



EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt am Main, Thursday, 5 October 2017, 13:00-17:00 CET

SUMMARY OF THE DISCUSSION

1. FX Outlook: Review of FX markets developments and outlook

Shahab Jalinoos (Credit Suisse) initiated a discussion on the current key themes in the FX market. His outlook for the euro was positive and supported by a cyclical upswing in euro area growth and momentum positioning factors while two-way political risks were affecting the US dollar. The lower correlation between EUR/USD movements and interest rate differentials between the United States and the euro area seemed to result from reduced risk premia associated with European political developments and moderated expectations regarding possible fiscal stimulus emanating from the United States.

Members discussed the low volatility prevailing across financial markets and asset classes. They mentioned a number of factors that could cause an increase in volatility, in particular changes in the current trends of systematic investors selling volatility and discretionary investors positioning cautiously as a result of any sudden break in price correlation between equity and bond markets. In that context, recent structural trends, such as the shortening of investor holding periods and market makers' reduced risk absorption capability, would likely exacerbate asset price movements.

2. The international role of the euro

Arnaud Mehl (ECB) presented the key findings of the 16th annual review of "The international role of the euro".¹ The reporting period from 2016 to early 2017 was characterised by heightened risks stemming from geopolitical developments and other non-economic factors. Against this backdrop, the euro continued to lose some ground across most indicators outlined in the Review. It remained the second most important currency in the international monetary system when measured, for example, in terms of international debt and loans, foreign exchange turnover and foreign exchange reserves, and its use in global payments.

He also presented one of the Review's Special Features on the impact of technology on the geography of FX trading. This article concluded that electronic trading erodes the effects of the standard spatial frictions (distance, liquidity, capital controls) that make trading widespread across financial centres and gear it towards domestic markets. Members asked questions about the methodology chosen, but agreed that there was a heavy reliance on physical infrastructure, technology and connectivity in the FX market. They also noted that these kinds of economy of scale effects create benefits by agglomerating similar businesses in large financial centres. However, members also pointed out that pricing and matching engines could relocate around the globe more rapidly than in the past, while the industry was also becoming increasingly complex, as various business operations could take place at multiple locations.

3. MiFID II: Main considerations and challenges

Nick Crawford (Commerzbank), Juan Landazabal (Deutsche Asset Management) and Paul Tivnann (Bloomberg) gave a presentation on MiFID II implementation and the related challenges from a buy, sell and platform perspective. MiFID II was generally viewed as

¹ <https://www.ecb.europa.eu/pub/pdf/other/ecb.euro-international-role-201707.pdf>

representing the broadest, most substantial and complex regulation to date for the financial services industry, with far-reaching scope and implications.

Members discussed the organisational challenges, external dependencies and data exchanges, demands on technological solutions and the widespread need to review and adapt existing policies and procedures in order to comply with the regulation by the implementation date of 3 January 2018. Most members were of the view that the financial industry would not be fully ready to implement all the required details of the regulation by January 2018, partly owing to the continued lack of guidance from regulators on a number of aspects. There were particular concerns regarding trading in over-the-counter FX derivatives, having all Legal Entity Identifiers available on time and the need for further guidance on time stamping for voice trading. Additionally, many trading venues had yet to notify their participants regarding their data requirements for trading once MiFID II was enacted. A few members warned about the potential for disruptions in market functioning and a possible deterioration in market liquidity in the first few weeks of 2018. Pragmatic guidance with further clarity from regulators, particularly from the European Securities and Markets Authority, was seen as helping to alleviate implementation risks, as was information on possible forbearance if not everyone was completely compliant on 3 January 2018.

4. FX Global Code: Current issues

Tobias Helmersson (ECB) informed the Group about the status of the Global Foreign Exchange Committee (GFXC) work streams on the consultation on last look practices, the survey on the FX Global Code and public registers.

The Group discussed the GFXC consultation on trading/pre-hedging in the last look window, in particular the arguments for and against the practice. Views continued to be mixed, with a majority of respondents in favour of strengthening the language around trading in the last look window. The Group agreed to hold a follow-up teleconference call to discuss the item ahead of the GFXC meeting on 14 November 2017.

The Chair reminded members that they should demonstrate adherence to the Code by endorsing the Statement of Commitment, preferably by the end of 2017, but by 25 May 2018 at the very latest, in order to remain eligible for membership of the Foreign Exchange Contact Group. This requirement also applied institutions wishing to join the Group. The FXCG's Terms of Reference had been updated in July 2017 to reflect these expectations.

5. Work programme

Roswitha Hutter (ECB) presented the work programme for 2018. There would be two recurring items on the agenda, namely the FX outlook and market developments, and the FX Global Code and its adherence framework.

Members proposed specific topics, subject to change, for discussion in 2018, such as an update on regulatory changes in the United States and Europe and their impact on FX markets, the structural evolution of FX market trading and liquidity, China's FX market developments and outlook, and cryptocurrencies and digitalisation.