Minutes of the Canadian Foreign Exchange Committee

12:00 – 14:00
7 November 2023
TD Securities

Present:

Dagmara Fijalkowski, RBC Global Asset Management
Stephen Best, London Stock Exchange Group
Jean-Philippe Blais - BMO Capital Markets
Mark Burnatowski, Scotiabank
Jian Cao – RBC Capital Markets
Greg Debienne, TD Securities
Lorne Gavsie, CI Global Asset Management
Tobi Jungmann, Bank of America
Martin Legault, National Bank Financial
Sean Macdonald, Canada Pension Plan Investment Board
Manuel Mondedeu, CIBC World Markets
Ivan Pelipenko, Ontario Teachers' Pension Plan
Charles Perreault, Department of Finance, Canada
Gaétan Reid, State Street Global Markets
Chris Soriano, CME
Elizabeth Steele, HSBC Bank Canada
Miro Vucetic, Citibank

Stéphane Lavoie, Bank of Canada (Chair)
Wendy Chan, Bank of Canada (Interim secretary)
Harri Vikstedt, Bank of Canada

External speakers:

Mark McCormick (TD Securities)
Warren Lovely (National Bank Financial)
Ann Battle (ISDA)
Megan O'Flynn (ISDA)

The meeting was conducted in person with video conference option.

1 Introduction

The chair welcomed members and thanked TD Securities for hosting the meeting.

Following the CFEC governance discussion at the last meeting, the chair announced that Dagmara Fijalkowski, Head of Global Fixed Income and Currencies at RBC Global Asset Management, will take on the role of private sector co-chair of CFEC, for an initial 2-year term. The chair also thanked members who have expressed interest for the role.

The Committee also welcomed four new members to CFEC: Mark Burnatowski, Managing Director and Head of Currency Options trading at Scotiabank; Jian Cao, Managing Director and Global Head of FX options at RBC Capital Markets; Sean Macdonald, Managing Director for Trading and Total Fund Management at Canada Pension Plan Investment Board; and Ivan Pelipenko, Director of Global Trading, Capital Markets at Ontario Teachers' Pension Plan.

2 FX market outlook

Mark McCormick, Global Head of FX Strategy at TD Securities, presented his firm's outlook for the currency market. In his analysis, he compares various currency portfolios constructed by themes and evaluates if such themes are rewarded by the markets.

The speaker noted that currency markets tend to have a different regime each year. For instance, 2022 was characterized as a year where G10 inflation dominated the currency markets. On the other hand, markets have been focusing on global macro risk factors, terms of trade and carry in 2023. Going forward, Mr. McCormick expects participants will turn their attention to growth, but unlike the current year, he thinks 2024 will be a year with de-synchronized macro themes. In particular, he expects weakness in the US economy over the medium term, and by extension a weaker US dollar, while growth in China will be more robust and act as a cushion against a global recession.

There was also a discussion on the relationship between oil prices and the level of the Canadian dollar. The speaker noted that this relationship has weakened since Canada no longer receives the same level of foreign investment in oil production when oil prices increase. Instead, the Canadian dollar has increasingly been traded as a proxy of the US dollar in recent times.

3 Canadian bond market update

Warren Lovely, Managing Director of Economics and Strategy at National Bank Financial, shared his insights on the impact of higher interest rates, foreign investors ownership and quantitative tightening (QT) on government deficits and bond supply. He pointed out that federal debt servicing charges, given its shorter average term to maturity in Canada relative both to other G7 countries and to provincial borrowings, have grown significantly since the beginning of the interest rate hiking cycle. At the same time, the positive surprises to government revenues have cushioned the impact of higher interest rates, allowing the debt burden to remain at modest level to date. However, he noted that risks of deterioration in debt affordability metrics have increased as government revenue drops with a slowing economy while central banks signal interest rates may stay elevated for longer.

The discussion then turned to Canada's exposure to foreign bond investors and the risks to the Canadian bond market from potential investors outflows. Mr. Lovely noted that only 4% of

Canada bonds are currently held by Japanese investors. Consequently, he thinks the risks to the Canadian bond market associated with Japanese investor outflow seem to be modest going forward. The speaker also pointed out that as Japanese ownership declined, other non-residents have continued to purchase bonds issued by Canadian issuers. The continued interest of foreign investors in Canadian bonds, both in Canadian dollar and in debt denominated in other currencies, is important for the health of the Canadian bond market and supports the market as QT continues to progress.

Lastly, Mr. Lovely mentioned that Canada's social security system is a clear strategic advantage for the country. The solid net asset positions in the public pension plans help support the long-term sustainability of Canada's fiscal policies.

4 ISDA FX Definitions

Ann Battle and Megan O'Flynn from ISDA informed CFEC members that ISDA is considering a major update to the 1998 FX and Currency Option Definitions (FX Definition). The new FX Definitions will replace the existing definitions with a consolidated and natively digital set of components, including a Main Book and several Annexes/Matrices.

Drafting will take place throughout 2024 and 2025. ISDA expects that it will finalize the new FX Definitions by November 2025 in order to allow time for implementation by infrastructure providers and market participants. ISDA will submit the final definitions to SWIFT in May 2026, assuming SWIFT's cycle for submissions remains the same. Implementation will then occur in November 2027 to align with SWIFT's release schedule and give market participants at least 2 years to update their systems and take other steps necessary for usage of the new FX Definitions.

The speakers encouraged CFEC members to reach out to ISDA should they have any questions or comments on the pending update.

5 Discussion of 10am option expiration

A member led the discussion on the timing of Bank of Canada (BoC) interest rate decision and the potential impact on the 10am ET FX option expiration for dealers.

Several years ago, the BoC consulted with the industry on the timing of the interest rate decision. Back then, no issues were raised regarding the 10am announcement time. Dealer members noted that several new factors have increased the risk to dealers when the timing of BoC decisions coincides with option expiration. Central bank decisions have increasingly become market moving events. The member noted that the global FX code has also pushed more volume to be transacted during key FX benchmark fixes, thereby increasing dealer risk exposure leading up to the 10am option expiration since the rate decision could substantially impact spot pricing. Given the inability for dealers to hedge this risk as the wide bid/ask spreads around the strike at 10am make it difficult to determine their FX option related positioning, dealer members felt that the current setup can affect market liquidity and functioning and would like to revisit the timing issue.

The chair noted that a letter from CFEC, signed by all member firms, is the next logical step should committee members want to proceed with a formal request for a change in the timing of FAD releases. Industry-wide support will be needed, and members were asked to seek internal support within their respective firms.

6 Other business

The chair gave a preview of the agenda for the upcoming GFXC meeting and encouraged members to reach out should they have any suggestions on topics the GFXC should considered in the upcoming FX code review.

A member raised an issued regarding multilateral trading facility (MTF) in the UK. Canadian regulators require any platform who wants to provide service to Canadian entities to be "Canadian exchange". Two entities, who are currently not deemed to be “Canadian exchange”, will require regulatory exemption by the end of the year for Canadian firms to remain on their platform. The member would like to raise awareness of the impending deadline. A Bank of Canada representative has agreed to follow up with the appropriate regulatory body on the issue.