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FX Options Weekly Report

Macro and Vol Commentary

The recent risk-on sentiment has seen assets rally as funds which were sitting on the side-line to return to the market. The pandemic in LATAM is behind the U.S. and European countries, but will the USDBRL rally continue?

Brazilian Data

- Manufacturing PMI for May improved on a month-on-month basis to 38.3, up from 36.0 the previous month
- New orders and output were once again weak due to the economic restrictions from COVID-19; export orders were sequentially weak, but as other countries ease lockdown restrictions, we expect this data set to improve
 - — The weakness in the real should help support Brazilian exports if orders can be processed
 - — The trade balance for May was above estimates at \$4,548m but weakened on the previous month which was \$6,702m
- Industrial production was -27.2% on a y/y basis
- As with the rest of the globe, unemployment increased to 12.6% in April, and we expect this to rise further in May but plateau in the superseding months
 - — The formal job creation total was -860,504 for April
- Electricity demand is starting to improve, Bloomberg high frequency suggests the economy is trying to return to normal
- The government's primary balance has declined to -92.0bn for April, and this will fall further in May
 - — There are calls for the government to extend the social aid package of BRL600/month to the vulnerable, this would increase government debt
 - — Public Net debt as a % of GDP was 52.7% for April, according to the Banco Central do Brasil
- Bolsonaro is attempting to re-open Brazil's economy, but the virus remains prevalent
- There is anger in Brazil, which is seen by the WHO as the epicentre of the virus now, at the government for releasing incorrect data on the virus
 - — Two health ministers resigned since the beginning of the pandemic

- _ Some health experts suggest that the virus in Brazil hasn't peaked and is expected to do so between July and September

Brazil Monetary Policy

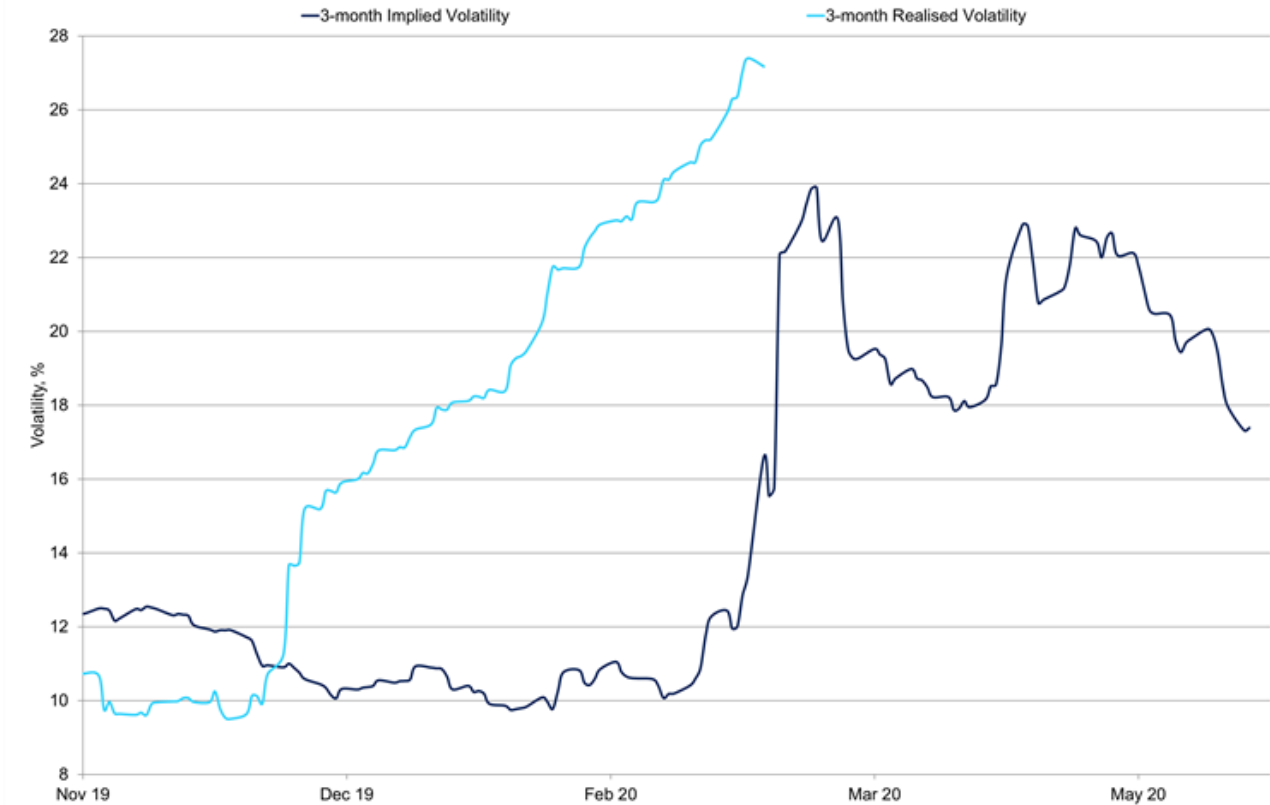
- Recent legislation has been passed in Brazil to allow the purchasing of private and public debt
- The Selic rate target rate is 3% but the decision next week will likely see interest rates cuts
- We expect traditional monetary tools to be the primary option before the central bank look to QE and bond-buying
- It is important for the bank to flatten the yield curve

The anti-government protests have been gaining momentum slowly, and this looks set to continue. The recent statement from the Fed suggests low rates in the long run and this has hampered risk appetite today. We expect this to be a bump in the road and risk sentiment to return. We need to see improvements in Brazil to suggest a sustained rally in the Real. The economic stimulus that is needed in Brazil is significant and will mean that the economic reform that was previously promised will have to take a back seat. This will keep the BRL weaker for longer. However, as risk appetite continues to return to the market, we may see the BRL ride that wave and strengthen somewhat, especially we if we continue to see dollar weakness.

Volatility Commentary

Over the Coronavirus crisis, USDBRL implied vols spiked along with most of the Macro FX vols in Q1 of this year. Implied vols for USDBRL, however, have not quite come off as much from the spike as other Macro FX vols, with recent volatility realising higher than implied. As mentioned above, we have seen BRL strengthen in the past month, but with a President who remains unwilling to impose lockdown measures and, as mentioned above, Brazil likely to have not reached its Coronavirus peak yet, BRL strength may not continue towards the latter half of Q3. We favour slight long vol positions which would benefit from a reversal spot/USDBRL moving higher towards the end of Q3, see below for trade idea.

USDBRL 3-month Implied and Realised Volatility



Source: Bloomberg

USDBRL Trade Idea

- Buy EKI Call option with strike 5.0000 and barrier 5.5000, with 3-month expiry for circa 242k USD (for reference vanilla equivalent is approximately 354k USD)
- In addition to the EKI above, those expecting a USDBRL to remain at current levels or go further lower in the short term, investors can take advantage of vol curve inversion (up to 1y) and reduce upfront vol/theta cost by additionally selling a Vanilla Call Option with strike 5.0000 with 1-month expiry for circa 221k USD
- Combining the two would give an upfront cost of circa 21k USD

Charts and Tables

FX Expiries

Currency Pair	Thursday 11 th	Friday 12 th	Monday 15 th	Tuesday 16 th	Wednesday 17 th
GBP/USD	872mn @ 1.25				
USD/JPY		750mn @ 108	2.83bn @ 108.3 2.44bn @ 108.54	660mn @ 106.6	
EUR/USD	610.62mn @ 1.13		781.52mio @ 1.126 1.04bio @ 1.15	646.56mio @ 1.16	
EUR/GBP					
USD/BRL					250mio @ 4.95 300mio @ 5.05
AUD/USD		100mio @ 0.7	100mio @ 0.69		143.88mio @ 0.695
USD/ZAR					250mio @ 16.8
USD/INR					

Source: Bloomberg DTCC Data 2% from spot levels as of 10/06/2020

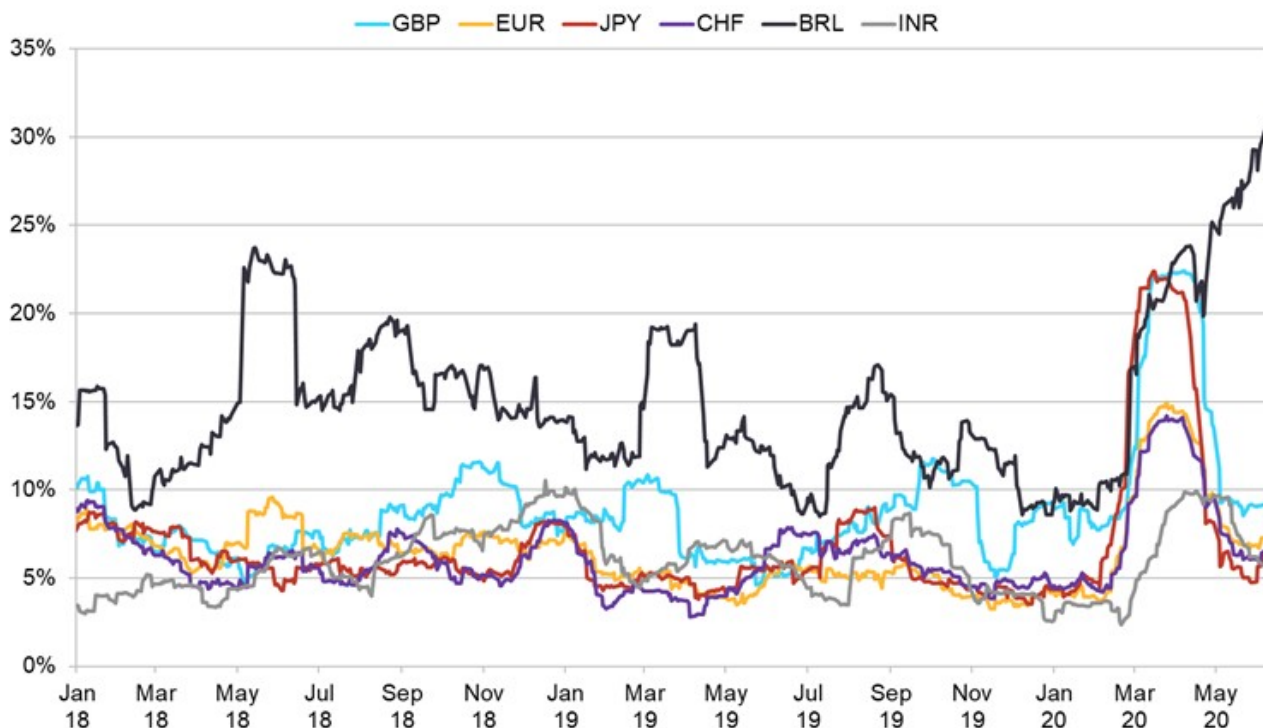
FX Volatility Grid

Time	EURUSD			GBPUSD			USDJPY			EURGBP		
	25d RR	25d BF	ATM	25d RR	25d BF	ATM	25d RR	25d BF	ATM	25d RR	25d BF	ATM
1W	0.17	0.16	8.00	-0.94	0.22	9.65	-1.15	0.31	7.89	1.31	0.19	7.80
1M	0.07	0.17	7.01	-1.59	0.26	9.21	-1.44	0.34	6.81	1.70	0.25	7.71
2M	-0.04	0.20	6.74	-1.81	0.30	8.96	-1.82	0.36	6.65	1.77	0.28	7.55
3M	-0.19	0.22	6.54	-1.95	0.34	8.83	-2.12	0.37	6.59	1.78	0.32	7.47
6M	-0.42	0.27	6.61	-2.38	0.42	9.26	-2.74	0.41	7.10	1.93	0.38	7.79
1Y	-0.66	0.34	6.46	-2.69	0.50	9.66	-2.77	0.41	6.99	2.04	0.45	8.20

Time	USDINR			USDTRY			AUDUSD					
	25d RR	25d BF	ATM	25d RR	25d BF	ATM	25d RR	25d BF	ATM			
1W	0.60	0.24	5.82	3.57	0.89	13.05	2.54	0.53	22.88	-1.17	0.41	15.66
1M	0.76	0.28	5.89	6.03	1.11	14.72	3.19	0.60	20.22	-1.65	0.46	13.29
2M	0.90	0.31	5.99	6.62	1.17	15.64	3.47	0.63	18.45	-1.87	0.46	12.45
3M	1.03	0.34	6.03	7.08	1.23	16.29	3.66	0.65	17.67	-1.98	0.46	11.95
6M	1.31	0.40	6.31	7.88	1.38	17.71	4.12	0.71	16.59	-2.32	0.50	11.57
1Y	1.52	0.47	6.42	8.56	1.56	19.12	4.50	0.80	15.29	-2.52	0.52	10.95

Source: Sueden Financial

Historical Spot FX Volatility (30D Rolling)



FX Matrix (today)

	USD	GBP	EUR	JPY	CHF	CAD	AUD	NZD
USD	-	1.2693	1.1379	0.0093	1.0618	0.7426	0.6941	0.6500
GBP	0.7878	-	0.8964	0.7363	0.8365	0.5850	0.5468	0.5121
EUR	0.8788	1.1155	-	0.8213	0.9331	0.6526	0.6100	0.5712
JPY	107.0000	135.8180	121.7500	-	113.6070	79.4540	74.2710	69.5500
CHF	0.9418	1.1955	1.0717	0.8802	-	0.6994	0.6538	0.6122
CAD	1.3467	1.7093	1.5323	0.0126	1.4298	-	0.9348	0.8753
AUD	1.4406	1.8286	1.6393	1.3464	1.5297	1.0698	-	0.9364
NZD	1.5385	1.9528	1.7506	0.0144	1.6335	1.1425	1.0679	-

Source: Bloomberg

Weekly Change

	USD	GBP	EUR	JPY	CHF	CAD	AUD	NZD
USD	-	0.76	0.36	2.01	1.46	0.26	0.00	0.56
GBP	-0.77	-	-0.40	1.24	0.69	-0.53	-0.80	-0.21
EUR	-0.37	0.41	-	1.63	1.07	-0.12	-0.39	0.21
JPY	-1.97	-1.21	-1.60	-	-0.54	-1.70	-1.98	-1.40
CHF	-1.42	-0.66	-1.07	0.53	-	-1.19	-1.45	-0.86
CAD	-0.25	0.51	0.11	1.75	1.20	-	-0.27	0.31
AUD	0.02	0.78	0.38	2.02	1.47	0.27	-	0.59
NZD	-0.57	0.21	-0.20	1.48	0.87	-0.31	-0.58	-

Source: Bloomberg

Key Events & Releases

Region	Date	Time	Indicator	Period	Survey	Prior
CN	10/6	02:30	CPI MoM	May	-0.5%	-0.9%
CN	10/6	02:30	PPI YoY	May	-3.3%	-3.1%
US	10/6	12:00	MBA Mortgage Applications	Jun 5		-3.9%
US	10/6	13:30	CPI YoY	May	0.2%	0.3%
BRL	10/6	14:00	IPCA Inflation	May	-0.2%	-0.31%
US	11/6	13:30	PPI YoY	May	-1.2%	-0.3%
US	11/6	13:30	Initial Jobless Claims	Jun 5	1,550k	1,877k
JP	12/6	05:30	Industrial Production YoY	Apr	-14.4%	-14.4%
UK	12/6	07:00	Industrial Production MoM	Apr	-15.0%	-4.2%
UK	12/6	07:00	GDP MoM	Apr	-18.4%	-5.8%
UK	12/6	07:00	Mfg Production MoM	Apr	-15.8%	-4.6%
EU	12/6	10:00	Industrial Production MoM	Apr	-20.0%	-11.3%
US	12/6	15:00	Mchg Consumer Sentiment Index	Jun	75.0	72.3
CN	15/6	03:00	Industrial Production YoY	May	1.5%	3.9%
CN	15/6	03:00	Retail Sales YoY	May	-7.0%	-7.5%
JP	16/6	04:00	BoJ Interest Rate Decision			-0.1%
UK	16/6	07:00	ILO Unemployment Rate (3M)	Apr	4.4%	3.9%
US	16/6	13:30	Retail Sales MoM	May	7.0%	-16.4%

Source: FX Street

Technical Charts

JP Morgan Global Volatility FX Index



The index has continued to trend lower in the last week, after failing into resistance at the 100 DMA. The stochastics have surged higher and are now overbought and starting to fall after a sell signal but the index fails to confirm the improvement in market sentiment and remains on-trend. The RSI is overbought and the break above resistance holds firm may prompt the index to test the 200 DMA at 8.60. The index has struggled above the 100DMA and this could prompt a break through support at 7.62 with secondary support at 6.60.

USDBRL



The USDBRL has weakened in recent weeks, investors rejected 6 and prices have broken support levels of the moving averages. The indicators are starting to improve and the stochastics have emerged out of oversold but the MACD diff is positive and starting to diverge. This suggests higher prices in the near term back towards 5, with the 38.2% fib level at 5.1120. In order to regain upside momentum, the market needs to gain a footing above this 38.2% fib level and the upper trend channel. However, on the downside, a death cross is on the horizon as the 50 DMA is set to cross below the 200 DMA. A rejection of prices above 5 may set the scene for a breach of the 50% fib level before the lower trend channel to 4.5810.

The Dollar Index



The dollar index has continued to weaken and remains within the trend channel. The stochastics are have given a buy signal and diverge suggesting higher prices, to confirm the signal prices need to take out the upper trend channel. The MACD diff is positive but lacks conviction. To regain upside conviction prices need to break out of the trend channel, this would set the scene for a test of 97, with the tertiary level at 97.812. However, momentum is on the downside in the longer term after the bearish engulfing candle and reaffirmation of resistance at the upper trend. If the index can break through support at 96 and hold below this level we could see a challenge of secondary support at 95.77. The market remains on-trend and we expect this to continue in the near term.

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