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FX Options Weekly Report

Macro and Vol Commentary

This week we turn our attention to the reoccurring trend of U.S. and China tension and what that means for USDCNH.

China Data

- Caixin manufacturing PMI was expansionary once again in May at 50.7
  - _ This shows improving in business conditions on the previous month and that the sector is recovering strongly
  - _ Export orders are constraining the economy as new orders continue to contract
- Non-manufacturing PMI for May was also expansionary at 53.6, however, this data set recovered a lot quicker than manufacturing and was only contractionary for February this year
- Industrial profits remained weak for April at -4.3% y/y, but this is a strong improvement from March's figure, at -34.9% y/y
- Most economic indicators have improved off the lows in Q1, and we expect this recovery to continue in the near term. However, on a historical basis, they remain weak
- The property market is also showing signs of recovery and developers are optimistic about the pace of recovery
- The threat of a second wave is threatening the commercial sector of the property market, but the residential and industrial sectors are the recovering well
- According to Bloomberg Intelligence, vacancies in Shanghai shopping malls may rise to 12.9% as shop struggle under the loss of foot traffic and preferences to shop online
- The National Party conference set out plans for 2020 and progressive for the economy and will support the underlying economy, one policy being employment after the surveyed jobless rate increased to 6%
- The PBOC has started to purchase loans made to SMEs from other banks to help boost lending and help China's recovery

U.S.-China tensions

- President Trump weighed in after Beijing's move to pass national security legislation on Hong Kong
- President Trump has suggested he would strip Hong Kong of some of its privileged trade status whilst promising further sanctions on Chinese and Hong Kong officials
- Trump has also blamed China for the coronavirus outbreak
- Cofco halted purchasing U.S. grains on Friday after the comment from President Trump
- There have also been inflammatory comments between U.S. and Chinese officials about recent riots in the U.S.
- All the above threatens the Phase One trade deal that was agreed between the two sides
- The U.S. recently announced tighter export rules for Huawei chips. The rule means that semi-conductors that use U.S. technology and software being shipped to Huawei need permission from the government
- The U.S. Department of Commerce has recently added Chinese entities to a blacklist

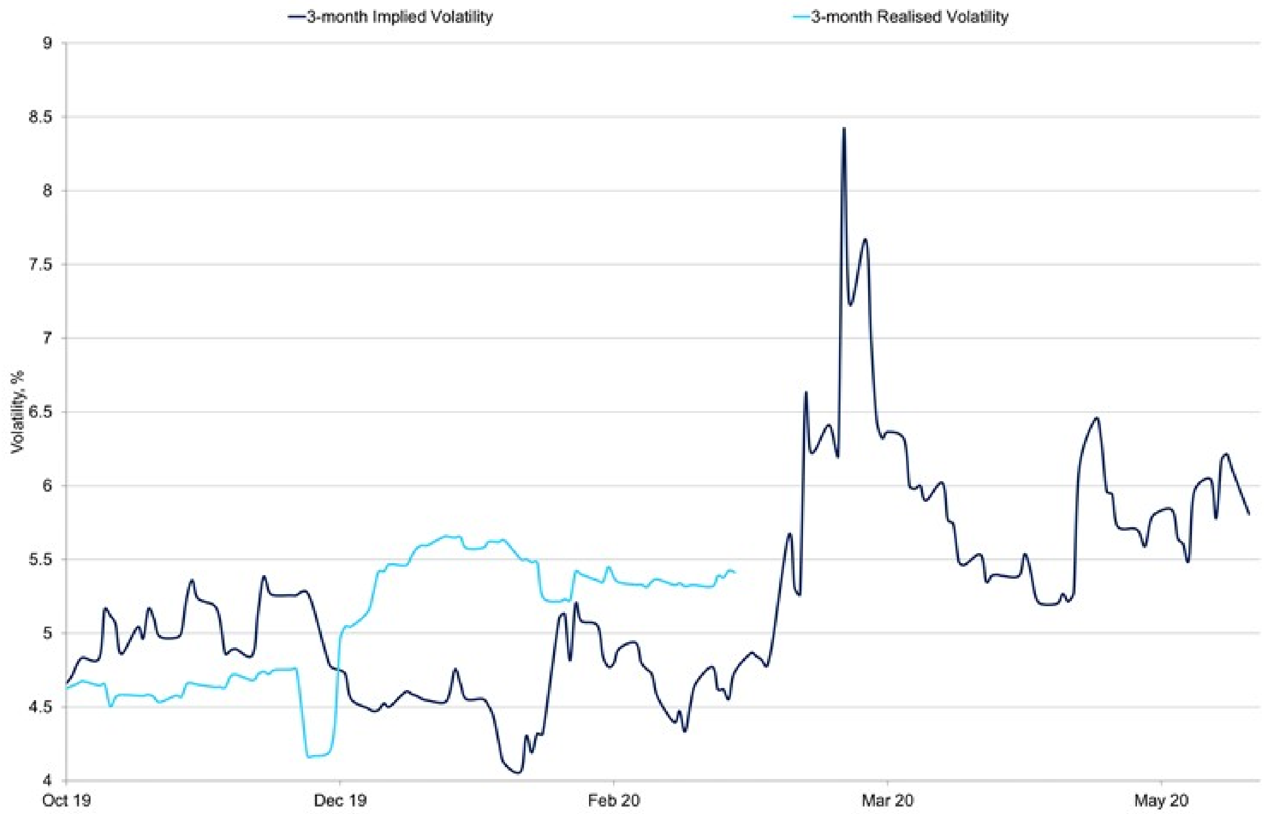
We have started to see the dollar weaken in recent sessions causing the index to post an 11 week low. The social unrest in the U.S. and the government's strategy during the coronavirus pandemic may have reduced the appeal of the dollar at this time and tarnished its 'safe haven' label it has adopted in recent years. The economic backdrop for both countries is uncertain, and further escalation of trade tensions and tariffs would compound economic woes.

Volatility Commentary

As with most Macro FX Vols pairs, USDCNH spiked earlier this year due to the outbreak of the coronavirus. However, with China's currency being heavily controlled by the PBOC, this spike was moderate compared to much more freely floating currencies FX vols. We also see a relatively flat FX Vol curve for this pair, with vols from 1m-1y ranging from circa 5.6 to 6.1 vols. In the short term, the global macro story is still being driven by economic reopenings as countries pass their coronavirus peaks, though President Trump has recently upped the ante on China blaming China for coronavirus and re-iterating his usual playbook on trade/South China Seas/Hong Kong etc.

On Friday, the President announced his intention to unwind Hong Kong's special trading status as a separate economic entity from mainland China. Though we do expect this rhetoric to continue, the short term focus for the President will be domestic reopenings and short term domestic riots. We are expecting to see the President to further escalate US-China relations toward October/November, with that timing being significant for a) being after the US reopenings strengthen the economy enough for further trade escalations to be possible b) proximity to the US Presidential election for maximum political and voter impact. All of which would likely see a rise in USDCNH vols and spot towards Q4 of this year. As such, we suggest a calendar spread trade to take advantage of the relatively flat vol curve: buying longer dates circa 6-month expiry and selling a shorter date such as 3m expiry too maximise exposure to Q4 volatility without paying too much for Q3 volatility. We also suggest a structure that benefits if USDCNH spot spikes in Q4.

USDCNH 3-month Realised and Implied Volatilities



Source: Bloomberg

USDCNH Trade Idea

- Below priced in 10m USD notional a leg
- Sell 3-month USDCNH Call with 7.1500 strike to receive circa 116k USD upfront premium
- Buy 6-month USDCNH Call with 7.1500 strike for a cost of circa 189k USD upfront premium (note this expiry also overlaps the US Presidential election)
- Overall strategy has a cost of circa 73k USD upfront premium

Charts and Tables

FX Volatility Grid

Time	EURUSD			GBPUSD			USDJPY			EURGBP		
Period	25d RR	25d BF	ATM	25d RR	25d BF	ATM	25d RR	25d BF	ATM	25d RR	25d BF	ATM
1W	-0.11	0.21	6.48	-1.53	0.34	8.78	-0.51	0.22	6.20	1.26	0.27	7.29
1M	-0.42	0.26	6.76	-2.01	0.41	9.46	-1.06	0.25	6.98	1.53	0.36	7.66
2M	-0.55	0.28	6.71	-2.24	0.46	9.97	-1.46	0.30	7.31	1.65	0.40	8.07
3M	-0.69	0.31	6.78	-2.32	0.50	10.06	-1.77	0.34	7.51	1.70	0.44	8.19
6M	-0.91	0.36	7.16	-2.49	0.57	10.37	-2.30	0.40	8.09	1.79	0.49	8.54
1Y	-1.14	0.41	7.27	-2.64	0.61	10.67	-2.45	0.43	8.08	1.85	0.55	8.93

Time	USDINR			USDTRY						AUDUSD		
Period	25d RR	25d BF	ATM	25d RR	25d BF	ATM	25d RR	USDJPY	ATM	25d RR	25d BF	ATM
1W	1.59	0.38	8.34	7.39	1.21	18.58	4.29	0.58	26.05	-1.64	0.49	12.58
1M	1.91	0.49	8.92	9.16	1.59	21.14	4.96	0.67	24.47	-2.54	0.57	12.48
2M	2.02	0.51	8.85	9.34	1.64	21.55	5.24	0.71	23.02	-2.88	0.62	12.19
3M	2.11	0.53	8.74	9.55	1.67	22.45	5.51	0.75	21.96	-3.10	0.66	12.01
6M	2.27	0.56	8.67	9.86	1.77	23.20	5.66	0.83	20.46	-3.45	0.72	12.02
1Y	2.41	0.56	8.31	10.16	1.94	23.76	5.82	0.91	19.00	-3.63	0.75	11.62

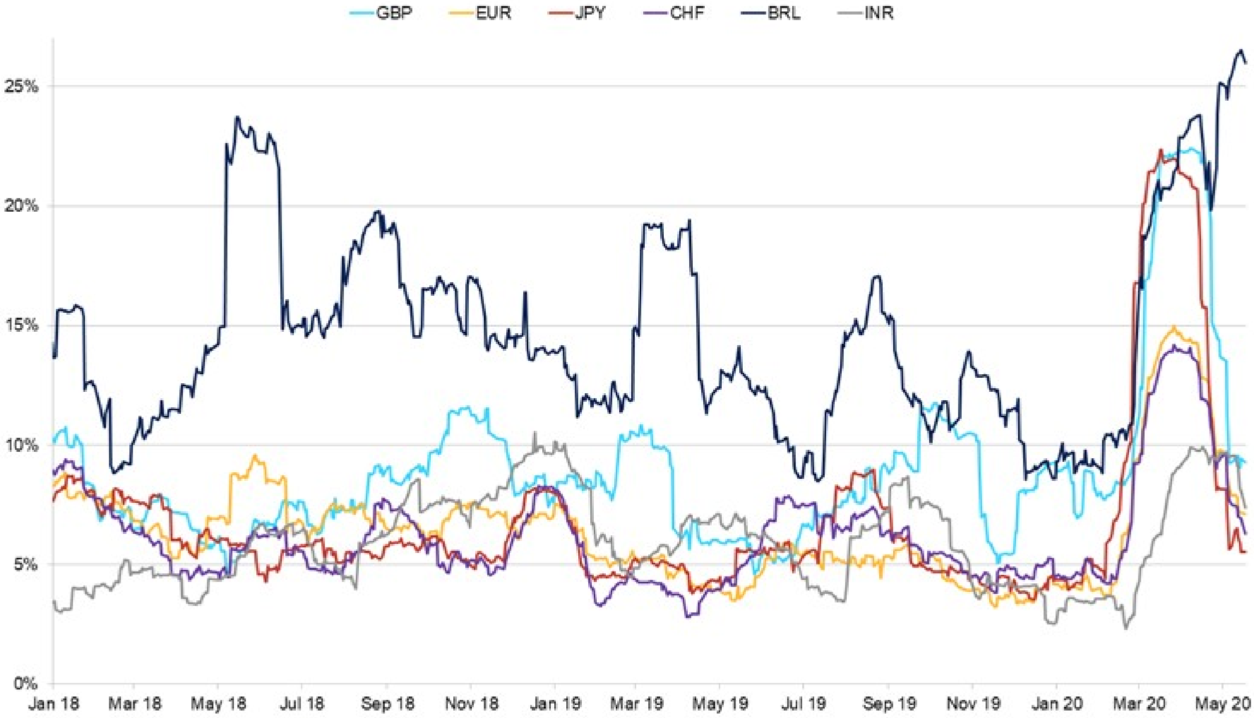
Source: Sucden Financial

FX Expiries

Currency Pair	Thursday 4th	Friday 5th	Monday 8th	Tuesday 9th	Wednesday 10th
GBP/USD					
USD/JPY	730mio @ 108.8		500mio @ 107.23	500mio @ 110	
EUR/USD	1.02bio @ 1.0925				
EUR/GBP					
USD/BRL	100mio @ 5.285				
AUD/USD	100.15mio @ 0.679 100.73mio @ 0.685 159.076mio @ 0.6915		146.52mio @ 0.6825		115.41mio @ 0.6845 478.26mio @ 0.69
USD/ZAR	150mio @ 16.85 150mio @ 17	150mio @ 16.85			390mio @ 17.25 200mio @ 17.49
USD/INR	100mio @ 74.6				

Source: Bloomberg DTCC Data 2% from spot levels as of 03/06/2020

Historical Spot FX Volatility (30D Rolling)



Source: Sucden Financial, Bloomberg

FX Matrix (today)

	USD	GBP	EUR	JPY	CHF	CAD	AUD	NZD
USD	-	**1.2510**	**1.1196**	**0.0092**	**1.0400**	**0.7407**	**0.6893**	**0.6409**
GBP	0.7993	-	0.8950	0.7324	0.8313	0.5920	0.5510	0.5123
EUR	**0.8932**	**1.1174**	-	**0.8184**	**0.9289**	**0.6615**	**0.6156**	**0.5725**
JPY	109.1400	136.5340	122.1900	-	113.5080	80.8340	75.2260	69.9510
CHF	**0.9615**	**1.2029**	**1.0765**	**0.8811**	-	**0.7122**	**0.6628**	**0.6163**
CAD	1.3501	1.6890	1.5116	0.0124	1.4042	-	0.9307	0.8654
AUD	**1.4508**	**1.8149**	**1.6243**	**1.3293**	**1.5089**	**1.0745**	-	**0.9299**
NZD	1.5602	1.9518	1.7468	0.0143	1.6227	1.1556	1.0754	-

Source: Bloomberg

Weekly Change

	USD	GBP	EUR	JPY	CHF	CAD	AUD	NZD
USD	-	1.55	1.13	-1.36	0.30	1.95	3.89	3.24
GBP	-1.53	-	-0.41	-2.85	-1.21	0.39	2.30	1.67
EUR	-1.11	0.41	-	-2.46	-0.82	0.82	2.74	2.09
JPY	1.37	2.94	2.51	-	1.71	3.34	5.31	4.65
CHF	-0.31	1.23	0.82	-1.66	-	1.60	3.53	2.87
CAD	-1.90	-0.38	-0.81	-3.25	-1.62	-	1.89	1.24
AUD	-3.74	-2.25	-2.66	-5.05	-3.46	-1.88	-	-0.63
NZD	-3.13	-1.63	-2.06	-4.48	-2.86	-1.23	0.64	-

Source: Bloomberg

Key Events & Releases

Region	Date	Time	Indicator	Period	Survey	Prior
EU	04/6	12:45	ECB Deposit Rate Decision		-0.5%	-0.5%
US	04/6	13:30	Initial Jobless Claims	May 29	1,800k	2,123k
US	04/6	13:30	Trade Balance	Apr	-$44.3bn	-$44.4bn
UK	05/6	00:01	GfK Consumer Confidence	May	-40.0	-34.0
JP	05/6	00:30	Overall Household Spending YoY	Apr	-15.4%	-6.0%
US	05/6	13:30	Nonfarm Payrolls	May	-8,000l	-20,500k
US	05/6	13:30	Unemployment Rate	May	19.6%	14.7%
JP	08/6	00:50	GDP QoQ	Q1		-0.9%
GE	08/6	07:00	Industrial Production MoM	Apr		-9.2%
EU	09/6	10:00	GDP YoY	Q1		-3.2%
US	09/6	15:00	Wholesale Inventories	Apr	0.4%	0.4%
JP	10/6	00:50	PPI YoY	May	-1.6%	-2.3%
CN	10/6	02:30	CPI YoY	May	3.7%	3.3%
US	10/6	12:00	MBA Mortgage Applications	Jun 5		-3.9%
US	10/6	13:30	CPI MoM	May	0.0%	-0.8%
US	10/6	19:00	Fed Interest Rate Decision			0.25%

Source: FX Street

FX Technical Charts

JP Morgan Global FX Volatility Index

The global FX volatility index has softened in recent weeks as resistance at the moving averages held firm causing a break at 8. Near term, support stands at previous trend resistance. The stochastics remain in oversold territory as the RSI fall as well. The MACD diff is negative but lacks conviction. The recent weakness looks set to continue but the moves are steady and lack real conviction. A break below previous trend resistance could set the scene for lower index through previous trend resistance at 7.30 to confirm the recent trend. On the upside, the index needs to break through the moving averages on the upside.

USDCNH

Rejection of prices at 161.8% at 7.1879 has caused a correction in recent sessions. The market reaffirmed support below 7.10 and has been bid back to the 100 DMA 7.1342. The indicators are positive as the stochastics enter overbought and the MACD diff is positive and diverging on the upside. This suggests higher prices in the near term and if prices take out resistance at the 100 DMA and then the more psychological level at 150% fib level. In order to keep the trend on the upside, prices need to take out 7.1879. Conversely, the market has been well supported at trend support and a break of this level could trigger losses to 7.0500. We expect prices to firm in the near term.

DXY Index

The market has sold off in recent days as selling pressure prompted a break of support at 98.874 and 97.812. The stochastics have given a buy signal and the RSI and MACD diff are also positive. To confirm the outlook of higher prices, futures need to take out the 50% fib level at 98.789. In the immediate term, a break above the 61.8% fib level would help confirm the hammer candle. On the downside, if the index rejects the 61.8% fib level we could see the market take out support at 97 and then target 96.604.