



Foreign Exchange Contact Group: Discussion on structural developments in the FX Market

Part 1: FX liquidity provision and market resilience

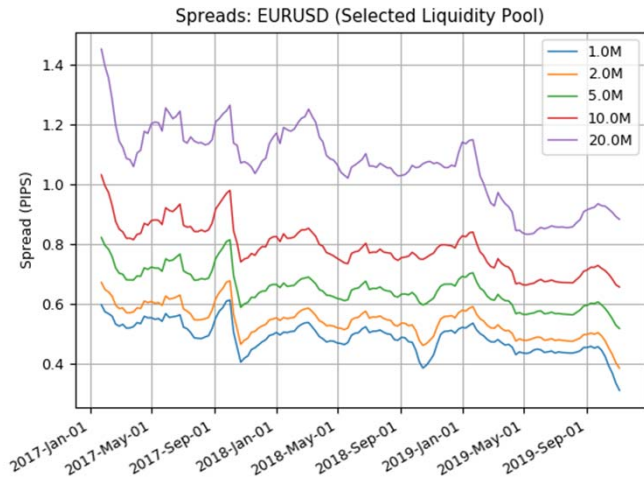
Hypothesis

- › The electrification of FX and the decreased number of manual traders has led to lack of liquidity, less position taking and increased the potential for there to be flash crashes
- › Technology has allowed eFX “out of the box” allowing for more uptake of cover and deal models causing market fragmentation and increasing toxic flow
- › Pressure to deal with the costs and technology challenges of eFX makes “genuine liquidity” provision harder and liquidity more fragile
- › The entry into the spot market of non-banks, who may be offering opportunistic liquidity as they don’t have direct client relationships, leads to less stability

Evidence

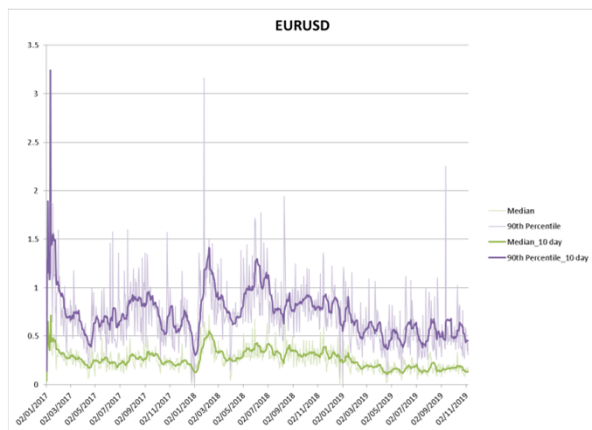
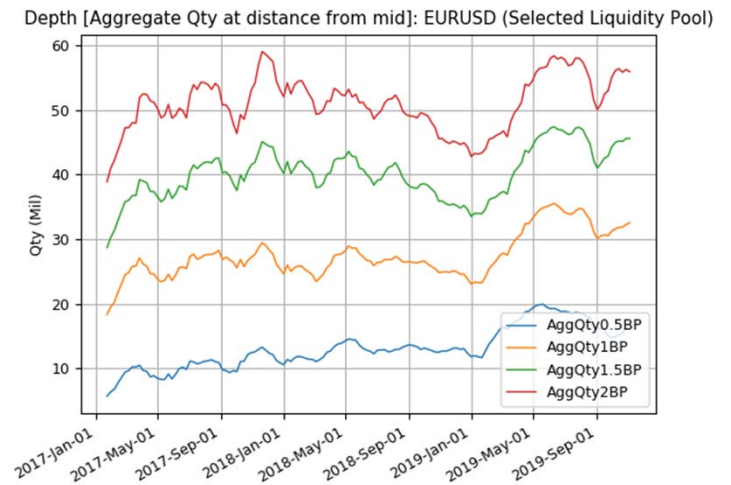
- › Does the data tell a similar story? We will take a look at the last three years in G3 and some EM pairs
 - › Spreads
 - › Liquidity
 - › Short term volatility
 - › Daily ranges
 - › Flash events
 - › Ticket sizes

Spreads, liquidity, volatility – EURUSD



In the most traded currency pair, spreads have tightened¹

Liquidities have improved

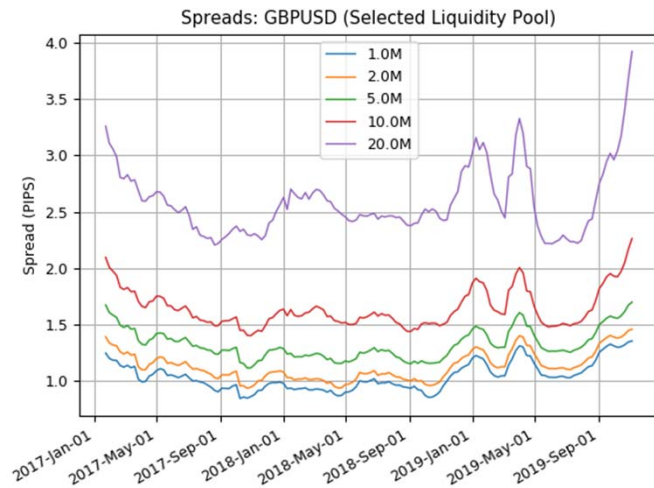


Short term intelli-vol signal² seems to be on a downward trend

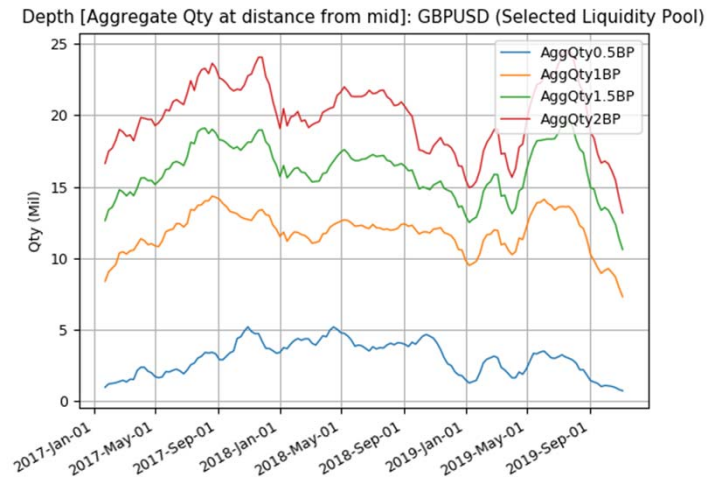
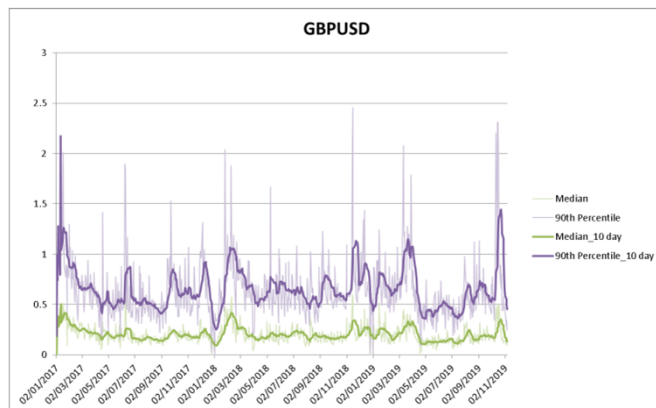
1: Five day moving average sampled every three days

2: Intelli-vol is a proprietary reactive activity signal calculated from multiple markets and designed to filter out noise

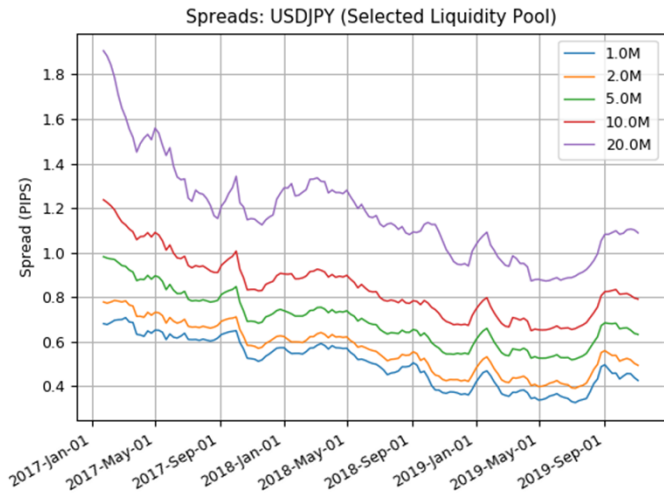
Spreads, liquidity, volatility - GBPUSD



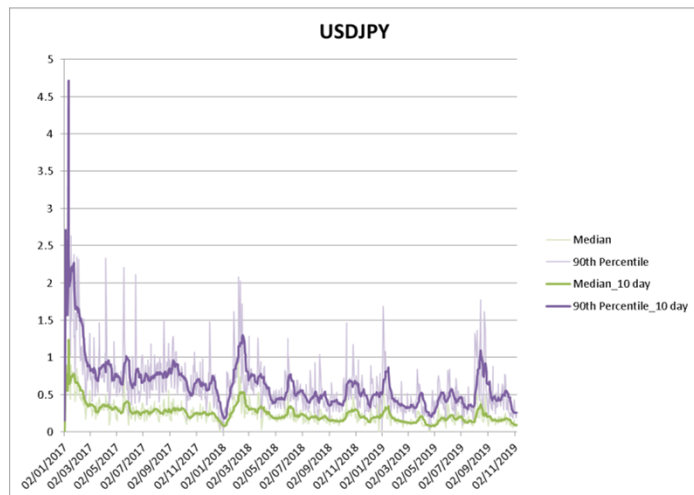
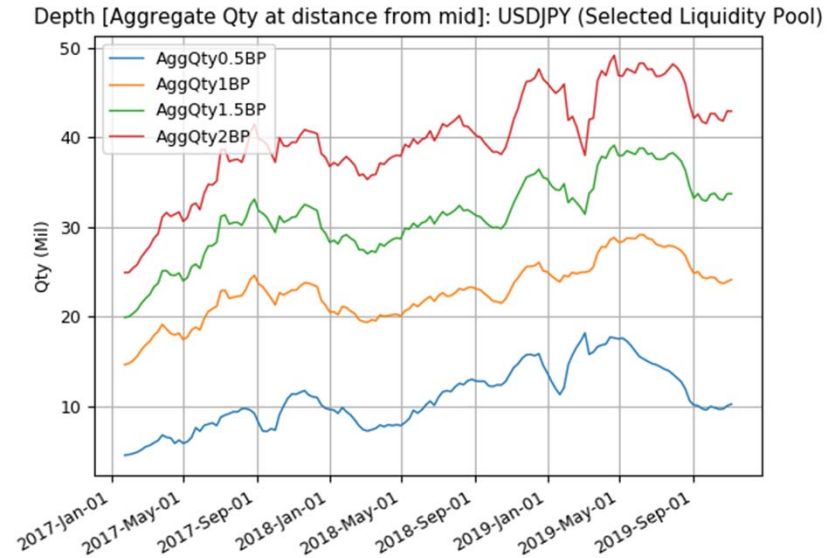
It looks like Brexit political risks, not market structure, determine spreads, volatility and liquidity



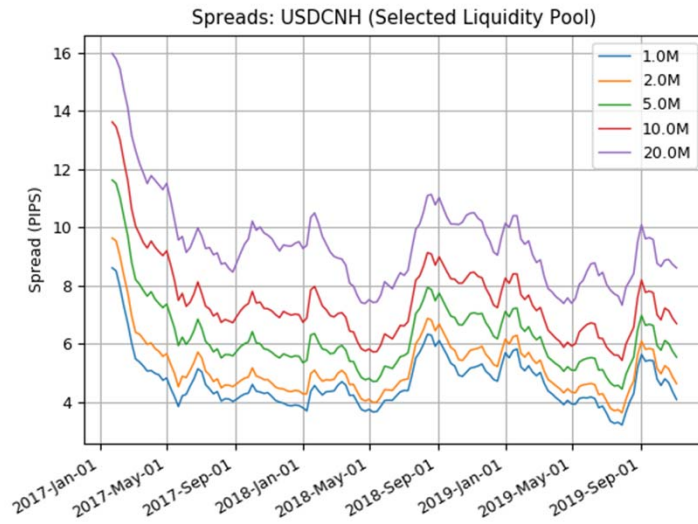
Spreads, liquidity, volatility - USDJPY



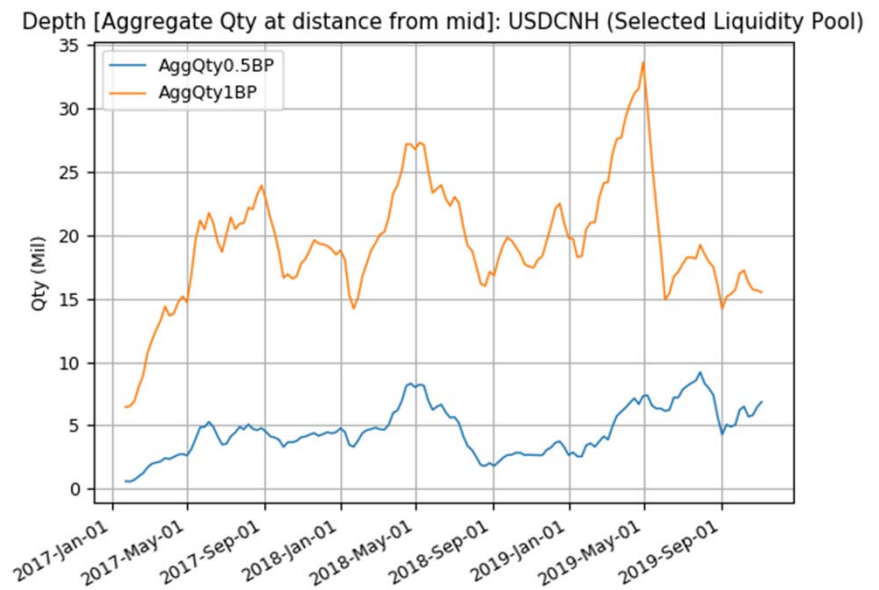
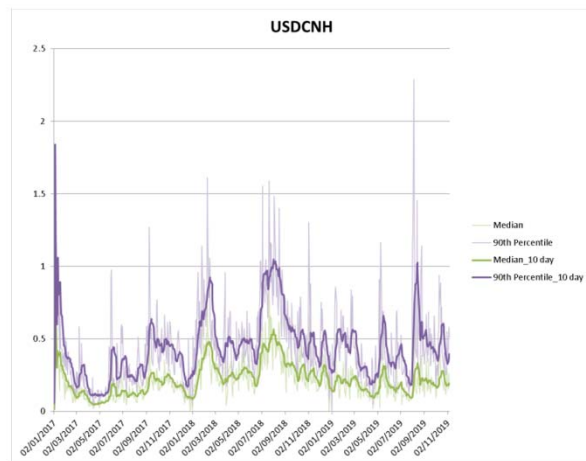
Yen's role as the global measure of riskiness



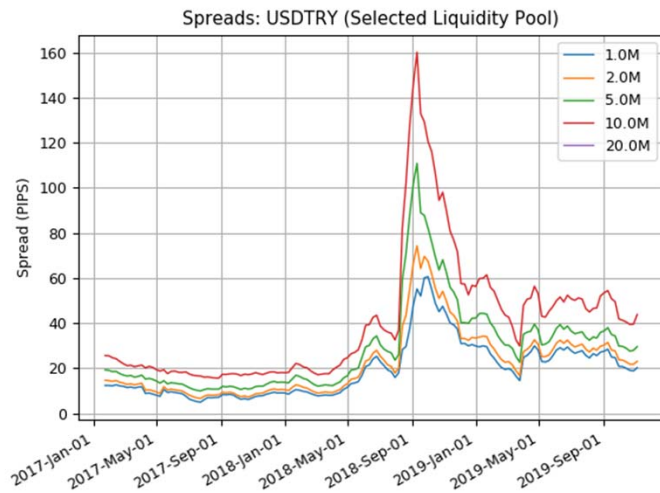
Spreads, liquidity, volatility - USDCNH



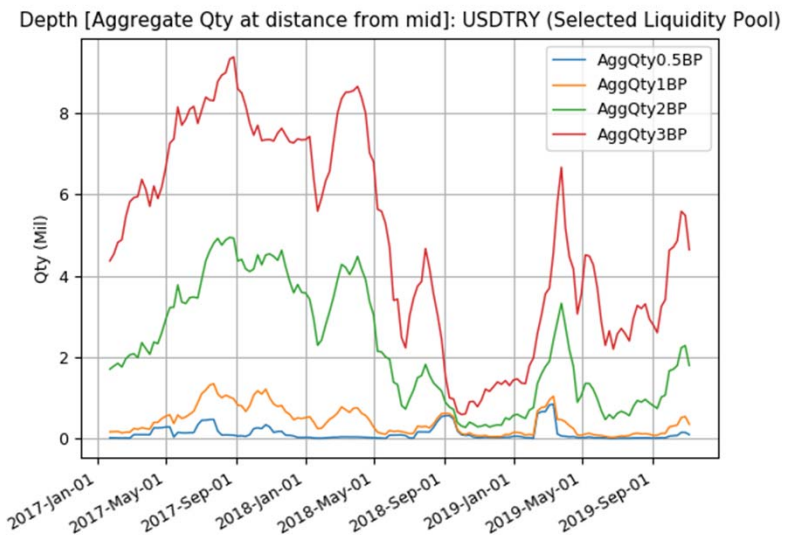
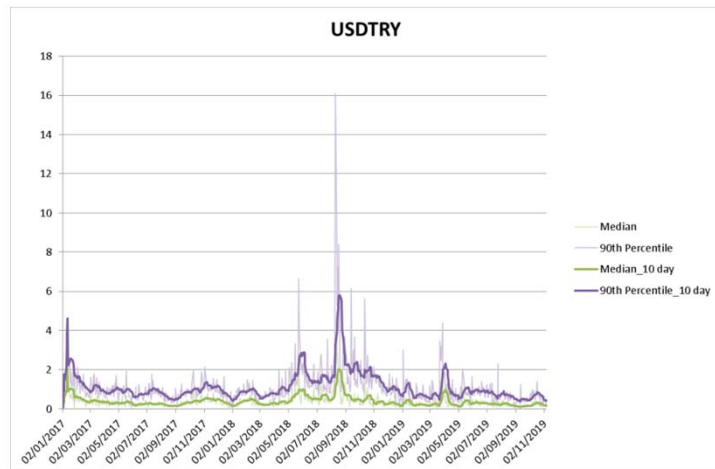
CNH - a story of trade wars with a theme of spread compression behind it



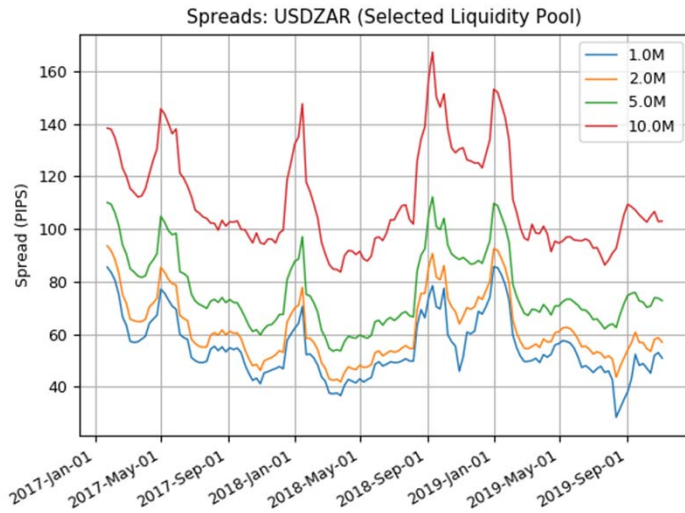
Spreads, liquidity, volatility - USDTRY



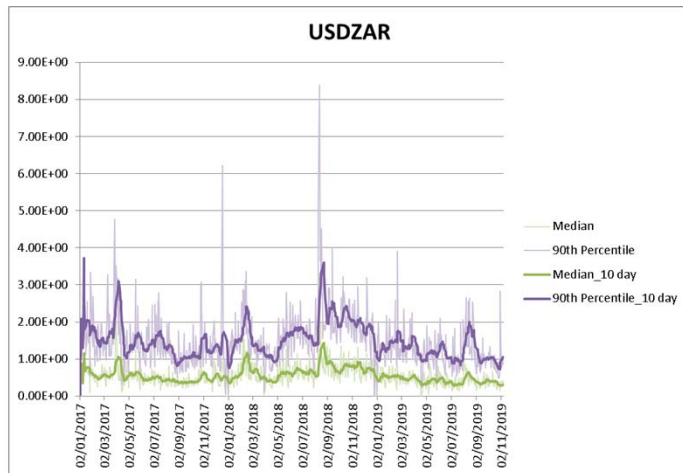
TRY - political decisions causing spreads to go much higher and liquidity to go down



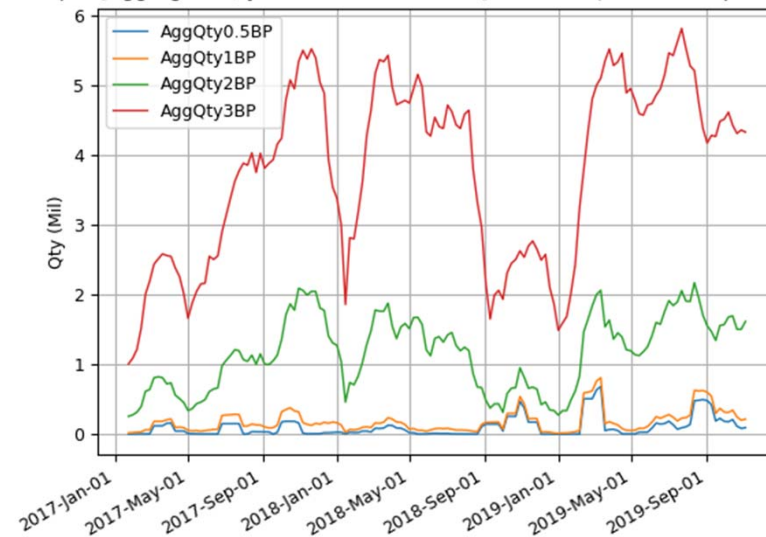
Spreads, liquidity, volatility - USDZAR



ZAR - another story of headline driven behaviour

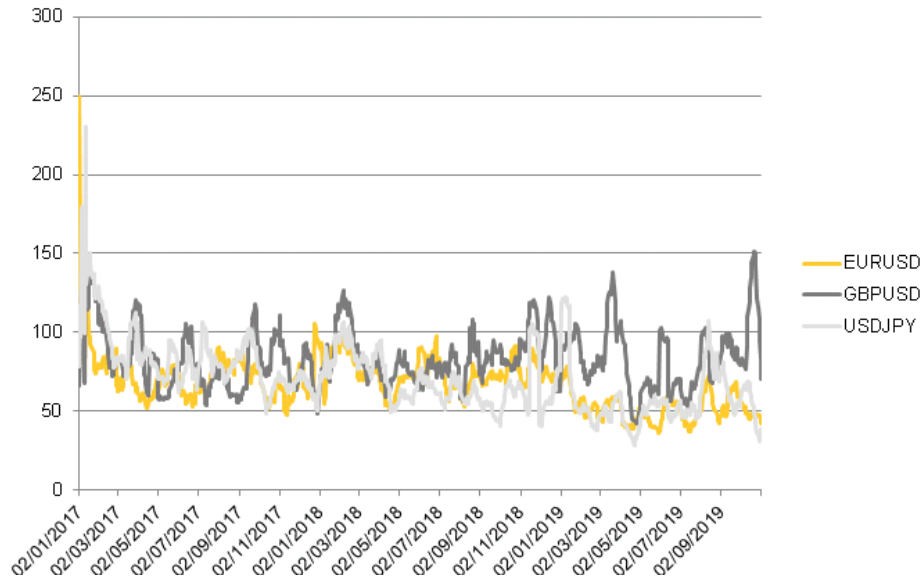


Depth [Aggregate Qty at distance from mid]: USDZAR (Selected Liquidity Pool)



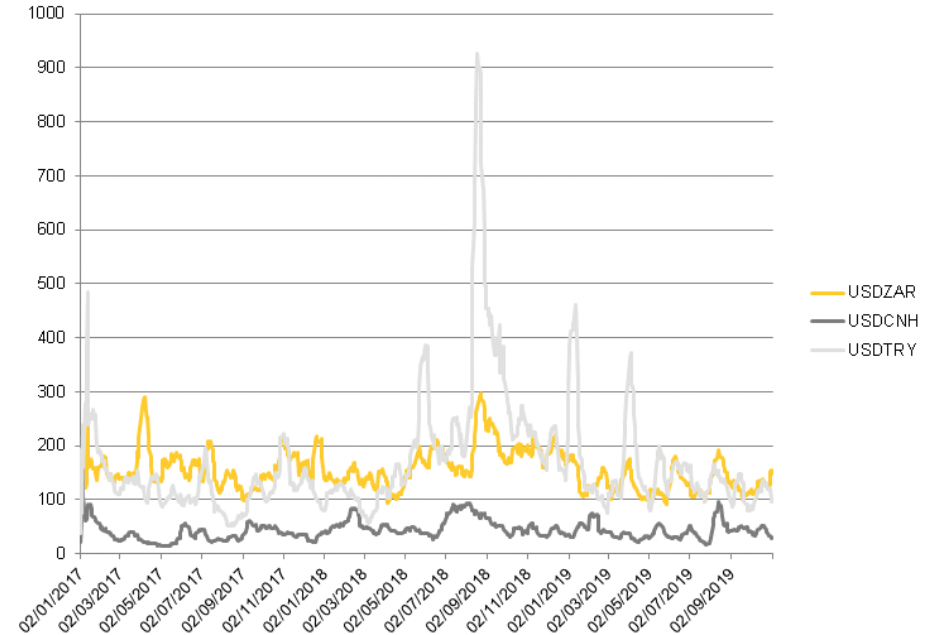
Daily ranges

10 day moving average of daily range (bp)

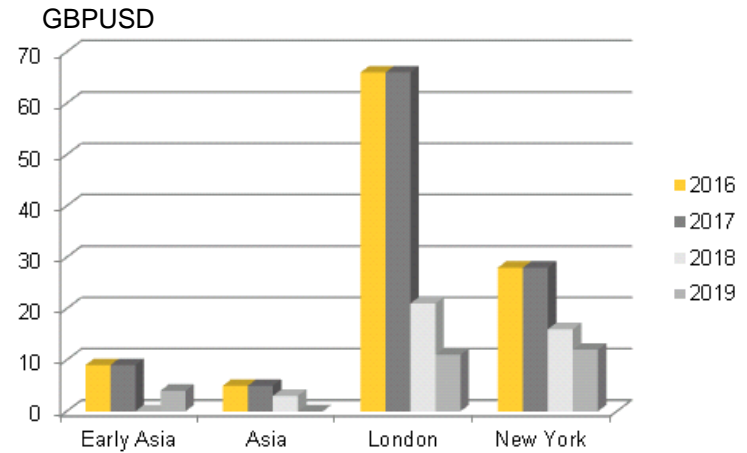
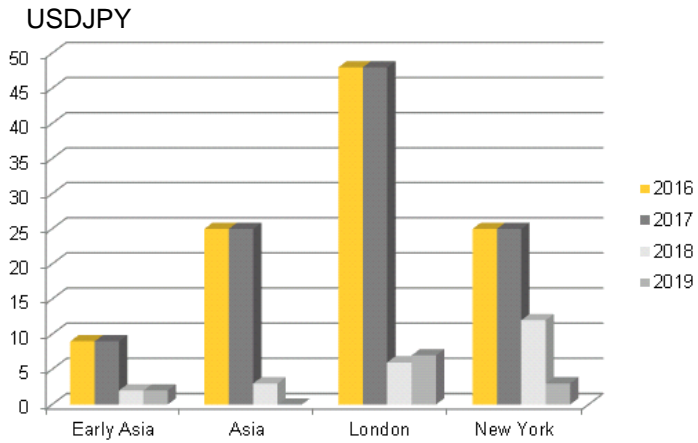


Once again, the market seems to be becoming more stable when events allow

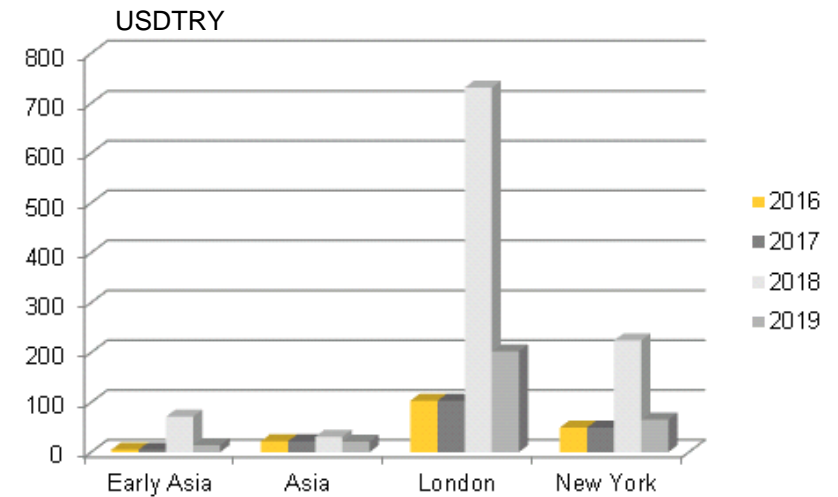
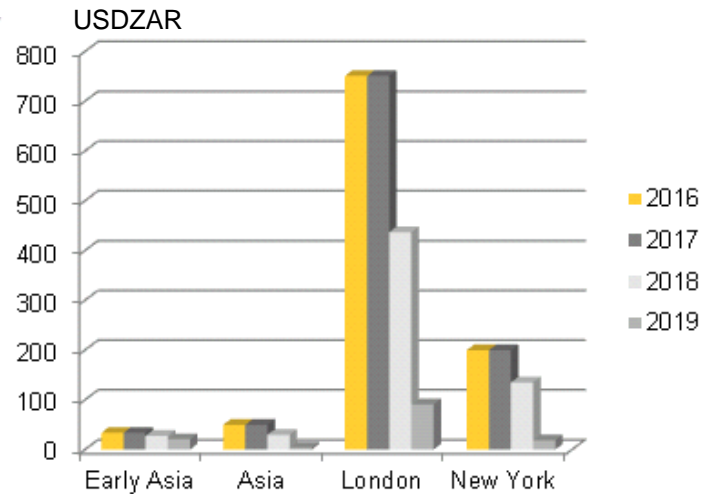
10 day moving average of daily range (bp)



Flash events – a jump in price of more than 20bps in 5minutes, a ten times increase in volatility,
 Followed by a reversion to at least within 5bps of starting price within 15 minutes

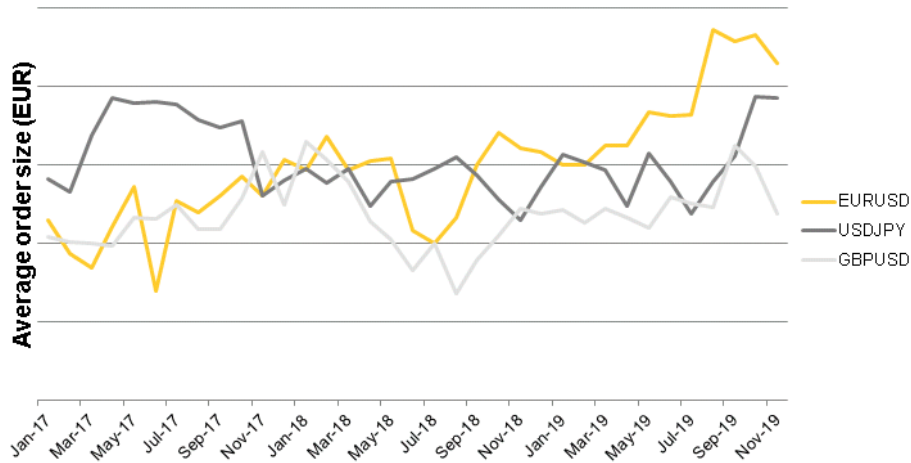


- Apart from in TRY there are less extreme events.
- They don't just occur at times of thin liquidity

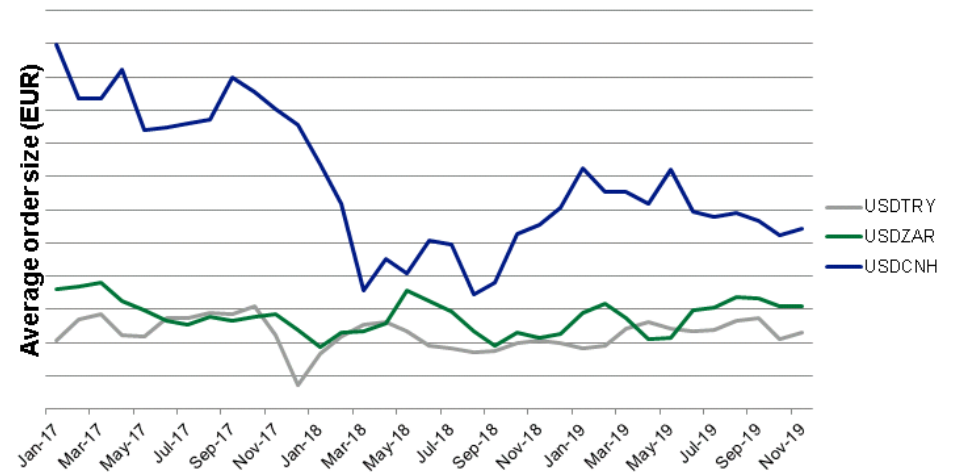


Average trade sizes – no evidence of more aggregation

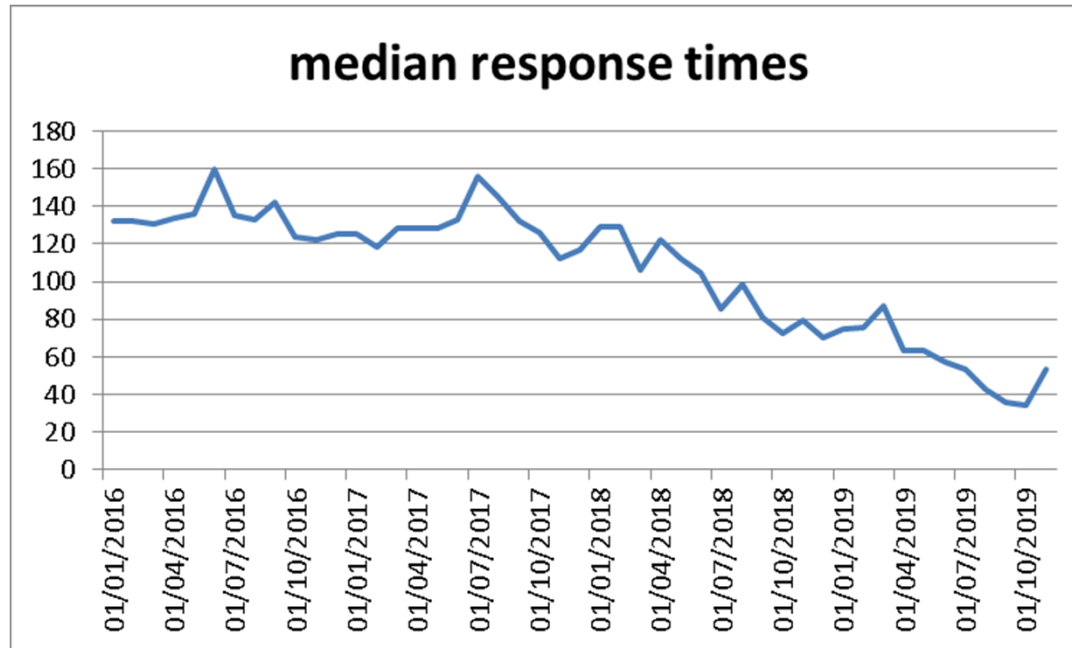
Average client order size (majors)



Average client order size (emerging markets)



Response times to placed orders “last look”



The graph shows the evolution in the last few years of the time in ms taken to receive an accept or reject of a trade attempt across a number of venues.

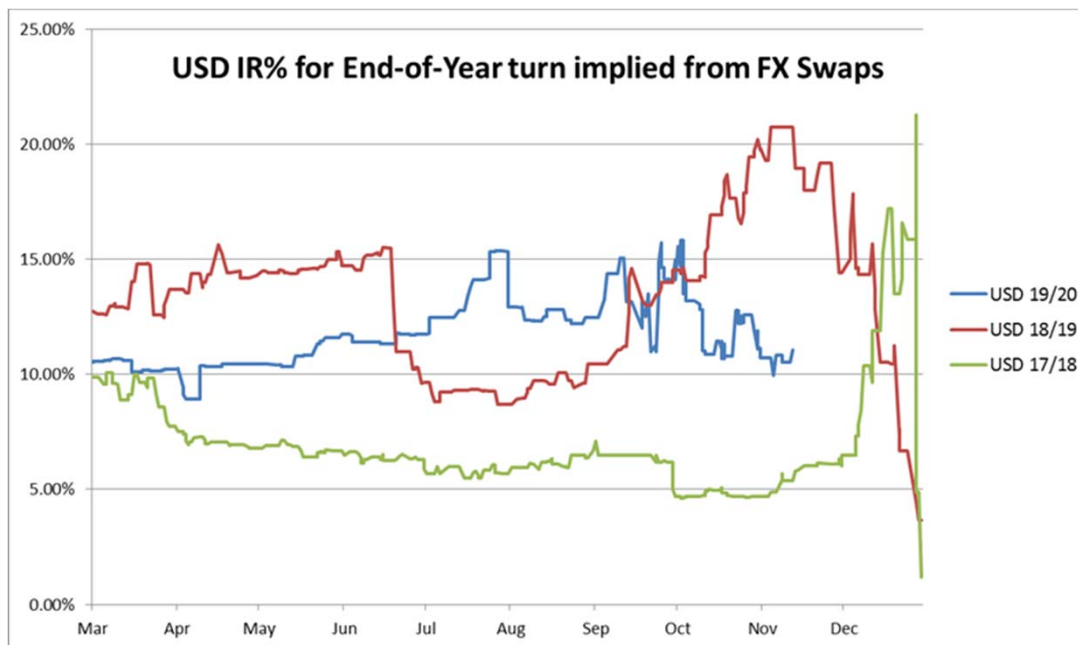
The market is becoming more efficient at deal processing.

Conclusions

- Spreads tend to get less except after / during geopolitical events
- Volatilities and market moves are decreasing
- Liquidity looks to be improving
- Flash events are decreasing, stress is managed better by the market
- Aggregation seems to have reached its limit
- Deal processing is speeding up

FX Swap market

- **FX Swap market provides sufficient liquidity mainly from Tier 1 market maker banks**
- Since the turbulent EOY in 17/18 market participants are better prepared for year end funding squeeze
 - Financial Institutions and large Corporates pre-hedge earlier
- USD funding squeeze at the end of September 2019 looks to have been triggered by the repo market and a temporary shortage of USD liquidity
 - Whilst FX Swap levels did move in line with elevated repo levels, two way pricing was available all the time
 - After FED repo intervention, funding swaps came back to more neutral levels quickly



Part 2: Trading venues and execution methods

Some hypotheses

- **Future of Single Dealer Platforms**
 - Single Dealer Platforms play a large role as part of a bank's franchise and will continue to do so especially for corporate clients whose day to day role is not necessarily FX
 - They provide products and access tailored to different client segments
 - Bi-lateral relationships can minimise information leakage and hence execution costs
- **Growth of the ECN market**
 - ECN market looks a little crowded now, perhaps there will be consolidation
 - Some LPs consciously exiting to save on infra-structure costs to support many ECNs
- **Electronification**
 - Swap interdealer market still mostly via voice brokers. Client to dealer via RFQ.
 - NDF 1m is becoming more like Spot
 - eFX still requires considerable investments in technology in the drive to automate processes and keep up with market changes
- **Execution algorithms**
 - usage is concentrated in specific client segments but there is steady growth

Part 3: FX Prime Brokerage

Some hypotheses

- **Are PBs at a new normal?**
 - FXPB are pricing in cost of capital and right sized business post SNB
 - Growth in FXPB flow seems to be related to the growth in non-bank market makers
 - FI PB flow continues to decline
- **Cost of credit and market access**
 - Increased Prime of Prime business as barriers to entry at tier one banks are higher
- **Reliance on prime of prime and implications**
 - Risk appetite of large PBs is most important – in the end they carry the risk
 - We see that credit and market risk is centralised to a few PBs
 - A uniform credit API across ECNs would help to reduce risk
- **How to better capture information on PoP in surveys such as Triennial**
 - Statistics on number of FXPBs per counterparty
 - Statistics on minimum margin required, leverage and instruments offered

Part 4: Feed back on Triennial Survey

- **Best quality survey available**
 - Could it be carried out more frequently?
 - Break down by order types? E.g. streaming, RFQ, algorithm, stop/limit orders, benchmark fixings?
 - Break down by tenor ranges?