**Minutes of the Canadian Foreign Exchange Committee**

**15:00 – 17:00**
**16 May 2023**
**Bank of Canada, Ottawa**

Present:
Stephen Best, Refinitiv
Dagmara Fijalkowski, RBC Global Asset Management
Lorne Gavsie, CI Global Asset Management
Brian Martin, Scotiabank
Greg Debienne, TD Securities
Russell Lascala, Deutsche Bank
Jim McCrindle, Bank of America
Manuel Mondedeu, CIBC World Markets
Charles Perreault, Department of Finance, Canada
Gaétan Reid, State Street Global Markets
Miro Vucetic, Citibank
Jean-Philippe Blais, BMO Capital Markets
Chris Soriano, CME Group
Tom Gillie, RBC Capital Markets
Lisa Chung, Federal Reserve Bank of New York
Sanja Peros, Federal Reserve Bank of New York

Grahame Johnson, Bank of Canada (Chair)
Zahir Antia, Bank of Canada (Secretary)
Harri Vikstedt, Bank of Canada
Wendy Chan, Bank of Canada

External speakers:
Alan Ruskin, Deutsche Bank

The meeting was conducted in-person with a video-conference option.

## 1 Adoption of Agenda

The Chair welcomed members. The Committee adopted the agenda as written.

## 2 FX market outlook

Mr. Alan Ruskin, Chief International Strategist at Deutsche Bank Securities, presented his outlook for FX markets. He expects the Federal Reserve will likely need to lower interest rates in 2024 as the US economy slows, unemployment rises, and inflation falls. Central banks in other countries will be slower to ease monetary policy as growth is expected to remain more resilient in these countries. As a result, he expects the US dollar will depreciate against most major currencies over the next two years as interest rate differentials move against the US dollar. In addition to the macro-economic drivers, he noted that the US dollar is "over-valued" relative to long-term fundamentals. He forecasts the EURUSD and USDJPY exchange rates will be 1.25 and 115 respectively by the end of 2024. The main risks to the weaker USD forecast are either a severe recession in the US, or if the US economy proves to be more resilient than expected and the Fed has to raise rates further.

Mr. Ruskin expects the Canadian economy will remain more resilient than the US economy, partly reflecting the absence of significant banking stresses in Canada. He expects the Bank of Canada will lag the Federal Reserve with respect to lowering interest rates and therefore, the Canadian dollar to appreciate modestly against the US dollar. An under-valued currency should also be supportive of the CAD going forward. However, given the close linkages between the US and Canadian economies, he expects the Canadian dollar will under-perform other G10 currencies.

Members discussed the potential market reaction if the US debt ceiling issues are not resolved in time. There was a consensus that the immediate reaction would be a stronger US dollar on a "flight-to-liquidity" because equity markets will likely fall. However, views around the longer-term implications for the US dollar varied.

One member provided an update on FX market functioning. He noted that liquidity in FX markets has recovered after a brief period of illiquidity around the peak of the US banking issues in March. FX volatility has also remained very low.

## 3 Update from New York FX Committee

Lisa Chung, Director of Foreign Exchange and Global Rates at the Federal Reserve Bank of New York, provided an overview of the New York Foreign Exchange Committee (FXC). She outlined the objectives and key priorities of the Committee. Similar to CFEC, the FXC is working to promote adherence of the FX Global Code amongst market participants through increased engagement and outreach. Other topics the FXC is working on include the impact of U.S. securities settlement cycle transition to T+1 on FX markets, FX settlement risk, potential areas of enhancements to the Code and the impact of technological innovation on the FX market.

## 4 Implications of T+1 settlement for FX markets

Johann Lochner from the Canadian Depository for Securities Limited (CDS), and Jason O'Born from RBC Capital Markets, presented on the implications of the proposed rule change to shorten the settlement cycle for securities in the US to one day from two days. Given the linkages between the US and Canadian markets, Canadian regulators have moved in tandem with the US to implement T+1 settlement in Canada, with an implementation date of May 27, 2024. Mr. Lochner noted that CDS systems are already compatible within a T+1 settlement environment and are unaffected by a shortened settlement cycle. There are some implications with respect to exchange trades, the overnight settlement window, and reporting. He emphasized that other stakeholders will need to ensure their systems are ready for T+1 settlement. Mr. O'Born highlighted the key areas of focus for this transition from a commercial bank's perspective. He noted that while most of the impacts are related to securities settlements, some FX processes related to securities transactions will need to be changed. For example, FX transactions currently linked to individual securities trades and executed for T+2 settlement will require changes in order to remain aligned. Dealers and foreign based investors will potentially need to change trade cut-off times and FX settlement processes due to the compressed timelines and time zone differences.

## 5 FX derivatives margining

A member presented on the potential implications for FX markets from Uncleared Margin Rules (UMR). He noted that the rules impact non-deliverable forwards (NDF) and FX options. Spot and physically settled forwards and swaps are out of scope. Since September 2022, firms with an "aggregate average notional amount" (AANA) of non-centrally cleared derivatives above $8 billion (down from $50 billion in Phase 5) are now required to post initial margin. Posting margin imposes additional costs. Firms can reduce their AANA (and therefore margin requirements) by clearing FX derivatives through a Central Clearing Counterparty (CCP). Clearing can provide other risk mitigation benefits, such as reducing a dealer's exposure to multiple counterparties and replacing it with exposure to the CCP. Dealers must however balance the benefits of reduced margin requirements with the additional costs of clearing through a CCP. Finally, members noted that there has been an increase in cleared NDFs since UMR was first implemented.

## 6 Preview of the June GFXC meeting

The Chair provided a preview of the GFXC meeting which will be held in Mexico City on June 1st and 2nd. The Proportionality Working Group and the Code Adherence Working Group will update the GFXC on their progress. There will be a discussion on the need to standardize the price adjustment of an FX trade if its settles on an unscheduled holiday, and implications of moving to a T+1 settlement cycle. The GFXC will also start its planning for the next 3-year review of the FX Global Code.

## 7 CARR update

Mr. Harri Vikstedt, Co-Chair of CARR, updated members on recent benchmark reform developments. He noted that CORRA-first initiatives relating to transitioning liquidity in the Canadian derivative markets from CDOR to CORRA continues to progress well. CARR's weekly derivative monitor shows the maturity-weighted notional volume in cleared Canadian dollar interest rate derivatives continues to migrate from CDOR to CORRA. After June 30, 2023, all new derivatives and securities contracts are expected to have transitioned to using CORRA, with no new CDOR exposure after that date except in limited cases, such as loans or their associated derivative hedges or transaction that reduce legacy exposure. He mentioned that the work to create a Term CORRA benchmark is progressing as expected, with the rate being published in beta form later in the summer and officially launched in September.

## 8 Other business

The Chair informed members that Mr. Russell Lascala will be retiring after over 30 years in the FX industry. He thanked Mr. Lascala for his active participation and contributions to CFEC and the broader FX market.

The next meeting currently scheduled for September 19th will be a virtual meeting with a shorter agenda.