



# ECB MMCG Meeting: CCY Basis – Executive Summary & Call for Discussions

Frankfurt, 26.09.2017, Oliver Deutscher

# Cross – Currency Basis: A short summary of DZ BANK's two research publication findings

## Interest Rate Derivatives

A Research Publication by DZ BANK AG

### Cross-currency basis – the new monetary policy barometer

- » The cross-currency basis represents a forex niche market with significant impact on the cost of cross-currency funding
- » A negative basis implies relative shortage of USD in FX derivatives – USD investments becoming more expensive for international investors
- » As lenders of last resort for FX repos, central banks provide protection for the basis while U.S. deregulation opens the gates for structural tightening

The cross-currency basis (basis) generally quantifies the cost of USD in FX derivatives. Before the financial crisis in 2008, the basis was close to zero and barely changed with the exception of USD-JPY. It therefore made little difference whether, for example, a borrower wanting to raise a loan in euros had access to the money market in the Eurozone or the USA. However, since the financial crisis, significant deviations have been observed versus the theoretical equilibrium value. Funding their USD liquidity has become significantly more expensive for EUR and JPY-based borrowers of USD.

#### BONDS

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Bloomberg DZBR <GO>

## Foreign Exchange Markets

A Research Publication by DZ BANK AG

### The cross-currency basis: a market analysis

- » The USD basis has been significantly negative since the beginning of 2015 – to the detriment of corporates who do not have direct access to the US bond market.
- » The basis is impacted by a variety of factors, but monetary policy is clearly the dominant influence at present.
- » We do not expect a significant narrowing of the basis towards the neutral zone in the foreseeable future.

The cross-currency basis spread (basis) widened significantly for the first time in the crisis year of 2008 and then acted as a risk-barometer in the years thereafter. Higher risk aversion led the (negative) USD basis to widen; as risk appetite normalised, the basis narrowed again. But even though the USD basis continues to act as a risk indicator, it is now driven by a wider range of influences.

#### FOREIGN EXCHANGE

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## Cross – Currency Basis: Indicator and/ or barometer of FX markets & liquidity ?

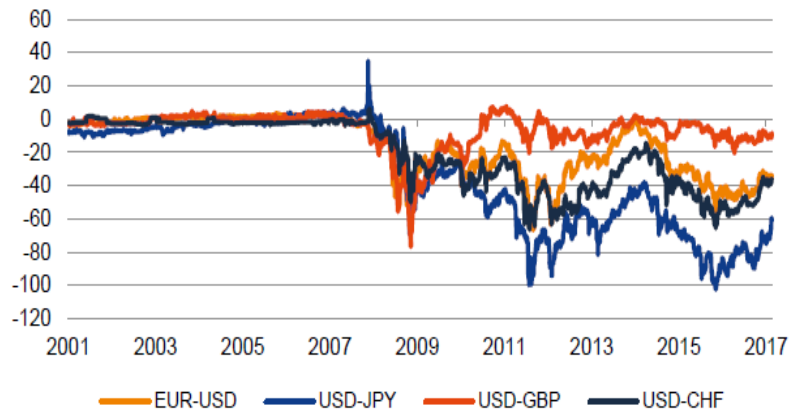
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### Summary of findings to DZ BANK research publication:

- A negative basis implies a relative shortage of USD in FX derivatives
- Cross – currency basis has significant impact on cost of cross-ccy-funding substantially for non US markets participants
- Missing direct access to USD funding for borrowers increases exposure to FX swap markets liquidity & market depth
- Since 2007/2008 central bank monetary policies and financial markets regulations have added to the importance of ccy basis as an sensitive indicator for FX markets participants
- Further more, economic policies and necessary banks balance sheet management have added to the volatility of ccy basis (e.g.: reform of the US money market fund sector 2016).

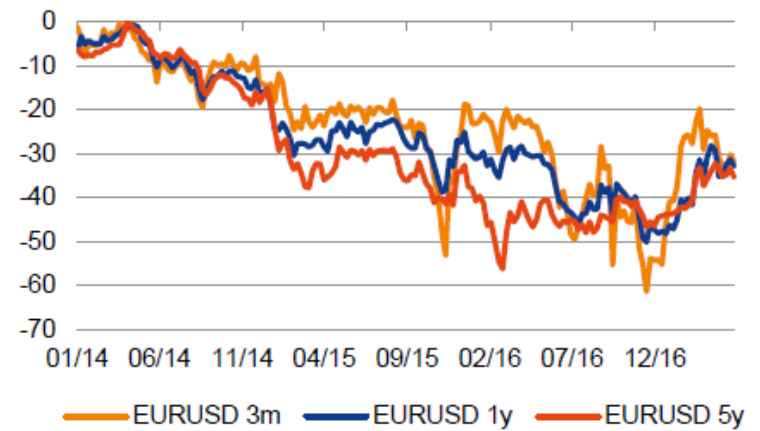
# Cross – Currency Basis: Indicator and/ or barometer of FX markets & liquidity ?

A CRISIS CAREER – BASIS ONLY ATTRACTED MORE ATTENTION FROM 2008 ONWARDS  
BASIS TO THE USD IN BASIS POINTS SINCE 2007



Source: DZ BANK Research, Bloomberg

EURUSD BASIS REMAINS SIGNIFICANTLY NEGATIVE  
IN BP



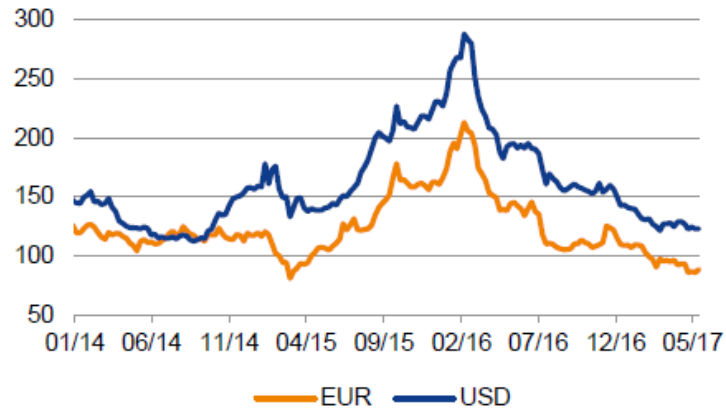
Source: Bloomberg, DZ Bank Research

- Negative values reflect structural shortage of USD in FX derivatives and shifting away from theoretical equilibriums

Source: DZ Bank research, dated June 21st and July 7th, 2017,

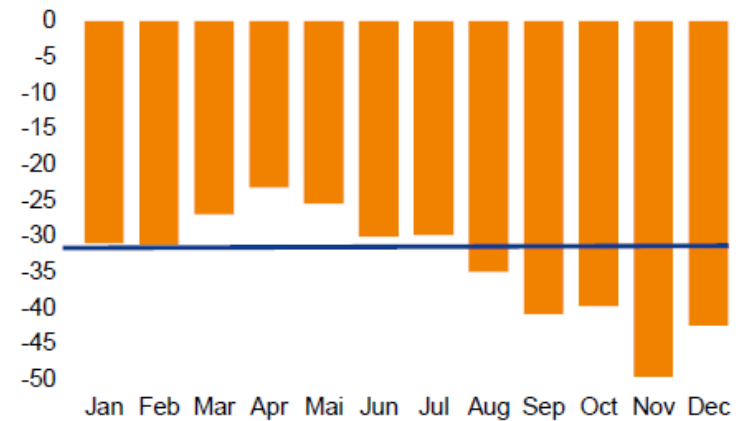
## Cross – Currency Basis: Indicator and/ or barometer of FX markets & liquidity ?

EURO FUNDING ATTRACTIVE FOR US CORPORATES  
ASW BBB CORPORATES 5-7Y IN BP



Source: Bloomberg, DZ Bank Research

EURUSD BASIS DISPLAYS MARKED SEASONALITY  
AVERAGE BASIS, SINCE 2009



Source: Bloomberg, DZ Bank Research

- Focus stays on central banks monetary policies and financial markets participants exposure to basis volatilities
- Narrowing of the basis rather unlikely looking at EoY but market should be better prepared than 4.Q.2016

Source: DZ Bank research, dated June 21st and July 7th, 2017,

## Cross – Currency Basis: Indicator and/ or barometer of FX markets & liquidity ?

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### Near term and future implications ?

- How does upcoming tightening of monetary policies impact ccy markets ?
- How does FED's decision on reduction of its balance sheet impact USD liquidity ?
- Who will be impacted most ?
- Will seasonal effects (e.g.: Quarterly & EOY activities) again propell effects in 2017 vs. EOY 2016 ?
- What effects will be seen in EURUSD FX rate ?

Thank you