



# **FX Idea Generation – See What Others Don't**

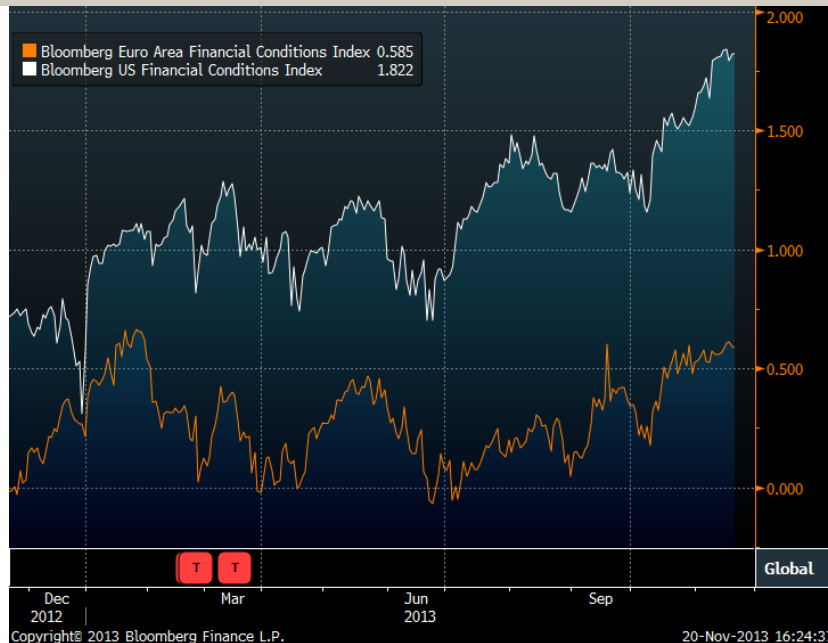
**Annie Grebenyuk**

*November 2013*

# Is Fed Delay Buying Time for Emerging Markets?

- Financial confidence across emerging markets is already seeing declines while developed economies are picking up seeing stronger growth numbers.
- The Fed Committee is likely to become modestly more dovish under Yellen - a Yellen-led Fed is probably a welcome scenario for emerging economies and fixed income markets, which have depended on extremely loose monetary policy from the Fed for growth since the global financial crisis.
- Economists predict tapering will begin in March. Still, the FOMC's Oct. 30 statement, which was less dovish than most economists expected, may imply the central bank has shortened its time line.

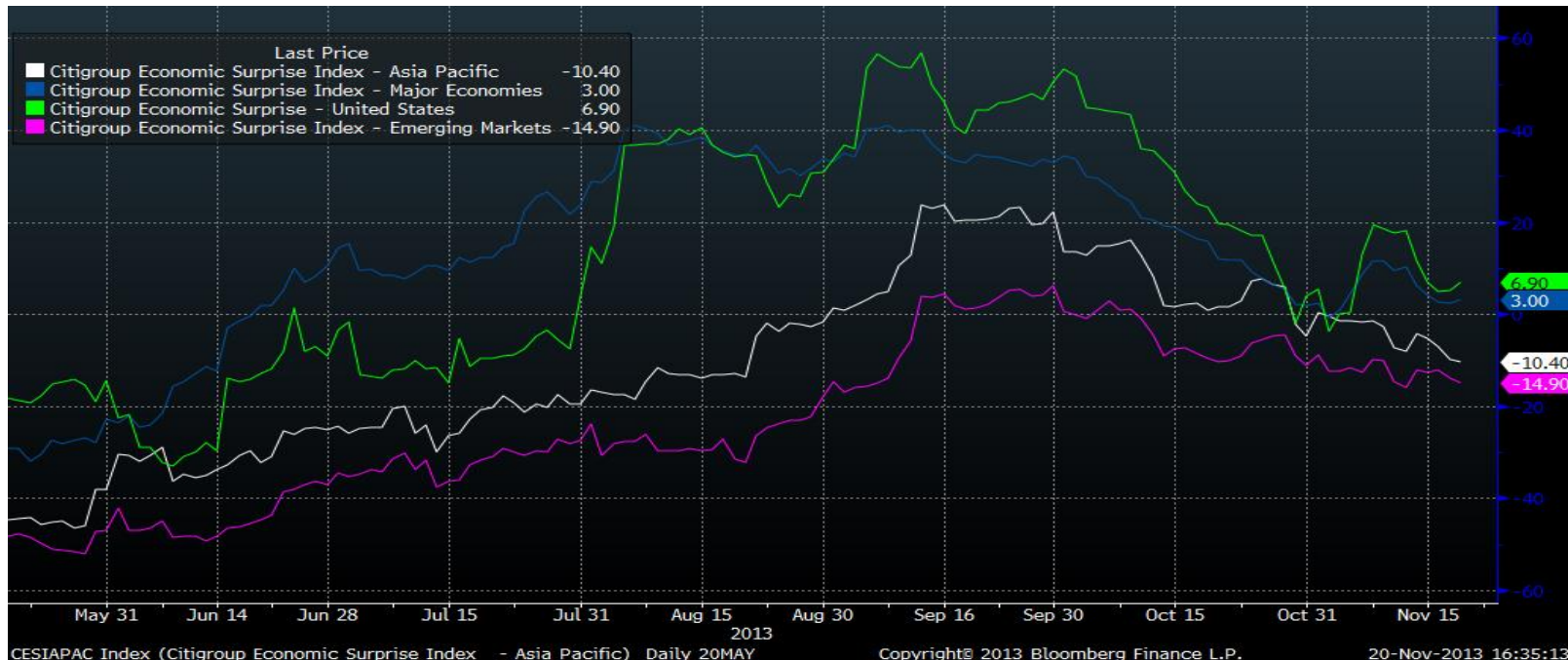
## Financial Conditions Index



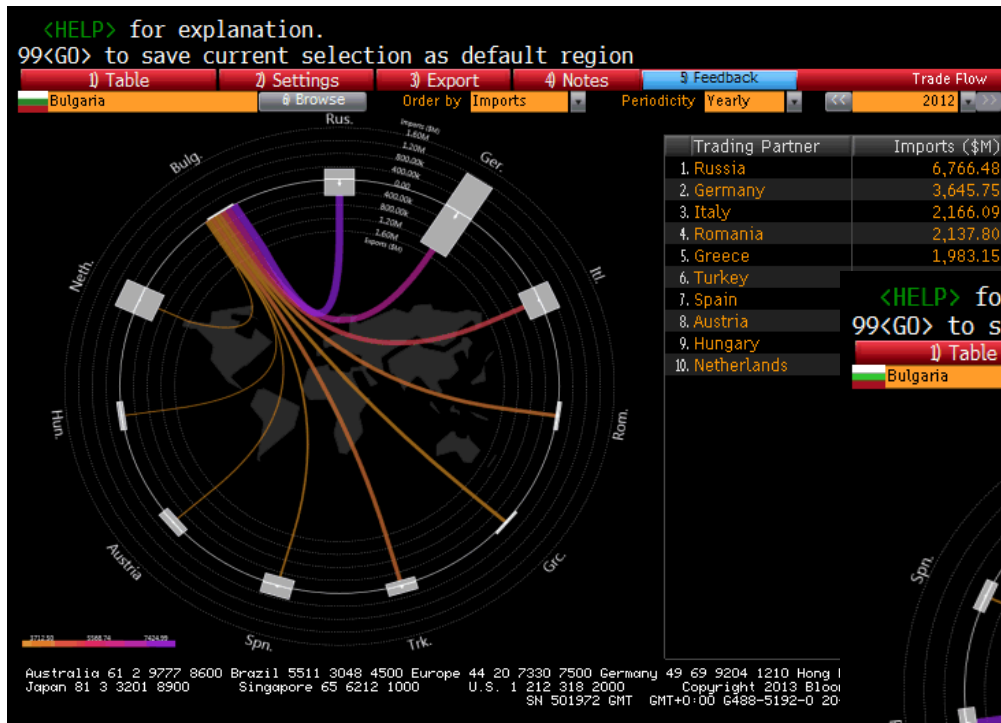
# Is Fed Delay Buying Time for Emerging Markets?

- Economies with current-account deficits are most at risk from higher U.S. interest rates.
- As Fed policy makers begin to tighten, these economies will need to reduce their dependency on cheap foreign capital by transitioning to domestic sources of funding.
- To attract foreign investors, some countries may be forced to raise their own interest rates, even in an environment of slowing growth.

## Economic Surprise Index



# Changing picture of Bulgaria's Exports and Imports

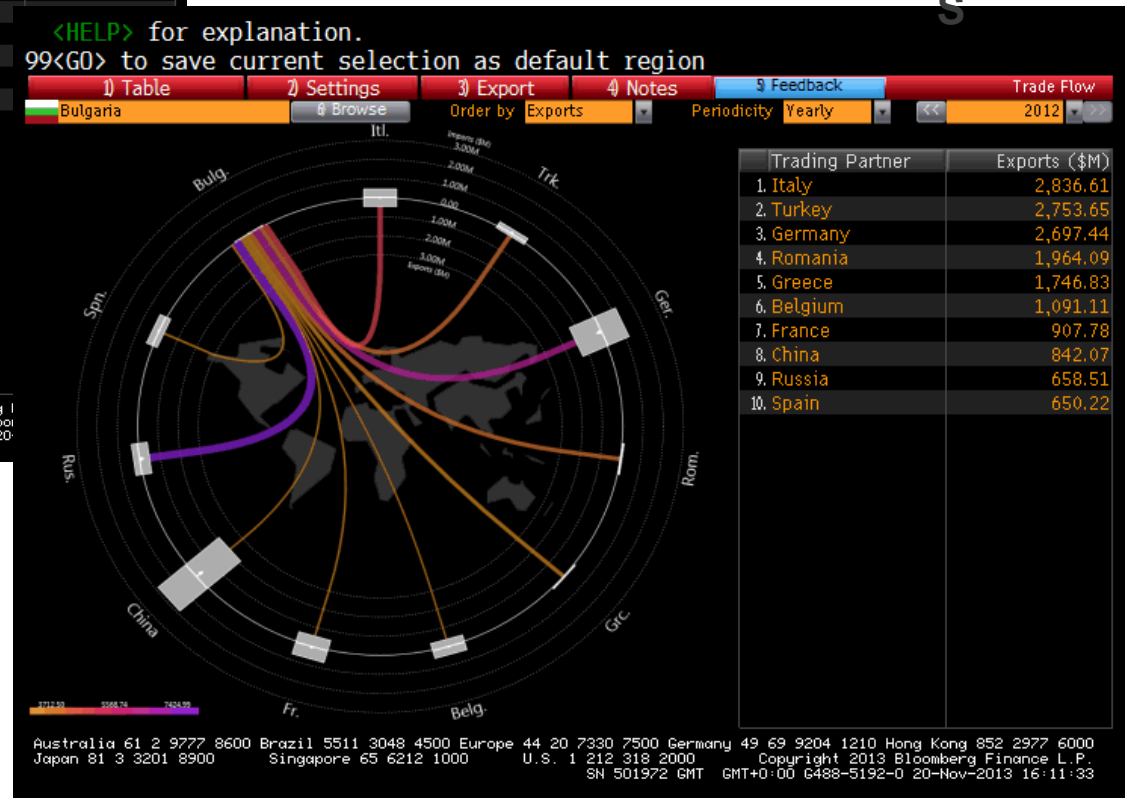


## • IMPORTS

Russia only became the biggest exporter to Bulgaria in 2007, prior to that Germany and then Italy were on top of the list

There is increasingly more Imports than Exports coming into Bulgaria, mainly from Emerging and Developing Economies

## • EXPORTS



# Bulgaria's Growing Dependency on Oil and Gas Imports?

- Imports to Bulgaria from Fuel Exporting Countries increased by almost 17% over 2012 as compared to previous year.
- In particular, imports to Bulgaria from Russia increased by more than 18% over 2012 as compared to the previous year.
- This reflects Bulgaria's growing dependency on oil and gas imports.

## *Bulgaria's Trade Flow*

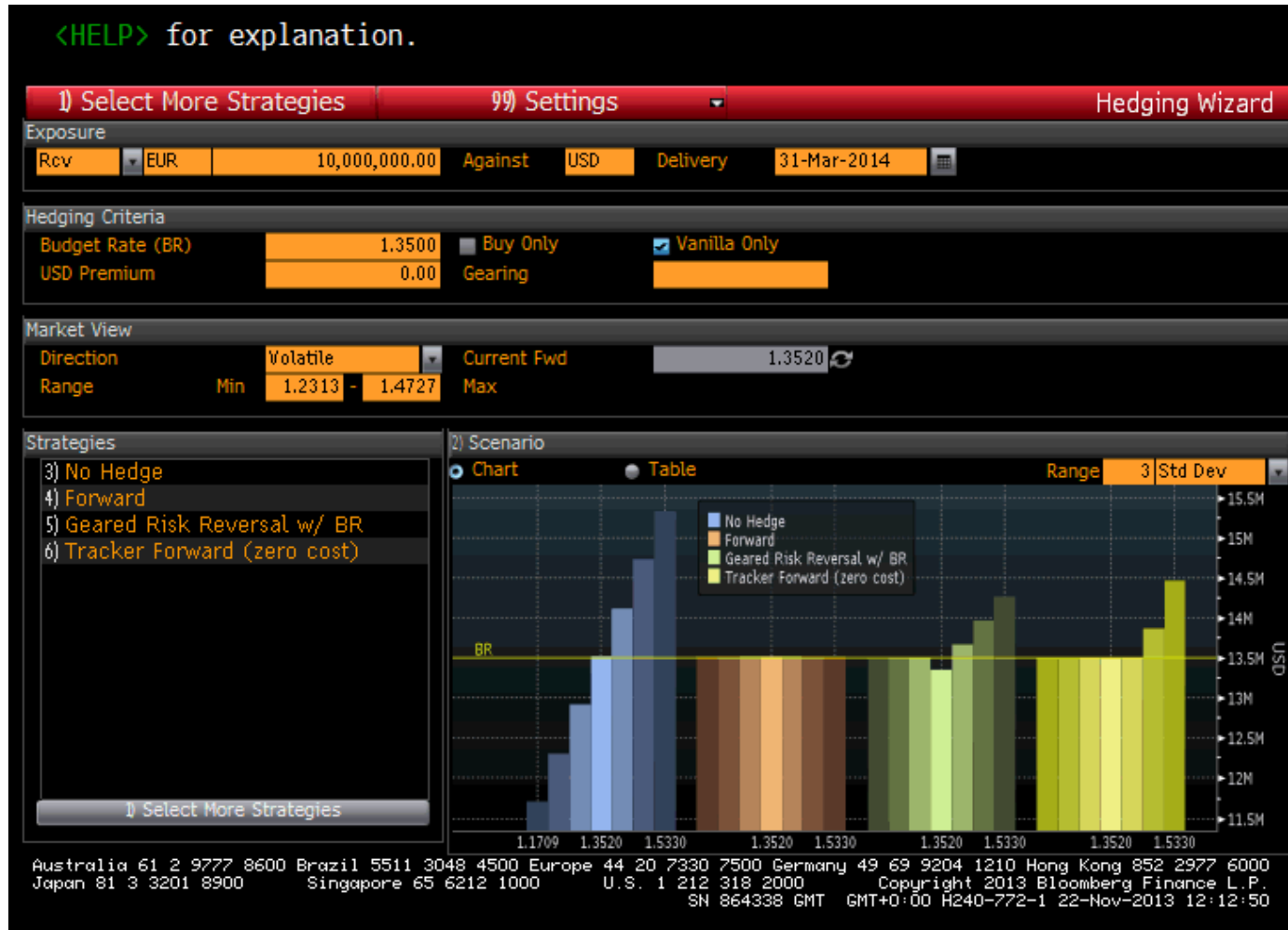
Trading Partner	Total Trade (\$M)	YoY (%)	Exports (\$M)	YoY (%)	Imports (\$M)	YoY (%)
World	58,564	-1.13	26,178	-3.11	32,386	0.54
European Union	34,204	-3.73	15,038	-7.28	19,165	-0.75
Advanced Economies	30,102	-4.03	13,901	-5.76	16,200	-2.5
Emerging and Developing Economies	28,301	2.13	12,266	0.05	16,035	3.78
Developing Europe	23,467	1.07	9,473	-2.33	13,994	3.5
Non Fuel Exporting Countries	19,647	-2.26	10,592	-0.3	9,055	-4.48
CIS Countries	9,519	6	1,560	3.98	7,958	6.4
Fuel Exporting Countries	8,654	13.74	1,674	<b>2.3</b>	6,980	<b>16.87</b>
Russia	7,425	16.65	659	<b>1.41</b>	6,766	<b>18.37</b>
Germany	6,343	1.82	2,697	-0.1	3,646	3.27
Italy	5,003	-4.57	2,837	-2.71	2,166	-6.89

# Past and Future Forecasted Performance of EURUSD



- Over 2013 Russian Ruble and US Dollar both weakened against both Euro and Bulgarian Lev which was particularly useful for coming Imports to Bulgaria from Russia.
- However according to marker FX forecast Ruble and US Dollar are expected to strengthen against Euro and Lev by the end of first quarter 2014 which might potentially hurt Imports coming to Bulgaria.

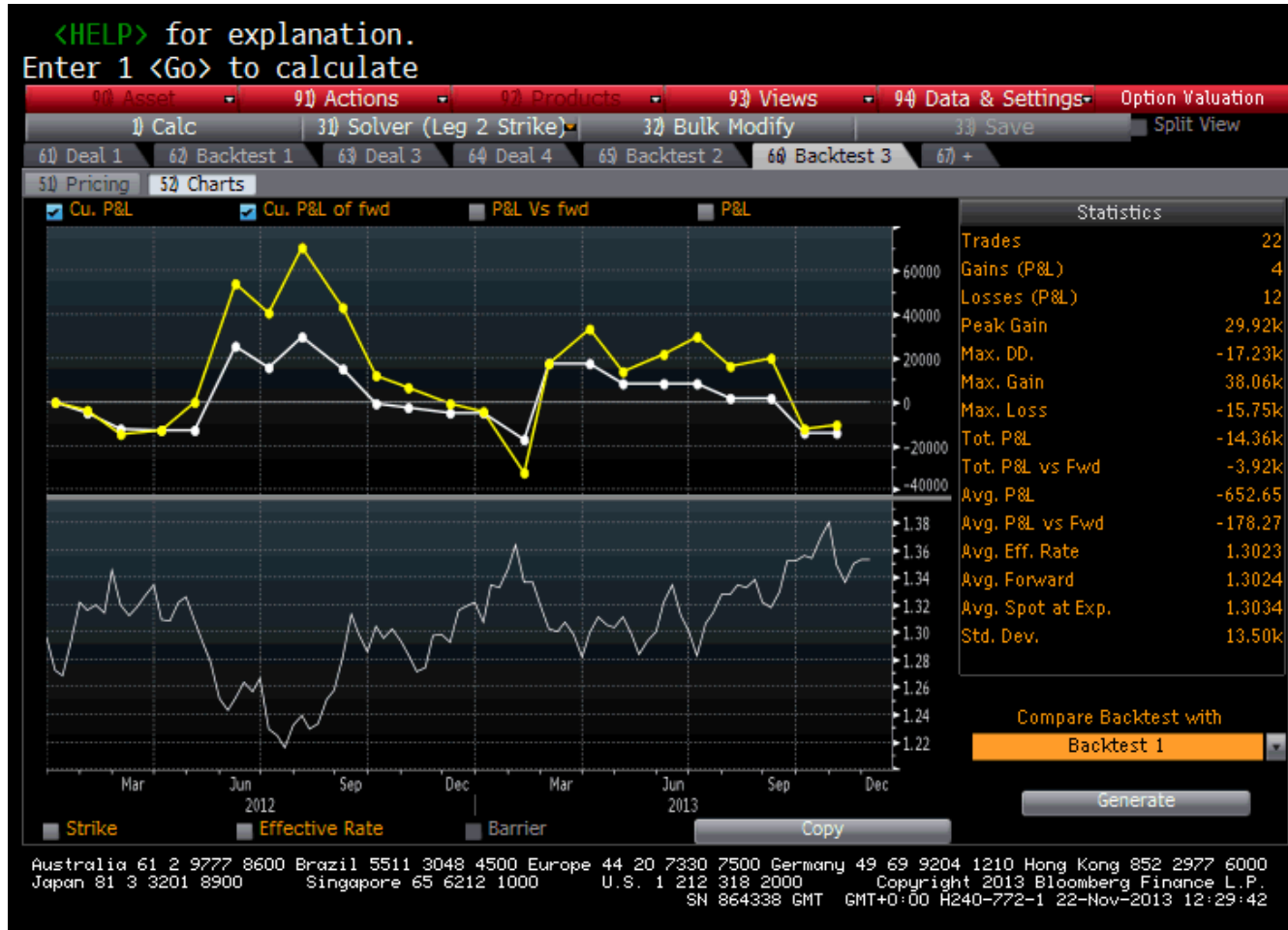
# How to Hedge Against Future Euro Weakness?



- Even though the most popular hedge strategy today in emerging markets remains FX Forward, the market is not limited to FX Forward alone and there might be other ways to extract opportunities in a better way.



# How to Hedge Against Future Euro Weakness?



- Yellow line represents cumulative performance of the rolling monthly short EURUSD FX Forward and White line is corresponding rolling Geared Risk Reversal strategy (buying Put and selling Call) to hedge against Euro weakness (Dollar strength).
- Even though both strategies give protection against Euro weakness (Dollar strength), the P&L volatility of the Risk Reversal is smaller than P&L volatility of the short Forward contract while both give relative desired protection.



# Is Implied Volatility Underpriced across FX Pairs?

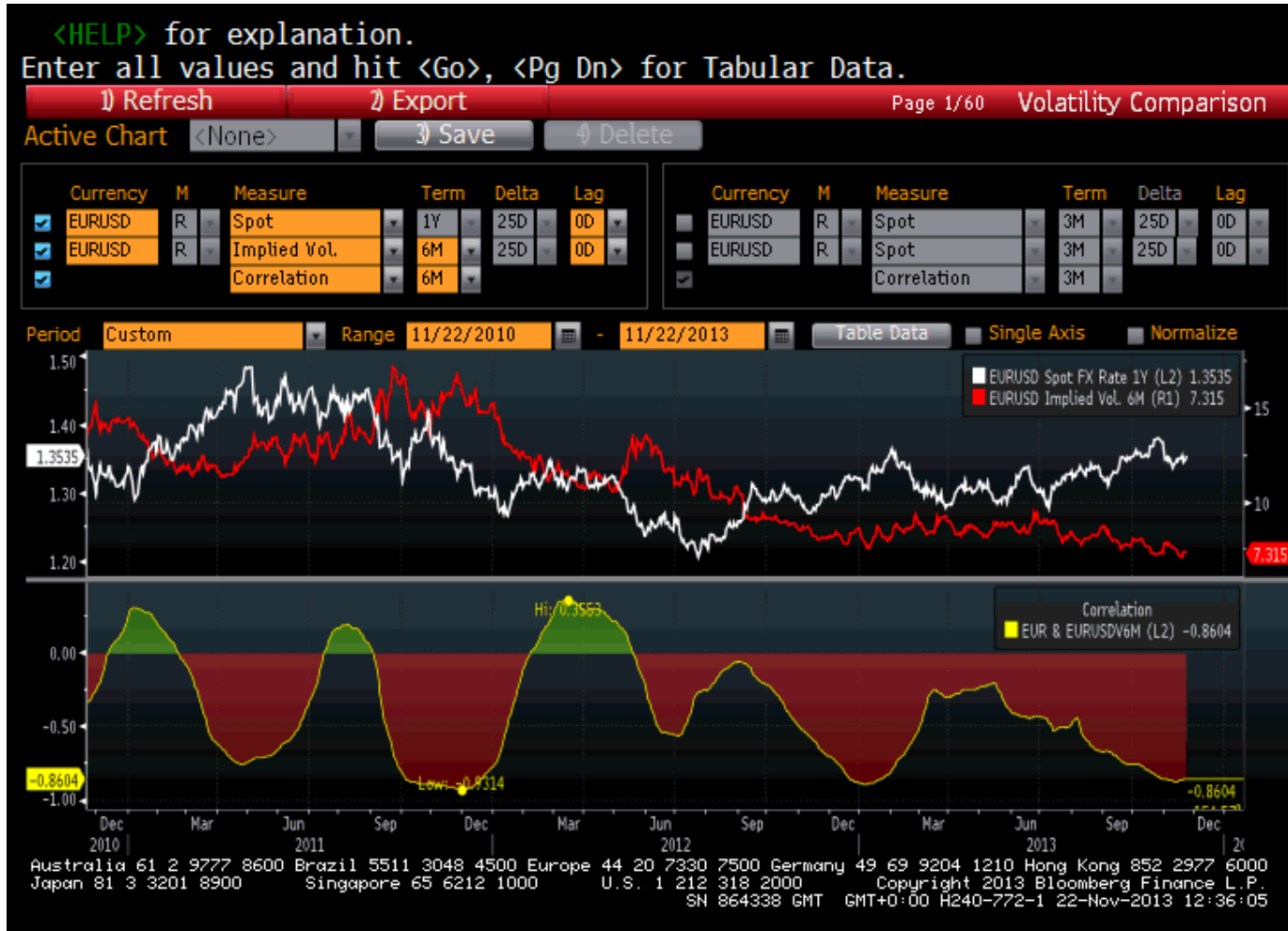
<HELP> for explanation.

Volatility and Correlation Analysis											
Currency											
%Money 100% Term 6 Months Range 6 Months											
9 Impl Vol 6 Impl/Realized Vol 7 Skew 8 Term											
Underlying	Vol	Chg	Low	Range	High	Avg	+/-	PCTL	StdDev	#SD	
1) Majors											
11) EURUSD	7.30	.19	7.11		9.42	8.21	-.90	3.38	.55	-1.63	
12) USDJPY	10.13	-.16	9.30		15.00	11.92	-1.78	10.90	1.32	-1.35	
13) GBPUSD	6.93	.04	6.89		9.27	7.86	-.92	1.88	.65	-1.42	
14) AUDUSD	8.87	.02	8.38		13.07	10.76	-1.89	4.14	1.11	-1.71	
15) EURGBP	6.60	.11	6.20		7.77	7.01	-.41	10.90	.37	-1.11	
16) USDCHF	8.05	.16	7.89		10.92	9.47	-1.42	1.88	.72	-1.97	
17) USDCAD	6.14	-.12	5.96		8.67	7.21	-1.07	2.63	.73	-1.47	
2) Latin America											
21) USDMXN	11.39	.02	10.10		15.41	12.94	-1.55	6.39	1.17	-1.32	
22) USDBRL	12.96	.09	10.36		16.27	13.59	-.63	28.20	1.34	-.47	
23) USDARS	21.37	.06	20.13		30.33	25.11	-3.73	12.18	2.22	-1.68	
3) Europe/Africa/Middle East											
31) USDPLN	11.45	-.07	11.45		14.89	13.32	-1.87	.00	.90	-2.07	
32) USDRUB	8.83	-.02	8.32		11.33	9.56	-.74	10.15	.78	-.94	
33) USDTRY	10.31	-.23	7.52		15.42	11.41	-1.10	26.69	1.81	-.61	
34) USDZAR	14.15	.07	14.00		18.61	15.84	-1.69	4.89	1.22	-1.38	
4) Asia											
41) USDSGD	5.13	-.05	4.82		7.74	6.06	-.93	13.91	.77	-1.22	
42) USDKRW	7.77	-.05	7.31		13.50	9.44	-1.66	10.90	1.41	-1.18	
43) USDTWD	3.87	.00	3.60		6.03	4.42	-.55	15.53	.56	-.99	
44) USDCNY	1.87	-.18	1.65		2.73	2.06	-.20	30.45	.29	-.68	

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 SN 501972 GMT GMT+0:00 G488-5192-1 20-Nov-2013 17:04:34

- Looking at the historical average of FX implied volatility across different currency pairs and expiries over the last 6 months period shows that current levels of implied volatility trading in the market are at their 6 months lows.
- Picture on the left shows example for the 6 months implied volatility over the past 6 months historical period.

# Is Implied Volatility Underpriced for EURUSD?



- The historical correlation between Spot and Implied Volatility in EURUSD on average has been strongly negative.
- Based on historical correlation observations that suggests that if Euro weakens against US Dollar (as suggested by market analyst forecasts) we might see an increase in the levels of (currently low) implied volatility in EURUSD.

# Headlines Suggesting Volatility is Underpriced?

<HELP> for explanation.

1) Clear Filter 2) Focus 3) Actions 4) Settings 5) Feedback First Word

Filters << Options

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<Narrow Search> Date 11/22/13

"EUR\*" IN HEADLIN X

- 1-week ATM, strike 99.98, 48 pips
- 1-mo. 25d put, strike 98.31, 40 pips... More

FX Options: EUR/USD Most Active, USD/JPY Second-Most on DTCC 11/18 12:39  
EUR/USD options account for 25% of total volume, with \$171m traded of Nov. 20 strike 1.35, the most-exchanged strike for the pair, according to DTCC data.

- USD/JPY options 23%
- AUD/USD options 16%
- Total volume was \$6.51b as of 12:13pm GMT/7:13am ET; global total on Nov. 15 was \$53.1b

EUR/USD 1Y Implied Volatility Falls to Lowest Since Dec. 2007 11/18 9:32  
Long-end implied volatility remains solid, with 1Y ATM implied volatility as low as 7.69% vs 7.74% last Friday, lowest since Dec. 2007

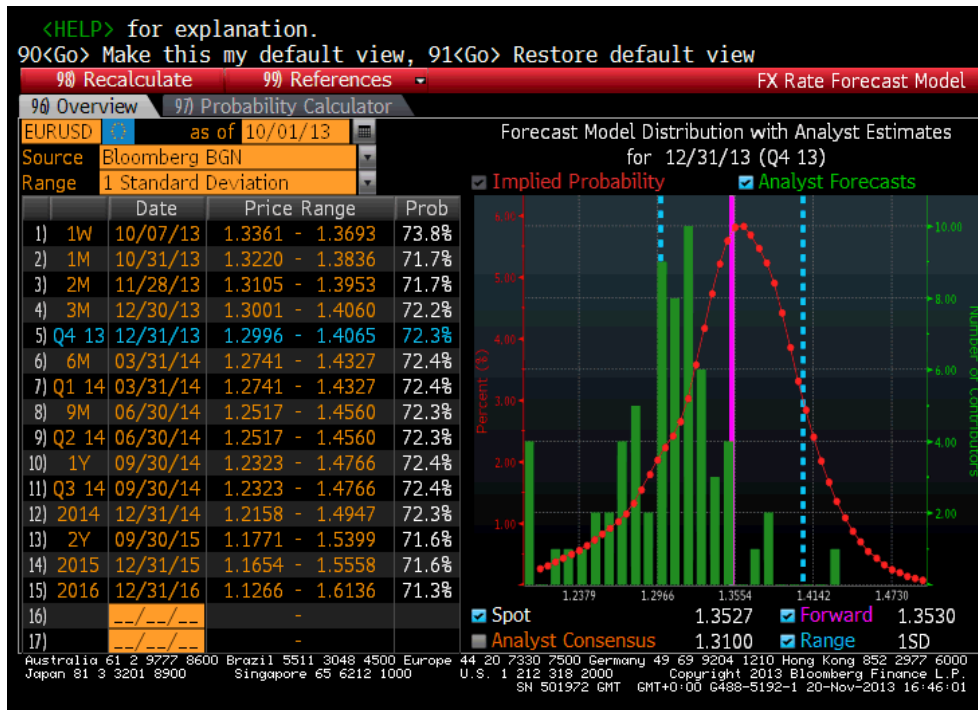
- NOTE: See [here](#) how implied volatility term structure has shifted from Sept. 17, a day before Fed decided not to taper QE; 1Y smile comparison, [here](#)

Go Short AUD/NZD, Buy 2-Mos. European Digital Put, Citi Says 11/18 8:22  
Open short positions in AUD/NZD by buying 2-mos. European digital AUD put, strike 1.0950, at 16% premium for spot reference of 1.1250, writes [Todd Elmer](#), FX strategist at Citigroup, in client note.

- AUD has been strong enough for long enough to trigger a new phase in policy makers concern on exchange rate
- Not clear that strong dovish language from RBA on AUD is well reflected in level of interest rate

- “Volatilities have decayed following ECB rate cut and strong payrolls data”
- “EUR/USD 1Y Implied Volatility Falls to Lowest Since Dec. 2007”
- “EUR/USD Calls Are Cheap on Low Volatility”

# Changing picture of EURUSD Forecast

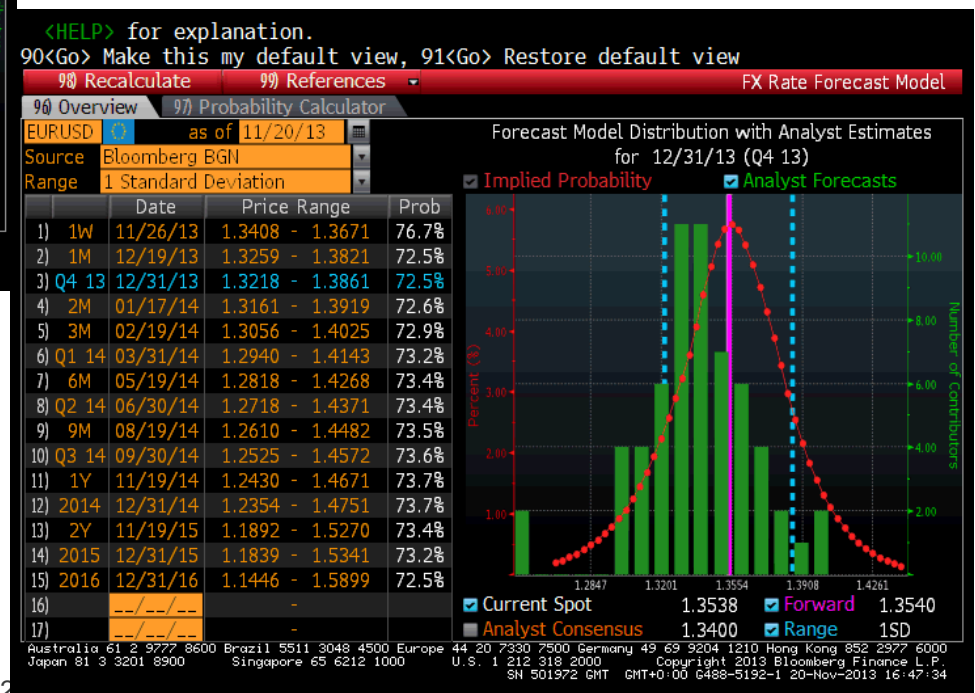


• 1 October 2013

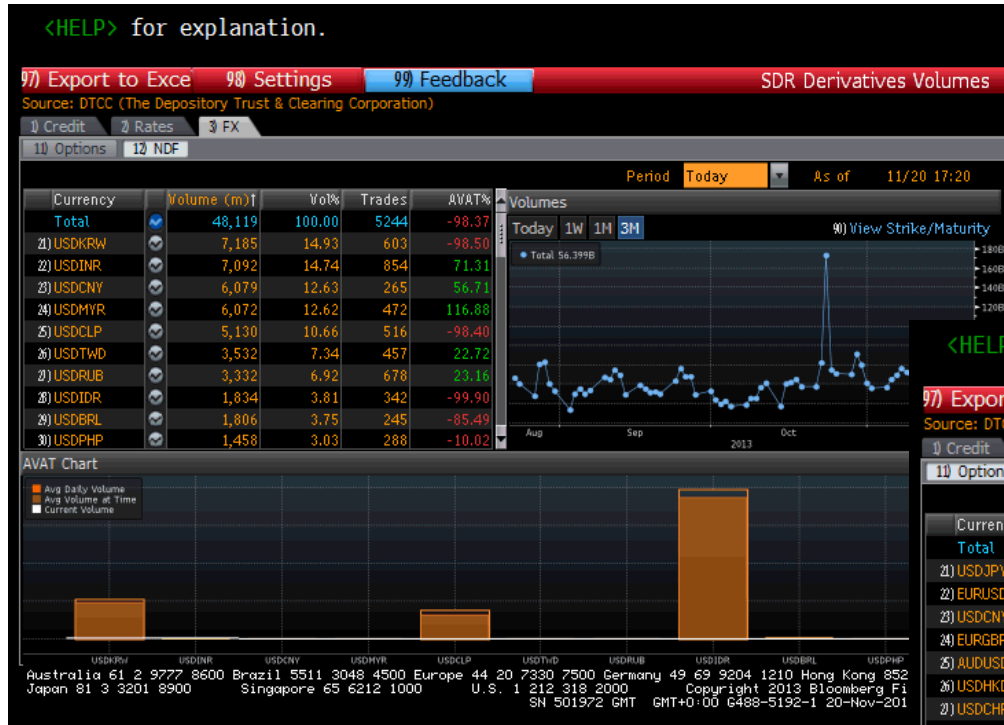
Market analysts / economists predict Euro to weaken against US Dollar by the end of 2013 while FX Options market expects EURUSD to stay unchanged by the end of the year.

Market analysts / economists are now more inline with FX Options market traders, both agreeing that EURUSD spot will not change much by the end of year 2013.

• 20 November 2013

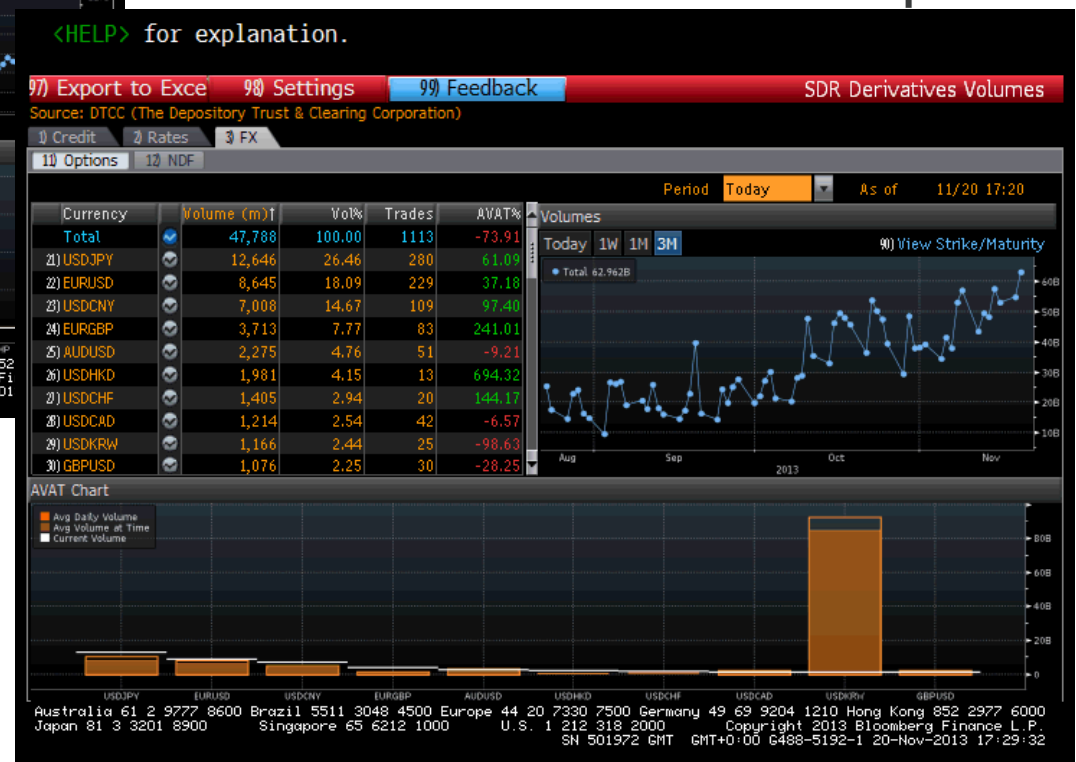


# Tracking the FX Trade Volumes



Same picture is observed for FX Options – there is a growing demand from Emerging Market currency pairs.

• FX - Options



• FX - NDF

The growing FX volumes traded are observed across Emerging Markets .



**Questions?**

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