EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt am Main, Tuesday, 13 June 2024, 14:00-16:00

SUMMARY OF THE DISCUSSION

1. Review of the recent foreign exchange developments and outlook

Peter Vincent (State Street) and Kate Lowe (State Street, GlobalLink) reviewed recent developments in the global foreign exchange (FX) market.

Since the last FXCG meeting in March 2024, liquidity conditions and market functioning in the EUR/USD FX market had remained orderly. Relative trading volumes EUR/USD were weaker compared to other G10 currencies, which have returned to above median levels. FX realized and implied volatilities in developed market currencies in comparison to some emerging market currencies have continued to decline to levels below their long-term moving averages, reflecting a more defined interest rate outlook in contrast to some members' mixed views on the US inflation outlook. Members noted that real money investors' positioning is still strongly underweighted euro against the US dollar with monetary policy expectations, US presidential elections and political uncertainties seen as the major drivers for EUR/USD developments going forward.

Members confirmed that elections are considered as main events with US election risk being priced in more than recent European Parliament and some emerging market elections. While political risk has re-emerged as an important driver of emerging market currency performance in recent weeks, some members expressed concern about potential market complacency towards non-US elections, as the focus remains on the impact of the US election on risk exposure and investment strategies. Political uncertainties in Europe and the potential for heightened geopolitical tensions could drive investors towards the US dollar as a safe haven currency, while an orderly US election process is considered as essential for maintaining stability in the currency market.

Regarding other currency pairs, the Bank of Japan's monetary policy normalisation was seen as a key event for the USDJPY rate. The Bank of Japan's upcoming monetary policy decisions remain in market focus with FX market intervention seen possible if the Japanese yen were to depreciate strongly. China's subdued economic recovery was perceived as having minimal impact on global FX markets, but two members stressed that the US elections were a key risk for China and Europe.

2. Feedback from T+1 settlement transition

The transition to a shorter standard settlement cycle for US securities went smoothly. Feedback from FXCG members was uniformly positive. Despite initial industry concerns, the occurrence of settlement failures remained largely unchanged, suggesting that clients were well-equipped to comply with the tighter settlement schedule. FXCG members attributed the smooth transition to a long and thorough preparation period, rigorous testing, and collaboration between various organisations. Members confirmed that the extension of custodians' cut-off times and extended operating hours by some trading platforms supported the smooth transition. Still, the final impact on FX trading and a potential shift in the liquidity demand is too early to assess. The successful transition may increase pressure on the UK and EU to follow suit soon, also considering the lengthy preparation phase required.

3. Global Foreign Exchange Committee and FX Global Code Review

Members discussed the areas of focus of the Global Foreign Exchange Committee (GFXC) in the light of the ongoing three-year review of the FX Global Code and the approaching annual GFXC meeting. The Group received updates on the ongoing work from different GFXC Working Group members and FXCG members shared their views focusing on three areas: mitigating settlement risk in FX transactions, further promoting adherence to the Code and examining FX data access with an aim to enhance transparency of FX transactions.