EUROPEAN CENTRAL BANK
EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt am Main, Thursday, 26 June 2025, 14:00-17:30

SUMMARY OF THE DISCUSSION

1. Review of the recent foreign exchange developments and outlook

Following the presentation by Luis Martins (BBVA) the group discussed developments in the global foreign exchange (FX) markets since the last FXCG meeting in March 2025.

Members highlighted a surge in trading volumes and heightened volatility in April, which led to record high volumes across FX trading venues and currency pairs. Early April period acted as a stress test but highlighted the resilience of the FX market both in terms of FX platforms and FX market functioning. Even though some decline has been observed in trading volumes since the high point in May, the levels remain elevated year on year. Risk reversals in FX options showed also some lightening in EUR/USD hedging activity.

Several key factors were mentioned as drivers influencing FX markets:

(i) **A shift in the US dollar positioning drives euro gains and benefits emerging market currencies.** The US dollar shifted from long at the start of the year to net short, boosting the euro and supporting emerging market currencies. Geopolitical risks in the Middle East, signs of stagflation in US data, and excessive US fiscal policy loosening could weaken the dollar further in the short term.

(ii) **Long-term US dollar potential amid short-term pessimism**. While members agreed on the negative current sentiment for the US dollar, some members saw reasons for a more positive longer-term US dollar outlook citing AI-driven economic growth as well as developments in the stablecoin markets and DLT adoption could reshape the FX and financial ecosystem in favour of the US.

(iii) **Trade policy was still causing uncertainty at least until 9 July** deadline but the US inflation has so far not risen as much as feared.

(iv) **A positive outlook for the euro is supported by US fiscal policy uncertainty, geopolitical developments** and growing concerns over the US policy bolstering. However, one member pointed out that minimal risk premium has been priced yet around the tariff deadline in July.

(v) **Europe was seen to have its "global euro" moment but needs to deliver on expected reforms.** There were mixed views whether Europe can deliver on expected reforms in the fragmented capital markets, digitalisation and defence spending in a growth-supporting manner.

The recent development in stablecoins could materially impact demand for US dollar and US denominated securities. The adoption of DLT-based financial products seems to be reaching an inflection point, supported by regulations like the US Genius Act, which could accelerate a shift away from traditional fiat systems. Members mentioned some large US retailers considering setting up their own stablecoins. They highlighted risks for regulatory arbitrage and raised concerns about the vulnerabilities of stablecoins to US Treasury market risks, and vice versa.

Members noted shifting correlations between US asset performance and US dollar strength, as well as the growing realization of non-FX hedged investment losses, particularly among slower-to-react asset managers and corporates. FX volumes have surged, and members reported this being linked to US dollar currency hedging rather than selling of underlying US assets. Some members felt that any larger asset allocation changes will be gradual and take several months to implement.

2. The international role of the euro

Linda Rousová (ECB) presented the key findings of the ECB's "The international role of the euro" report published in June 2025.

The ongoing diversification away from the US dollar supported by targeted reforms could enhance the liquidity and depth of EU capital markets and thereby strengthen the international role of the euro. The lack of unified EU safe assets was considered an obstacle, but members also highlighted challenges in achieving the necessary scale of joint EU bond issuance to establish a comprehensive EU yield curve, making other reforms equally important. Reducing regulatory complexity and market fragmentation were considered key to encourage the formation of deep and liquid capital pools and enhance growth, thereby enhancing the rates of return on European assets and the attractiveness of the euro area as an investment destination. The lack of a cohesive European Savings and Investments Union was seen a key barrier to growth. Some participants believed the timing was favourable for the reform momentum in Europe to increase and thus strengthen the euro's international role.

3. FX Settlement data and T+1 settlement transition in the EU/UK

Janusz Ryzner (ECB) presented FX settlement data collection initiated in 2024 outlining recent trends related to FX settlement. Sandra Carpentieri (UBS) provided an industry perspective on the progress to T+1 settlement transition in the EU/UK.

Innovation is key to mitigate the risks associated with gross bilateral FX settlement in an environment of market volatility and increased volumes. One member noted the recent developments in PvP settlement using DLT (distributed ledger technology) which is gaining importance in mitigating FX settlement risk particularly for non-CLS eligible trades and for market participants without CLS access. DLT-based intraday settlement and PvP mechanisms were identified as potential alternatives to CLS in such cases.

Europe's transition to T+1 securities settlement cycle is expected to be more complex than the US transition, mainly due to the fragmented market structure. Lessons from the US highlight the importance of improving post-trade STP (straight-through processing) and preparing for shifts in trading volumes, as seen with spot and pre-spot transactions ahead of the US implementation. Tokenized securities and hybrid models might smoothen the transition, though the shift to a hybrid environment could persist for decades. Understanding liquidity patterns, especially for less liquid currencies, is essential for effective FX hedging during this transition. Members were interested in regular updates on the T+1 settlement transition going forward.