EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt am Main, Thursday, 1 March 2022, 11:00-11:30

SUMMARY OF THE DISCUSSION

The Group held an ad hoc call to exchange views on FX market functioning in the light of the recent escalation of tensions in Ukraine, focusing on areas of market disruption and broader spillovers.

1. Conditions in the FX markets for Russian roubles

Market liquidity in the Russian rouble (RUB) is significantly impaired as liquidity in the USD/RUB currency pair has disappeared from several secondary trading venues. On secondary venues, only a handful of transactions are taking place on a daily basis. By contrast, primary market venues saw a surge in trading volumes last week, but have seen a significant decline since Monday, 28 February 2022, as more recently the market has started migrating to voice or bilateral trading. Given the reluctance of participants to have exposure to Russia and to provide funding for such related transactions, the risk that the market could gradually grind to a halt was highlighted. Western banks with subsidiaries in Russia are facing the risk that Moscow may impose further restrictions on their foreign currency trading activity in the coming days.

There is also a significant fragmentation between onshore and offshore rouble market pricing. Several members described the rouble market as segregated, with trading in deliverable and non-deliverable instruments occurring at significantly different rates. The offshore deliverable market in rouble was seen as being at risk of ceasing soon. Participants reported ongoing efforts to convert some exposure to onshore rouble to non-deliverable forward contracts.

There are widespread market concerns about clearing and settlement issues involving the rouble. The main concern is that Russia could retaliate against Western sanctions by freezing rouble-denominated assets of foreign entities. Therefore, even large banks have restricted the provision of market pricing (across FX spot and derivatives), so that only clients who already have the available rouble pre-funding with them can obtain such pricing. Some liquidity consumers who previously used now sanctioned Russian banks as clearers do not seem to have contingency plans in place to replace them. Members doubted whether smaller Russian banks not covered by sanctions could effectively be used or step in to fill the gap, both from an operational aspect and given that they may eventually be covered by sanctions or domestic restrictions.

2. Spillovers to broader financial market conditions

Some members voiced concerns about the availability of US dollar funding. Following reports of a potential freeze on US dollar-denominated assets of Russian entities, US dollar-providing operations by central banks will be important. For that reason, some communication from central banks on the availability of US dollar funding backstop facilities would be useful and was expected to be forthcoming. The US dollar funding pressures are most pronounced for Russian onshore entities seeking to obtain US dollars. Regarding US dollar funding more generally, while the recent rise in costs is reversing somewhat and funding is still available for very short dates (up to one week maturity), term funding for longer tenors is unavailable or prohibitively expensive amid the prevailing uncertainties.

Major currency pairs and emerging market currencies as a whole are largely unaffected, but some tensions are visible in central and eastern European currencies (the Polish zloty, Hungarian forint and Czech koruna have experienced a deterioration in market liquidity).

The decision to sanction some Russian oligarchs was perceived to have triggered an outflow of money into crypto-assets in attempts to circumvent sanctions.