Minutes of the Canadian Foreign Exchange Committee

12:00 – 14:00
24 September 2024
RBC Global Asset Management

Present:
Stephane Lavoie, Bank of Canada (Co-Chair)
Dagmara Fijalkowski, RBC Global Asset Management (Co-Chair)
Audra Scharf, LSEG
Lorne Gavsie, CI Global Asset Management
Mark Burnatowski, Scotiabank
Greg Debienne, TD Securities
Tobias Jungmann, 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
Matthew Gierke, CME
Tony Kim, RBC Capital Markets
Sean Macdonald, CPPIB
Ivan Pelipenko, OTPP

Zahir Antia, Bank of Canada (Secretary)
Harri Vikstedt, Bank of Canada
Wendy Chan, Bank of Canada
Boran Plong, Bank of Canada
David Ilesanmi, Bank of Canada

External speakers:
Eric Lascelles, RBC Global Asset Management
Marc Bayle de Jessé, CLS

The meeting was conducted in-person with a virtual option.

1 Adoption of Agenda

The co-chairs welcomed members to the meeting. The co-chair from the Bank of Canada thanked RBC Global Asset Management for hosting the meeting. The co-chair welcomed Audra Scharf to the Committee as the new CFEC representative from LSEG. Ms. Scharf is the Head of FXall and has been with LSEG for just over 10 years. She has replaced Stephen Best as the LSEG member.

The Committee adopted the agenda as written.

2 Update from CLS

Marc Bayle de Jessé, CEO of CLS, provided an overview of CLS and recent initiatives at the firm to reduce settlement risk. CLS is a systemically important financial market infrastructure and its payment-versus-payment settlement service, CLSSettlement, is the market standard for reducing FX settlement risk. There has been considerable growth in volumes settled in CLSSettlement over the years. In 2024, there were over 70 members using CLSSettlement and average daily values settled was over USD7.0 trillion. This compares with 39 members settling USD0.3 trillion in 2002, when the firm was launched. Settling FX trades in CLSSettlement not only reduces settlement risk, it also provides an efficient flow of liquidity and capital savings for its clients and the wider FX ecosystem. However, the growth in trading volumes of non-CLS eligible currencies in the FX market has increased overall settlement risk exposures, which needs to be addressed. Mr. Bayle de Jessé highlighted the growth in CLSNet, an automated bilateral payment netting calculation service for over 120 currencies. Finally, he noted that there has been no material impact on FX settlement following the move to accelerated securities settlement in the US and Canada at the end of May. However, more volumes are being submitted later in the afternoon.

3 Funding conditions in Canada

Boran Plong and Neil Maru from the Bank of Canada presented their analysis on the recent drivers of CORRA. They noted that since the move to T+1 settlement of securities in May 2024, daily eligible CORRA volume has more than doubled to about $30 to $50 billion. This is due to repo trades that were originally settled on a tomorrow-next basis (which are not CORRA-eligible) now being settled overnight (which are CORRA-eligible). The mechanical effect of including these repo trades, which primarily reflect demand from hedge funds to fund their long bond positions, has increased CORRA by about 3 basis points. They emphasized that this demand for funding existed prior to the change in the settlement period, but because these repo trades occurred in the tomorrow-next market, the trades were not included in the calculation of CORRA. Harri Vikstedt from the Bank of Canada informed members that the Bank will be conducting a review of the CORRA calculation methodology in 2025 as part of the mandated five-year "CORRA sunset review". He noted that the Bank is currently consulting the Canadian Alternative Reference Rate working group (CARR) and the CORRA Advisory Group (CAG) members on the potential timing and scope of the review.

CFEC members discussed funding conditions in the FX forward market. They noted that despite the mechanical increase in the CAD-USD FX basis due to higher CORRA settings, overall funding conditions are benign. Implied funding costs spiked briefly at the end of June, but quickly reverted to normal levels. Similarly, implied funding rates around year-end in most currency pairs do not indicate any major funding pressures. Although, there is some year-end premium in funding rates but it is low by historical standards. One member noted that banks are more efficient in managing their balance sheets around year-end, which alleviates some of the funding pressures.

4 Economic and financial market outlook

Eric Lascelles, Chief Economist at RBC Global Asset Management, presented his outlook on the global economy. He noted that globally, inflation is normalizing and growth is moderating. As a result, many central banks are pivoting from rate increases to rate cuts. He has raised his subjective probability of a soft landing of the US economy to 70% from 60%, reflecting expectations of further monetary easing by central banks.

The Canadian economy is growing, but at a modest rate. Growth has been driven by population growth, but GDP has been shrinking on a per capita basis. Mr. Lascelles acknowledged that while population growth does have positive implications for growth, it can lead to a short-run increase in unemployment and lower productivity. While the increase in the Canadian unemployment rate is a sign of economic weakness, it also reduces inflationary pressures. The outlook for the Canadian housing market remains uncertain. On the one hand, high interest rates (even though they have declined from the peaks), and poor housing affordability continue to exert downward pressure on home prices. On the other hand, population growth and supply constraints are supporting home prices. Reflecting the overall weakness in the Canadian economy along with declining inflation, he expects the Bank of Canada to continue lowering interest rates. The key risks to his outlook are geo-political risks, uncertainty around the upcoming US elections, and fiscal challenges in the medium term.

The member from the Bank of America shared his views on the recent drivers of exchange rates. He noted that since August, FX markets have been driven by expectations of slower economic growth in the US and lower US interest rates. As a result, the US dollar has weakened on a trade-weighted basis. He expects the US economy to experience a “soft landing” along with some further modest depreciation in the US dollar. He further noted that volatility in the Japanese Yen in early August was driven by the rapid unwinding of over-extended positions in the Japanese Yen and the Nikkei following the weak US labour market data and hawkish comments by the Bank of Japan. However, the instability was short-lived and market functioning returned to more normal conditions shortly after.

5 Buy-side outreach strategy

Members discussed ways CFEC could promote adherence to the Code amongst Canadian buy-side firms. The co-chair informed members that a representative from the Bank of Canada would participate in a panel with other central banks on promoting the Code at the US TradeTech conference in early 2025. The Bank of Canada will also engage with pension funds and asset managers that have not signed the Statement of Commitment to promote adherence. Members were encouraged to identify other conferences and events where CFEC members could promote the benefits of adhering to the Code. Some members offered to share insights from their experience in going through the review and adherence process.

6 Other business

The next meeting will be held in person in Toronto on November 12th.