EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt, Wednesday 23 November 2016, 13:00-17:00 CET

S U M M A R Y O F T H E D I S C U S S I O N

1. ECB Reference Rates and FX Fixings

Istvan Mak (ECB) presented an assessment of the changes to the ECB reference rates (ECBRR) almost one year after their announcement in December 2015 and five months after their implementation on 1 July 2016. The changes aimed primarily at discouraging trading on the ECBRR and limiting their usage for reference purposes only through the delay of their publication at around 16:00 CET instead of previously around 14:30 CET.

Analysis of data from various electronic platforms provides evidence that the trading volume on many euro currency pairs at the time of the setting of the ECBRR has decreased and is now in line with the average volume within the time window from 13.30 to 14.30 CET. Members confirmed that a wide range of market participants has adjusted their behaviour. Specifically, electronic platforms offering order matching service and banks providing execution at the ECBRR have stopped these activities while buy-side institutions have gradually moved to alternative benchmarks provided by various vendors or shifting their FX benchmark execution from one time point to time range. Members indicated that the remaining limited flows on the ECBRR are largely related to existing legacy contracts for which the volume will decline over time upon the termination of those contracts.

The ECB, with the help of the FXCG, will continue to closely monitor trading activity around the setting of the ECBRR and assess from time to time whether further changes are warranted.

2. BIS's FX Working Group on FX Global Code: Phase 2

Guy-Charles Marhic (ECB) reviewed the ongoing work to establish global principles for good practice in the FX market ("FX Global Code") and to promote and incentivise adherence to the FX Global Code under the auspices of the BIS FX Working Group. The first work stream of the FXWG, which develops the FX Global Code in its second phase, has received a substantial number of comments on the second review of the draft circulated in. Most comments focused on contents and almost half of the comments were on the part related to execution. After Cédric Beaurain (Société Générale) and Ankur Pruthi (NBIM) reported the discussion at the Market Participants Group and the latest BIS FX Working Group meeting in Basel in early November, members discussed the most contentious topics of last look, daily highs and lows and prime brokerage and of the ways to promote and incentivise adherence to the FX Global Code. Overall, members expressed their intention to attest their adherence to the FX Global Code relatively soon after its planned publication in May 2017. Members were reminded that the third and fourth review of the draft for the FX Global Code will be circulated for their comments in December 2016 and February 2017, respectively, before publication in May 2017.

3. Market review and discussion

Johannes Gräb (ECB) reviewed the 2016 ECB interim report on the International role of the euro. The euro remains the second most important currency[1] in the international

[1] of those included in the revised SDR basket.

monetary system, albeit with a significant gap to the US dollar. A number of the indicators tracked in the report showed the share of the euro to have declined slightly over the review period. This was particularly the case for foreign exchange reserve holdings, issuance of foreign currency-denominated debt and cross-border loans. The medium-term decline in the shares of both the euro and the US dollar in globally disclosed holdings of foreign exchange reserves may suggest a trend towards greater multipolarity in the international monetary system.

Roswitha Hutter (ECB) reviewed the headline results of the latest BIS Triennial Central Bank Survey. Average daily FX volumes aggregated across instrument categories declined in April 2016 to USD 5.1 trillion compared to USD 5.4 trillion in the previous survey in April 2013. This decline was largely caused by a significant fall in FX spot volumes, which was only partially offset by an increase in FX swap volumes. The breakdown into geographical location of the FX market showed a further increase in concentration with sales desk in five countries intermediating 77% of the FX volume in April 2016. Finally, the BIS survey confirmed the euro as the second most used currency in the FX market while the US dollar remained the dominant currency, being on one side of 88% of all trades in April 2016.

Members’ discussion on market developments focused on the market functioning in the immediate aftermath of the outcome of the US election. Despite elevated FX-trading volumes and volatility, members confirmed that they did not experience any major disruptions or gaps in liquidity nor market dislocation while electronic platforms performed smoothly. Some members noted that the skew of the FX-option market ahead of the UK referendum on EU membership and the US Presidential elections were correctly pointing to the possibility of a different outcome of what had been initially indicated by polls. After US election results market participants sold initially US equities and the US dollar against other currencies, but these flows reversed very quickly. US equities in particular have seen steady inflows on expectations of higher earnings driven by increased public spending, promised corporate tax cuts and stronger domestic growth expectations.

Meanwhile, emerging market currencies have depreciated broadly driven by large capital outflows, with currencies where foreign investors hold a high share of the domestic bond market depreciating the most. Some members noted that demand for US dollar is expected to remain strong, particularly stemming from emerging markets, and that demand may further increase ahead of year end. Some also reported that also a repatriation of US dollar may provide further support to the US dollar.

As regards other currencies, some members noted that the marked increase in the Japanese current account surplus will provide some support to the Japanese yen but the British pound should remain under pressure on expectations of a larger current account deficit, also driven by political developments. Other members however cautioned that the unwinding of short speculative positions may provide some support to the British pound.