

FX Vol Insight

USD optionality is trendy

Key takeaways

- USD vols rose and skew moved for USD puts. As RV, we like to fund short-dated EURUSD vol with rich EURCHF vol.
- Performing USDCHF-USDJPY correlations on risk-on/risk-off suggest CHF and JPY calls once again offer hedges for risky assets.
- Negative USD Up-down vol sees risk of more USD sell-off, front-end AUD put skew is rich. EM is more sensitive to US election.

Recent trends in FX vol: higher FX vol, skew for USD puts

FX vols have sharply increased in recent weeks on the back of rising equity vol. Volatility has exploded among JPY crosses in July but partially retraced last month, while USD vol has continued to increase. As the USD broke out of its range, its realized volatility has picked up from a trough in early July.

Front-end skew has moved sharply for USD puts. For USD bears, this favors structures like USD put spreads and RKO's that cheapen from USD put skew. Our up-down volatility measure suggests that the risk is for a continued USD sell-off, with recent volatility realizing higher in the direction of USD weakness. We see front-end AUDUSD and NZDUSD put skews as rich, not having retraced to their July levels despite their spots having done so.

Vol Dashboard highlights: USD correlation snapshot

[Our FX Vol dashboard](#) correlations tab is showing notable dislocations in USD-based correlations. 3m USDCHF-USDJPY correlation has strongly increased with JPY and CHF rediscovering their so-called "safe haven" status. Investors looking to hedge risky assets should consider CHF and JPY calls as hedges.

RV: fund EURUSD vol using rich EURCHF vol

We remain bullish USD vol into the fall as we are approaching Fed policy action after two years of staying on hold. We like funding short-dated EURUSD vol using rich EURCHF vol as implied spread is at historic highs, while realized spread has already reversed. The risk to this view is for realized spread to widen further to support rich vols.

Special theme: what is priced in for US election

Forward volatility premium shows that currently EM vol is the most sensitive to US election risks (ZAR, CNH and TWD), while G10 pairs like AUD and EUR are underpricing US election risks vs. prior elections.

06 September 2024

G10 FX Strategy
Global

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Sustained rise for USD vols as JPY vols started to recede

FX vol has been biased lower over most of 2024, but the last 6 weeks have seen the highest levels of FX vol since Q1 2023 on the back of spiking equity volatility. The USD had been on a backfoot in the spot market amid renewal of bearish wagers with Chair Powell giving a dovish-tilted speech at Jackson Hole. As the USD broke out of the range lower, its realized vol has picked up from a trough in early July, doubling for pairs like AUDUSD.

Over the last 3 months JPY pairs have seen the largest increases in front-end vol (1m expiries – Exhibit 1): 1m USDJPY (+2.96), CADJPY (+2.70), NZDJPY (+2.51) and GBPJPY (+2.44) but vol fell over the last month for JPY crosses like AUDJPY (-1.48). As the JPY factor is receding into the background, the USD block saw sustained vol moves higher last month: USDCHF (+1.15), EURUSD (+0.82), GBPUSD (+0.76) and USDCD (+0.60) with 1m USDJPY unchanged.

Exhibit 1: 1m USDJPY and CADJPY vol has seen the largest pickup since 1w ago

Changes for 1m vol tenor in G10 vs. 1d, 1w, 1m and 3m lookback periods

1M Implied Vol Changes (Cell Color Shows Magnitude of Change in Vol)

Category	Currency	Implied Vol	1-day Vol Change	1-week Vol Change	1-mth Vol Change	3-mth Vol Change
G10	EURUSD	6.2	0.06	-0.27	0.82	0.84
	USDJPY	11.8	0.33	-0.87	0.01	2.96
	GBPUSD	7.0	0.14	-0.22	0.76	1.24
	AUDUSD	9.3	0.34	0.21	0.05	0.89
	NZDUSD	9.7	0.46	0.40	0.19	1.32
	USDCAD	5.3	0.15	-0.09	0.60	0.34
	USDCHF	8.6	0.09	0.26	1.15	2.28
	USDNOK	11.7	0.17	-0.17	0.66	2.36
	USDSEK	10.6	0.36	-0.36	0.70	1.79
EUR-pairs	EURJPY	9.9	0.42	-0.90	-1.41	1.88
	EURGBP	4.5	0.12	-0.03	0.30	1.11
	EURAUD	6.9	0.28	0.03	-0.18	1.29
	EURNZD	7.3	0.33	0.16	-0.03	1.55
	EURCAD	5.4	0.33	-0.03	0.14	0.91
	EURCHF	6.8	0.15	0.26	-0.10	1.81
	EURNOK	8.6	0.30	0.12	-0.28	2.17
	EURSEK	6.5	0.26	-0.08	-0.31	1.01
G10-crosses	AUDJPY	11.5	0.27	-1.15	-1.48	2.31
	AUDNZD	5.9	0.56	0.90	0.30	1.90
	AUDCAD	6.5	0.15	0.02	-0.15	0.93
	NOKSEK	7.1	0.26	0.24	-0.45	1.48
	CADJPY	11.0	0.41	-1.08	-0.58	2.70
	GBPJPY	10.7	0.41	-0.71	-1.02	2.44
	NZDJPY	11.6	0.50	-1.05	-1.49	2.51
	GBPCHF	7.8	0.09	0.12	0.55	2.24

Source: BofA Securities, BofA Global Research

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Front-end skew has moved sharply for USD puts

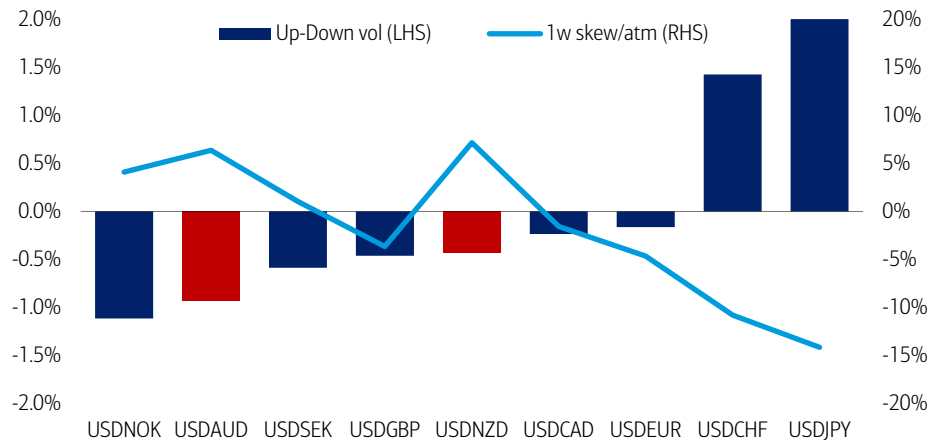
1w risk reversals in EURUSD and GBPUSD have turned positive (also 1m EURUSD). In the GBPUSD case, the short-dated skew in late August was the highest post-COVID (most favoring GBP calls / USD puts). For USD bears, this favors structures like USD put spreads and RKO's that cheapen from USD put skew.

Our up-down volatility measure suggests that the risk is for a continued USD sell-off, with recent volatility realizing higher in the direction of USD weakness for every currency except USDCHF and USDJPY (Exhibit 2). As a result, we see front-end AUDUSD and NZDUSD put skews as rich, not having retraced to their July levels despite their spots having done so.



Exhibit 2: Negative USD volatility favors OTM AUD and NZD calls

Up-down volatility spreads in G10 vs. 1w implied skews (%atm)



Source: BofA Global Research, Bloomberg.

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Vol Dashboard highlight: Correlation snapshot

(See report) [Our FX Vol dashboard](#) correlations tab is showing notable dislocations in 3m USD-based correlations (Exhibit 3). At a glance, most USD correlations are shaded orange (rich) with 3m USDGBP-USDNOK correlation most expensive with 3m implied correlation at 26pp above 3m realized correlation (Exhibit 5).

By contrast, 3m USDCHF-USDJPY correlation is cheap by 18pp (Exhibit 4) as CHFJPY cross-vol fell since early August. The broad orange shade for the USD block is partially due to JPY-factor driving G10 cross vols over the last 3m by more than the co-movement of USD legs.

Exhibit 3: 3m GBP vs. NOK corr is rich, CHF vs. JPY corr is cheap (USD base)

Rich vs. Cheap implied correlations for USD based pairs at 3m tenor



Source: BofA Securities, BofA Global Research

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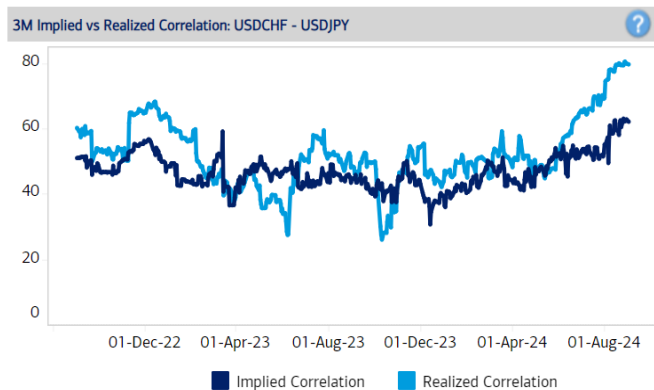
Rising USD correlation shows CHF and JPY regaining “safe haven” status

USD became more of a driver in the last 1m, while the earlier BOJ hike drove risk-off correlations in G10 space in late July. Since August investors traded CHF and JPY in tandem against the USD, first buying both pairs during risk-off, then selling during a relief rally with 3m realized correlation at nearly 80%. These low-yielding currencies have also benefitted from US rates market contemplating additional cuts from the Fed.

As a result, investors looking to hedge risky assets should consider CHF and JPY calls as hedges.

Exhibit 4: USD correlation is realizing vs. CHF and JPY

3m Implied vs. Realized Correlation for USDCHEF – USDJPY pairs



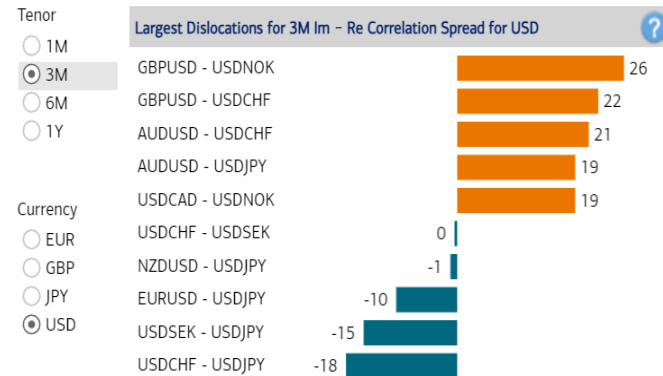
Source: BofA Securities, BofA Global Research

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Exhibit 5: 3m USDGBP-USDNOK corr is rich, USDCHEF-USDJPY is cheap

Largest dislocations for 3m Implied – Realized correlation spread (USD base)



Source: BofA Securities, BofA Global Research

Source: BofA Securities, BofA Global Research

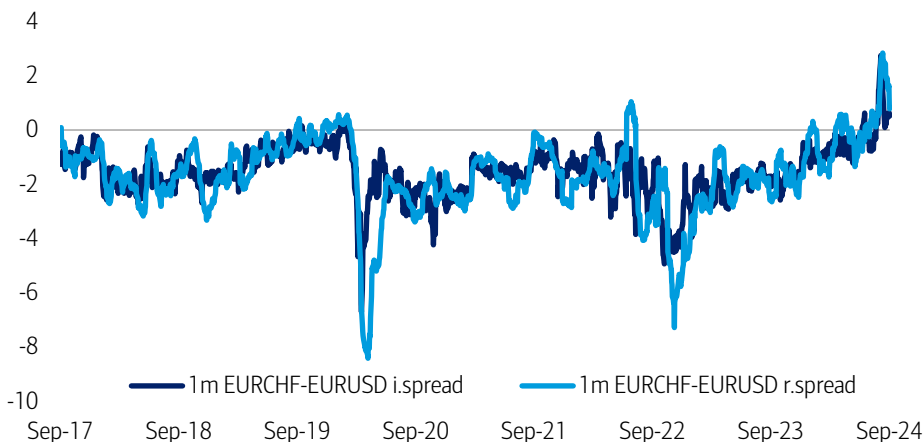
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RV: fund EURUSD vol using rich EURCHF vol

We remain bullish USD vol into the fall as we are approaching Fed policy action after two years of staying on hold. We like funding 1m EURUSD vol using rich EURCHF vol as the implied spread is at historic highs, while realized spread has already started declining (Exhibit 6).

Exhibit 6: 1m EURCHF – EURUSD vol spread is rich to history

At the money implied and realized volatility spreads at tenors shown as Rich – Cheap



Source: BofA Global Research, Bloomberg.

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The EURCHF-EURUSD implied spreads trade above 99th percentile over the last 7 years across multiple expiries (Exhibit 7) with the largest implied premium in the front end. The risk to this view is for realized spread to widen further to support rich vols.



Exhibit 7: 1m EURCHF is rich vs. 1m EURUSD vol

Implied vol spread vs history and realized spreads (same tenors)

Tenor	Rich RV	Cheap RV	Atm spread	7y avg (atm)	7y Percentile	Implied premium	Net I-R
1m	EURCHF	EURUSD	0.6	(1.57)	99.2%	2.2	1.4
3m	EURCHF	EURUSD	0.0	(1.48)	99.1%	1.5	0.8
6m	EURCHF	EURUSD	0.0	(1.41)	99.4%	1.4	1.1
1y	EURCHF	EURUSD	(0.3)	(1.39)	99.3%	1.1	1.5

Source: BofA Global Research, Bloomberg. Implied premium = implied spread – 7y average. Net I-R column shows implied premium minus matching tenor realized vol spread.

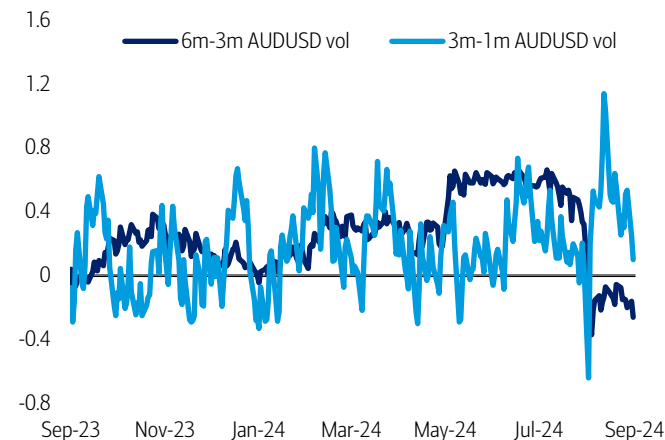
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Special theme: AUDUSD underprices US election

The US election is starting to show-up in the USD term structure, especially for AUDUSD. While the 1m3m slope had steepened, 3m6m slope had inverted (Exhibit 8, Exhibit 9). However, AUDUSD 1m2m forward vol remains below its 2016 and 2020 analogs from late August (see report) ([FX Viewpoint: AUD mid-year update, 26 Aug '24](#)), so the forward premium is likely to richen in the coming weeks. AUD election premium had peaked on Aug 15 and has moderated somewhat in recent weeks to 0.54 vols, comparable to 2004 and 2012 elections but below 2016 and 2020 analogs (Exhibit 11).

Exhibit 8: AUDUSD term structure is pricing a premium for US election

1m3m and 3m6m AUDUSD volatility term structure

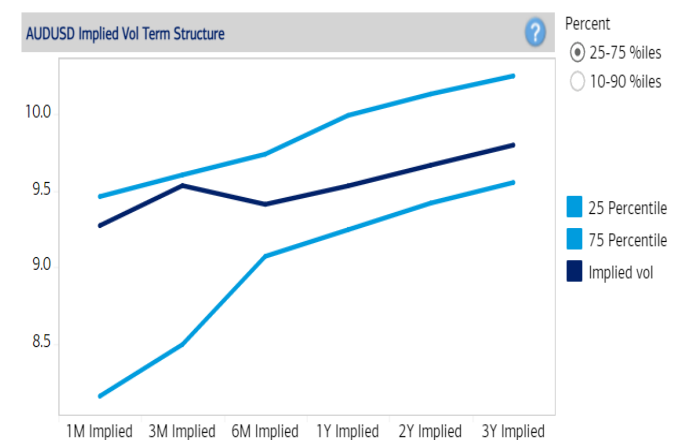


Source: BofA Securities, BofA Global Research. Data as of Sep 4, 2024

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Exhibit 9: A notable kink at 3m for AUDUSD vol spans US election risk

AUDUSD implied vol term structure



Source: BofA Securities, BofA Global Research

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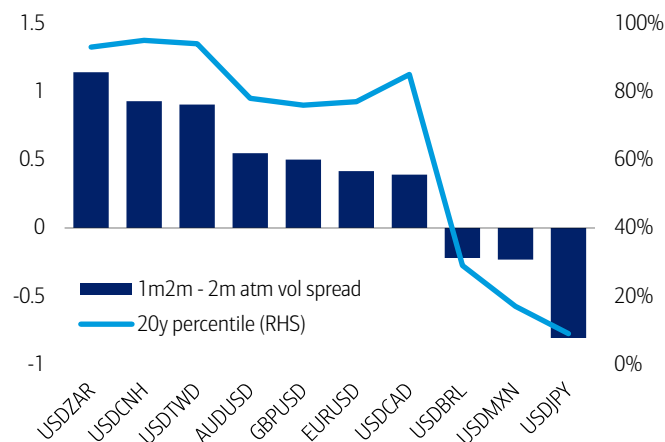
EM vol is most sensitive to US election risks

The forward volatility that covers US election is also above current implied vol levels for EM pairs and the markets are anticipating volatility to increase into the fall (Exhibit 10). The forward vols for EM are elevated to their 20y history. The currencies with the richest forward vol premium are ZAR, CNH, TWD where the premium is around 1 vol. In our view, USD volatility is expected to pick up in US hours as the US elections tend to come into focus post Labor day.

The FX market expects geopolitical tensions to continue in the EM Asia region. The EM Asia (TWD, CNH) forward vol premium over the US election has persisted since our earlier analysis in July (see report) ([US Rates Viewpoint, 29 Jul '24](#)), even though the likelihood of the electoral sweep outcome has fallen.

Exhibit 10: Markets are pricing notable premia in major FX pairs over the US election

Forward vol premium in FX that covers US election

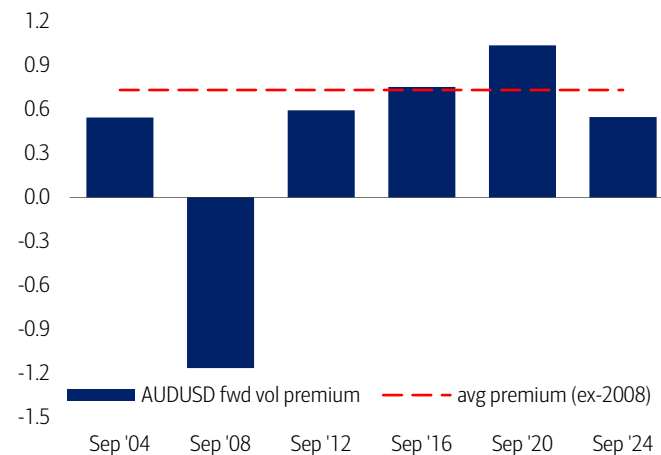


Source: BofA Global Research, Bloomberg. A larger positive number for the 1m2m-2m atm spread means forward vol covering election is elevated. Data as of Sep 4, 2024

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Exhibit 11: AUDUSD fwd vol premium below election year avg

1m2m - 2m atm vol spread in early Sept of US election years



Source: BofA Global Research, Bloomberg. Data as of Sep 4, 2024

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