Foreign Exchange Contact Group

Frankfurt am Main, Tuesday, 20 November 2024, 14:00-18:00

SUMMARY OF THE DISCUSSION

1. Review of the recent foreign exchange developments and outlook

Liquidity conditions and market functioning in the FX market have remained orderly in 2024, with brief episodes of volatility. The year has been characterized by relative stability in most G10 FX markets with the euro and US dollar predominantly trading within relatively narrow ranges until very recently. In contrast, the Japanese Yen has displayed significant volatility, also in the early August when there was a short-lived equity and bond volatility event. Overall, the FX landscape has been primarily driven by yield-based relationships and central bank narratives. Recent developments around the US presidential election have introduced new dynamics in the euro and led to elevated volatility with many 3-month implied FX volatilities rising above the top quartile of the 2024 range. Members emphasized the potential effects of US-led tariffs and deregulation on various sectors. Concerns were raised about the underpricing of risks associated with the Trump administration's policy mix and upcoming policy changes in Germany and France. These could be potential factors for adjustments in EURUSD risk reversals. Looking ahead, FX volatility is expected to remain elevated given the prevailing policy uncertainties and potential geopolitical risks.

One key discussion point among members was the changing structure and diminishing role of primary venues in FX trading. The shift of trading volumes from primary venues to other OTC trading platforms and FX futures over the last years was seen as a natural evolution of a market that has become more efficient in executing FX transactions. Members noted that banks are increasingly internalizing trades and market participants turning to technology-driven liquidity providers. One member predicted that primary venues will evolve into all-to-all platforms within the next 5-10 years, aligning with other asset classes due to diminishing flows. Members raised concerns that the decline in traded volume at primary venues undermines or puts at risk their traditional role as shock absorbers during periods of market stress. While FX volatility remains relatively elevated compared to other asset classes, the resilience of primary venues is yet to be tested under high-stress conditions (at least in 2024).

The group also discussed how the rise in regional regulations challenges the global nature and benefits of the FX market, contributing to further fragmentation. This is particularly important for FX, which is a truly global asset class and deeply embedded in global trade and global economics. Increasing global regulatory fragmentation was told to affecting liquidity, increasing operability costs, and decreasing efficiency despite the introduction of the FX Global Code. Members therefore called regulators to ensure market harmonization to prevent country or region-specific arbitrage and establish a level regulatory playing field.

2. Triennial FX Global Code Review

Members discussed the Global Foreign Exchange Committee's (GFXC) consultation results and final proposals for the 3-year review of the FX Global Code ahead of the upcoming GFXC meeting on 5 and 6 December.

3. Best Practices in FX markets

The presentation focused on standardizing FX reject codes to improve communication in the FX market. Current rejections of electronic FX trade requests by Liquidity Providers (LPs) use varied terminologies, complicating client interpretation. The presenter advocated for increased standardization efforts, involving third-party providers and buy-side participants encouraging LPs and platforms to adopt the proposed reject codes.

Members generally expressed support for the industry initiative to standardize FX reject codes, recognizing the potential for improved communication and operational efficiency. Members noted that while the standardization of reject codes is seen as a positive development, its implementation may take time, especially with Liquidity Providers. There was also a discussion on the applicability of standardization across different platforms, with an emphasis on the need for industry collaboration to achieve broader standardization.

4. Artificial Intelligence (AI) in FX markets

The Group discussed the impact of artificial intelligence (AI) on FX markets. Members noted significant investments by high-frequency traders and the competitive edge AI could provide, particularly in data analysis. AI is already widely used in FX market data analytics as well as pricing activities. It was mentioned that non-bank liquidity providers are better positioned to implement AI solutions due to their lighter regulatory burden, but also that there should be more efforts to create equal trading opportunities between different regions. Finally, the necessity of keeping humans involved for efficiency and oversight of more automated processes was emphasized.