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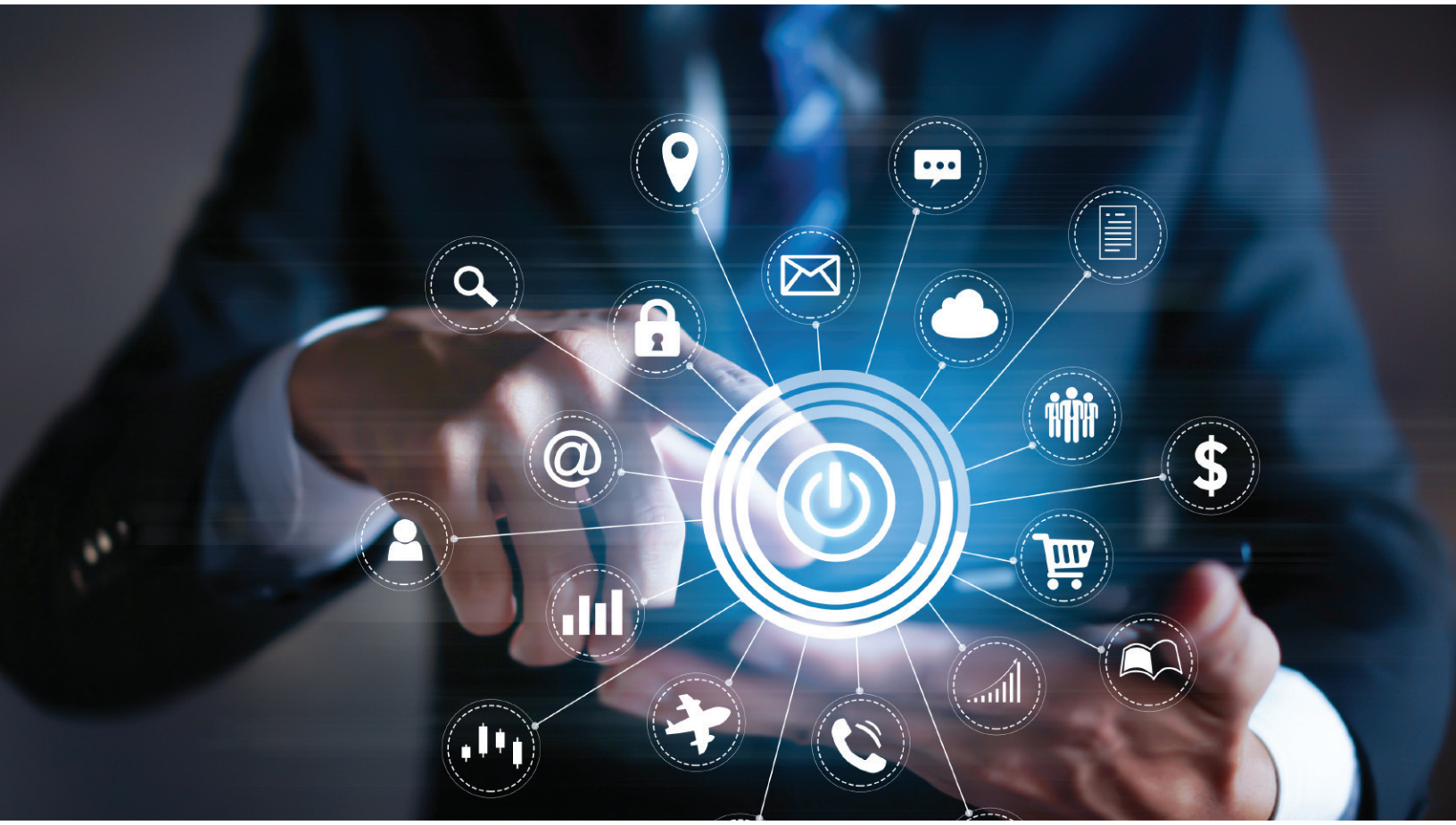
FX Markets in the Age of COVID-19

By David Brown, Chief Operating Officer, IPC

White paper



Connecting opportunities

FX, as an asset class, has long exhibited certain key and defining features in the context of the global financial markets. Firstly, there is the intrinsic link between FX and the real economy – and the role that FX plays not only in facilitating global trade and commerce, but also payments. FX markets are primarily driven by macroeconomic events, and relative exchange rates are a direct reflection of a country's economic health. Secondly, FX is typically the most immediately reactive asset class when it comes to economically significant events – whether these be, for example, the announcement of a change in Bank of England base rates, through to new data on the impact of Brexit and COVID-19.

These two factors combine to lend FX markets a significance to national policy and security that is unmatched by any other asset class; when the markets hit a turbulent patch, it's the FX trading floors of systemically important banks that are the first port of call for prudential regulators globally. Under normal conditions, a constant flow of news and data around economic and political events informs FX pricing and trading decisions. As we have seen of late, however, COVID-19, and governments' responses to the crisis, introduce unprecedented short, medium and long-term uncertainties for economic growth and stability that are directly reflected in the volatility of the FX markets.

Thirdly, the ubiquity of FX as an asset class underpinning all other cross-border, cross-currency trading, and the associated high volumes of activity, have resulted in it becoming the most highly electronified asset class. As a result, with much FX trading activity now highly automated and driven by algorithms, periods of increased volatility inevitably lead to an explosion in volumes.

A new digitally connected and decentralized world

We are facing one of the greatest health threats in a generation. During these wild times, financial market participants are all experiencing the same issues. Price discovery is challenging as spreads are widening and it's unclear where the liquidity really lies. For FX firms in particular, given their crucial role in the real economy, there is a need to continue servicing clients, making prices, accessing liquidity and managing risk. Those of us who have prepared for a digitally connected decentralized world will certainly do well and probably maintain business continuity.

Reassuringly, through all of this, we have not seen the same spectacular freezes in liquidity that characterised the last financial crisis, and this should give us all – whether financial institutions, regulators or policy makers – greater confidence in the resilience of the measures that have been implemented around systemic risk and the robustness of systems, processes and controls.

What is happening in the FX markets?

The FX markets have enjoyed a notably quiet decade since the global financial crisis in terms of volatility. The advent of the COVID-19 pandemic completely upended this period of relative calm, exacerbated by the new logistical challenges of trading in a lockdown, accessing accurate market information and finding liquidity in all required currencies.

Never before has the close relationship of FX to the real economy been so clearly illustrated as in the events of 9th March 2020, following the decision of Russia and Saudi Arabia, key OPEC members, to maximise oil production and effectively kick off a price war in the oil markets. The response of investors in all asset classes was to sell – to sell everything – and flee to the relative safety of USD. This has thrown a spotlight on the Eurodollar market, and the US Federal Reserve, in recognition of USD's systemic importance, has taken hitherto unheard of action to maintain some semblance of stability: cutting the cost of accessing USD liquidity swap lines for the Bank of England, European Central Bank, Bank of Canada, Bank of Japan and Swiss National Bank, providing brand new USD swap lines to a further nine central banks, and introducing a new repo facility that allows any central bank to exchange their UST holdings for USD.
By late March, we saw the US Federal Reserve buying USTs and mortgage-backed securities at a rate of almost $1m per second. On 9th April, the Bank of England announced that it would completely bypass the standard mechanisms whereby HM Treasury issues gilts to raise funds, in favour of giving the Treasury a direct line to monetary finance. The ECB crossed a number of its own red lines when it announced a pandemic emergency purchase programme that would include the buying of EUR750bn of government and corporate debt.

What does this mean for FX market participants?

With major and unheralded policy decisions being announced on a near-daily basis, and a lack of prior experience in pricing under circumstances as calamitous and globally impactful as the current crisis, FX markets have been plunged into a maelstrom of volatility.

For firms that are highly dependent on a small group of venues and counterparties for market access, this spells disaster. But for those with access to a large, diverse community, this is an opportunity to shine, to demonstrate real differentiation from competitors. Large networked communities create resilience. A successful community network offers its participants connectivity to an already built, diverse and global financial ecosystem - one that includes a wide variety of counterparties for price discovery, liquidity sourcing and trade execution. In other words, the information that firms need to find liquidity, and the ability to access it.

This level of activity brings challenges as well as opportunities, and FX markets are more competitive than ever. Three technological trends in particular, namely artificial intelligence (AI) and the continuous need for innovation, the advent of new models like the "subscription economy," and the importance of mission critical communications and infrastructures – have disproportionately impacted FX markets, and continue to do so in the time of COVID-19.

Innovate in a brave new world

Use of Artificial Intelligence and Machine Learning techniques has substantially increased in recent years, driven in no small part by the industry embracing cloud technology and the corresponding benefits of scalability and access to large data sets that underpin AI / ML. This is having a significant impact on trading activity, deployment of investment capital and the use of technology. AI is often touted as the most disruptive of all the technologies that are currently driving digital transformation in the enterprise. It is rapidly changing financial markets, and FX is certainly no exception.

AI / ML techniques are informing better decision-making in the often volatile, fast-moving FX markets, by analysing huge amounts of data and information in a matter of seconds. This is critical in our current crisis conditions – the ability to augment the judgment of human beings, and to better react to volatile market conditions.

The impact is not only felt within the electronic and algorithmic trading space. There has also been a dramatic growth in AI-assisted voice trading, which can listen to calls, translate voice to data, interpret that data, and provide in-depth insight for traders. For traders working from home or off-site, the ability to rely on these tools not only as aids to decision-making, but also as a means of facilitating crucial regulatory data capture requirements over voice and chat channels, is invaluable.

Reinventing flexibility with subscription

Markets have also witnessed extraordinary growth of the "subscription economy": the growing trend for businesses to offer their products and services on a subscription basis to customers, rather than charging them a large upfront fee in the form of a license payment.

The subscription model is transforming the way in which FX firms evaluate investing in new technologies and systems. Market participants no longer have to weigh the high initial payment of purchasing a new system, as a subscription structure allows for less commitment and lower upfront costs. It is now much easier for an FX trading firm to switch technology platforms and providers, as their needs change. On the other side of the fence, subscription-based service providers must now be even more responsive to customer needs, in order to retain long-term recurring revenue.

The subscription economy also enables FX firms to rapidly respond to changing needs during the COVID-19 crisis. Firms can now switch more easily between market data feeds, and finding and accessing liquidity on new venues more quickly. They can also deploy new tools and set up new work environments quickly– essential when rapidly transitioning to a home-based workforce.

Think about FX markets as mission critical

In calmer times, it's easy to forget the critical role that our financial markets and their infrastructure play in underpinning world trade, commerce and supply chains. And taking a step further – the role that these then play in ensuring that workers get paid, that people can buy food, that they can continue to access healthcare and medicines. This is absolutely dependent on maintaining effectively functioning FX markets. Considering these factors, most of the governments around the world have classified many financial services workers as key workers. These critical workers must be supported in continuing to work through this time through the provision of adequate transport and childcare.

IPC recognises that the necessity for operating efficiently and effectively – remotely – is critical too. We remain laser-focused on enabling our customers to maintain business continuity and continuing our critical role to ensure that the capital markets function smoothly. This, through a variety of our products and services such as **IQ/MAX® Omni, Remote Devices, EVS as a Service** and the **IPC-Cloud9 Disaster Recovery as a Service**.

Connectivity is also mission critical to business continuity and having access to a secure and resilient network that meets every compliance requirement is vital during stressed market conditions. Wild times, when you need to have access to the right network and counterparties to find liquidity.

IPC has a very large and diverse ecosystem and a network with different solutions for different needs (voice and data). We experienced that the use of "voice" during stressed market conditions is one of the few reliable resources in a crisis, but depending on need, IPC can provide, low latency, electronic connectivity, Extranets or other services.

Participants in **IPC's Connexus Cloud** are connected to a community of **110,000+ users in over 6,600 capital market participants** around the globe, **across 750 cities** in **over 60 countries** including buy-side firms, sell-side firms, trading platforms, liquidity venues, interdealer brokers, application and market data providers, and clearing/settlement services. With nearly 5 decades of experience and being a beacon of stability during periods of crises, we are an important partner to our customers and other industry leaders during this difficult time.

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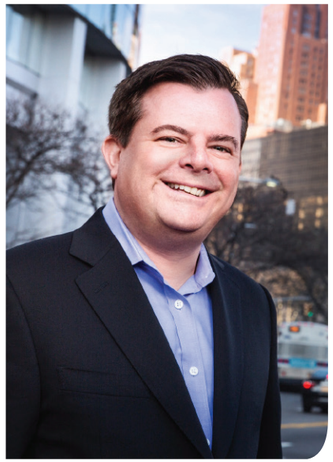
About the
Author



As **Chief Operating Officer of IPC, David Brown** is responsible for global product, research and development, operations and support, leading significant, complex integration initiatives. During his tenure with the firm, David has contributed substantially to IPC's growth and has served in a multitude of senior management roles including, most recently, as Senior Vice President and Managing Director of IPC's Financial Markets Network. In this position he oversaw service, operations and delivery as well as all aspects of the Global Network Services business, including worldwide sales and marketing, engineering, product management, network operations and customer support. David has also managed IPC's global trading communications solutions operations, led global network operations and product management for the Financial Markets Network business including multiple successful network acquisition and integration projects.

Prior to joining IPC in 2003, he held management positions at IXNet and Global Crossing, and also worked for Orange PCS and Rolls Royce PLC. A native of the U.K., David earned a B.A. from Sheffield Hallam University and resides in New York.

About IPC

IPC is a technology and service leader that powers financial markets globally. We help clients anticipate change and solve problems, setting the standard with industry expertise, exceptional service and comprehensive technology. With customers first and always, we collaborate with each to understand their individual needs to help make them secure, productive and compliant within our connected community. Through service excellence, long-developed expertise and a focus on innovation and community, we provide agile and efficient ways for our customers to accelerate their ability to adapt to the ever–changing requirements for advanced data networks, compliance and collaboration with all counter-parties across the financial markets.

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