

18 May 2009

## Headlines

- FX Options: Yen vols rally as risk aversion returns
- EUR/GBP following downward trajectory as EZ data underperform
- Data focus this week: German ZEW, EZ PMI and Philly Fed surveys

## Overview

Risk sentiment remains the dominant driver of FX. A small rise in risk aversion last week led to USD and JPY outperformance (see chart across). The worst performing currencies over the same period were EM and commodity linked currencies. For now EUR/USD appears to be finding support around its 200-day moving average (\$1.3412).

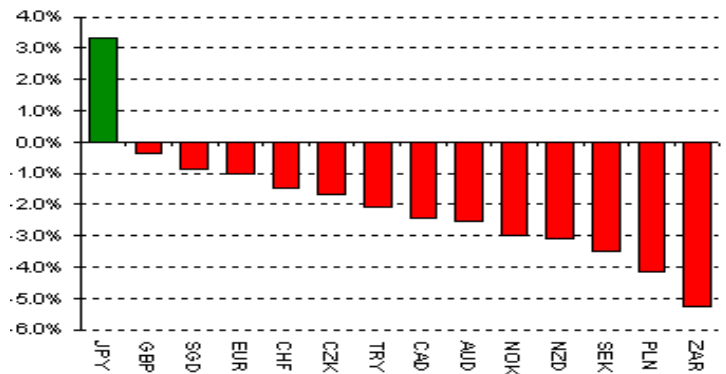
Across financial markets, the S&P500 (US equities) has been in a consolidation formation. The key support level is 877, the break out level. A move below this level would signal a significant rise in risk aversion.

Hence the data focus this week lies around leading indicators (German ZEW, EZ PMI and Philadelphia Fed manufacturing survey). A rise in leading indicators (which we favour) is now needed to support the broader growth rally. A failure would leave currencies range bound, leaving EUR/USD and GBP/USD targeting \$1.3170 and \$1.49 respectively.

EUR/GBP continues on its downward trend, despite the sharp rally in short-sterling (triggered by the Bank of England's latest Quarterly Inflation Report. This indicates the scale of concerns over EZ growth, supported by the latest Q1 GDP report (where growth fell by 2.5% q/q). Hence bouts of risk aversion are now negative for EUR/GBP – this is a reversal from last year when banking sectors woes left GBP underperforming in periods of high risk aversion. As such we look for further downside for the currency pair.

## Chart of the Day

Last Week's Winners & Losers Against The Dollar



Source: Bloomberg & BOS Treasury

## Market Correlations

|                | EURUSD | GBPUSD | USDJPY | EURJPY | AUDUSD | EURCHF |
|----------------|--------|--------|--------|--------|--------|--------|
| Oil            | 0.97   | 0.94   | -0.36  | 0.69   | 0.97   | -0.23  |
| Gold           | 0.80   | 0.71   | -0.74  | 0.21   | 0.72   | -0.32  |
| S&P 500        | 0.82   | 0.87   | 0.06   | 0.87   | 0.91   | -0.14  |
| 2Yr US YLD     | -0.32  | -0.31  | 0.77   | 0.29   | -0.20  | 0.23   |
| 10Yr US YLD    | 0.79   | 0.78   | 0.05   | 0.85   | 0.85   | -0.16  |
| EU-US 2Yr SPD  | -0.48  | -0.44  | 0.06   | -0.43  | -0.48  | 0.42   |
| EU-US 10Yr SPD | -0.23  | -0.22  | -0.37  | -0.54  | -0.25  | 0.33   |

\*1 Month Correlations - Data Source Bloomberg

## FX Trend Analysis

| Currency  | ST Trend | MT Trend | LT Trend |
|-----------|----------|----------|----------|
| DXI Index | -1       | 1        | 1        |
| EURUSD    | 1        | -1       | -1       |
| GBPUSD    | 1        | -1       | -1       |
| USDJPY    | -1       | 1        | -1       |
| EURJPY    | -1       | 1        | -1       |
| AUDUSD    | 1        | 1        | -1       |
| EURCHF    | -1       | -1       | -1       |
| EURGBP    | -1       | -1       | 1        |
| USDCAD    | -1       | -1       | 1        |

## Today's Key Economic Events

| Time  | Country | Event                         | Consensus | Previous |
|-------|---------|-------------------------------|-----------|----------|
| 10:00 | EUR     | Trade Balance                 | n/a       | -€4.0bn  |
| 10:00 | EUR     | ECB's Weber speaks            | -         | -        |
| 16:30 | US      | US Treasury's Geithner speaks | -         | -        |
| 18:00 | US      | NAHB Housing Market Index     | 16        | 14       |

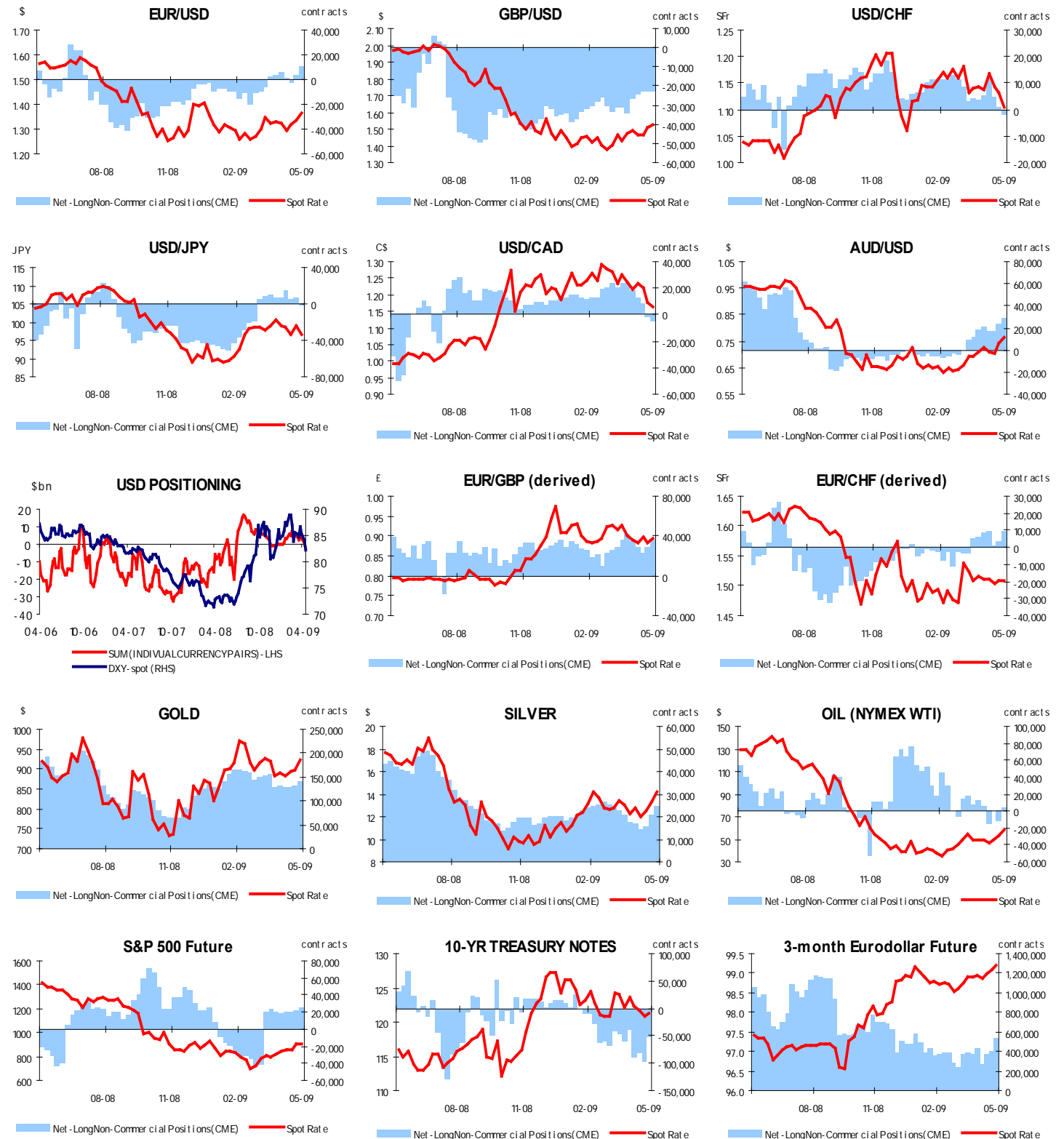
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Data from the major US futures & options exchanges are released each Friday evening and report positions up to the close of business on the previous Tuesday. Traders are classified as either commercial or non-commercial. The positioning of the non-commercial traders can be used as a proxy for the speculative side of the market as a whole. Extreme net long or net short positions are taken as an indication of the market's vulnerability to a sharp move higher or lower. For a squeeze to occur, however, a separate catalyst such as a piece of fundamental news or a breach of a key technical level is usually required.

The latest IMM data report, released on Friday 15th May, covers speculative positions up to Tuesday 12th May 2009. The data indicate that speculators have been net-sellers of USD. The selling has been broad based, across all 6 major currency pairs analysed in this section. The data has been somewhat superseded by the moves in FX after the reporting period. This suggests that much of the USD selling, against higher yielding non defensive currencies, has most likely been unwound. This means that data lags have reduced the value of the data this week as they do not reflect the latest bout of risk aversion.





EUR/USD (range 1.3461/1.3722). A very confined spot market with short term weekly actual volatility measuring just 11.8 percent and hardly surprising given the range. Volatility opened the week firm due to the large spot move after the London close (vols had also been given post US payrolls too). Volatility failed to rally on a risk adverse spot move on Thursday so the stage was set for a selloff late in the week. 3-month implied vol sold off 0.7 percent to close at 13.5. We have seen interest in topside strikes and ranges, the vol curve closed very flat. The risk reversal mildly favours EUR calls across the curve.

GBP/USD (range 1.5059/1.5354). Volatility opened much stronger with the busy data calendar for the UK, 1-month was paid at 13.85 in a reasonable amount early and headed higher from there. Gamma was value and far more so than EUR/USD, actual measuring 14.6 percent for the week. Also a victim of the selloff, vol fell post data late in the week, 3-month closed at 13.6 percent. We have seen variety of smaller structures deal with customers. We have barriers concentrated on our book on the run up to 1.6000.

EUR/GBP (range 0.8880/0.9037). Actuals vols measured 11.1 percent and the currency has been in 900 point range all year and does not look to test either side of this any time soon. We have barriers positioned 300 points on either side of spot and this is hardly a surprise. A sell off late in the week left the whole curve about 1 percent lower, the shape flat and close to about 11.2.

AUD/USD (range 0.7466/0.7705) vol finished slightly higher with some whippy spot moves. There have been interests in knockout AUD calls again this week.

USD/JPY (range 94.78/98.83) vol was the big mover on the week, 3-month rallied about 2 percent higher to finish at 14.2 percent. The risk reversal is stronger with the 1-year 25 delta now at 5.1 percent on the JPY calls/ USD puts. There was some interesting long term options trade like a 4-year leveraged range and 5-year knock in options with triggers below.