EUROPEAN CENTRAL BANK
EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt am Main, Thursday, 20 November 2025

SUMMARY OF THE DISCUSSION

1. Review of the recent foreign exchange developments and outlook

Following the presentation by Alan Stewart (Goldman Sachs), the group discussed developments in the global foreign exchange (FX) markets since the last FXCG meeting in September 2025.

Members noted that liquidity conditions and market functioning have remained robust since the last FXCG meeting, despite slightly suppressed volatility driven by the US government shutdown and the absence of official data, which prompted derisking. Most members expressed a positive outlook for the euro going into 2026 mostly attributed to developments oversees with the German fiscal stimulus remaining the main domestic driver. However, some pessimism was expressed regarding its implementation as well as Europe's slower response mechanisms, with reforms and bureaucratic hurdles continuing to act as investment barriers despite some progress. That said, it was noted that a significant portion of defence spending is likely to benefit European suppliers, potentially offsetting some of the negative sentiment. As regards the US dollar, members noted the recent shifts in rate cut probabilities and that the period from mid-December to mid-January, with key US labour market data being released, could prove critical for market expectations. One member stated that the market perceives the risk to Fed independence as already broadly priced in, with political pressures expected to have only marginal effects on policy rate decisions, while another member noted that market concerns about FOMC staff decisions will continue to weigh on the US dollar.

Members discussed trends in hedging activity and emphasized the relevance of volatility trends, hedging costs, and correlation dynamics in this regard. While the second quarter of the year had seen a notable increase in hedging ratios, further momentum would require significant changes in volatility. Members emphasized that hedging costs remain a key consideration, alongside factors such as long-term correlations. Another member noted the mechanical nature of hedging strategies during volatility spikes and highlighted that some market participants are considering renewed hedging efforts in the second half of 2026 and in 2027, even if such moves fall outside their typical policy framework. Consequently, members acknowledged the potential for continued hedging activity to act as a catalyst for strengthening the euro. One member pointed out that sustained hedging flows could support the euro in the medium term, though broader market dynamics and sentiment would play a significant role in determining the extent of this impact.

Emerging market (EM) currencies were also discussed. Members expressed optimism about EM prospects, particularly from a carry perspective, though it was noted that declining real interest rates could reduce the attractiveness of EM assets over time, especially considering the fact that around half of the EM indices' performance in 2025 has been attributable to FX performance rather than underlying asset performance. Nonetheless, structural challenges, including inflation and particularly a high sensitivity to US policy changes, remain key risks for EM currencies.

The discussion also touched on the Japanese yen (JPY) and its recent depreciation. Speculation about potential FX interventions was noted, and members highlighted that market memory of prior successful interventions could provide some support for the yen in the near term, though broader diversification dynamics continue to weigh on the currency. Fiscal challenges and political uncertainty as well as the newly elected prime minister, and uncertainty about the impact of China's political decisions, were also cited as factors contributing to the yen's struggles.

2. Distributed Ledger Technology (DLT) based innovation in FX markets: Stablecoins, FX markets and emerging trends in tokenization

Hinrich Paul (Commerzbank) presented on the topic of DLT based innovation and their potential implications for the FX market. Carlo Kölzer (360T) provided an industry perspective.

The discussion on tokenization and stablecoins revolved around their global experimentation and future prospects. The group discussed the diverging levels of success of Central Bank Digital Currencies (CBDCs) and Stablecoins so far. It was pointed out that stablecoin usage outside the Decentralized Finance (DeFi) space is currently only of minor relevance for banks and their customers. One member noted that the US stablecoin market is characterized by rapid innovation but significant fragmentation, with numerous stablecoins emerging for various purposes. However, trust in the issuer remains critical, as evidenced in China where stable coins did not manage to take off and a CBDC had to be considered. Europe lags behind, and there is scepticism about European stablecoins reaching scale without ECB intervention. The ECB's urgent focus on programmable wholesale CBDC is seen as vital to compete with the US and address inefficiencies in cross-border payments.

Benefits as well as core risks or challenges of tokenised transactions and stablecoins were also discussed. Use cases for tokenization and stablecoins include remittances, instant payments, and treasury operations. Corporates are increasingly interested in tokenization for improved cash management, 24/7 operations, and cost efficiency. Emerging markets, such as Brazil and Colombia, are modernizing payment systems to improve speed and cost, reducing the appeal of stablecoins for domestic payments. Key challenges include regulatory uncertainty and trust, lack of interoperability, and fragmentation in stablecoin offerings. A common standard and greater consolidation are needed to facilitate broader adoption up to a critical mass, enable currency hedging, and establish a viable FX market for tokenized assets.

3. Microstructure developments in the FX market

Paul Houston (CME) presented emerging trends in primary market volumes. Simon Jones (LSEG) presented the latest developments in the electronification of the FX swap market[1].

The group discussed the future of FX Swaps electronification. The Indian INR swap market was highlighted as an example of accelerated electronification due to regulatory transparency, a central credit register, and a close-knit participant community. However, this centrally cleared market remains unique and should be viewed in isolation from its G10 peers. Additionally, the discussion centred on whether the future of FX Swaps would follow that of FX Spot. One member argued that, if there was significant interest in the FX Swap market for such a transformation, it would have happened already. Consensus was that the market would move in this direction, but it was likely to be slow progress due to limited Push factors versus competing priorities. Additional comments included how non-bank market makers, who have played a significant role in the FX Spot market, are unlikely to be a driver of market innovation here, due to the costs of entry. It was highlighted that the FX swap market is essentially a bank captive market as it requires recourse to credit lines and intermediation capacity. Finally, the discussion also focused on the potential benefits to the buyside: It was acknowledged that while spreads in the interbank FX Swap market are highly competitive, progress in electronification would be supported if it improves workflow automation, though major players are unlikely to lead such efforts.

[1] According to the Bank for International Settlements (BIS) 2025 Triennial Survey, FX swaps remained the single most traded instrument in the global FX market, accounting for 42% in average daily turnover.