are largely implemented through a review of internal policies, procedures and guidelines and through the ongoing work to establish a Single Code of Conduct (see below).

Shirley Barrow (WM/Reuters) reviewed the changes implemented by WM/Reuters, a provider of FX benchmarks, since the publication of the above-mentioned FSB report. WM/Reuters has completed the IOSCO evaluation in April/May 2014 and reviewed its compliance in 2015. It has implemented the extension of the time window on 15 February 2015 after a client consultation. WM/Reuters is in the process of incorporating a broader range of data sources in the benchmark setting and setting up a user group. Several members of the ECB FXCG expressed their interest to join.

Members agreed on the increased electronification of FX execution as well as the growing usage of algorithmic execution and of matching facilities for benchmark execution. Some banks are now offering agency execution for fixing transactions. Members enquired about the future public disclosure of the WM/Reuters user group's discussions. Smaller banks reported that separating fixing activity as recommended by the FXWG is costly and that they resort to matching facilities. Discussion also focused on the adequate length of the fixing window and the regular review of the process. Finally, some members noted that some currencies were more volatile than others during the fixing window, possibly reflecting lower liquidity of those currencies.

Christophe Beuve consulted the group on a few changes to the framework of the ECB reference rates. He indicated that the ECB wants to reinforce the reference-only nature of the ECB reference rates and enhance transparency. To do so, the ECB envisages to delay the publication of the ECB ref rates (from 2.30 to 4 pm) and to provide a 3-month notice period between announcement and implementation for market participants to adjust to the change. The methodology for setting the ECB references rates will remain unchanged. The ECB could further delay the publication if no decrease in trading takes place. The ECB will publish information on the governance and methodology, on the policies on cessation and republication of the rates and public feedback procedures. The ECB reference rate framework will be in line with the FSB recommendation 5 for central bank reference rates and will ensure broad compliance with IOSCO principles.
Members understood the emphasis of the ECB on the information/reference purposes only of the ECB reference rate and its desire to discourage trading but noted that some adaptation

will be needed. European corporates in particular use the ECB reference rates in their contracts as the rates are perceived as independent and transparent. The proposed delay to 4 pm was seen as manageable. A publication on the next day would be however much more challenging in terms of accounting processes. Members were asked to provide comments to the Secretary by 17 November.

2. BIS's FX Working Group on single code and adherence: state of play

Guy-Charles Marhic reviewed the work related to promote and incentivise adherence to the Code to be established under the auspices of the BIS FX Working Group[1]. The BIS Economic Consultative Committee set up the BIS FX Working Group (FXWG) on 11 May 2015 with a view to facilitating the establishment of a single code of conduct standards and principles in foreign exchange. The FXWG is organised around two workstreams: one is developing the single code and the other the proposals to promote adherence to the single code. On the single code, the secretaries of the eight Global FX Committees are leading the work to harmonise the language across the existing codes of best practice. A Market Participants Group (MPG) has been setup to develop further topics given the limited or insufficient coverage in existing codes to be considered for inclusion in the new Global FX Code. All groups will interact and regularly report to the FXWG. Adrian Bohler, also member of the MPG, updated the group on the ongoing work of the MPG. Overall, work is progressing well with two FXWG meetings already held in September and November 2015 and two upcoming in January and February 2016. The first parts of the future single code will be shared for comments with the eight Global FX Committees in February 2016. The goal is to publish the new Global FX Code along a framework for adherence to the new code in May 2017.

Members welcomed the initiative to establish a single code and the information provided on the ongoing work as well as the greater details on the timeline. Members were asked to provide comments and suggestions to a draft high level outline circulated to the eight FXCs.

3. Latest developments in the Chinese renminbi

Yao Wei (Société Générale) reviewed the latest developments regarding the Chinese renminbi (CNY). She deemed that the PBoC is facing the “impossible trinity” of having a stable currency, easing monetary policy and open capital account. She expects that the PBoC will have to let the currency depreciate further. The weakening pressure on the currency is illustrated by the ongoing pressure on the off-shore currency which is trading constantly weaker than the on-shore. Resident flows dominate the capital outflows. On a short term horizon, capital account dynamics are key to the currency trend. The external debt is overall manageable as it is small (less than 10% of GDP) but it was noted that it is mostly unhedged and the short duration implies a rollover risk. Actual interventions could be larger than the data and estimations infer. So far, PBoC has been focusing in liberalising inflows (via QFII for instance) while outflows remain constrained. China has low external non-reserve assets and plenty of scope to increase them as private outflows should gradually replace public outflows. She expects the CNY to be included in the SDR basket by the IMF following political support from other IMF members and as the currency is meeting all IMF requirements (e.g. reliable reference rates, interbank opened to central banks, publish reserve data). Monetary policy remains restrictive in China following the massive interventions and the reduction in the PBoC’s balance sheet. Large NPLs also continue to burden banks and demand for credit remains subdued despite lower borrowing costs.

Members shared their trading experience in the Chinese market and discussed the FX hedging instruments available in the Chinese market.

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[1] BIS Press release: http://www.bis.org/press/p150511.htm