EUROPEAN CENTRAL BANK
EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt am Main, Wednesday, 26 March 2025, 14:00-16:00

SUMMARY OF THE DISCUSSION

1. Review of the recent foreign exchange developments and outlook

Following a presentation by Yasemin Artar (HSBC) and Hinrich Paul (Commerzbank) the group discussed developments in the global foreign exchange (FX) and gold markets.

Since the last FXCG meeting in November 2024, liquidity conditions and market functioning in the FX market showed increased trading volumes and heightened volatility. Several factors were mentioned as drivers influencing FX markets, most notable the diminishing perception of US exceptionalism, fuelled by concerns over US trade protection policies changing the market sentiment for the US dollar. One member argued that the new US administration actions will lead to a flattening of the US dollar smile, reducing the US dollar’s usual pattern of appreciating during strong economic growth or significant market distress. Increased market volatility has led to increased FX volumes and use of FX options. In the options markets risk reversals are pricing less positive outlook for the USD, with policy uncertainty having also been reflected in increased corporate hedging activities.

Diverging fiscal policies and geopolitical risks are expected to remain pivotal in shaping market dynamics going forward. Germany's fiscal policy shift, coupled with anticipated increases in EU defence spending and gradually implemented structural reforms, may sustain the euro's appreciation, supported by a rotation of equity investments from the US to Europe. Upcoming tariff decisions are likely to heighten global trade tensions and increase currency volatility. In the near term, short-term retracements and positioning adjustments could weaken the euro but the medium-term outlook was mentioned to be positive. While these factors were expected to benefit gold as well as some safe-haven currencies like the Swiss franc and the Japanese yen, further trade war escalation was seen as posing a risk to the Canadian dollar and a few emerging market currencies.

Another point of discussion was the upcoming US regulatory framework for crypto currencies and stablecoins, which could impact demand for US dollar and US denominated securities. Views were mixed on cryptos, with some members seeing Trump Administration’s pro-crypto and stablecoin stance to lead to new more open regulatory framework and rapid growth, whereas others felt the jury is still out and were not yet sure about immediate breakthrough. Increased institutional participation in stablecoins, backed by investments in US Treasuries, might increase demand for both crypto assets and stablecoins. The 24/7 nature of stablecoins was mentioned to make them a future competitor for the money market funds, particularly the new yield-bearing stablecoins which have witnessed strongest growth most recently ahead of the launch of the new US regulatory framework.

2. Update on “Spot+” and its impact on the FX Futures market

Paul Houston (CME) and Peter Vincent (State Street) updated the group on one new technological product innovation in the FX market opening a discussion for structural market developments.

The launch of the CME’s new electronic communication network “Spot+” has a potential to improve FX market liquidity by bridging spot FX trading with FX futures liquidity. The platform is designed to complement primary markets like EBS, but with a different market microstructure alongside linkages to the broader participant mix of the FX Futures market. It also aims to lower credit barriers, enabling broader participation without the need for extensive credit arrangements. Views were mixed on its impact on price discovery and effectiveness in changing liquidity access for regional banks, given their existing indirect access through larger banks. Overall, it was recognized as one innovative addition to the FX landscape with the potential to connect spot and futures markets, complementing existing market alternatives and potentially broadening liquidity access, which can be only assessed after its launch in April.